MONTREAL PILT CASES

An Analysis of the Decision of the Federal Court of Appeal

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I. Background – The Facts of the Cases

The decision of the Federal Court of Appeal discussed in this note is the latest development in litigation originally instigated by the City of Montreal against three federal entities: the CBC, the Port of Montreal, and Public Works and Government Services Canada (PWGSC).[1] At issue is the interpretation and application of the *Payments-in-Lieu of Taxes (PILT) Act* and the Crown Corporation Payments Regulation (CCPR), a regulation taken under the *PILT Act*.

Under the CCPR, a number of Crown corporations, including the CBC and the Port of Montreal, are exempted from the payment of PILT for local Business Occupancy Taxes (BOT). A BOT had been in effect in the pre-amalgamation City of Montreal. After amalgamation, since only 10 of the 28 former municipalities had a BOT in place, Montreal decided to eliminate the BOT altogether, essentially increasing the commercial tax rate to make up for the shortfall.

In concrete terms, this change in taxation policy resulted in a substantial increase in the annual tax bill for both the CBC and the Port.[2] Both Crown corporations were of the view that they should not have to pay the full amount charged to them under the new, higher, comprehensive tax rate and each proceeded to deduct an amount more or less equivalent to the previous year's BOT from the amount they paid to Montreal.

There was a secondary issue in the Port case, namely disagreement between the Port Authority and Montreal as to whether or not PILT were payable on the various silos located in the Port. This separate legal issue is addressed in the final section of this memo.

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[1] The issue at play in the PWGSC case was different from the one in the cases against the two Crown corporations. In essence, although federal property is exempt from the payment of property taxes, when a commercial (non-governmental) tenant occupies federally-owned property, the tenant is subject to property taxes. If such a tenant is in arrears, the *PILT Act* provides that PWGSC is liable for the outstanding amounts. PWGSC was refusing to pay for the arrears of some of its sub-tenants at the Montreal-Trudeau Airport. The trial judge ruled that PWGSC's liability extended to the arrears of all non-governmental occupants, regardless of their legal relationship with PWGSC. This decision was not appealed.

[2] For the Port, the 2004 taxation year was used as a basis for the litigation. The Port had paid $1,326,497.53 as PILT based on the tax rate applicable prior to the elimination of the BOT. Montreal was claiming an additional $737,889.67 as the equivalent of the BOT (now part of the applicable tax rate) and a further $1,247,355.98 as PILT for the value of the silos located in the Port.

For the CBC property, there were three taxation years at play (2003, 2004 and 2005). Essentially, the CBC's position was that, under the previous taxation system, the corporation paid approximately $2 million per year in PILT. Following the elimination of the BOT, Montreal's position was that the new total payable was in the order of $4.4 million.

II. The Legal Issues and Justice Martineau's Judgment

Together, the *PILT Act* and the CCPR authorize payments in lieu of property taxes, by federal departments and Crown corporations, based on a simple formula. For Crown corporations, the formula is set out at Section 7 of the CCPR (emphasis added):

> **7.** (1) Subject to subsection (2), a payment made by a corporation in lieu of a real property tax for a taxation year shall be not less than the product of
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> (*a*) the corporation effective rate in the taxation year applicable to the corporation property in respect of which the payment may be made; and
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> (*b*) the corporation property value in the taxation year of that corporation property.

At the heart of the dispute in Montreal is the interpretation to be given to the definition of "corporation effective rate" found at Section 2 of the CCPR:

> "corporation effective rate" means the rate of real property tax or of frontage or area tax that a corporation would consider applicable to its corporation property if that property were taxable property;

This definition does indicate that the rate will be one which the corporation "would consider applicable" These words obviously appear to confer discretionary powers on corporations with respect to the tax rate to be applied in calculating the PILT to be paid. However, the definition goes on to qualify this discretion with the phrase, "if that property were taxable." It would therefore also appear that the discretion is not unfettered.

Both the CBC and the Port Authority decided to adopt a broad interpretation of their discretionary powers with respect to the tax rate and unilaterally reduced the amount payable under the Act. In response, Montreal applied to the Federal Court for a judicial review of these decisions.

The presence of the second passage in the definition is what led Justice Martineau, at trial, to conclude that the CBC and the Port could not simply pick a tax rate arbitrarily. Based on the wording of the CCPR, Crown corporations must ask themselves a question along the lines of, "If the property were taxable, which rate would be applicable to the corporation?" In formulating the test in this way, Crown corporations are therefore restricted to a choice among the various existing rates and must find the one most logically applicable to them.

Reading Justice Martineau's judgment, it is clear that he held the view that municipalities have every right to structure their tax system as they see fit. For Martineau, the elimination of

the BOT by Montreal was a legitimate exercise of the city's legislative authority. Although the CBC and the Port had enjoyed a federally-mandated exemption from the BOT, since this tax no longer existed, the exemption could no longer be logically applied. Both Crown corporations, like all taxpayers, were therefore bound by the outcome of this legitimate change in municipal policy.

At trial, therefore, Federal Court Justice Martineau ruled in favour of Montreal. The two Crown corporations appealed, which led to the newly-released decision of the Federal Court of Appeal. Although the legal point of contention revolves around arguments of statutory interpretation, the consequences of the Federal Court of Appeal's decision for municipalities, and arguably for the very policy objectives of the *PILT Act* as a whole, are significant.

III. The Federal Court of Appeal Decision – Review and Analysis

In a nutshell, the three judges of the Federal Court of Appeal reversed Justice Martineau's decision in no uncertain terms. They ruled that although the two Crown corporations did not have the authority to simply set any arbitrary tax rate for themselves, their discretion is quite broad and is only limited by the fact that the rate they choose to apply must be "reasonable." The Court then proceeded to recalculate the amount of PILT to be paid by the CBC and the Port by deducting an entirely hypothetical BOT from the total.

This decision not only creates significant practical difficulties, it also has far-reaching policy implications. Furthermore, from a legal perspective, the Court's underlying rationale misses the mark in at least three important ways.

1. The Discretion Issue

On the key issue of the interpretation to be given to the definition of "corporation effective rate" and, consequently, of the scope of discretion given to Crown corporations in this matter, the Federal Court of Appeal compared the definition in Section 2 of the CCPR to the text of Section 9 of the same regulation as well as legislative provisions generally.

In Section 9, similar language (though not identical) is used to allow Crown corporations to make certain deductions from their PILT. This contrasting technique is often used in statutory interpretation and Section 9 does help shed some light but it does not, in this case, lead logically to the Court's conclusion.

The Court simply concluded that since all these expressions are meant to grant some discretion to the decision-making body, they must therefore all have the same meaning. Unfortunately, this view ignores the specific context of each provision and Section 9 is an excellent illustration of the legislator granting each type of discretionary power: broad in the first instance, restricted in the other. Sub-sections 9(c) and 9(d) allow different deductions:

> (*c*) if a taxing authority, or a body on behalf of which the authority collects a real property tax, is, in the opinion of the corporation, unable or unwilling to provide the corporation property with a service, and no special arrangement exists, an amount that, in the

> opinion of the corporation, does not exceed reasonable expenditures incurred or expected to be incurred by the corporation to provide the service; and
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> (*d*) an amount that, in the opinion of the corporation, is equal to any cancellation, reduction or refund in respect of a real property tax that the corporation considers would be applicable to the taxation year in respect of its corporation property if it were taxable property.

In the case of 9(c), it is entirely up to the Crown corporation to determine whether or not it deems it is receiving the service in question. If not, it can deduct all costs associated with that service from its PILT.

In 9(d), however, we find very similar language to the one used in the definitions. In these cases, there is a clear intention expressed by the legislator to limit the discretion by the use of the words "if its corporation property were taxable property." These words qualify the discretion given to the Crown corporations and must be given meaning. It is a basic principle of statutory interpretation that if Parliament has taken the time to include certain words, it must be for a reason. This passage must therefore be read as having an effect on the breadth of the discretionary powers granted.

The application of this principle led Justice Martineau to formulate the legal test to be used in determining the appropriateness of a Crown corporation's calculations. The PILT must be calculated as if the corporation were a taxable entity. In its decision, the Federal Court of Appeal does not reflect on this issue at all other than to dismiss Martineau's interpretation. Ignoring the qualifying passages included in the *PILT Act* or the CCPR inevitably led to the conclusion that Crown corporations enjoy significant discretion in setting their rates.

Montreal objected to the notion that the CBC and the Port could simply pick a rate out of a hat. Interestingly enough, the Federal Court of Appeal agreed that this might lead to unacceptable results. It therefore ruled that the discretion given to Crown corporations was limited, but not by the wording found in the statute. Instead, the Federal Court of Appeal ruled that the rates used by Crown corporations had to be "reasonable". This term, widely used in law, means that choosing a tax rate is not a subjective decision (left entirely to the person making the choice), but an objective one which can be reviewed by the Court.

The introduction, by the Court, of the notion of a "discretionary but reasonable" tax rate is remarkable. The legislation already includes a limiting factor ("if it were taxable property"). There was no need to replace it with a judicial fiction. This outcome is even more surprising when one reads other provisions, like Section 9(c), which explicitly refer to the need for deductions to be reasonable. The concept of reasonableness was included in 9(c), but left out of the definition of "corporation effective rate." Such distinctions must be presumed to have meaning and, contrary to the Federal Court of Appeal's approach, the legislation should be read in that light.

2. Legislative History and Policy Objectives of the *PILT Act*

To his credit, Justice Martineau took the time to fully understand the policy objectives behind the *PILT Act*. Since federal properties receive all the benefits of municipal services, he felt it was only logical that they pay their share of the cost of providing these services. He also spoke of the need for municipalities to count on stable and predictable sources of funding, indicating that he had grasped the change which took place in 2000 when the new PILT provisions were enacted.

It is most unfortunate that the Federal Court of Appeal appears to not have taken these significant factors into account. The decision is entirely silent on this topic, yet it is crucial. Under the previous scheme, government departments and Crown corporations were essentially free to pay whatever they wanted. Municipalities were constantly negotiating for fair payments. When it enacted the new provisions, Parliament must have had the intention to provide for a new regime. This too is a basic principle of statutory interpretation. The new statute must be interpreted as representing a new or revised position on the part of Parliament.

In this case, it seems fairly obvious that the intention was to move away from purely discretionary payments. The whole structure and the language of the *PILT Act* support the position adopted by Justice Martineau. For example, the CCPR specifically states that the PILT "shall not be less than" the product of the tax rate and the assessed value. How can this be interpreted as anything but the intent to remove discretion in order to allow municipalities to count on stable and predictable income? Furthermore, as indicated above, all the so-called discretionary provisions are greatly qualified.

3. The Right of a Municipality to Set Tax Policy

The only aspect of the legislative history on which the Federal Court of Appeal spent a great deal of time (several pages of its decision, in fact) is the distinction between Crown corporations listed in Schedule III of the Act and those listed in Schedule IV. Schedule III corporations are not permitted to make payments for BOTs, while those on Schedule IV are permitted to do so.

The Court reviewed in detail the various memoranda and discussion papers which led to the final lists. It concluded that the CBC and the Port were quite intentionally left on Schedule III so that they would be exempt from BOT payments. No one would argue the contrary. Yet, even though this conclusion is sound in and of itself, where it ultimately leads the Court is again nothing short of remarkable.

The Federal Court of Appeal then turned to the *Maritime Act* and the *Telecommunications Act* for further guidance. In both cases, these acts speak to the need to run the affairs of the Crown corporations (the Port in one case, the CBC in the other) in an efficient manner and for the greater good of the country.

If you take the Schedule III nature of the CBC and the Port and you add the broad policy objectives in the other legislative texts, you end up with what is, in the opinion of the Federal Court of Appeal, a clear intention of Parliament that these two entities are never to be subject to the deleterious effects of Business Occupancy Taxes, whether they actually exist or not.

This outcome is very hard to fathom. One cannot simply brush aside the authority of municipalities to determine local tax policy by setting the various tax rates (within the powers conferred by their provincial government, of course). What if Montreal had simply decided to reduce the BOT slightly while increasing the commercial tax rate? Would this be acceptable? What if, instead of eliminating the BOT overnight, Montreal had decided to phase it out over a five-year period? Would this be acceptable?

In coming to its conclusion on this point, the Federal Court of Appeal argues that it has no choice but to calculate and deduct a value for the non-existent BOT because the judiciary has no authority to substitute its preferences to those of the legislator. Yet, that is exactly what the Court is doing. The local council exercised its legitimate authority and decided to change its taxation system. In doing so, it has, in fact, followed the trend of the last decade which has seen the elimination of the BOT in several jurisdictions. Montreal never argued that the CBC and the Port had to pay the BOT. The BOT simply does not exist anymore and this is the result of a valid policy decision made by elected officials. How the Federal Court of Appeal feels it has the legitimacy to interfere with this choice is anyone's guess. The possible argument of federal paramountcy is not discussed anywhere in the decision and, in this case, it would be a risky one to make.

4. Practical Implications

Beyond the shortfall in revenue, how exactly does one calculate the rate of a tax which no longer exists? The question is not rhetorical. That is effectively what the City of Montreal is now left to deal with in the wake of the Court's decision.

Is the proportion of the total tax bill attributed to the non-existent BOT to remain the same over time? This is another important question. Does Montreal have to continue applying this deduction in perpetuity? This is not entirely clear as the decision only dealt with a small number of specific taxation years. And what should be done with other Crown corporations in Montreal, and elsewhere?

The law certainly should not operate without regard for reality. When Montreal raised these entirely valid concerns, the Court's response was to say that Montreal had "raised the specter of confusion over the effective tax rate to be used." It conceded that, in the long run, this might become an issue but curtly added that, "if such confusion were to materialize, it would be as a result of the actions of the City, not those of the appellants." The Court went on to state that Montreal should not be "allowed to profit" from the confusion it created. To make matters slightly worse, the Court actually included, as part of the BOT deductions for the Port, a new water surcharge which the Port had actually agreed to pay.

IV. Next Steps

1. The Montreal Cases

The result of this decision is obviously problematic for Montreal and the city has already decided to seek leave to appeal to the Supreme Court of Canada. The decision of the Federal Court of Appeal truly should be challenged. The financial and practical ramifications of the decision are significant for Montreal, they have the potential of affecting other municipalities and, more importantly, the decision constitutes a completely unjustified attack on the authority of a local council to determine local tax policy.

Looking at the broader context, it is worth noting that for the last 13 years or so, the Supreme Court has been very supportive of the rights of municipalities to exercise their powers. A number of provincial Court of Appeal cases have been reversed by the Supreme Court in favour of municipalities (the pesticides case in Hudson, Que., is a perfect example). Even before the Hudson case, the Chief Justice herself had used very supportive language on this issue. However, when reading the Federal Court of Appeal's CRTC-related cases and this latest gem, it would appear that the message on the importance of recognizing the validity of municipal decisions might not yet be part of the culture of a court which, unlike provincial courts, seldom deals with municipal matters.

2. The Valuation Issue – The Halifax Citadel

This decision will likely have an effect on the Halifax Citadel case which deals with the valuation aspect of the PILT formula. Although the issue in Halifax arises because of the method used by the PILT Dispute Advisory Panel (DAP) (and subsequently accepted by the Minister) in setting the value of the Citadel for purposes of PILT calculations, the breadth of the Minister's discretion with respect to the value is likely to come up.

Justice Martineau had been of the view that the value of federal property was to be set by the Minister or the Crown corporation, but based on what an "assessment authority" would do. In fact, he went as far as to say that where an assessment authority is in place, the value to be used for the property is the one established by that authority. In his view, therefore, the DAP process was merely a conflict resolution process, not a decision-making body. The Federal Court of Appeal is not as explicit on this issue, but it does link the Minister's discretionary powers to the DAP and sees the panel as a way of assisting the Minister in exercising the broad discretion conferred by the *PILT Act* (as long as it is reasonable, presumably).

What is now becoming clear is that the interpretations of both components of the PILT formula, the rate and the value, are making their way through the courts. The rate component is heading to the Supreme Court and the value component will likely follow suit.

3. Government Intervention

The Attorney-General of Canada intervened before the Federal Court of Appeal, as it had at trial, in support of Montreal's position. In short, the AG indicated that it agreed with Justice Martineau's judgment and saw no grounds for appeal. The Court questioned the relevance of the AG's presence since the Crown corporations are independent and are the ones who own and manage the properties. The Court also indicated that it was surprised to see the AG take such a position given the wording of the *PILT Act* and the CCPR.

Given the fact that the issue centered on the interpretation of a federal statute, this reaction is somewhat surprising. Typically, the courts will at least give some weight to the government's representations.

V. The Silo Issue

This secondary legal issue related to the interpretation of Schedule II of the *PILT Act* which excludes certain structures from PILT calculations. Silos are not mentioned specifically and the closest applicable provision lists the following: **10.** Reservoirs, storage tanks, fish-rearing ponds, fishways.

At trial, Justice Martineau had ruled that since three of these words clearly referred to facilities for storing liquids, silos could not be read into the word "reservoir" as silos are for the storage of dry goods.

The Federal Court of Appeal, in an analysis which is nothing short of overkill, concludes that the word "reservoir" is sufficiently broad to include silos. It makes one interesting point in comparing the storage facilities for liquid sugar (reservoir or storage tank) to that for storing granulated sugar (silo). In its view, it would be illogical to apply PILT calculations to one and not the other. In this case, there is a grey zone and a final decision on appeal is hard to predict.