



Ottawa, Tuesday, September 28, 1993

Appeal Nos. AP-91-190 to AP-91-200

IN THE MATTER OF an appeal heard on
March 8, 9 and 10, 1993, under section 81.19 of the
Excise Tax Act, R.S.C. 1985, c. E-15;

AND IN THE MATTER OF decisions of the Minister of
National Revenue dated September 23, 1991, with respect
to notices of objection served under section 81.17 of the
Excise Tax Act.

BETWEEN

VIA RAIL CANADA INC.

Appellant

AND

THE MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeals are allowed.

Michèle Blouin
Michèle Blouin
Presiding Member

Kathleen E. Macmillan
Kathleen E. Macmillan
Member

Charles A. Gracey
Charles A. Gracey
Member

Michel P. Granger
Michel P. Granger
Secretary

UNOFFICIAL SUMMARY

Appeal Nos. AP-91-190 to AP-91-200

VIA RAIL CANADA INC.

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

The key issue in these appeals is to determine whether fuel used by the appellant in the generation of electricity to provide hotel services (air conditioning, heating and lighting) in the conventional cars of the appellant's passenger trains qualifies for tax exemption under section 3 of Part VI of Schedule III to the Excise Tax Act. The remaining appeals raise different issues. In Appeal No. AP-91-197, the issue is whether the appellant is entitled, in accordance with section 4 of Part VI of Schedule III to the Excise Tax Act, to a tax refund on fuel used for heating its conventional cars when the trains are laid over at stations. Appeal No. AP-91-192 raises the issue of duplication of refund claims.

HELD: *As to the issue of hotel services in conventional passenger cars, the appeals are allowed. There is uncontested evidence that electricity is generated under each conventional car by way of an axle generator and that this electricity is used exclusively to provide hotel services. There is a clear link between the fuel in the locomotive's fuel tank and the electricity used to provide hotel services aboard these cars. This fuel comes within the purview of section 3 of Part VI of Schedule III to the Excise Tax Act. As to the secondary issue raised in Appeal No. AP-91-197, the Tribunal considers that the burner and the boiler do not constitute an "internal combustion engine" within the meaning of section 4 of Part VI of Schedule III to the Excise Tax Act. They constitute, in the Tribunal's opinion, an "external combustion engine." The fuel burned in this engine for heating trains during layovers falls within the statutory requirements laid down in this section and is, therefore, tax-exempt. As for Appeal No. AP-91-192, the respondent conceded that this appeal should be allowed and that the matter should be referred back to the Minister of National Revenue for reconsideration.*

Place of Hearing: Ottawa, Ontario
Date of Hearing: March 8 to 10, 1993
Date of Decision: September 28, 1993

Tribunal Members: Michèle Blouin, Presiding Member
Kathleen E. Macmillan, Member
Charles A. Gracey, Member

Counsel for the Tribunal: Robert Desjardins

Clerk of the Tribunal: Dyna Côté

Appearances: Guy Du Pont and François Barette, for the appellant
Alain Préfontaine, for the respondent

Appeal Nos. AP-91-190 to AP-91-200

VIA RAIL CANADA INC.

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

TRIBUNAL: MICHÈLE BLOUIN, Presiding Member
KATHLEEN E. MACMILLAN, Member
CHARLES A. GRACEY, Member

REASONS FOR DECISION

These are 11 appeals under section 81.19 of the *Excise Tax Act*¹ (the Act) from decisions of the Minister of National Revenue (the Minister) in relation to tax refund claims made by the appellant. These claims were made for the periods from December 1, 1983, to May 31, 1985, and from December 1, 1985, to March 31, 1989.

Nine of these appeals raise the same issue, namely, whether fuel used in the generation of electricity to provide hotel services (air conditioning, heating and lighting) in the conventional cars of the appellant's passenger trains qualify for the tax exemption under section 3 of Part VI of Schedule III to the Act.

The remaining appeals raise different issues. In Appeal No. AP-91-197, the issue is whether the appellant is entitled, in accordance with section 4 of Part VI of Schedule III to the Act, to a tax refund on fuel used for heating its conventional cars when the trains are laid over at stations. Finally, Appeal No. AP-91-192 raises the issue of duplication of refund claims. On this last appeal, the Tribunal duly takes notice that the respondent, during the hearing, conceded that this appeal should be allowed and that the matter should be referred back to the Minister for reconsideration.

For purposes of these appeals, the relevant statutory provisions read as follows:

23.(8) The tax imposed by subsection (1) or by section 26 or 27 is not payable in the case of

...
(c) diesel fuel for use in the generation of electricity, except where the electricity so generated is used primarily in the operation of a vehicle.

*PART VI
FUELS AND ELECTRICITY*

3. Fuel oil for use in the generation of electricity except where the electricity so generated is used primarily in the operation of a vehicle.

4. Fuel for lighting or heating, but not including fuel when for use in internal combustion engines; crude oil to be used in the production of fuel.

1. R.S.C. 1985, c. E-15.

Mr. Timothy S. Secord testified on behalf of VIA Rail Canada Inc. (VIA). Currently a consultant, Mr. Secord was an employee of VIA, where he worked as Director of Equipment Acquisitions and Development, as well as Director of Engineering. After giving background information on the establishment of VIA, Mr. Secord described the kind of rolling stock (locomotives and cars) acquired in 1978 by VIA from Canadian National Railway Company (CN) and Canadian Pacific Limited (CP). This stock included conventional locomotives, self-propelled passenger cars and turbotrains.

Originally designed for use in freight operations, the conventional locomotive had to be modified for passenger operations in order to provide heating for the passenger cars. Thus, a separate water tank was installed in the locomotive to generate the steam used to heat such cars. The fuel for the boilers is located in the locomotive's fuel tank. Steam-generating units (SGUs), made up of a boxcar with a water tank, a fuel tank and boilers, were also acquired; these SGUs provide additional steam to the passenger cars in case of extremely cold temperatures. Finally, lighting and air conditioning in the conventional cars are derived from electricity generated by an axle generator attached to one of the axles of each car. Each of the approximately 1,000 passenger cars acquired by VIA had an axle generator. All of these cars were designed to be heated with steam heat. This original equipment has remained the same in spite of repair and refurbishing operations undertaken since its acquisition by VIA.

Mr. Secord also described the Light, Rapid and Comfortable (LRC) equipment acquired by VIA directly from Bombardier in the early 1980s. This equipment is also known as HEP (Head End Power) locomotives and cars. In an HEP train, heating is not done on the basis of steam, but on the basis of electrical heat. The electricity for the hotel services in the cars is provided through a dedicated hotel-power alternator located in the locomotive. The power generated by this alternator, at a voltage of 480 volts, is used solely and exclusively to provide lighting, heating and air conditioning in each passenger car, and does not contribute to the propulsion of the HEP train.

Mr. Secord then explained that the transfer of the responsibility for fuel purchases from CN and CP to VIA occurred only in 1985. Between 1978 and 1985, both established railway companies purchased fuel on behalf of VIA and billed VIA for the net cost of such fuel. According to Mr. Secord, it was the responsibility of CN and CP to purchase the fuel, to deliver it to VIA trains and also to look after all the administrative aspects of such purchases, including submissions for a tax rebate for the fuel.

Because fuel purchases were always made in quantity and stocked in a common tank on the locomotive, it was always necessary to derive the quantity of fuel used for the provision of heating and other hotel services by the application of various formulae developed for that purpose.

Before VIA started filing its own refund claims in the fall of 1986, it received the formulae used by CN and CP. These formulae have long been accepted by the Department of National Revenue (Revenue Canada). According to Mr. Secord, Revenue Canada acknowledged the acceptance of these formulae in 1955 after a careful review. Between then and the time of the present appeals, Revenue Canada accepted tax refund claims by CN and CP for fuel used for heating purposes in passenger trains.

The introduction of the HEP equipment meant that new calculations and formulae had to be developed to attribute the amount of diesel fuel used in the HEP locomotive to overcome the resistance caused by the axle generators in producing the electricity used for lighting, heating and air conditioning of the LRC cars. Mr. Secord, entrusted with this work, underlined for the Tribunal the different complex variables required to be factored into the establishment of such formulae. According to Mr. Secord, these formulae were audited and subsequently accepted by Revenue Canada. With respect to lighting and air conditioning aboard the

conventional cars, Mr. Secord explained that a methodology similar to that accepted by Revenue Canada for the LRC cars was adopted. The Tribunal was shown several documents, such as the appellant's documentary evidence,² a tax refund claim for diesel fuel by VIA to heat and light its conventional and HEP cars; this refund claim, like others, was audited and accepted by Revenue Canada.

However, refund claims filed by VIA were disallowed in 1988 with respect to lighting and other electrical services in conventional cars. As explained by Mr. Secord, VIA continued to file refund claims for exemption for heating and lighting. In parallel to the appeal process, representations were also made on this matter by VIA to various officials of Revenue Canada. In support of these representations, VIA sent reports prepared by recognized Canadian experts in the field of railway engineering and transportation, namely, Mr. Gordon W. English, Executive Director of the Canadian Institute of Guided Ground Transport, former Director of the Railway Laboratory (now the Centre for Surface Transportation Technology) of the National Research Council of Canada and Mr. Norman Edward Rudback, former Executive Director of the Transportation Development Centre at the Department of Transport. A consulting engineering firm, Beauchemin-Beaton-Lapointe Inc., pursuant to a standing agreement with the Transportation Development Centre, was also commissioned to prepare a report on the matter raised by VIA.

In the course of his testimony, Mr. Secord also referred to a letter³ written by an official of Revenue Canada. In this letter dated October 17, 1989, Mr. J.P. Guèvremont, Director General, Tax Interpretations, Excise, informed the appellant that Revenue Canada, after a careful review of VIA's submissions, had "decided to allow exemptions for fuel used to generate electricity for use in heating, lighting and cooling your trains (i.e. fuel used for 'hotel power')." This letter, the contents of which pleased VIA, prompted the latter to cancel a meeting which had already been scheduled with the Deputy Minister of National Revenue for Customs and Excise on this matter.

Finally, Mr. Secord told the Tribunal of the active role played by VIA with respect to the Excise Communiqué 191/TT⁴ entitled Diesel Fuel/Fuel Oil Used to Generate Electricity in Vehicles and issued in December 1989 by Revenue Canada. This communiqué sought to clarify a statement made in the July 1989 edition of Excise News to the effect that lighting, heating and cooling of vehicles were viewed by Revenue Canada as part of the normal operation of these vehicles and reversed this position. VIA was consulted by Revenue Canada prior to the issuance of the final text of the December communiqué. According to Mr. Secord, Revenue Canada, by asking VIA to comment on a draft document, wanted to ensure the consistency of Revenue Canada's approach with the long history of tax refund claims filed by the national railway companies.

During cross-examination, Mr. Secord explained that he devised the various formulae (other than the one determining the consumption of fuel for steam heat) used by VIA to calculate the amount of fuel consumed to produce electricity used for hotel services. Mr. Secord also affirmed that electricity, in a conventional car, is generated by the axle generator on each car and is distributed throughout the car's circuits. Counsel for the respondent questioned Mr. Secord on the issue of the amount of fuel used for propulsion purposes as opposed to fuel used to provide hotel services aboard the conventional cars. Mr. Secord's answers indicated that there are many variables or factors which influence such fuel consumption and that these variables are accounted for in the formulae used. Finally, Mr. Secord pointed out that part of the energy of a locomotive's motors serves to overcome the resistance offered to the movement of the conventional train by the very function of the axle generators.

2. Vol. 2 at tab A-15.

3. Appellant's Documentary Evidence, vol. 4 at tab A-92.

4. Appellant's Documentary Evidence, vol. 3 at tab A-74.

A private consultant, Dr. Bernard-André Genest was the appellant's expert witness. At the request of VIA, he prepared a report dated December 1992 and entitled The Use and Consumption of Diesel Fuel by VIA Rail for the Generation of Electricity for the Provision of Train Operation and Passenger Comfort. Counsel for the respondent had earlier indicated that he was ready to accept this report in its entirety. According to Dr. Genest, this document explains the processes of energy generation, transformation and transmission that occur on board a VIA passenger train. In the case of a conventional train, the report explains that there is generation of electricity, that fuel is consumed to generate that electricity, that the electricity so generated is used solely for the comfort of passengers and could not be put to any other use. Using charts⁵ and through his testimony, Dr. Genest focused on these very points.

Thus, Dr. Genest briefly outlined, for the Tribunal, the train operation system of an HEP locomotive and of a conventional locomotive. With respect to the latter, the processes of energy transformation start with the chemical energy contained in the diesel fuel carried in the locomotive's tank. The fuel is fed to the diesel engine which transforms the chemical energy to thermal energy (i.e. heat) and then to mechanical energy. This mechanical energy takes the form of the rotation of the diesel engine shaft. The shaft then transmits the mechanical energy to the locomotive generator. The mechanical energy is transformed by the generator into electrical energy which is transmitted, through a series of power cables, to the traction motors. These motors, in turn, take the electrical energy and transform it into mechanical energy, which then rotates the wheels and induces movement to the locomotive.

Dr. Genest then proceeded to explain the various steps which take place in the production of "comfort" in a HEP train and in a conventional train. As to the latter, he explained that additional mechanical energy is needed to overcome or counteract the resistance induced by the axle generators and to ensure that the train does not decelerate upon the coming into operation of such generators. According to Dr. Genest, this additional energy has to come from the only source of energy aboard the train, namely, the locomotive's fuel tank. There is a direct requirement of extra fuel to overcome the resistance and to generate electricity. This additional energy, as pointed out by Dr. Genest, "is eventually picked up, by the fact that the wheels turn on the rail, by the axle generator, the axle generator transforms this into electricity, and that electricity is fed to the hotel service appliances in the car."

Dr. Genest also confirmed that electricity fed to the traction motors of a conventional locomotive is unsuitable for the power requirements of hotel services. Conversely, he added that electricity produced by the axle generators does not and cannot serve any purpose other than that of providing comfort to passengers sitting in the cars.

Finally, Dr. Genest characterized the boiler and the burner used in the production of steam as an external combustion engine or an "external combustion apparatus."

On the main issue to be determined by the Tribunal, counsel for the appellant made, in essence, three arguments. First, they contended that VIA meets all the statutory requirements set out in section 3 of Part VI of Schedule III to the Act. In their view, there is unchallenged evidence that there was electricity generated aboard the conventional cars using fuel oil and that such electricity was not used primarily for the operation of a vehicle, but was used exclusively for hotel services aboard these cars. Counsel contended that the percentage of diesel fuel used to generate electricity in the axle generators was immaterial, since all the electricity generated by such generators is used exclusively for hotel services. They also noted that the statutory provision at issue contains no test of "direct use of the electricity." Counsel also argued that the number of steps involved in the process of generating electricity was an irrelevant consideration.

5. Exhibits A-11 and A-12.

In this connection, it should not matter that there are more steps in the generation of electricity in the case of conventional cars than in the case of HEP cars.

Secondly, counsel argued a "*fin de non-recevoir*" against the respondent. In other words, the respondent is "estopped." In their view, an estoppel stands for the proposition that one cannot make, to a third party, representations upon which this party will act to its own detriment. In this connection, counsel pointed to a number of representations made to the appellant by Revenue Canada. In particular, counsel referred to a few documents, including Exhibit A-92.

Thirdly, counsel for the appellant argued that there is no basis in law to support a retroactive change in administrative policy, particularly in light of all the representations made by Revenue Canada over four decades to VIA and its predecessors, CN and CP. In counsel's view, the doctrine of equity dictates that changes in a long-established policy should not be given retroactive effect.

On the secondary issue, namely, the layover issue in Appeal No. AP-91-197, counsel for the appellant argued, having regard to section 4 of Part VI of Schedule III to the Act, that the boiler and burner do not constitute an "internal combustion engine," but rather an "external combustion engine." Alternatively, taking into account the point made by counsel for the respondent that both the boiler and burner do not even constitute an "engine," counsel for the appellant then argued that the respondent should not have any objection to the tax refund claim.

Counsel for the respondent sought to establish the intent of Parliament behind the enactment of section 3 of Part VI of Schedule III to the Act. In his view, Parliament intended to provide tax relief, for example, to isolated communities deprived of access to the public electric grid. In counsel's view, the exemption cannot be stretched so far as to accommodate a particular case like the one at hand. In addition, when looking at section 3 of Part VI of Schedule III to the Act, it should be borne in mind that fuel used for transportation is taxable under the Act and that Part XVII of Schedule III to the Act (exemptions specific to the transportation industry) contains no provision dealing with fuel used for transportation purposes.

Counsel for the respondent also argued some principles of statutory construction. In this respect, he underlined that VIA had the burden of proving its right to the exemption. He also underlined some of the principles relating to the interpretation of bilingual legislation. On this last point, he contended, *inter alia*, that the word "generation" in the English version of section 3 of Part IV of Schedule III to the Act has a narrower meaning than the word "*production*" in the French version and that this narrower meaning should be considered as the proper one. Given the meaning of the word "generation" as can be found in some dictionaries, the scope of the exemption is then physically limited to the locomotive itself. It means the initial creation of electricity in the locomotive's generator; what takes place in the axle generators is beyond the exemption's purview. According to counsel for the respondent, the case law cited by counsel for the appellant raises a different scenario than the one at hand, since those cases dealt with equipment implicated in the "*production*" of electricity.

In the view of counsel for the respondent, Parliament intended that there be an immediate connection — a nexus — between the consumption of fuel and the generation of electricity. He contended that the axle generators do not generate electricity by reason of the consumption of fuel. Such axle generators generate electricity by reason of transmission to them of the mechanical energy that moves the wheels of the train.

Counsel for the respondent offered an argument about the proportion of fuel used to generate electricity for hotel services. He contended that most of the fuel used and most of the

electricity produced by the consumption of fuel was used to operate VIA's trains and not to provide hotel services.

On the issue of estoppel, counsel for the respondent questioned its relevancy in the present appeals. On the question of equity, he pointed out that the Tribunal does not have jurisdiction on matters of equity.

On the secondary issue, counsel for the respondent asked the Tribunal to consider the equipment as an "internal combustion engine" or, alternatively, as not constituting an engine at all since it does not produce any movement; it solely produces steam to heat the cars.

In arriving at its decision, the Tribunal reviewed the evidence and argument. It also took into account the respondent's acceptance of voluminous documentary evidence adduced by VIA and the various expert reports which set out the method by which electricity is generated and used in the different locomotives and passenger trains in issue in the present appeals. There is substantive agreement between the parties on the facts of these cases. The issue is one of statutory interpretation, and more specifically, the question of how close the nexus must be between the fuel burnt and the electricity generated for hotel services in conventional passenger trains in order to qualify for the exemption under the Act. The Tribunal notes that the HEP trains are not in issue, as the respondent has allowed the tax refund claims filed by VIA in relation to this relatively new rolling stock. In other words, a refund is allowed in respect of fuel consumed to generate electricity in the dedicated alternator in the HEP locomotives, which electricity is used to provide heat, lighting and air conditioning in the HEP passenger cars.

With respect to the issue of hotel services in conventional passenger cars, the Tribunal concludes that the appeals must be allowed.

Pursuant to subsection 51(1) of the Act, the sales tax does not apply to the sale of the goods mentioned in Schedule III to the Act. Section 3 of Part VI of this schedule contains an exemption for "[f]uel oil for use in the generation of electricity except where the electricity so generated is used primarily in the operation of a vehicle." The Tribunal is of the view that this section is applicable to the appeals at issue. If Parliament's intention had been to restrict the applicability of this exemption to the kind of situations mentioned by counsel for the respondent, there would have been no reason for the legislator to use words excluding electricity "used primarily in the operation of a vehicle" from the scope of the exemption. The Tribunal is convinced that the diesel fuel used by VIA to generate electricity for hotel services aboard conventional cars meets the statutory requirements set out in section 3 of Part VI of Schedule III to the Act.

There is uncontested evidence that electricity is generated under each conventional car by way of an axle generator and that this electricity is used exclusively to provide hotel services and that it is unsuitable to propel a train.

On the contention made by counsel for the respondent that there is no nexus between the consumption of fuel and the generation of electricity aboard the conventional cars, the Tribunal observes that section 3 of Part VI of Schedule III to the Act contains, explicitly or implicitly, no reference to a "direct use" test or to the word "direct." This being said, there is a clear link between the diesel fuel in the locomotive's fuel tank and the electricity used to provide hotel services aboard these cars. On this point, the various specialists introduced by VIA are in agreement. Thus, according to Mr. Rudback, "the energy required to furnish the hotel load can only come from one source, the fuel tank of the locomotive." According to Mr. English of the Canadian Institute of Guided Ground Transport, it is appropriate to seek the exemption for fuel used in driving the axle generator systems as "this energy must come from the locomotive engine as it is the only source of energy for the train."

There is unchallenged evidence that the generation of electricity in the conventional cars is the result of a multi-stepped energy transformation process. Simply put, the energy in the fuel in the locomotive is transformed by a relatively complicated process which is fully integrated. This transformation was particularly well explained by Dr. Genest during his testimony.

There is also uncontradicted evidence establishing that additional diesel fuel is used to overcome the resistance imposed on the train movement by the operation of the axle generators. In the Tribunal's view, this is an important consideration to show the relationship between the diesel fuel and the generation of electricity aboard the cars. The report prepared by the firm Beauchemin-Beaton-Lapointe Inc. at the request of Mr. Rudback (and endorsed by him) is to the point. According to Mr. Edwin I. Garnis, who wrote the firm's report, the axle generator connection to the axle of each car increases the rolling resistance of that axle and increases the energy required by the locomotive propulsion system to move the train. Therefore, a portion of the fuel consumed by the locomotive propulsion system is directly attributed to the additional rolling resistance caused by the axle generator system being connected to the passenger vehicle axle. The consultant's conclusion is that the fuel consumed by the locomotive can be differentiated between that used to move the train and the portion used to provide hotel services.

For all the foregoing reasons, the Tribunal concludes that VIA is entitled to obtain tax refunds with respect to the portion of fuel, as is calculated through various complex formulae, used in the generation of electricity needed to provide hotel services aboard conventional cars. Such fuel comes within the purview of section 3 of Part VI of Schedule III to the Act. Having reached such conclusion, it does not appear necessary for the Tribunal to address the other arguments developed by counsel for the appellant on the main point.

On the secondary issue raised in Appeal No. AP-91-197, the Tribunal is of the view that the burner and boiler do not constitute an "internal combustion engine" within the meaning of section 4 of Part VI of Schedule III to the Act. They constitute, in the Tribunal's opinion, an "external combustion engine." The fuel burned in this engine for heating trains during layovers falls within the statutory requirements laid down in this section and is, therefore, tax-exempt.

Accordingly, the appeals are allowed.

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