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PRIVILEGED & CONFIDENTIAL

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Attention: Gregory Nash

Dear Sir:

Re: William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware Inc.

NAFTA AWARD Canadian Tax Implications

We are writing to provide our legal opinion on certain questions you have posed to us regarding the Canadian tax implications under the *Income Tax Act* (Canada) (the "Act")[1] of a payment to be made by Canada to certain investors, as more particularly described below.

Our opinions are based on the facts set forth below, the current provisions of the Act, the regulations made under the Act (the "Regulations"),[2] all specific proposals to amend the Act and the Regulations publicly announced by or on behalf of the Minister of Finance (Canada) (the "Minister") prior to the date of this letter, and our understanding of the current published administrative policies and assessing practices of the CRA.

My curriculum vitae setting out my qualifications is attached as Appendix "A" to this letter.

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1 R.S.C. 1985, c. 1 (5th supp.), as amended to the date of this letter. Unless otherwise stated, in this memorandum all statutory references are to the Act.

2 C.R.C., c. 945, as amended. All regulatory references in this letter are to the Regulations.

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Facts

For the purposes of this opinion, we have relied on the following facts you have provided to us, and on certain assumptions, which you have confirmed:

1. William Ralph Clayton, William Richard Clayton, Douglas Clayton, and Daniel Clayton (collectively, the "Individuals") are U.S. citizens that are not "resident in Canada" and as those expressions are understood for the purposes of the Act. In addition, none of the individuals

2. The Individuals (save for William Ralph Clayton) are shareholders of Bilcon of Delware, Inc. (the "Corporation"), a corporation incorporated under the laws of the State of Delaware. For the balance of this letter, the Individuals and the Corporation will be referred to collectively as the "Investors".

3.

4. The Corporation is the sole shareholder of Bilcon of Nova Scotia ("ULC"), a company without limited liability governed by the laws of Nova Scotia.

5. ULC is still in existence.

NAFTA Claim

6. In 2008, the Investors commenced a claim under Article 1116 of Chapter 11 of the *North American Free Trade Agreement* ("NAFTA"), which provides rules and standards for the treatment of investors and their investments by the governments of Canada, Mexico and the United States.

7. Article 1102 of the NAFTA requires that each Party treat investors of another Party no less favourably than it treats its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.

8. Article 1105 of the NAFTA requires that each Party give investors of another Party treatment that accords with international law, including fair and equitable treatment and full protection and security.

9. In 2013, an arbitration Tribunal constituted under the NAFTA (the "Tribunal") found that in denying approval for the Whites Point Quarry, Canada contravened Articles 1102 and 1105 of NAFTA.[4]

10. The Tribunal ordered that the quantum of damages and costs be heard at a later date (currently early 2018).

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[3] Title 26, *U.S. Code*.

[4] The Tribunal did not determine whether Canada was liable *vis á vis* William Ralph Clayton.

Damages

11. In the "Investors' Damages Memorial" the Investors argue that Canada must make full reparation for their loss, as contemplated by the *Case Concerning the Factory at Chorzow* and Article 31 of the International Law Commission's *Articles on State Responsibility*. The "full reparation" will take the form of a cash payment (the "Award") to the Investors.

12. We have assumed that a discounted cash flow ("DCF") valuation approach is the appropriate methodology to determine the amount of the Award.

13. The Investors rely on the expert valuation of Howard Rosen that determines the amount of the Investors' losses.

14. The Investors' losses are the sum of the total amount of lost profits (which is comprised of two separate periods: 2008 to the end of 2016, and 2017 onward) adjusted for tax consequences along with some pre-judgment interest.

15. We have assumed that the Award will be paid by Canada directly to the Investors, not ULC, and that ULC is not entitled to the Award.

Questions

1. ***"Would the damages award payment be excluded from income for Canadian tax purposes or be exempt from tax? Would the exemption cover both federal and provincial taxes?"***

Yes.

Residents of Canada are liable to tax on their world-wide income.[5] Persons who are not resident in Canada are only liable for tax if the person was employed in Canada, carried on a business in Canada or disposed of "taxable Canadian property".[6]

[5] Subsection 2(1) and 3.

[6] See ss. 2(1) and (3), and ss. 115(1)(a) to (b). Taxable Canadian property is defined in s. 248(1).

[7] The fact that the Award was made as a consequence of certain actions by Canada that eroded the value of the ULC shares does not give rise to a disposition of ULC shares by the Corporation, or the Corporation's shares by the relevant individual Investors. Also, we do not believe that the Investors' ability to claim relief under NAFTA constitutes "an interest" in the ULC shares. If we are wrong, then this "interest" would constitute taxable Canadian property if more than 50% of the value of the ULC shares was derived from Canadian real property in the last five years. However, in this event Canada should not be permitted to tax the gain since the "interest" should not meet the definition of "real property situated in the other Contracting State" in article XIII(3) of the Treaty (as defined in the text below).

[8] See ss. 2(1), 5, 6 and 7 of the *Income Tax Act* (Nova Scotia), R.S. 1989, c. 217 as amended to the date of this memorandum.

The fact that ULC was the legal entity that held the quarry project does not alter this conclusion. The Award will be paid by Canada directly to the Investors, not ULC, and ULC is not entitled to the Award. Thus, common law constructive receipt principles and statutory rules such as s. 56(2) should not be relevant.

2. ***"Would Canadian withholding taxes apply to the damages award payment? If so, what rate would apply?"***

No.

Federal withholding tax is levied under Part XIII of the Act on amounts paid by a Canadian resident (or, in some circumstances, amounts deemed to be paid by a Canadian resident or amounts paid by some non-residents) to non-residents where the amount paid is described, or is in lieu of an amount described, in one of the specific rules in s. 212(1). The Award should not be described in any of these rules.

As in the case of the answer to question 1 above, the fact that ULC was the legal entity that held the quarry project should not alter this conclusion.

Lastly, the Province of Nova Scotia does not levy a withholding tax.

3. ***"How would the damages award payment be classified by Canada for treaty purposes and what rate would apply?"***

The *Canada-U.S. Tax Convention* (the "Treaty") relieves tax levied by the Act. Since there is no tax levied by the Act on the Award, the Treaty should not be relevant to the analysis.

4. ***"Would the Canadian withholding tax on dividends only be applied on a distribution of profits or on all distributions?"***

This answer requires some additional context, since Canadian tax law generally treats dividends differently from U.S. tax law.

There is no "earnings and profits" concept in the Act, and so the Act does not specify that the dividend withholding tax should apply only to distributions of profits.

Subsection 212(2) levies a 25% withholding tax on dividends paid by Canadian-resident corporations to non-resident shareholders. For this purpose, an amount will only be subject to dividend withholding tax if the amount constitutes a dividend under corporate law or is deemed to be a dividend under certain rules in the Act.[9]

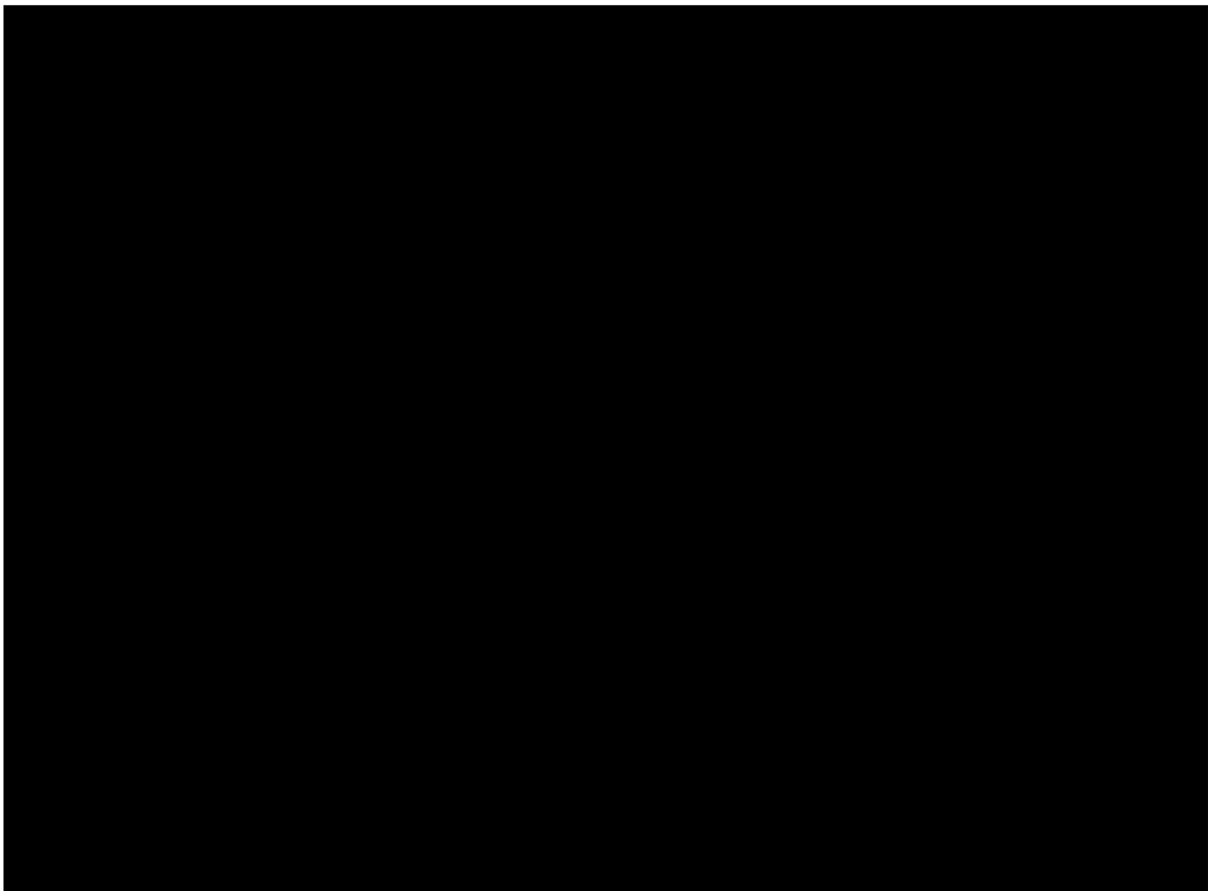
Subsection 212(2) also applies to payments made "in lieu of" a dividend. The definition of "in lieu" is subject to some debate, although it would not apply to a capital distribution.

[9] For example, the specific deeming rules in ss. 84(1) to (4.2) and ss. 212.1 and 212.2 and s. 214(3)(a).

Nova Scotia company law is unique in Canada in that dividends are subject to common law rules regarding distribution of profits (i.e., the general rule that dividends must be paid from profits as determined under common law principles or, in some cases, from other "accounts" such as appraisal surplus).[10]

It is possible to return share capital under Nova Scotia company law. As noted, where a company distributes share capital the amount is not subject to dividend withholding tax.[11] It is noteworthy that there is no ordering rule which applies to specify that one must distribute profits before capital, or *vice-versa*.[12]

5. "*What rate of Canadian withholding tax is applied on a distribution*



[10] The other, modern, corporation-styles statutes of Canada and the provinces and territories have no such restriction. They instead employ statutory "solvency" tests which act as safe harbours for directors' liability when dividends are declared.

[11] Although if the amount distributed exceeds a non-resident shareholder's "adjusted cost base" of the shares and the shares constitute "taxable Canadian property" then the excess gives rise to a capital gain that is subject to Canadian tax subject to Treaty relief, if any. Based on the corporate structure of ULC, common tax planning would likely make this irrelevant.

[12] Also see the comment in text above that there is no "earnings and profits" concept in the Act that applies to corporate distributions.

[13] For example, see CRA Doc. 2014-0534751R3.

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Lastly, we can confirm that the combined income tax rate for a company carrying on business in Nova Scotia and no other province is 31%.

Yours truly,

Michael W. Colborne

MWC:kw

APPENDIX A

REPLY EXPERT REPORT OF THORSTEINSSONS LLP

Curriculum Vitae - Michael Colborne

Michael Colborne received his LL.B. from the University of Manitoba and a LL.M (U.S. tax) from New York University.

After clerking at the Federal Court of Canada, Michael joined Thorsteinssons LLP and became a partner in 2005. He has been called to the Bar in Ontario and British Columbia. Michael is the managing partner of Thorsteinssons LLP.

Michael's practice focuses on corporate and international tax planning, regularly advising Canadian and foreign-based multi-national groups on a variety of matters, including financing, mergers and acquisitions, and natural resource taxation. He also has considerable experience in handling tax controversy issues in Canada and a number of other countries. In this regard, Michael has appeared in the Supreme Court of Canada, Federal Court of Appeal, Tax Court of Canada, the superior courts of British Columbia and Ontario, and the Revenue Tribunal of the United Republic of Tanzania.

Over the past 20 years Michael has developed a widely-recognized expertise in issues involving the mining industry, and regularly advises a number of Canadian and foreign-based multinational mining companies. In addition to his transactional experience (which has involved everything from complex acquisitions and divestitures to metal stream financing transactions), Michael has counseled both taxpayers and governments on legislative and tax policy matters relating to the mining industry.

Michael also acts for a number of large multi-national companies in a broad range of industries including aerospace and defence, paper and household products, pharmaceuticals, financial services, nuclear and hydro power, and real estate.

Michael speaks and writes frequently on international and mining tax matters, having presented numerous papers for the Canadian Tax Foundation, International Fiscal Association, International Bar Association and Rocky Mountain Mineral Law Foundation. He is on the editorial boards of the CCH *Income Tax Act* and the *Resource Sector Taxation* and *International Tax Planning* Journals.

In 2007 Michael was named one of the leading lawyers under 40 in Canada by Lexpert magazine, and he is recognized in numerous industry publications such as *Chambers* and *Lexpert*. He is a former Governor of the Canadian Tax Foundation.