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Unofficial translation

BETWEEN:

dossier: 2014-3152 (IT) G

OLDCASTLE BUILDING PRODUCTS CANADA INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent.

Appeal heard on July 6, 2016, Montreal (Quebec).

Before: The Honourable Justice Pierre Archambault

appearances:

Counsel for the appellant: Mr. Nicolas Simard
Counsel for the Respondent: Mr. Claude Lamoureux

JUDGMENT

Appeals of assessments under *the Income Tax Act (Act)* for the years 2010 and 2011 tax contributions are welcomed and are referred to the Minister of National Revenue for reconsideration and reassessment for taking granted that:

- 55% of the variable salary amount committed by Mr. Castonguay Oldcastle in 2010 and 40% of the variable salary for 2011 are expenses referred to in [section 37](#) of the *Act* and the eligible expense definition of [subsection 127 \(9\)](#) of the *Act*, and also constitute such expenses in the calculation of the replacement amount described in paragraph 2900 (4);
- Oldcastle is entitled to an amount of replacement according to data provided by this company to the CRA and by the conclusions set out in these reasons;
- Capital expenditure 22 \$ 850, the deduction was claimed for 2010 is eligible for the calculation of R & D expenditure for the 2011 tax year.

The appellant must file its written submissions on costs within 30 days of this judgment, unless the parties request within 10 days of this judgment to present their submissions orally.

The respondent must file written submissions within 15 days of receipt of the written observations of the appellant.

Signed at Magog, Quebec, 25th day August 2016.

"Pierre Archambault"
Archambault J.

Reference: 2016 CCI 183
Date: 20160825
Dossier: 2014-3152 (IT) G

BETWEEN:

OLDCASTLE BUILDING PRODUCTS CANADA INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent.

REASONS FOR JUDGMENT

Justice Archambault

[1] The only question that remains to be decided in the appeals of Oldcastle Building Products Canada inc. (**Oldcastle**) is: does the amount of compensation qu'Oldcastle hired in 2010 and in 2011 (**relevant years**) in respect of Mr. Bertin Castonguay, president of Oldcastle Research Center, is a scientific research expenditure and experimental development (**R & D**) for the purposes of [Article 37](#) of the *tax Act on income* (**Act** or **Act**) and for purposes of the definition of "qualifying expenditure" in [subsection 127 \(9\)](#) of the *Act* and the calculation of investment tax credit (**ITC**) under [subsection 127 \(5\)](#) of the *Act*? the question arises because the remuneration of Mr. Castonguay is determined by a formula that takes into account of a percentage of the sales figures of the products developed or improved by the research Center.

[2] It should be mentioned that the dispute raised by the assessments by the Canada Revenue Agency (**CRA**) raised other issues, the parties settled before the

hearing of appeals. In particular, the CRA denied the deduction in the amount of \$ 22,850 as R & D capital expenditure for the 2010 taxation year on the ground that the expenditure had been incurred in 2011. In the contribution 2011 under appeal, the CRA had not granted the deduction of this expenditure. Counsel for the CRA informed the Court that he recognized that this expenditure was eligible for the calculation of tax for the 2011 tax year.

[3] In preparing its contribution, the CRA assumed that the activities of Mr. Castonguay were not directly related to R & D activities of the audited projects [1] . Therefore, the CRA refused to consider the salary of Mr. Castonguay as an expense of R & D for the purposes of [section 37](#) of the [Act](#) and for the calculation of the CII on the expense. After meetings between Mr. Castonguay and CRA representatives, counsel for the respondent informed the Court, by letter of 4 July 2016, the respondent was prepared to recognize that 55% of working hours Mr. Castonguay in 2010 were directly related to R & D activities of the audited projects [2] . For 2011, it informed the Court at the beginning of the hearing that that percentage was 40%.

[4] Also, Oldcastle had chosen to use the alternative method under [clause 37 \(8\) \(a\) \(ii\) \(B\)](#) of the [Act](#) [3] but the CRA had established zero replacement amount. Subsequently, the CRA received the necessary information to enable it to calculate the amount. (See the letter of 4 July 2016). However, there is still the issue of whether the salary paid to Mr. Castonguay is a qualified expenditure for the purposes of this calculation.

I. Factual Background

[5] Oldcastle is a Canadian company that is part of an international group (CRH Group) based in Ireland. CRH, a multinational building products, has a global turnover of approximately \$ 30 billion. A company of CRH Group purchased in 2001 to over 100 million, the Permacon. A founder of the latter company was Bloc Vibré inc., A Sherbrooke company that belonged to the family of Mr. Castonguay. At the time of purchase, Mr. Castonguay, then aged 49, was the president of Permacon while his brother, also a major shareholder of the group, wanted to retire. Between 2001 and 2003, Mr. Castonguay has assured the transition from Permacon companies in the lap of the CRH Group.

[6] Oldcastle as desired retain Mr. Castonguay services after the transition, we accepted his proposal to establish a research center for the development of new products and new processes. Oldcastle is a North American leader in the

manufacture of concrete products for masonry and landscaping, as well as retail products distributed for DIY construction and landscaping.

[7] To accommodate the Research Centre, Oldcastle has built in Ville d'Anjou (Montreal) a building whose cost was between six and seven million. Mr. Castonguay has agreed to become chairman. The number of employees of the Research Center has varied between 25 and 30 from 2004 to 2012. The terms of Mr. Castonguay employment contract are recorded in a signed document that took effect ^{January} 1, 2004. (Exhibit A-4). In Clause 2.1 of the contract describes the nature of its services as follows:

2.1 As Director, Research and Development of APG's R & D Group and as Chairman of the Corporation [Oldcastle], the Executive's Duties and Responsibilities shall include, in addition to Those inherent to the Executive's titles, The Following Duties and Responsibilities:

- (A) hiring, organizing and managing effective year research and development team and on behalf facility for the benefit of the Corporation;
- (B) executing a process for Consistently Producing and Assisting in the launch of New Products, Products Modified and new manufacturing processes;
- (C) Creating a process to obtenir, and Obtaining the Corporation's senior management approval of annual budget recherche et développement;
- (D) managing the filing of patents concernant New Products and Modified Products and Supporting litigation efforts;
- (E) liaising with outside sources of innovation to attract & Attain exclusive products / services agreements for the Corporation;
- (F) managing the recherche et développement budget in order to Maintain tight control over funding of projects and Ensure the efficient utilization of resources recherche et développement;
- (G) Ensuring the proper care and maintenance of recherche et développement facilities and equipment; and
- (H) managing the delivery of ideas from third party to be the best obtenir royalty levels for APG.

[8] In addition, the contract provides that inventions developed by Mr. Castonguay belong to Oldcastle:

7.2 In consideration of the Salary Base, bonus and --other remuneration paid by the Corporation to the Executive hereunder, all Works (Including all data and records Pertaining thereto) que la Executive May invent, discover, author, originate or conceive During this Agreement with the gold Corporation During the three (3) -month period Any Following termination of this Agreement and all Intellectual Property Rights Relating thereto `shall be the sole and exclusive property of the Corporation. The Executive Hereby waives Any and All de son moral rights in the Works or Intellectual Property Rights.

[I underline.]

[9] In Clause 10 describes the remuneration to which is entitled Mr. Castonguay:

10.1 For the first year de son employment with the Corporation, the Executive `shall Receive an annual base salary of four hundred thousand Canadian dollars (CDN \$ 400,000) (hereinafter, the " Base Salary "). For the second and third year de son employment with the Corporation, the executive's annual base Salary `shall be three hundred thousand Canadian dollars (CND \$ 300,000), plus an amount of one hundred thousand Canadian dollars (CND \$ 100,000) payable if the executive meets the objective Determined by the Corporation at the Beginning of the year falling. **Such After three (3) -year period**, and subject to Section 10.6, the Executive's annual Base Salary `shall be one hundred thousand Canadian dollars (CND \$ 100,000). The base salary is payable in equal monthly Installments.

10.2 The Corporation `shall pay the Executive, we quarterly basis, a bonus based on the annual Net Sales of New Products and Calculated as Follows:

	Net sales of New Products	Percentage of Net Sales Payable as Bonus
(at)	US \$ 0 US \$ 25 million through	1.5%
(b)	US \$ 25,000,001 US \$ 50,000,000 through	1.0%
(c)	US \$ 50,000,001 through US \$ 100 million	0.75%
(d)	US \$ 100,000,001 US \$ 200,000,000 through	0.50%
(e)	US \$ 200,000,001 US \$ 400,000,000 through	0.25%
(f)	US \$ 400,000,001 or more	0.125%

10.3 The Corporation aussi `shall pay to the Executive Bonus is based on the annual Net Sales of Products and Modified Calculated as Follows:

	Net sales of Modified Products	Percentage of Net Sales Payable as Bonus
(at)	US \$ 0 US \$ 25 million through	0.30%
(b)	US \$ 25,000,001 US \$ 50,000,000 through	0.20%
(c)	US \$ 50,000,001 through US \$ 400 million	0.15%
(d)	US \$ 400,000,001 or more	0.10%

10.4 The bonuses to be paid pursuant to Sections 10.2 and 10.3 `shall be paid, with respect to Each product, for a period of time Determined as Follows: (a) if the Gold Corporation Affiliates thereof-have filed one or more patents with respect to Such product, up to the expiration of all patents Such, or (b) Otherwise, ten (10) Years After the first sale of Such product. Except as set forth in Section 13.2, `shall be no bonus payable to the Executive after-three (3) years Following The termination de son employment with the Corporation. It est aussi Understood That no such bonus will be payable after-termination for cause of the Executive's employment.

10.5 **During the first three (3) years** Following the Effective Date, the Corporation `shall only pay to the Executive the portion of the bonus Calculated pursuant to Sections 10.2 and 10.3 That Is in excess of three hundred thousand Canadian dollars (CDN \$ 300,000). **After the end of the first three (3) years** Following The Effective Date, HOWEVER, the bonus `shall be payable in whole, Without Any Such deduction, subject to Reviews the other terms and conditions of this Agreement.

10.6 **After the end of the third year** Following the Effective Date, the Executive's Base Salary `shall be Reduced by twenty thousand Canadian dollars (CDN \$ 20,000) For Each slice of one hundred thousand Canadian dollars (CDN \$ 100,000) of bonus in excess of five hundred thousand Canadian dollars (CDN \$ 500,000). For example, if the Executive is Entitled to a bonus of six hundred thousand Canadian dollars (CDN \$ 600,000) for a specific year, His Base Salary for year Such `shall be Reduced to eighty thousand Canadian dollars (CDN \$ 80,000). For greater certainty, the Executive's Base Salary for a specific year `shall be CDN \$ 0.00 if the Executive is Entitled to a bonus of one million Canadian dollars (CDN \$ 1,000,000) for Such year. The Corporation May, at ict discretion, offset the amount of Any reduction for the Executive's Base Salary Against the payment of Any Base Salary or bonus installment payment.

[The underlining and bold are mine.]

[10] To better understand the scope of the provisions relating to remuneration, there are the definitions in Annex A of the agreement, including the following definitions:

(B) "**APG**" shall mean the North American branch of Oldcastle's Architectural Product Group.

[...]

(J) "**Modified Products**" means clustering significant improvements to Existing products (excluding New Products) in terms of Either cost reduction, functions on improvement and / or aesthetic improvement developed by APG's R & D Group under the Executive's leadership while the Executive is employed by the Corporation. The list of Modified Products Will Be Determined in writing and Agreed by the Executive and the Corporation Within thirty (30) days Following Each day anniversary of the Effective Date. The current list of new and modified products and is attached Schedule B. Labeled

(K) "**sales Net**" shall mean, in respect of Any New Product or Modified Product, the gross amount invoiced and file Managed by the Corporation or any of ict Affiliates for Such product-to-any Person (other than an Affiliate) in North America less (i) Any discount;(Ii) shipping and insurance expenses, (iii) gold credits Refunds and (iv) sales and taxes and duties --other Directly related to the sale.

(L) "**New Products**" means clustering completely Call new products or systems of products developed by APG's R & D Group under the Executive's direction Regardless of whether or not the item originated in APG gold Was therefor obtained from a third party, while the executive is employed by the Corporation and Corporation que le gold icts Affiliates are not Producing and / or selling on the day hereof (with the exception of ISO Stone / Brick ISO qui will be included). Examples of New Products Developed in the past include Dufferin Stone, Brick Gallea, Bergerac and Mega-Celtik Wall. The parts AGREE que le product Suretouch Wall System `shall Constitute a New Product for the Purposes of this Agreement. The list of New Products will Otherwise Be Determined in writing and Agreed upon by the Executive and the Corporation Within thirty (30) days Following Each day anniversary of the Effective Date. The current list of new and modified products and is attached Schedule B. Labeled

[I underline.]

[11] During the transition period Permacon in the lap of Oldcastle, Mr. Castonguay compensation totaled between \$ 200,000 [4] and \$ 290,000. During this period, we granted Mr. Castonguay option rights on shares of CRH Group.

[12] During the first years that he was president of the Research Center, the remuneration of Mr. Castonguay totaled approximately \$ 400,000. In 2008, it amounted to \$ 789,000 in 2009 to \$ 906,000 in 2010 to \$ 1.058 million, and in 2011, to \$ 1,114,000. Therefore, if we apply the formula in clause 10.6 of his contract, his base salary for the relevant years was zero while its remuneration which is described as a "bonus" in the employment contract and that I call for the reasons stated below, the "variable pay", amounted to \$ 1,058,000 in 2010 and \$ 1,114,000 in 2011.

II. Analysis

A. Relevant provisions of the Act

[13] To decide appeals as those of Oldcastle, it is always useful to first review the relevant legislation applicable in the relevant years. There are those concerning the deduction of R & D expenses in computing income from a business, found in Article 37 of the Act and those relating to the calculation of the tax, particularly the CII, in paragraphs 127 (5) and 127 (9) of the Act. The first relevant provision is sub-clause 37 (8) a) (ii) (B) (IV) of the Act, which states that:

37 (8) In this section:

a) references of expenditure on scientific research and experimental development:

[...]

(ii) when they appear outside of subsection (2) [5], are limited to:

[...]

(B) if a taxpayer elects [6] on a form prescribed [...] expenditure [...] representative each:

[...]

(IV) or the portion of an expenditure made in respect of expenses incurred during the year for the salary or wages of an employee directly engaged in scientific research and experimental development in Canada, it

is reasonably be considered to relate to this work because of the time the employee spent; to this end, the expense part is deemed to be the amount of the expenditure if it represents all or substantially all

[I underline.]

[14] The term "salary or wages" is defined in [subsection 248 \(1\)](#) of the [Act](#):

"**Salary or wages**", except in Articles 5 and 63 and the definition of "death benefit" income derived by a taxpayer from an office or employment, calculated from the sub-section of the section B of part I, including fees earned by the taxpayer for services not provided in the course of its business, but excluding retirement or pension benefits, and retirement allowances.

[I underline.]

[15] We see that the notion of wages is wide. However, for purposes of [subsection 37 \(8\) ITA 37 \(9\)](#) lays down limits that apply in certain circumstances:

37 (9) The expenditure of a taxpayer:

a) does not, for the purposes of clauses (8) a) (ii) (A) and (B), remuneration based on profits or a bonus, if the remuneration or bonus relate to a **specified employee** the taxpayer;

b) [...]

[The underlining and bold are mine.]

In paragraph 248 (1) of the [Act](#), defines "employee" as follows:

"**Eligible employee**" With regard to the specified employee of a person, the employee of the person who is a specified shareholder of it or has a length from it.

[16] [Subsection 37 \(9.1\) ITA](#) adds another limit on the salary paid to specified employees:

37 (9.1) For the purposes of clauses (8) a) (ii) (A) and (B) are excluded from the expenditures of a taxpayer in a taxation year those incurred by him during the year in respect of the salary or wages of **the employee determined**, to the extent that they exceed the result of the following calculation:

$A \times B / 365$

or:

A is five times the yearly maximum pensionable earnings, as determined under section 18 of the *Canada Pension Plan* for the calendar year in which the tax year ends;

B is the number of days in the taxation year in which the employee is a specified employee of the taxpayer.

[The underlining and bold are mine.]

[17] Mention right away that counsel for the CRA recognizes that Mr. Castonguay is not a "specified employee" because during the relevant years, it held no shares of Oldcastle or the CRH Group and n did not exist at arm's length between him and his employer.

[18] The R & D expenditures can be deducted, as we have seen, in computing income from a business under [section 37](#) of the [Act](#), but some of them are relevant for the calculation of ITC under [subsection 127 \(5\)](#) of the [Act](#). The provisions relevant to resolving the dispute concerning the compensation of Mr. Castonguay include the definition of "qualified expenditure" in [subsection 127 \(9\)](#):

"Qualifying expenditure" expenditure incurred by a taxpayer in a taxation year is:

a) an expenditure on scientific research and experimental development, as applicable:

(i) is referred to in paragraph 37 (1) a) (i) [\[7\]](#) ,

[...]

b) a prescribed proxy amount by regulation applicable to the taxpayer for the year [...].

Are not eligible expenses:

c) an expenditure prescribed by the taxpayer incurred during the year;

[...]

[I underline.]

[19] The relevant provisions of *the Income Tax Regulations* *Income (Regulation)* regarding the replacement value are:

2900 (4) For the purposes of the definition of "qualified expenditure" in subsection 127 (9) of the Act, the **prescribed proxy amount** of a taxpayer on a business for a taxation year in respect of which he elected under clause 37 (8) a) (ii) (B) of the Act is equal to 65% of the total of all amounts each part of the amount incurred during the year in respect of the salary or wages of an employee directly involved in scientific research and experimental development in Canada, it is reasonable to consider related to these activities given the time that the employee spends there.

[The underlining and bold are mine.]

[20] Subsections 2900 (7) and (9) also lay down limits:

2900 (7) For purposes of calculating the prescribed proxy amount of a taxpayer for a taxation year, the portion of the amount committed by him during the year under the salary or wages of a **specified employee** [8] of it, which is included in calculating the total referred to in paragraph (4) shall not exceed the lesser of:

- a) 75% of the amount committed by him during the year in respect of the salary or wages of the employee;
- b) the result of the following calculation:

$$2.5 \times A \times B / 365$$

or:

A is the yearly maximum pensionable earnings (as determined under section 18 of the *Canada Pension Plan*) for the calendar year when the tax year ends;

B is the number of days in the taxation year in which the employee is at his service.

[...]

2900 (9) For the purposes of subsections (4) and (7) are excluded from the amount committed under the salary or wages of an employee in a taxation year:

- a) the amounts referred to in Articles 6 or 7 of the Act;

- b) the amount deemed to commence pursuant to [subsection 78 \(4\)](#) of the [Act](#);
- c) bonuses;
- d) remuneration based on profits.

[The underlining and bold are mine.]

B. Bonuses or remuneration based on profits?

[21] As can be seen, in terms of the treatment of the deduction of R & D expenditure and treatment ITC purposes, there are similar rules, in particular as to the limits applicable to the salary paid to specified employees, but there are also differences, including those applicable to gratuities. Thus, for purposes of the deduction of expenditure on R & D, the limit for gratuity applies only if the bonus is paid to a particular employee, but it applies to any employee for ITC purposes. Therefore, we must first determine whether it has paid a bonus ("Bonus" in the English version of the [Act](#) and [Regulations](#)) to Mr. Castonguay. Recall that 10 of its labor contract clause uses the term "bonus" in dealing with the calculation of the remuneration to which he is entitled for its services.

[22] The terms "bonus" in English and "gratification" in French are not defined in the [Act](#) or [Regulations](#). Then you must use their common sense. Antidote is defined in [9] the word "bonus" as "an amount paid in addition to what is due." In English, "bonus" is defined as "something That Is Given as an extra When It Was not expected, necessary". (Emphasis added.) It adds: "an extra amount of money That Is Given To an employee, Especially at the end of the year for good work." (Emphasis added.) Here, the employment contract stipulates that the compensation of Mr. Castonguay has two components: a fixed salary plus an amount calculated based on proceeds from the sale of the "New Products" and "Modified Products" sum I describe these patterns as variable pay.

[23] This variable pay is like a "performance bonus" that could be added to a fixed salary. In Antidote, we define "premium" as follows:

Money paid to an employee in addition to his salary, to reward or to cover certain expenses. Prime removal. Transport allowance, risk.Business premium. Performance bonus. Bounty hunter.

[I underline.]

[24] By cons, here, as the employment contract expressly provides that the base salary disappears (becomes zero) when the variable salary reached \$ 1,000,000, there is the variable salary due. The term "performance bonus" does not appear to me then the most appropriate to describe the compensation paid to Mr. Castonguay during the relevant years.

[25] This variable pay is much like the compensation of employees working as intermediaries, including salespeople, sales representatives or brokers (either securities or in property or insurance) that are often paid by commissions, also calculated relative the proceeds of the sale, for example, manufactured goods, securities, real estate or insurance policies. Antidote defines "commission" as "[P]centage which amounts to an intermediary. The seller receives a 10% commission. Working on commission or [QUEBEC](#) - be paid commission. "

[26] However, one can not speak of commission here because there is no remuneration paid to an intermediary who is selling products or services of their employer [10]. Mr. Castonguay manages a research center and is involved in specific projects of R & D. Presumably the sale of Oldcastle products is carried out by other employees of this company.

[27] Under the terms of the employment contract, the variable salary is not a sum that the employer pays Mr. Castonguay at will at the end of the year because it is satisfied with the work, sort of gift we offer more than what is due. Here, Oldcastle has no freedom or not to pay the variable salary. It is payable under the terms of the employment contract. In addition, the employment contract also states that there is no base salary when the variable salary reached the million. Therefore, the only compensation that was paid to Mr. Castonguay in 2010 or 2011 was not an "amount paid in addition to what is due." It can not therefore be a bonus for the purposes of the [Act](#) and [Regulations](#).

[28] This is not a remuneration based on profits since the formula in the employment contract provides for remuneration based on the product sales figure of calculation developed by the Centre for Research, decreased spending two or transport and insurance costs. (See the definition of "net sales" reproduced above.) It lacks too many expenses for the sale of these products it is possible to see if Oldcastle realized a profit on the sale thereof. In the end, the term "variable pay" appears to me the most appropriate to describe the compensation paid to Mr. Castonguay.

C. salary expenditure incurred during the year for an employee directly engaged in R & D activities?

[29] In oral argument, counsel for the respondent argued that the variable salary paid to Mr. Castonguay was not an expense covered by [Article 37](#) of the [Act](#) because the formula for determining the amount of the wages referred to the sale of products for which the R & D activities were carried out in previous years. Therefore, it could be a compensation for R & D activities by Mr. Castonguay during the relevant years.

[30] In my view, this perception of the CRA is totally unfounded. With respect, I believe that the CRA confuses the nature of the sum paid to the method of calculation of this amount and thus distorts the sums paid by Oldcastle Mr. Castonguay. It is clear to me qu'Oldcastle intended to adequately remunerate the work to work which Mr. Castonguay as Chair of the Research Centre, as revealed by the description of his duties in the employment contract. Apart from the function - often honorific in the case of a subsidiary of a multinational - chairman of the board (chairman of the board) Oldcastle, his work was fully connected to the management and R & D activities Center. Moreover, the CRA acknowledged that 55% and 40% of his working hours respectively in 2010 and 2011 were devoted "directly" to R & D activities, and there is no dispute as to the eligibility of R & D projects by Oldcastle and which Mr. Castonguay participated during the relevant years.

[31] The CRH Group had paid more than \$ 100 million for the Permacon and the transition into the fold of this multinational had been completed between 2001 and 2004. However, Oldcastle wished to retain Mr. Castonguay services and the latter could be persuaded if he were offered a challenge corresponding to his interest and passion. Mr. Castonguay had followed at the University of Sherbrooke courses related to research into concrete products. He holds 72 patents for inventions he has made or processes it has developed during his long career in the concrete block industry and architectural masonry [11]. He had the qualities and experience to take care of the Centre for Research and carry out R & D. We built him a research center six million. In reaching an agreement, the parties have negotiated extensively. The employment contract signed by the parties is the ninth version of the agreement. Mr. Castonguay has an entrepreneurial mentality: he was ready to receive a lower base salary to receive a larger variable salary calculated based on the results of his work. Obviously, Oldcastle was willing to pay well its contribution to the success of the business, while ensuring that this remuneration took account of Mr. Castonguay performance as president of the Research Center.

[32] This is according to the formula described in clause 10 of the contract of employment. By linking the compensation of Mr. Castonguay in proceeds from the sale of goods produced through the work performed at the Research Center, we ensured that the R & D work would be relevant in relation to the mission of

Oldcastle, that of making a profit by offering goods corresponding to market needs. This agreement appears to have been beneficial to both parties. In 2010 and 2011, the base salary was nil, but the variable salary of Mr. Castonguay exceeded the million and the number of sales of products developed through the Research Centre activities was \$ 120 million in 2010 and 200 million in 2015! This variable salary formula appears to me appropriate to fix the value of the work provided annually by Mr. Castonguay in Oldcastle. Mr. Castonguay holds no shares of Oldcastle or the CRH Group. The employment agreement was negotiated by the parties between whom there was no dependency.

[33] Nothing in the evidence suggests that the sums were paid by Oldcastle Mr. Castonguay as compensation were for consideration other than the work done by him as president of the Research Center . In particular, they did not constitute a fee for the right to Oldcastle to use property as patented inventions (patented or not) since these assets belong to Oldcastle, according to the employment contract. (See clause 7.2 reproduced above.) Furthermore, if Mr. Castonguay had to be dismissed because he would lose his right to receive variable salary after termination of employment [12] and if he had been dismissed without cause valid in 2010 or 2011, he would have been entitled to a sum of \$ 100,000 [13] .

[34] The amounts do not constitute remuneration for the sale of products Oldcastle because the work done by Mr. Castonguay was not to sell products but to develop the new products research center , to improve the products or to discover new methods. This is not because the formula for variable salary is based on the sale of new or modified products resulting from the R & D work of the research center that Mr. Castonguay should be considered as a commissioned salesperson. I think the formula is only intended to quantify the value of the work of Mr. Castonguay within the Research Centre.

[35] Even if the labor contract defining the formula variable pay (" *bonuses* " according to the term in the employment contract)for a given year provided that account was taken of the product Annual sales made during this year developed or improved properties by the Centre for research in previous years [14] , it would still be less qu'Oldcastle intended to pay for work done by Mr. Castonguay during the given year . Again, the CRA confuses the formula with the nature of the amount paid and the purpose of the payment. It was not intended to pay for services rendered by him in previous years [15] . Mr. Castonguay had already been paid for previous years. In addition, we took into account the sales figure for the year to determine the variable salary this year. Given the difficulty in obtaining the relevant quarterly data, we paid a partial amount of \$ 300,000 throughout the year, and the outstanding

balance of the variable salary was paid once could complete the calculation of that salary.

[36] For a taxpayer who has chosen the alternative method referred to in [clause 37 \(8\) \(a\) \(ii\) \(B\)](#) of the [Act](#) , only the portion of the expenditure on salary of an employee directly engaged in R & D activities that relates to the work of R & D employee is eligible for favorable tax treatment created by [Article 37](#) and by [section 127 \(5\)](#) of the [Act](#) . As variable pay Mr. Castonguay is his salary for substantially all of its work related to R & D (and the only salary he received Oldcastle during the relevant years) and as CRA admitted in Court that 55% of his working hours in 2010 and 40% in 2011 were directly related to R & D activities of the audited projects, it is reasonable to conclude that 55% of variable pay in 2010 and 40% in 2011 are thus eligible for purposes of [subsections 37 \(1\)](#) and [127 \(5\)](#) of the [Act](#) . These parts of the variable salary paid by Oldcastle in 2010 and 2011 are expenses made in respect of expenses incurred during the year for the salary of an employee directly engaged in R & D activities that can reasonably be considered to relating to this work, given the time that the employee has spent. There are no limits similar to those applying to the salary paid to a specified employee [\[16\]](#) , particularly as regards the maximum amount that is eligible: see [paragraphs 37 \(9.1\) ITA](#) and [2900 \(7\)](#) of the [Regulation](#) , reproduced above.

[37] The view taken by the CRA before the Court is difficult to reconcile with the legislation. His lawyer recognizes that remuneration based on profits Oldcastle would qualify for the purposes of [Article 37](#) , but claims that based on the product sales of new or modified products developed by the Research Centre would not! Why remuneration based on profits of the company likely be more acceptable than pay based on sales of products developed by the Research Centre? There is an even stronger link between the proceeds of sales of these products than there is between the benefits of society and R & D activities. Moreover, counsel for the CRA was unable to justify this contradiction.

[38] Therefore, call Oldcastle are welcomed and contributions are referred to the Minister of National Revenue for reconsideration and reassessment on the basis that:

- 55% of the variable salary amount committed by Mr. Castonguay Oldcastle in 2010 and 40% of the variable salary for 2011 are expenses referred to in [section 37](#) of the [Act](#) and the eligible expense definition of [subsection 127 \(9\)](#) of the [Act](#) , and also constitute such expenses in the calculation of the replacement amount described in [subsection 2900 \(4\)](#) of the [Regulation](#) ;

- Oldcastle is entitled to an amount of replacement according to data provided by this company to the CRA and by the conclusions set out in these reasons;
- Capital expenditure 22 \$ 850, the deduction was claimed for 2010 is eligible for the calculation of R & D expenditure for the 2011 tax year.

[39] Counsel for Oldcastle asked that his client has the opportunity to make submissions before the Court to rule on costs. Therefore, the determination of costs will be made at a later date.

Signed in Magog, Quebec, this 25th day of August, 2016.

"Pierre Archambault"
Archambault J.

REFERENCE: 2016 CCI 183

N ° THE COURT FILE: 2014-3152 (IT) G

STYLE OF CAUSE: OLDCASTLE BUILDING PRODUCTS
CANADA INC. c. HER MAJESTY THE
QUEEN

PLACE OF HEARING: Montreal, Quebec)

DATE OF HEARING: July 6, 2016

REASONS FOR JUDGMENT: The Honourable Justice Pierre
Archambault

DATE OF JUDGMENT: On August 25, 2016

APPEARANCES:

Counsel for the appellant: M^e Nicolas Simard
Counsel for the Respondent: M^e Claude Lamoureux

LAWYER REGISTERED BACK TO:

For the appellant:

name: M^e Nicolas Simard

Cabinet: Fasken Martineau DuMoulin

E for the respondent: William F. Pentney
Deputy Attorney General of Canada
Ottawa, Canada

[1] Paragraph 42m) of the response to the notice of appeal.

[2] The eligibility of R & D itself is not in dispute.

[3] See paragraph 42) of the response to the notice of appeal.

[4] This was the salary for a period of less than 12 months.

[5] Who deals with R & D expenditure for activities abroad.

[6] This is the choice to use the alternative method.

[7] This paragraph provides:

37 (1) A taxpayer who carries on a business in Canada in a taxation year may deduct in computing income from that business for the year an amount not exceeding the amount, if any total of:

a) all amounts each of which is an expenditure of a current nature made during the year or a preceding taxation year ending after 1973:

(i) for scientific research and experimental development carried on in Canada by the taxpayer in connection with his business,

[...]

[I underline.]

[8] It should be mentioned again that Mr. Castonguay was not a specified employee.

[9] Antidote 9, bilingual, v3, 2016 Druid computer inc., Montreal.

[10] See clause 7.2 of the employment contract, reproduced above.

[11] Excluding those that are pending.

[12] See clauses 10.4 and 12.1 of the employment contract.

[13] See section 13.1 of the labor contract, applicable whether the dismissal occurs after a period of 6 years from the date the contract takes effect.

[14] In my view, the employment contract does not as explicitly expressed, but this is the interpretation I remember. The variable salary of Mr. Castonguay is calculated based on annual sales of new and modified products or products and is payable quarterly. (See clause 10.2 of the labor contract reproduced above.) In addition, the formula does not exclude the products developed in the current year, but we can assume that the sale of such products should not in practice often occur.

[15] The one exception could be the variable salary paid during the three years following the termination of his employment under the terms of clause 10.4 of the contract of

employment. However, I do not have to decide this question because during the relevant years Mr. Castonguay was still employed by Oldcastle.

[16] The authors of the Canadian Tax Reporter Commentary (Wolters Kluwer Limited), the ¶5936 under the heading " Limitations for remuneration paid to a specified employee " write the following:

[...]

The Department of Finance's Is That concern for the Purposes of the SR & ED incentives, the compensation of specified employed shoulds Reflect the value of the SR & ED work the employed perform as Opposed to the Profitability of the corporation as a whole. In order to "better accomplish achieve this objective," Finance further Top annoncé restrictions for wages and salaries paid to specified employed , found in subsections 37 (9.1) through 37 (9.5) [...]

[I underline.]

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