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1. Overview

1. In 1998, the City began to actively address the risk of potential problems posed by the Year 2000 computer issue. By January 1999, the City's Y2K initiative was well underway. As part of the Y2K initiative, the City began to acquire Y2K compliant computer equipment. By October 1999, the City had acquired approximately \$20 million worth of Y2K compliant equipment. The City had paid for \$14.4 million worth of equipment. The remaining \$5.6 million had not been paid for as of October 1999.¹

2. I&T decided that it wanted to place this equipment on lease with MFP. This decision led to the sale leaseback transaction, which required the City to sell the equipment it had purchased to MFP who immediately leased it back to the City. In October 1999, the City sold \$14.4 million in equipment to MFP, which was immediately placed on lease.²

3. There was no express Council authority for the sale leaseback transaction. The sale leaseback transaction was not mentioned in the RFQ, MFP's response to the RFQ, or the Report to P&F and Council that recommended that MFP be awarded the contract. Without Council approval, staff had no authority to execute the sale leaseback.

4. The sale leaseback transaction also resulted in a significant tax liability for the City. The City paid PST on all the equipment it purchased. The City was not required to charge PST on the sale of the equipment to MFP and it did not do so. However, the subsequent lease payments to MFP were subject to PST. Therefore, the City paid PST twice on the same equipment.³ The City's duplicate PST payments at the time totaled \$1,882,372.73.⁴ The transaction also created GST issues for the City because the City

¹ COT036732 at COT036741, 33:2:27.

² COT036732 at COT036741, 33:2:27. Sale leaseback items were eventually placed on 838-1, PA1-1 and PA1-2. These lease schedules had commencement dates of October 1, 1999, January 1, 2000, and April 1, 2000, respectively.

³ COT080176 at COT080188, 61:1:Report.

⁴ 838-1, PA1-1 and PA1-2 were ultimately rewritten in July 2000. The total duplicate tax amount for these lease schedules was \$1,521,197. The cost of the equipment that the City had not yet paid for in October 1999 was paid for by MFP. MFP paid the amount directly to the vendors of the equipment. Then, in

made unnecessary GST payments when it first acquired the equipment. However, the City eventually retrieved these payments from MFP in the amount of \$1,647,076.25.

5. City staff did not anticipate the tax issues that arose from the sale leaseback transaction. Andrew testified that the possibility of a GST or PST issue did not occur to him.⁵ Power testified that he did not turn his mind to the tax implications of the sale leaseback transaction.⁶ Rabadi testified that he believed that the sale leaseback transaction could be accomplished without any tax implications for the City.⁷

6. The failure to expressly reference the proposed sale leaseback transaction and, therefore, to include any reference to the potential tax liability associated with the sale leaseback transaction in the Report to Council meant that the analysis of the costs of leasing versus debenturing was flawed. The analysis should have referenced the \$1.8 million cost to account for the increased tax liability on the portion of the assets that would be the subject of the sale leaseback transaction. Council never had the opportunity to consider the tax issue when deciding to award the leasing contract to MFP.

7. Only MFP and Wilkinson appeared to have been aware from the outset of the tax liability faced by the City. If MFP advised the City that there was a potential tax liability associated with this transaction, it never did so in writing and never told the appropriate person. MFP should have clearly disclosed its knowledge so that the City could properly cost the sale leaseback transaction and determine whether or not it wished to proceed. An ethical leasing company would have made sure that its client was fully aware of a \$1.8 million transaction cost associated with a lease before the client committed to a multi-million dollar deal.

January 2001, the City sold an additional \$4,514,695 in assets to MFP, which leased it back to the City on lease schedule PA1-4. The commencement date for lease schedule PA1-4 was January 1, 2001. The duplicate tax amount for this lease schedule was \$361,175.73. Thus, the total duplicate PST amount was \$1,882,372.73: COT036212, 56:1:26; COT036732 at COT036744, 33:2:27; COT080176 at COT080196, 61:1:Report.

⁵ Andrew 10/02/2003 at 211.

⁶ Power 03/06/2003 at 73.

⁷ Rabadi 06/25/2003 at 20-21.

2. There was no Council approval for the sale leaseback

a) I&T knew by May 1999 that there would be a sale leaseback

8. Power testified that he discussed the sale leaseback transaction with Viinamae prior to drafting the 1999 RFQ.⁸ Viinamae agreed that either Power or Andrew advised her that there would be a sale leaseback component to the computer leasing procurement exercise.⁹ Andrew agreed that the City had been considering the concept of a sale leaseback transaction since April 1999.¹⁰ He confirmed that he was in favour of a sale leaseback component, and that he could not recall anyone who was not in favour.¹¹ Andrew agreed that he knew that the sale leaseback transaction would be complicated.¹²

9. According to these individuals, there was no other way that equipment purchased and paid for prior to October 1, 1999 could have been included on the leases. Despite this, there was no mention of the proposed sale leaseback transaction in the 1999 RFQ or the P&F Report.¹³

b) The RFQ did not explicitly refer to a sale leaseback

10. The final version of the RFQ dated May 31, 1999 did not describe a sale leaseback, but it did contain two subtle references hinting at the sale leaseback transaction.

11. First, the RFQ included a table that listed the City's hardware and software configurations. The table referred to:

⁸ Power 03/06/2003 at 156.

⁹ Viinamae Affidavit, para.49, 10/15/2003 at 25-26.

¹⁰ Andrew 10/01/2003 at 75.

¹¹ Andrew 10/01/2003 at 75-76.

¹² Andrew 10/02/2003 at 210.

¹³ COT032202, 46:1:63.

City hardware and software configurations (typical new configurations) *already purchased* or to be purchased in 1999.¹⁴

12. Second, under the heading “Usage Assumptions”, there was another oblique reference to a sale leaseback transaction:

Approximately 9,000 desktops will be installed in the calendar year 1999. It is anticipated that another 4,000 desktops will be installed during the term of an agreement resulting from this RFQ.¹⁵

13. Power testified that readers of the RFQ would assume that the 9,000 desktops to be installed in calendar 1999 would be part of a sale leaseback.¹⁶ The proposed sale leaseback transaction was not explained or described further.

14. It was not self-evident that readers of the RFQ would see either or both of these references as calling for a sale leaseback. In fact, only two bidders specifically addressed the sale leaseback transaction in their responses.¹⁷

c) The report to P&F did not refer to the sale leaseback transaction

15. The July 9, 1999 report to P&F from Liczyk and Andrew did not contain a single reference to a sale leaseback.¹⁸ P&F would have had no idea that the computer leasing transaction they were reviewing would include the sale of over \$20 million in City owned assets. The risk of a significant additional PST liability was neither raised, nor included in the analysis of the costs of leasing.

16. Neither Power nor Rabadi could recall whether or not they discussed including a specific reference to the sale leaseback transaction in the P&F Report.¹⁹ Power agreed

¹⁴ COT006104 at COT006116, 46:1:66 [emphasis added].

¹⁵ COT006104 at COT006117, 46:1:66.

¹⁶ Power 03/06/2003 at 169.

¹⁷ Power 03/31/2003 at 16-17.

¹⁸ COT001565, 2:1:3.

¹⁹ Power 03/24/2003 at 84; Rabadi 06/25/2003 at 19.

that, in retrospect, he should have included more detail about the sale leaseback transaction.²⁰

17. On June 25, 1999, Rabadi sent an email to Power requesting the value of the equipment that I&T had already received from the \$43.15 million of equipment that I&T intended to lease.²¹ Power replied to Rabadi's email five days later:

In addition to the \$15.1 million I mentioned in yesterday's e-mail, there is approximately another \$8 million spent or committed in this calendar year, YTD June, 1999²²

18. As of June 30, 1999, I&T and Rabadi believed that \$23.1 million in equipment had been already spent or committed.

19. An early draft of the P&F report prepared by Rabadi specifically referred to the vendors of equipment received by the City "re-invoicing" that equipment to the lessor. This reference was contained in Rabadi's June 29, 1999 draft P&F Report:²³

Considering the urgency of the Y2K project, equipment worth \$__ has already been received by the City. If the recommendation in this report is adopted, the said equipment will be re-invoiced by the vendors to the lessor and then leased to the City.²⁴

20. Rabadi envisioned the equipment vendors reversing the entire transaction, refunding all of the money paid by the City, including taxes. The vendors would then rebook the transaction with MFP. For example, Dell would issue the City a credit note for the full amount and then re-invoice MFP for the same amount.²⁵

²⁰ Power 03/24/2003 at 21-22.

²¹ COT031948, 46:2:14.

²² COT014320, 46:1:40.

²³ Rabadi Affidavit, para. 40, 06/24/2003 at 133-134; COT012716, 49:2:11.

²⁴ COT012716 at COT012717, 49:2:11.

²⁵ Rabadi 07/03/2003 at 84.

21. Rabadi assumed that vendors would agree to provide PST credits to the City without any attendant legal obligation.²⁶ Brittain considered this assumption to be reasonable.²⁷ He testified:

[T]o the extent he [Rabadi] was assuming, as I recall it, that the equipment and software, I presume, that had been delivered by the time the lease was entered into would be re-invoiced, I think that problem would have disappeared. And to the extent that the equipment again, it was put on lease, as long as that was handled in that manner, that the vendors would simply re-invoice MFP instead of invoicing the City, that that problem would have disappeared.²⁸

22. Rabadi did not consider the type of transaction he proposed to be a true sale and leaseback.²⁹ Rather, he thought it to be purely a financing transaction, which incurred neither profits nor losses.³⁰ Brittain agreed with this characterization of the transaction:³¹

A: The vendor would give a credit note to the City and would pay the City the amount. At the same time, MFP would pay to the vendor and MFP would be invoiced by the vendor.

Q: All right. And is that not the same thing as a sale leaseback?

A: No. It is not the same thing because in a sale and leaseback the City would be selling the equipment to MFP and MFP would then be leasing it back to the City. So we were excluding the vendor entirely from that scenario.³²

23. In furtherance of this plan, Viinamae emailed all City suppliers on August 29, 1999 requesting that they issue a credit note to the City for “the cost of all hardware, software licenses and maintenance, including tax, issued in 1999”, and an invoice to

²⁶ Brittain 07/31/2003 at 40.

²⁷ Brittain 07/31/2003 at 40-41.

²⁸ Brittain 07/31/2003 at 40-41.

²⁹ Rabadi Affidavit, para. 40, 06/24/2003 at 133-134.

³⁰ Rabadi 07/02/2003 at 50.

³¹ Brittain 07/28/2003 at 103-104.

³² Rabadi 07/03/2003 at 84.

MFP for those items.³³ Marks testified that I&T never received a single credit note from any supplier in response.³⁴

24. Regardless, Power July 5 Draft of the P&F Report removed Rabadi's reference to the vendor re-invoicing.³⁵ The reason for this deletion is unclear. The final version of the P&F Report contained no reference to a sale leaseback or vendor re-invoicing.

25. On July 20, 1999, P&F approved the Report, as amended by Councillor Jakobek, and recommended that Council adopt the Report, which contained no reference to the sale leaseback.

26. The Committee's recommendation was approved by City Council at a Council meeting held between July 27 and July 30, 1999. The Council Resolution provided that the City could enter into a leasing contract to lease computer equipment and related software for three years.³⁶

27. Council approved the computer leasing transaction without knowing that I&T staff believed that implementing the transaction would require a sale leaseback at an undisclosed cost of \$1.8 million.

d) City staff were uncertain whether Council approval was required

28. Pagano agreed that he was the individual responsible for the disposition of surplus and obsolete assets at the City.³⁷ However, other individuals at the City could have disposed of assets, provided that Council approval was obtained.³⁸

29. Pagano testified that he was not aware that the computer leasing transaction involved the sale of assets and the reacquisition of those assets on lease.³⁹ If he had

³³ COT024963, 56:1:3.

³⁴ Marks 08/14/2003 at 121-122.

³⁵ COT013811, 46:2:23; Rabadi 07/02/2003 at 83- 84.

³⁶ COT005026, 63:8:43a.

³⁷ Pagano 03/04/2003 at 174.

³⁸ Pagano 03/04/2003 at 174-175.

known that such a sale leaseback was contemplated, he would have recommended that I&T obtain explicit approval from Council for the sale.⁴⁰ Pagano acknowledged that he was not certain whether or not Council approval was required. He noted that the sale leaseback transaction was considerably different from a situation in which the assets physically left City property and the City lost all use of the assets.⁴¹

30. Liczyk said that did she not believe that the sale leaseback transaction was a true sale of City assets, as the City would continue to possess and use the assets.⁴²

31. Power testified that it did not occur to him that the process by which acquired assets were sold by the City to be placed on lease to the City might be governed by some procedure at the City.⁴³ However, Power agreed with Liczyk and Pagano's assessment; namely, that the sale leaseback transaction did not constitute a disposition of assets since the City continued to have use of the equipment.⁴⁴

32. Altman did not consider the omission of the term "sale leaseback transaction" from the P&F Report, and later the Council Report, to be significant.⁴⁵ He testified that the sale leaseback transaction was an "operational question". Altman believed that the third recommendation in the Council Report provided a signal of the sale leaseback transaction:

Q: And you wouldn't be concerned that Council wasn't being specifically advised of that?

A: To my way of thinking, Council -- and -- and when you look at the final report, all right, Council was being apprised that something that they'd previously approved to be funded in this manner, is now being funded in that manner. And the recommendation that I added to the report, that talks about the transfer of the funding between debt service and the operating accounts, to me, is flagging -- should be flagging that for -- for Councillors. And then obviously it speaks to how knowledgeable of a Councillor did you need to be in order to recognize that, but,

³⁹ Pagano 02/25/2003 at 54.

⁴⁰ Pagano 02/25/2003 at 55.

⁴¹ Pagano 03/04/2003 at 175.

⁴² COT036732 at COT036752, 33:2:27.

⁴³ Power 03/06/2003 at 70-71.

⁴⁴ Power 03/06/2003 at 71.

⁴⁵ Altman 07/09/2003 at 90-91.

that to me, being immersed in this, to me that's -- that's why the sale leaseback issue is of less consequence to me, because I saw it strictly as a) operational, and b) it would be clearly evident that if you're moving something from debt charges to operating, then clearly you're moving from debenturing to something else. And they would have known that we were already buying the stuff -- presumably would have known we were buying the stuff and so on, so, that's sort of, I think, where I was at, at the time.⁴⁶

33. On balance, Pagano's view that the report should have clearly indicated that there would be a sale leaseback is to be preferred. In addition, the risk of a significant tax liability should have been averted to and disclosed.

e) No express Council authority for the sale leaseback transaction

34. Since neither the recommendations of the Report to Council, nor the body of the Report, made any reference to the sale leaseback transaction, Council did not approve the sale of assets owned by the City to MFP. Indeed, MFP's bid, which Council accepted, did not make any reference to the sale leaseback transaction. It is difficult to characterize the disposal of a \$23 million asset as simply incidental to carrying out Council's instructions. In the absence of Council approval, staff had no authority to enter into the sale leaseback transaction.

i) Disposition of assets bylaw

35. The City's Purchasing Bylaw contained a section on the sale or disposal of surplus materials or equipment. This section was included in Bylaw 151-2000, adopted by Council on March 2, 2000.⁴⁷ However, this section did not exist in the interim bylaw which governed the time period pertaining to the sale leaseback transaction (Bylaw 57-1998 and Bylaw 304-1998).⁴⁸

36. For the reasons set out above, staff erred in not obtaining explicit Council authority for the sale and leaseback transaction. In Finance, Brittain was ultimately

⁴⁶ Altman 07/09/2003 at 90-91.

⁴⁷ COT036845 at COT036853-36854, 54:2:44.

accountable for this error, which was made by Rabadi, whom he supervised. Rabadi should have been alive to this issue. Similarly, Andrew and Viinamae were accountable for Power's failure to spot the issue and his decision to remove Rabadi's paragraph that dealt with the issue from the final Report to P&F and later to Council.

⁴⁸ COT031536, 3:2:48; COT038188, 3:2:50.

3. PST and GST overpayments

a) Overview

37. When it first purchased the equipment in 1999, the City paid both GST and PST on the purchases.⁴⁹ The sale leaseback transaction resulted in additional tax liability for the City.

38. The City was not required to charge PST on the sale of the equipment to MFP, and it did not do so. However, the subsequent lease payments to MFP were subject to PST. Therefore, the City paid PST a second time on the same equipment.⁵⁰ The City's duplicate PST payments at the time totaled \$1,882,372.73.⁵¹

39. The transaction also raised GST issues. MFP subsequently provided a credit to the City in respect of the GST overpayment (\$1,647,076.25) and the City obtained some GST relief on future lease payments.

40. The City applied for a \$1.8 million PST refund from the provincial Ministry of Finance in December 2001.⁵² It appears the City could only obtain a PST refund if it could demonstrate an intention to lease equipment at the time it first began to purchase the equipment in January 1999.⁵³

41. The Ministry of Finance determined that the City had not demonstrated an intention to lease at the requisite time and denied all but \$200,000 of the City's

⁴⁹ Colley Affidavit, para. 44, 09/02/2003 at 248-249.

⁵⁰ COT080176 at COT080188, 61:1:Report.

⁵¹ All of these three lease schedules were ultimately rewritten in July 2000. The total duplicate tax amount for these lease schedules was \$1,521,197. The cost of the equipment that the City had not yet paid for in October 1999 was paid for by MFP. MFP paid the amount directly to the vendors of the equipment. Then, in January 2001, the City sold an additional \$4,514,695 in assets to MFP, which leased it back to the City on lease schedule PA1-4. The commencement date for lease schedule PA1-4 was January 1, 2001. The duplicate tax amount for this lease schedule was \$361,175.73. Thus, the total duplicate PST amount was \$1,882,372.73: COT036212, 56:1:26; COT036732 at COT036744, 33:2:27; COT080176 at COT080196, 61:1:Report.

⁵² Colley Affidavit, para. 44, 09/02/2003 at 248-249; Griffiths 09/09/2003 at 179-180.

⁵³ Colley 09/04/2003 at 193-194.

request.⁵⁴ The City appealed the Ministry's decision. The appeal is still pending.⁵⁵ Thus, the City continues to have incurred an unforeseen PST liability of \$1.6 million.⁵⁶

b) PST

i) MFP was aware of the PST issue from the outset

42. Wilkinson gave evidence that he had completed sale leasebacks in the past, and was familiar with the PST issues raised by such transactions.⁵⁷ He understood at the time the sale leaseback transaction was being effected that, in order to receive a PST refund from the government, the City required evidence that demonstrated the City's intention to lease equipment proximate to the time the City bought the first equipment.

43. Wilkinson's affidavit stated that he mentioned the PST issue to Viinamae at the time that the City's intention to proceed with the sale leaseback transaction crystallized, and he testified that this conversation occurred prior to the execution of the first Equipment Schedule on October 1, 1999.⁵⁸

There are a number of additional events and discussions that I can recall during August and September 1999, and that are relevant to the issues raised by this Inquiry. Firstly, there were some discussions regarding asset management, which I describe below in the portion of my affidavit dealing with the lease rewrites. Secondly, I distinctly recall there being a discussion and recognition of the issue relating to provincial sales tax. When it became clear that the City did indeed intend to proceed with the sale-leaseback transaction, I mentioned to Lana Viinamae the fact that there was a PST issue and that the City should make sure that it applied for a rebate of that PST. I did not hold myself out as an expert in this area, but I knew from past sale and leaseback transactions that I had been involved in that it was possible to apply for and obtain a rebate. My understanding was that if this was done in a timely way and if reasonable evidence were available to demonstrate an intention to lease equipment proximate to the time of the sale-leaseback acquisitions, that such a rebate would be available. I did not purport to give advice to the City about this issue but I raised the matter and assumed the City would look into this issue further

⁵⁴ Colley Affidavit, para. 45, 09/02/2003 at 249.

⁵⁵ Colley Affidavit, para. 45, 09/02/2003 at 249.

⁵⁶ Griffiths 09/09/2003 at 181.

⁵⁷ Wilkinson Affidavit, para. 79, 09/16/2003 at 72-73.

⁵⁸ Wilkinson 09/16/2003 at 250, Wilkinson Affidavit, para. 79, 09/16/2003 at 72-73.

and give it such consideration as it felt was necessary in finalizing its plans to proceed with the sale-leaseback.⁵⁹

44. Wilkinson also indicated that the City appeared to be aware of the double PST issue. In this respect, Wilkinson pointed out Rabadi's reference to a plan in which the vendors of the sale leaseback equipment would unwind the City's original invoices.⁶⁰ However, Wilkinson admitted that he never understood that the City intended to unwind all of the invoices.⁶¹

45. In this Inquiry, it appears that no counsel directly asked Viinamae whether or not she recalled Wilkinson raising this issue with her. Thus there is no evidence to refute Wilkinson's testimony about this conversation.

46. Viinamae wrote Wilkinson an email dated August 30, 1999, which referred to a conversation with Wilkinson about the sale leaseback. Although the email suggested that Viinamae was somewhat aware of the PST issue, there was nothing in the email that indicated that Wilkinson provided the warning he described:

Rob,

By copy of this email I am notifying all suppliers of our discussion.

As a result of a request for proposal [sic] for leasing services, the City of Toronto has entered into a leasing contract for Computer hardware and software (licence and maintenance).

As the City is required to follow due process to obtain approval from Council, the establishment of a leasing arrangement took longer than planned. *The City plans to sell all goods acquired in 1999 from all of you to MFP and to lease it back.*

In order to facilitate this process, I am requesting each of you to:

- a) issue a credit invoice to the City of Toronto for the cost of all hardware, software licences and maintenance, *including tax*, issued in 1999, and
- b) issue an invoice to MFP for the same items outlined above, excluding tax.

⁵⁹ Wilkinson Affidavit, para. 79, 09/16/2003 at 72-73.

⁶⁰ Wilkinson Affidavit, para. 80, 09/16/2003 at 73.

⁶¹ Wilkinson Affidavit, para. 80, 09/16/2003 at 73; COT035869, 62:1 at 210.

Rob will contact each of you to work through this process.⁶²

47. When asked by the Commissioner about issues related to PST and GST, Viinamae replied only that she remembered hearing from MFP that there were tax advantages to leasing:

Q: This came to your knowledge, the issue came to your knowledge --

A: In 1999 I was aware that there was some GST advantages and some work that had to be done on GST and PST and Finance was handling that, and I think it was, Alex So was assigned after to deal with that.

Q: And when you say: " Do you require a report from Y2K to justify why leasing was a pre-planned activity." Are you saying in that statement that leasing was a pre-planned activity and that -- and asking whether a report is required to justify that?

A: No, it's the other way around, because they -- in order to get the GST rebate, I think it's a rebate from the Government, basically you had to show that there was some sort of pre-planning on this, and I was asked to go back and look in that action report, sorry, not the action, the Committee Report that was used as the basis for the action report.

Q: All right.

A: Yes.

MADAM COMMISSIONER: Do you remember where you first heard about that?

THE WITNESS: I can't remember whether it was from general discussions with Mr. Power, Mr. Andrew, or even with MFP, on the fact that there was some advantage to leasing, as it related to tax.⁶³

48. Not even the most fervent leasing proponent could characterize an additional \$1.8 million tax liability as an advantage of leasing.

⁶² COT015645, 63:8:48 [emphasis added].

⁶³ Viinamae 10/17/2003 at 29-30.

49. Accepting Wilkinson's evidence, he did nothing further and assumed that the City would further assess the PST issue.⁶⁴ Wilkinson testified that he did not follow up with respect to the double PST issue and did not hear anything further until Leggieri emailed him over a year later.⁶⁵

50. Wilkinson never raised the issue with anyone in Finance. He did not commit his warning to paper and send it to the City. He never followed up. If he raised it at all, he mentioned it in passing to a person from I&T with little leasing experience and with even less knowledge about complicated tax issues. Wilkinson, the senior representative of the City's newfound leasing partner - the leasing partner committed to assisting the City structure its lease transaction to its maximum advantage - should have given the City the courtesy of a letter outlining an unforeseen \$1.8 million transaction cost. The City would then have been in a position to evaluate how it wished to proceed with the transaction.

51. The City might well have decided to do exactly what it ended up doing. On the other hand, the City might have decided to rethink the transaction or, perhaps, not lease the computers at all. In any event, the \$1.8 million should have been a factor in this decision making.

ii) The City discovered the PST issue

52. Bulko testified she first became aware of the GST and PST issue from Power in early 2000, sometime between January and March.⁶⁶ Bulko testified that Power advised her and Leggieri (who was with Bulko at the time) to work with Alex So to resolve the problem.⁶⁷ Bulko did not know whether Leggieri was already aware of the tax issue when they discussed the matter with Power.⁶⁸

⁶⁴ Wilkinson Affidavit, para. 79, 09/16/2003 at 72-73.

⁶⁵ Wilkinson 09/16/2003 at 251.

⁶⁶ Bulko 08/13/2003 at 197 -198.

⁶⁷ Bulko 08/13/2003 at 198.

⁶⁸ Bulko 08/13/2003 at 199.

53. Leggieri testified that she discovered the PST issue after she reviewed and tracked the copies of cheque stubs that recorded payments from the City to MFP.⁶⁹ One of the cheque stubs related to a credit for the sale leaseback amount. She realized that the City sold equipment to MFP for the pre-tax amount.⁷⁰ In other words, the City paid both GST and PST upon purchase. Then, the City sold the equipment to MFP and MFP credited the City for the equipment; however, MFP did not give the City credit for the GST or PST the City had already paid.⁷¹ Leggieri indicated that she spoke to Bulko, Viinamae and Andrew.⁷² Andrew advised Leggieri to speak to So.

54. Viinamae was aware of the PST rebate issue no later than January 17, 2000, when she sent an email to several individuals in Finance, which she copied to Bulko and Marks.⁷³ The email attached a list of questions to Finance, which included the following:⁷⁴

Do you require a report from Y2K to justify why leasing was a pre-planned activity and therefore we should not be required to pay tax on equipment previously paid for by the City and purchased back by MFP? If so, by when?⁷⁵

55. Viinamae's question referred to the requirement that the City demonstrate an intention to lease pre-dating the purchase of the equipment. Viinamae indicated that either Colley or Brittain was responsible for finding someone to work on the tax issue, and she wanted to know who was assigned to the task.⁷⁶ This email precipitated the involvement of Accounting Services with the tax liability issue. Colley testified that this issue properly fell under his purview, but that Accounting Services did not have a handle on the nature or extent of the tax issues associated with the sale leaseback transaction

⁶⁹ Leggieri 04/09/2003 at 179-180.

⁷⁰ Leggieri 04/09/2003 at 181.

⁷¹ Leggieri 04/09/2003 at 182.

⁷² Leggieri 04/09/2003 at 183-184.

⁷³ COT013801, 63:13:15a.

⁷⁴ COT013802, 63:13:15a.

⁷⁵ Wilkinson 09/18/2003 at 15-16; COT013802, 63:13:15a.

⁷⁶ Viinamae 10/17/2003 at 28.

at that point.⁷⁷ Colley assigned to So, who was in an indirect reporting relationship with him, the task of figuring out the tax issues.⁷⁸

iii) City external auditors examined tax issues

56. During the same time frame that Colley assigned the tax issue to So, he asked Ernst & Young, the City's external auditors, to examine the entire leasing program, including the tax issues.⁷⁹ Colley did not approach the City's external auditors specifically for this task; he simply asked them to look into the issue during the course of their regular working relationship.⁸⁰

57. On May 30, 2000, the City's external auditors prepared a report for their own records, and copied Shultz and Colley.⁸¹ This report dealt specifically with tax issues. The auditors concluded that no PST refund was available to the City on the initial purchase of the equipment.⁸² Specifically, at that time the City could not provide written proof that it contemplated the sale leaseback transaction prior to its initial purchase of the equipment. The auditors confirmed that the City's lease payments to MFP were subject to PST, and that the City would effectively pay PST twice on the equipment.

58. After the auditors concluded that the City needed to show an intent to lease prior to the Council report, Accounting Services began to search for a report that predated the July 1999 Council report. So started to make inquiries of the CMO.⁸³

c) Alex So and the City's attempt to recoup the PST overpayment

59. So sent one of his first emails with respect to the tax rebate issues on February 21, 2000.⁸⁴ This email pertained exclusively to GST. Six months later, on August 24,

⁷⁷ Colley 09/03/2003 at 29.

⁷⁸ Colley 09/04/2003 at 13.

⁷⁹ Colley 09/04/2003 at 15.

⁸⁰ Colley 09/04/2003 at 22.

⁸¹ COT074239, see Colley 09/04/2003 at 38-40; Colley 09/04/2003 at 17-18.

⁸² COT074239 at COT074241, see Colley 09/04/2003 at 38-40.

⁸³ Colley 09/04/2003 at 45-46.

⁸⁴ COT015584, 62:4:33.

2000, Leggieri then sent an email to So, copied to Viinamae, Bulko, and Franey.⁸⁵ Leggieri confirmed that MFP paid the City \$16.7 million for the sale leaseback equipment. She attached an earlier email to Wilkinson about the outstanding tax amounts in which he explained the tax recovery process and attached a spreadsheet summary of the taxes to be recovered.⁸⁶ Leggieri asked So to advise as to the recovery of the tax rebates.

60. Later on August 24, 2000, So sent an email to Bulko and Leggieri.⁸⁷ The subject of his email was both the GST and the PST tax issues. With respect to the PST rebate issue, So advised them that, in an earlier phone conversation, the provincial Ministry of Finance had denied the City the PST rebate. However, So intended to send a PST ruling request to the provincial government.⁸⁸ On September 21, 2000, So drafted a letter to the Ministry of Finance for a PST ruling request.⁸⁹ Power worked with So to draft this letter.⁹⁰ On September 28, 2000, Power sent an email to So, copied to Bulko and Leggieri.⁹¹ The email attached So's letter with some changes, and noted that the City had available all of the documentation on the initial purchases, the contract with MFP, and the details of the asset transfers.⁹² So sent this letter, dated September 28, 2000, to the Ministry of Finance.

61. On October 3, 2000, the Ministry of Finance responded to So's letter.⁹³ The letter explained the requirements for the City to receive a PST refund for the sale leaseback equipment. The letter concluded that, provided the City had documentation evidencing its intent to sell and then lease the equipment, it should proceed with a formal refund application.

⁸⁵ COT063979, 55:2:42.

⁸⁶ COT036687, 62:2:445; COT027467, 62:2:444.

⁸⁷ COT072239, 55:2:43.

⁸⁸ COT072239, 55:2:43.

⁸⁹ COT062099, 58:2:4.

⁹⁰ Bulko 08/13/2003 at 109.

⁹¹ COT062098, 55:2:44.

⁹² COT062098, 55:2:44.

⁹³ COT076444, 58:2.

62. On December 5, 2000, Leggieri sent an email to Viinamae, copied to Marks and Bulko.⁹⁴ She updated Viinamae with respect to So's progress. So recommended that the City write back to the Ministry of Finance and better explain the City's position.

63. After receiving the Ministry of Finance's letter dated October 3, 2000, So began to put together the documentation required for the City's formal application for a PST rebate. As part of the formal application, the City was required to provide supporting documents for the amount of PST rebate that it was seeking.⁹⁵ So referred to this requirement in his November 15, 2001 email to Leggieri:⁹⁶

I am looking for the vendors' invoice copies, as indicated on the spreadsheet for the sales and leaseback listing.

...

To claim PST refund, we need to photocopy the front and back sides of cancelled cheques and send them to the Ministry of Finance.⁹⁷

64. On November 27, 2001, So followed up with Leggieri.⁹⁸ So requested any further information for his supporting documentation. Leggieri did not know of any final report evidencing the City's intent to lease prior to the July 1999 Council report.⁹⁹ On November 29, 2001, So requested copies of the RFQ, MFP's response to the RFQ, and the MLA.¹⁰⁰

65. The City formally submitted its application for the PST rebate to the provincial government in December 2001.¹⁰¹ On May 21, 2002, So sent an email to Bulko, copied to Shultz and Colley.¹⁰² So indicated that the PST Refund Auditor would be visiting the City. He repeated his request for any documents that showed the City's original intention to lease the equipment. There was a flurry of emails about which documents,

⁹⁴ COT015702, 55:2:48.

⁹⁵ Colley 09/04/2003 at 82.

⁹⁶ COT062363, 58:2:12.

⁹⁷ COT062363, 58:2:12.

⁹⁸ COT062365, 58:2:13.

⁹⁹ COT062365, 58:2:13.

¹⁰⁰ COT074048, 58:2:14.

¹⁰¹ Griffiths 09/09/2003 at 180; Colley 09/03/2003 at 31.

¹⁰² COT063797, 58:2:18.

even in draft form, might evidence this intention. Undoubtedly, one of the important documents evidencing the City's intention to lease was the July 1998 Council Report, which was a prelude to the November 2000 Y2K Report.¹⁰³ On May 27, 2002, Bulko suggested that the operating budget manual and the capital budget manual for 1999 may have stated that all computer equipment had to be leased.¹⁰⁴

66. On June 6, 2002, So sent an email to Leggeri, Bulko, Shultz, So, and Ridge.¹⁰⁵ The email provided an update on the status of the City's PST claim. So was responding to an email from Leggeri, praising his efforts with respect to the City's PST claim. Colley confirmed that So located, assembled, and copied numerous invoices and their corresponding cheques that constituted part of the PST refund claim.¹⁰⁶

67. In December 2002, the City's formal application was accepted in part.¹⁰⁷ The Ministry of Finance gave the City a PST rebate of \$200,000 of the \$1.8 million in duplicate PST payments.¹⁰⁸ In June 2003, the City appealed the Ministry's ruling, and the appeal is still pending.¹⁰⁹

68. Blame for the failure to appreciate the significance of the potential PST liability does not rest entirely with the City. MFP generally, and Wilkinson in particular, had an obligation to advise and follow through with the City regarding the additional PST liability associated with the sale leaseback transaction. MFP held itself out as an experienced governmental leasing partner and the City properly relied on MFP to disclose tax liability issues and to confirm the City's understanding of such issues.

¹⁰³ Bulko 08/13/2003 at 116-117.

¹⁰⁴ COT066170, 58:2:24.

¹⁰⁵ COT062725, 58:1:69.

¹⁰⁶ Colley 09/04/2003 at 101-102.

¹⁰⁷ Colley 09/04/2003 at 99.

¹⁰⁸ Colley 09/04/2003 at 78.

¹⁰⁹ Colley 09/04/2003 at 99.

d) GST**i) Overview**

69. The City of Toronto was a municipality and was registered for the purposes of the GST. The City paid the GST on the equipment at the time of purchase, used the equipment exclusively in exempt activities, and claimed a 57.14% rebate on the purchase of the equipment.¹¹⁰

70. After the sale leaseback transaction was completed, MFP charged the City the full GST on the full amount of the lease payments. However, GST relief was available to the City on the transaction since the City:

- a. made a supply by way of sale of tangible personal property to MFP;
- b. was not required to collect tax in respect of the supply of tangible personal property; and
- c. immediately leased the tangible property back from MFP.¹¹¹

71. MFP subsequently provided credits to the City in respect of GST on the sale price portion of the lease charges.¹¹²

ii) City identified GST issue and attempted to resolve it

72. On January 17, 2000, Viinamae sent an email to several individuals in Finance, copied to the CMO.¹¹³ The email attached Viinamae's list of questions for Finance.¹¹⁴ One of the questions was:

Who is handling the hold on 1999 GST payments for leasing?¹¹⁵

¹¹⁰ COT074239 at COT074239, see Colley 09/04/2003 at 38-40.

¹¹¹ COT074239 at COT074241, see Colley 09/04/2003 at 38-40.

¹¹² Colley Affidavit, para. 44, 09/02/2003 at 248-249.

¹¹³ COT013801, 63:13:15a.

¹¹³ COT013802, 63:13:15a.

¹¹⁴ COT013802, 63:13:15a.

¹¹⁵ COT013802, 63:13:15a.

73. Viinamae indicated that either Colley or Brittain was responsible for finding someone to work on the GST issue.¹¹⁶ Viinamae could not recall whether or not she initially learned of the GST issue from Leggieri.¹¹⁷

74. Leggieri testified that she “hounded” Wilkinson until MFP obtained a GST rebate for the City.¹¹⁸ Bulko agreed that Leggieri was instrumental in obtaining the GST rebate.¹¹⁹ In an email dated February 21, 2000, Alex So advised Viinamae that Colley had assigned him to investigate the GST rebate issue.¹²⁰ So copied this email to Colley and Bulko.

75. So sent a letter to the Canada Customs and Revenue Agency (“CCRA”) with respect to the GST refund issue on May 17, 2000. On July 7, 2000, Joe Levstik from the CCRA, replied to So’s letter.¹²¹ Levstik interpreted the *Excise Tax Act* to apply to the City’s sale leaseback transaction, such that the sales price of the equipment for MFP would be deducted from the City’s lease payments in order to determine the GST payable.

76. On August 24, 2000, So sent an email Bulko and Leggieri.¹²² In the email, So advised them that the City had successfully obtained a GST refund. The City would receive GST credits up to the purchase price for the equipment paid by MFP. Leggieri testified that MFP remitted the GST.¹²³ The GST remittance from MFP constituted part of the total amount of the May 2001 cheque.¹²⁴ MFP repaid the City \$1,647,076.25 for the sale leaseback transaction.

¹¹⁶ Viinamae 10/17/2003 at 28.

¹¹⁷ Viinamae 10/17/2003 at 28-29.

¹¹⁸ Leggieri 04/09/2003 at 186.

¹¹⁹ Bulko 06/18/2003 at 135.

¹²⁰ COT015584, 63:9:28.

¹²¹ COT076640, 58:2.

¹²² COT072239, 55:2:43.

¹²³ Leggieri 06/17/2003 at 232.

¹²⁴ COT027485, 45:1:26