Tax Dispute Insights
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# Avoiding and Navigating Tax Disputes in the Mining Sector

## From Ore to Opportunity: Lessons from Glencore's Tax Dispute in the FCA

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In ***Glencore Canada Corporation v. His Majesty the King***[1] ***("Glencore FCA")***, the Federal Court of Appeal examined and ultimately rejected Glencore's contention regarding the tax treatment of commitment fees and non-completion fees.

Glencore argued that these fees should be exempt from taxation, asserting that they were "extraordinary receipts" not categorized as taxable income under section 3 of the ***Income Tax Act.***

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### Practical Implications

The FCA's decision aligns with our expectations based on the facts and law. However, *Glencore FCA* presents a valuable opportunity for companies to learn from this situation.

In navigating M&A transactions and securing favourable tax dispute outcomes connected to these transactions, Glencore FCA offers these lessons:

1. Begin by understanding how the courts will broadly interpret commitment fees, non-completion fees, and paragraph 12(1)(x) of the ITA.

2. Select the optimal deal structure and language that lays the groundwork for more favourable tax results.

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3. Develop adaptive tax filing and dispute strategies. Establishing a secure tax filing position while maintaining flexibility to challenge that position is a high-quality strategy in the right cases. stance on rejecting ITC claims. The CRA will likely continue its pattern of auditing, disallowing ITCs, and dismissing taxpayer objections on comparable grounds. Moving through these stages (while avoiding unforced errors) might be the best strategy.

## Glencore's Fees And Tax Challenge

Glencore's predecessor, Falconbridge Limited (after this always "Glencore"), focused on developing a nickel deposit in Canada and managing a refinery in Norway.

In 1996, Glencore launched a merger bid for Diamond Fields Resources Inc. to secure a controlling stake in its Voisey's Bay nickel mine. The deal included terms for Diamond Fields to pay Glencore a commitment fee of $28,206,106 upon agreement and a non-completion fee of $73,335,881 (the "Fees").

Following this, Inco Limited proposed a merger with Diamond Fields, which was accepted, leading to the rejection of Glencore's offer. As stipulated in their agreement, Diamond Fields paid the Fees to Glencore.

Glencore included the Fees as part of its income, anticipating the Agency would review its tax return as filed and intending to dispute this assessment. This strategic approach aimed to:

1. maintain the option for an election under subsection 12(2.2) of the ITA, tied to the tax return filing deadline, with the expectation the Agency would assess the return as filed; and
2. object to the assessment to eliminate the tax.

The Agency assessed Glencore's return as filed, and Glencore objected to this assessment. During the objection stage, Glencore argued that the Fees should not be subject to tax according to their preferred interpretation of the facts and law. Glencore argued the Fees were unusual or non-recurring payments (*i.e.*, extraordinary receipts), which, in their view, did not fall within any defined category of taxable income under section 3 of the ITA.

The Agency rejected Glencore's objection and Glencore filed an appeal in the Tax Court of Canada.

### *Tax Court Ruling: Glencore's Fees as Business Income*

The Tax Court dismissed Glencore's appeal, classifying the Fees as business income under subsection 9(1) of the ITA.

Justice Favreau emphasized the Fees' direct connection to Glencore's core mineral exploration and development activities. He relied on the Supreme Court of Canada's decision in *Ikea v. Canada.*[2] In Ikea, the SCC held that a tenant inducement payment qualified as regular income because it was integral to Ikea's standard business activities and closely tied to its day-to-day operations. Similarly, Justice Favreau held that, in Glencore's case, the Fees were part of the company's regular business activities and ordinary revenue.

Based on this rationale, Justice Favreau did not consider Glencore's additional arguments, skipping over Glencore's paragraph 12(1)(x) argument and its capital gain argument. Justice Favreau dismissed Glencore's appeal. Following this, Glencore appealed the Tax Court's decision to the Federal Court of Appeal.

### *FCA Ruling: Fees as Inducement Income Under Paragraph 12(1)(x) of the ITA*

The FCA dismissed Glencore's appeal. The FCA and Tax Court arrived at the same outcome but for different reasons. Essentially, the FCA found that Glencore's initial filing position and the Agency's assessment were correct, putting the parties back to their original positions.

The FCA held that the Fees were an inducement that Glencore received for the purposes of subsection 12(1)(x) of the ITA. This was pretty clear from how Diamond Fields set up the agreement, wording, and supporting evidence.

The FCA believed that the Tax Court misinterpreted and misapplied *Ikea v. Canada*. Ikea received a tenant inducement payment to reimburse an expense on income account. The Tax Court did not consider whether the Fees had a connection to capital; Justice Favreau did not conduct any analysis or distinguish between the possible capital or income nature of the receipt.

The FCA held that the Fees qualified as inducement income under paragraph 12(1)(x) of the ITA. They satisfied the four conditions for inducement:

1. no applicable exclusions in paragraph 12(1)(x) apply,
2. met the payer requirement in subparagraph 12(1)(x)(i) or (ii),
3. received as inducements or reimbursements under subparagraphs 12(1)(x)(iii) or (iv), and
4. linked to earning income from business or property.

The FCA examined the "inducement" concept.

### *Received as an Inducement*

The FCA analyzed the nature and context of the Non-Completion Fee (also known as a "Break Fee"). Citing *Re Bison Acquisition Corp.*[3] and *CW Shareholdings Inc. v. WIC Western International Communications Ltd.*[4], the FCA affirmed that the break fee's purpose is to entice bidder engagement in auctions. This mirrors the facts in *Glencore FCA*, where Diamond Fields used the non-competition fee to encourage Glencore to make an offer.

Despite its conditional nature tied to bid failure, Diamond Fields added the non-completion fee to persuade Glencore to make an offer for the Voisey's Bay shares. Glencore received these payments as inducements, fulfilling the third condition listed above.

### *Linked to Business or Property Income*

Paragraph 12(1)(x) applies to amounts not classified as business or property income under section 9(1), a broader condition than the standard test under subsection 9(1). The FCA clarified that it encompasses amounts "in connection with", "incidental to", or "arising from" business or property activities. In Glencore's case, the Fees were linked to its nickel mining operations and potential property income from Voisey's Bay shares. This satisfied the condition for paragraph 12(1)(x).

Based on these reasons, the FCA concluded that paragraph 12(1)(x) was applicable in this situation.

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## Closing Insights: Navigating M&A Tax Challenges

Much like Glencore's tax filing and dispute journey, this article's trajectory brings us full circle, returning to the foundational lessons outlined at the beginning.

We take and offer the following insightful lessons from *Glencore FCA:*

1. **Understand Paragraph 12(1)(x):** Begin with a comprehensive grasp of how the courts will interpret commitment fees, non-completion fees, and paragraph 12(1)(x) of the ITA. This foundational understanding informs effective tax planning and prepares for potential tax-related disputes.

2. **Enhance Deal Structure and Language:** The choice of deal structure and terms, obviously, plays a crucial role in shaping the tax outcomes of M&A transactions and tax disputes that might surface. By making informed decisions, companies can enhance their ability to capitalize on tax benefits while mitigating potential liabilities, lowering the probability of tax-related disputes or raising the likelihood of success.

3. **Develop Adaptive Tax Strategies:** Develop flexible tax filing and tax dispute strategies tailored to the M&A transaction and the situation. Establish a secure tax filing position while maintaining the opportunity to challenge it when necessary for improved tax outcomes. Strategies like this enable companies to effectively manage tax compliance and "push tax boundaries" in a way that makes sense.

By integrating these ideas into their corporate strategies, company leaders can more confidently navigate M&A transactions and associated tax disputes, achieving their business goals and optimizing tax dispute outcomes.

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[1] F1 2024 FCA 3

[2] [1998] 1 S.C.R. 196, 155 D.L.R. (4th) 295

[3] 2021 ABASC 188

[4] (1998), 39 O.R. (3d) 755 (Ontario Court (General Division))





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