Date: 20080704

Docket: A-545-07

Citation: 2008 FCA 231

CORAM: **NOËL J.A.**
BLAIS J.A.
EVANS J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

DOW CHEMICAL CANADA INC.

Respondent

Heard at Calgary, Alberta, on June 24, 2008.

Judgment delivered at Ottawa, Ontario, on July 4, 2008.

REASONS FOR JUDGMENT BY: NOËL J.A.

CONCURRED IN BY: BLAIS J.A.
EVANS J.A.

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REASONS FOR JUDGMENT

NOËL J.A.

[1] This is an appeal from a decision of Mogan D.J. of the Tax Court of Canada (the "Tax Court Judge"), allowing Dow Chemical Canada Inc.'s (the "respondent" or "Amalco") appeal from a loss determination made under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "Act"). By this determination, the Minister of National Revenue (the "Minister") included in the computation of the respondent's income for its 2001 taxation year the amount of $30, 990, 628.

[2] The respondent is an amalgamated corporation and the adjustment made by the Minister reflects an amount previously deducted by one of its predecessors which remained unpaid at the end

of the second taxation year following the year in which it was accrued. The appellant maintains that the inclusion of this amount in the computation of the respondent's income is mandated by subsections 78(1) and 87(7) of the Act, and that the Tax Court Judge erred in failing to give effect to these provisions.

[3] It is useful to immediately set out the relevant parts of these two provisions:

78. (1) Where an amount in respect of a deductible outlay or expense that was owing by a taxpayer to a person with whom the taxpayer was not dealing at arm's length at the time the outlay or expense was incurred and at the end of the second taxation year following the taxation year in which the outlay or expense was incurred, is unpaid at the end of that second taxation year, either

(*a*) the amount so unpaid shall be included in computing the taxpayer's income for the third taxation year following the taxation year in which the outlay or expense was incurred, or…

78. (1) Lorsqu'une somme, relative à des dépenses déductibles et due par un contribuable à une personne avec laquelle il avait un lien de dépendance au moment où les dépenses ont été engagées et à la fin de la deuxième année d'imposition qui suit celle durant laquelle ces dépenses ont été engagées, n'a pas encore été payée à la fin de la deuxième année d'imposition, il faut :

a) soit inclure la somme ainsi impayée dans le calcul du revenu du contribuable pour la troisième année d'imposition suivant celle au cours de laquelle les dépenses ont été engagées;

[My emphasis]

87(7) Where there has been an amalgamation of two or more corporations after May 6, 1974 and

(*a*) a debt or other obligation of a predecessor corporation that was outstanding immediately before the amalgamation became a debt or other obligation of the new corporation on the amalgamation, and

87(7) Lorsqu'il y a eu fusion de plusieurs sociétés après le 6 mai 1974 et que :

a) d'une part, une dette ou autre engagement d'une société remplacée qui n'avait pas été réglé immédiatement avant la fusion est devenu une dette ou autre engagement de la nouvelle société lors de la fusion;

(*b*) the amount payable by the new corporation on the maturity of the debt or other obligation, as the case may be, is the same as the amount that would have been payable by the predecessor corporation on its maturity,

the provisions of this Act

(*c*) shall not apply in respect of the transfer of the debt or other obligation to the new corporation, and

(*d*) shall apply as if the new corporation had incurred or issued the debt or other obligation at the time it was incurred or issued by the predecessor corporation under the agreement made on the day on which the predecessor corporation made an agreement under which the debt or other obligation was issued,

…

b) d'autre part, le montant que doit payer la nouvelle société à l'échéance de la dette ou de l'engagement est le même que celui que la société remplacée aurait dû payer à l'échéance,

les dispositions de la présente loi :

c) ne s'appliquent pas à l'égard du transfert de cette dette ou de cet autre engagement à la nouvelle société;

d) s'appliquent comme si la nouvelle société avait contracté la dette ou l'engagement au moment où la société remplacée l'a contracté en vertu de la convention conclue le jour où la société remplacée a conclu une convention en vertu de laquelle la dette ou l'engagement a été contracté.

[…]

[My emphasis]

RELEVANT FACTS

[4] The relevant facts are the subject of an agreed statement of fact which is set out in full in the decision under appeal (reported at 2007 TCC 668) and need not be reproduced. It is sufficient, for present purposes, to provide the following summary.

[5] In 1998, Union Carbide Corporation. ("UCC") as lender and Union Carbide Canada Inc. (UCCI) as borrower entered into an inter-company loan agreement (the "loan") which took the form of a line of credit with a maximum authorized amount of one billion ($ CDN). Subsequently,

in 1999, UCC assigned its interest in the loan to Union Carbide Canada Finance Inc ("UCCFI"). It is common ground that at the time when the loan agreement was entered into, as well as at the time when the assignment took place, the three corporations (UCC, UCCI and UCCFI) were related to one another for the purpose of the Act. (The provisions of the Act which bear on the non-arm's length relationship of the corporate entities involved in this appeal (251(2)(*c*)(i), 251(3) and 251(3.1)) are set out in Appendix "A" to these reasons.)

[6] In computing its income for the taxation year ending December 31, 2000, UCCI deducted the amount of $30, 990, 627 as accrued interest for the 2000 calendar year. For purposes of this appeal, the respondent acknowledges that this amount has remained unpaid at all material times.

[7] On February 6, 2001, Dow Chemical Company ("Dow") acquired control of UCC. Then, on October 1, 2001, UCCI amalgamated with Dow's wholly-owned subsidiary, Dow Chemical Canada Inc. ("DCCI") under the provisions of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44. The amalgamated corporation which is the respondent in this appeal, retained the name Dow Chemical Canada Inc. and as noted at the beginning of these reasons, is referred to herein as the "respondent" or "Amalco".

[8] UCCI had two taxation years in 2001: one beginning January 1, 2001 and ending February 6, 2001, due to the acquisition of control and the other beginning February 7, 2001 and ending September 30, 2001, as a result of the amalgamation. Amalco's first taxation year began the next

day, October 1, 2001 and ended December 31, 2001. The provisions of the Act which triggered these shortened taxation years are subsections 249(4) and 87(2) which provide respectively:

> **249(4)** Where at any time control of a corporation (other than a corporation that is a foreign affiliate of a taxpayer resident in Canada and that did not carry on a business in Canada at any time in its last taxation year beginning before that time) is acquired by a person or group of persons, for the purposes of this Act,
>
> (*a*) subject to paragraph 249(4)(*c*), the taxation year of the corporation that would, but for this paragraph, have included that time shall be deemed to have ended immediately before that time;
>
> (*b*) a new taxation year of the corporation shall be deemed to have commenced at that time;

> **249(4)** En cas d'acquisition du contrôle d'une société à un moment donné (sauf une société étrangère affiliée d'un contribuable résidant au Canada, qui n'a pas exploité d'entreprise au Canada au cours de sa dernière année d'imposition commençant avant ce moment) par une personne ou un groupe de personnes, les règles suivantes s'appliquent dans le cadre de la présente loi :
>
> *a*) sous réserve de l'alinéa *c*), l'année d'imposition de la société qui, sans le présent alinéa, comprendrait ce moment est réputée se terminer immédiatement avant ce moment;
>
> *b*) une nouvelle année d'imposition de la société est réputée commencer à ce moment;

[My emphasis]

> **87(2)** Where there has been an amalgamation of two or more corporations after 1971 the following rules apply
>
> (*a*) for the purposes of this Act, the corporate entity formed as a result of the amalgamation shall be deemed to be a new corporation the first taxation year of which shall be deemed to have commenced at the time of the amalgamation, and a taxation year of a predecessor

> 87. (2) Lorsqu'il y a eu fusion de plusieurs sociétés après 1971, les règles suivantes s'appliquent :
>
> *a*) pour l'application de la présente loi, l'entité issue de la fusion est réputée être une nouvelle société dont la première année d'imposition est réputée avoir commencé au moment de la fusion et l'année d'imposition d'une société remplacée, qui se serait autrement terminée après la fusion, est réputée

corporation that would otherwise have ended after the amalgamation shall be deemed to have ended immediately before the amalgamation;	s'être terminée immédiatement avant la fusion;

[My emphasis]

[9] For its taxation year ending December 31, 2001, Amalco reported a net loss of $35, 066, 100 and a current year non-capital loss of $61, 604, 100. After issuing a confirmative assessment, the Minister issued a T7W-C Form followed by a reassessment whose effect was to significantly reduce these losses. One of the underlying adjustments was the inclusion in income of the amount in dispute in this appeal.

[10] Amalco took issue with this adjustment. As 2001 was a nil taxation year, Amalco requested the Minister to determine the amount of its losses for that year. A notice of loss determination was eventually issued by the Minister reducing Amalco's current year non-capital loss to $9, 381, 511 on the basis that the interest previously accrued and deducted by UCCI had to be included in Amalco's income for its 2001 taxation year.

[11] Amalco filed an objection and the matter was eventually brought before the Tax Court of Canada. The Tax Court Judge allowed the appeal on the basis that the provisions relied upon by the Minister, in particular paragraph 87(7)(*b*), were not sufficiently precise to support the adjustment.

[12] This is the decision now under appeal.

DECISION OF THE TAX COURT

[13] Although, there is no ambiguity in section 78, the Tax Court Judge finds that section 87 is ambiguous (Reasons, para. 18). An important condition in subsection 78(1) is that a non-arm's length relationship between the debtor of the deductible expense and the creditor exists both at the time the expense was incurred and immediately before the amalgamation. The Tax Court Judge concludes, that Amalco and UCCFI were related "immediately before amalgamation" (Reasons, para. 22):

> Immediately before amalgamation, UCCI and UCCFI were related because they were both controlled by Dow; and UCCI was deemed to have been related to the [Respondent] under subsection 251(3.1) as noted above. Under subsection 251(3), any two corporations related to the same corporation are deemed to be related to each other. Therefore, in a hypothetical sense, the [Respondent] was related to UCCFI immediately before amalgamation by the operation of subsections 251(3) and 251(3.1).

[14] The Tax Court Judge goes on to hold that there are no provisions which result in Amalco and UCCFI being related in calendar year 2000, when the interest expense was incurred (Reasons, paras. 23, 26 and 27). Therefore the initial non-arm's length requirement contemplated by subsection 78(1) was not present.

[15] The Tax Court Judge rejects the submission made on behalf of the Minister that subsection 87(7), which provides that the Act is to be applied "as if" the debt had been incurred by Amalco, is sufficient to establish that Amalco and UCCFI were non-arm's length when the debt was incurred (Reasons, para. 24):

> The plain language of subsection 87(7) covers all debts of a predecessor corporation (on revenue account and on capital account) which become debts of the amalgamated

> corporation. Section 78 is concerned only with deductible expenses when the debtor taxpayer and the creditor are not at arm's length. With respect to all kinds of debt, section 78 is aimed at a narrow target but subsection 87(7) is aimed at a much wider target. <u>I have no reason to conclude that subsection 87(7) was drafted with section 78 in mind. Indeed, if subsection 87(7) was drafted to bring the concept of section 78 within the rules of amalgamating corporations, I would expect to find additional language in subsection 87(7) much closer to the language of section 78.</u>
>
> [My emphasis]

[16] The Tax Court Judge advances three grounds in support of this conclusion (Reasons, para. 28). First, section 78 of the Act provides that a debtor taxpayer may deduct an expense without paying it out or including it in income for a period of up to two taxation years, usually 24 months in total. According to the Tax Court Judge, it would be contrary to the object and purpose of section 78 of the Act to require the expense to be included in the respondent's income in this case since two 12 month taxation years have not passed since the expense was incurred (Reasons, paras. 29 to 33).

[17] Second, relying on the decision of this Court in *The Queen v. Pan Ocean Oil Ltd.*, 94 DTC 6412 ("*Pan Ocean*"), the Tax Court Judge concludes that the respondent and UCCI are distinct corporations and so, the respondent's first taxation year cannot be regarded as UCCI's third taxation year, for purposes of paragraph 78(1)(*a*) of the Act (Reasons, paras. 34 to 37).

[18] Finally, the Tax Court Judge relies on subsection 78(2) of the Act which specifically requires that previously deducted debts of corporations that are wound-up be included into income:

78(2) Where an amount in respect of a deductible outlay or expense that was owing by a taxpayer that is a	**78(2)** Lorsqu'une somme, relative à des dépenses déductibles et due par un contribuable qui est une société à une

corporation to a person with whom the taxpayer was not dealing at arm's length is unpaid at the time when the taxpayer is wound up, and the taxpayer is wound up before the end of the second taxation year following the taxation year in which the outlay or expense was incurred, the amount so unpaid shall be included in computing the taxpayer's income for the taxation year in which it was wound up.	personne avec laquelle il avait un lien de dépendance, n'a pas encore été payée au moment de la liquidation de la société qui est le contribuable et que cette liquidation a lieu avant la fin de la deuxième année d'imposition suivant celle au cours de laquelle les dépenses ont été engagées, la somme ainsi impayée doit être incluse dans le calcul du revenu du contribuable pour l'année d'imposition au cours de laquelle a eu lieu la liquidation.

No similar provision exists with respect to amalgamated corporations. According to the Tax Court Judge, this is indicative of a gap, and it is not the role of the Court to supplement failings in legislative drafting (Reasons, paras. 38 to 42).

POSITIONS OF THE PARTIES

The appellant

[19] According to the appellant, the Tax Court Judge erred in law in failing to give effect to paragraph 87(7)(*d*). The purpose of this provision is to establish the continuation of the predecessor corporation trough the new corporation "as if" the new corporation had been in existence when the debt was incurred (Appellant's memorandum, paras. 21 and 22). It follows that Amalco is to be viewed as UCCI, and since it is conceded that UCCI and UCCFI were related at that time, the Tax Court Judge erred when he held that a non-arm's length relationship did not exist when the debt was incurred (Appellant's memorandum, paras. 31 and 32).

[20] The appellant also takes issue with the three separate reasons given by the Tax Court Judge for refusing to give effect to subsection 87(7) (Appellant's memorandum, paras. 34, 37 and 41). In particular, the appellant maintains that there is no gap in the legislation. While a special provision is required to deal with corporations that are wound-up, since they cease to exist, no such requirement exists in the case of an amalgamation (Appellant's memorandum, para. 48).

The respondent

[21] Although the respondent contends that the correct conclusion was reached, it is not entirely supportive of the Tax Court Judge's reasoning in coming to this conclusion. In particular, the respondent does not agree with the Tax Court Judge's finding that Amalco and UCCFI were related "immediately before the amalgamation" pursuant to subsections 251(3) and 251(3.1) (Respondent's memorandum, para. 23). The respondent points out that subsection 251(3.1) has no such temporal limitation (Respondent's memorandum, paras. 25 to 27). The Tax Court Judge also misconstrued the scope of subsection 251(3) (Respondent's memorandum, paras. 30 to 35).

[22] That said, the respondent submits that none of the provisions in section 251 operate to deem Amalco to be related to UCCFI at the time the obligation to pay the interest was incurred or at any time prior to the acquisition of control (Respondent's memorandum, para. 35). It follows that the Tax Court Judge came to the correct conclusion when he held that subsection 78(1) can have no application because Amalco and UCCFI were not related in year 2000 when the deductible expense was incurred.

[23] To the extent that subsection 87(7) is relevant, the only issue is the application of paragraph 87(7)(*d*). In this respect, the respondent again departs from the reasoning adopted by the Tax Court Judge. According to the respondent, although this provision deems Amalco to have incurred the obligation to pay the interest in the year 2000, it does not have the effect of deeming Amalco to have been related to UCCFI at that time (Respondent's memorandum, paras. 39 to 42). More specific words would be required to achieve this result.

[24] In the alternative, the respondent submits that UCCI's second taxation year (ending September 30, 2001), cannot be viewed as Amalco's second taxation year. The respondent further submits that Amalco's first taxation year (ending December 31, 2001), cannot also be viewed as its third. Again more precise language would be required for paragraph 87(7)(*d*) to have the effect which the appellant contends (Respondent's memorandum, paras. 47 to 55).

[25] Finally, the respondent supports the Tax Court Judge's conclusion at paragraph 40 of his reasons that there is a gap in subsection 78(1) which is highlighted by the more specific winding-up provision in subsection 78(2). The respondent reiterates that the Court's role does not extend to filing legislative gaps (Respondent's memorandum, paras. 56 to 65).

ANALYSIS AND DECISION

[26] The parties are agreed that the interpretation of subsection 78(1) and paragraph 87(7)(*d*) raises questions of law which stand to be reviewed on a standard of correctness (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 at paras. 33 and 36).

[27] Applying this standard, I am of the view that the Tax Court Judge misconstrued paragraph 87(7)(*d*), and committed a reviewable error in failing to give effect to this provision on the facts of this case. When effect is given to this provision, one is bound to conclude that the conditions precedent for the application of subsection 78(1) are met.

[28] Issues of construction are to be resolved by reading the words of the Act:

> … in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament (*Rizzo and Rizzo Stores*, [1998] 1 S.C.R. 27 at para. 21).

[29] There can be no doubt about the object and purpose of section 87. A common thread throughout this provision is the continuation of the rights and obligations of the predecessor corporations to the "new corporation". With respect to any debt or other obligation incurred or issued by a predecessor, paragraph 87(7)(*d*) provides that the Act is to be applied "as if" the obligation had been incurred or issued by the "new corporation".

[30] The respondent correctly states that when the scope and extent of a deeming provision is ambiguous, a narrow construction should be preferred (*The Queen v. La Survivance*, 2006 FCA 129). However, when a deeming provision is clear and unambiguous, effect must be given to it. Here, based on both a plain and a contextual reading of paragraph 87(7)(*d*), an amalgamated corporation stands in the shoes of its predecessor insofar as previously incurred debts are concerned as of the time when they were incurred.

[31] I can see no basis for the respondent's submission that Amalco should be viewed as having incurred the obligation back in 2000, but without regard to the non-arm's length relationship that prevailed at that time (Respondent's memorandum, paras. 38 and 41). The words "as if" are not so limited, and such a reading would frustrate Parliament's clearly expressed intent that deductible expenses that are owing to a related party be included in income unless they are paid within the subsequent two taxation years.

[32] It is common ground that when UCCI incurred the obligation to pay the interest (sometime in 2000), it was not dealing at arm's length with UCCFI since both were controlled by UCC (see subparagraph 251(2)(*c*)(i) which provides that corporations that are under the same control are related to one another). In order to give effect to paragraph 87(7)(*d*) and place the respondent in the shoes of UCCI at that time, one must conclude that Amalco was not dealing at arm's length with UCCFI when the obligation to pay the interest was incurred.

[33] As to the other relevant point in time (*i.e.*, the end of UCCI's second taxation year after the year in which the interest was accrued), Amalco is deemed to have been related to its predecessor, UCCI, on that date (*i.e*., prior to the amalgamation) pursuant to subsection 251(3.1) and it is conceded that a non-arm's length relationship also prevailed between UCCI and UCCFI at that time since they were both controlled by Dow (Respondent's memorandum, para. 28).

[34] It follows that, as subsection 78(1) contemplates, and contrary to the finding made by the Applications Judge, a non-arm's length relationship between Amalco and UCCFI prevailed at the

time when the expense was incurred in 2000, as well as at the end of the second taxation year following the year in which the expense was incurred.

[35] The Tax Court Judge also reasoned that applying subsection 78(1) to the facts of this case would be contrary to the purpose of that provision since it contemplates a period of two consecutive 12 month periods to pay the deductible amount and UCCI had only 9 months to do so (Reasons, para. 33). However, subsection 78(1) refers to "taxation years" (not "12 month periods") and while a taxation year usually lasts 12 months, there are numerous instances under the Act where a taxation year has a duration which falls short of 12 months. In my respectful view, subsection 78(1) was intended to apply where a deducted amount remains unpaid after two taxation years have lapsed, regardless of their duration.

[36] Similarly, I see no merit in the respondent's contention that the three taxation years contemplated by subsection 78(1) (the year of inclusion and the two prior years) must be those of the same taxpayer. Obviously, that will ordinarily be the case. However, as we have seen, where an amalgamation occurs, paragraph 87(7)(*d*) places the "new corporation" in the shoes of its predecessor insofar as the expense incurred by its predecessor is concerned so that for purposes of determining the tax treatment of this expense, UCCI's two last taxation years are to be viewed "as if" they were Amalco's. The decision of this Court in *Pan Ocean, supra* is of no assistance to the respondent on this point since nothing turns on the fact that Amalco and UCCI are otherwise distinct corporations (*Pan Ocean* at para. 15).

[37] Finally, there is no gap in section 78. Subsection 78(2) on which the Tax Court Judge relies to support his finding that there is a gap deals with corporations that are wound-up. In such a case, a specific provision was required to provide for an income inclusion given that a wound-up corporation ceases to exist and therefore, cannot have a third taxation year. No such issue arises in the context of an amalgamation which explains why no similar language was inserted.

[38] In summary, paragraph 87(7)(*d*) provides that the respondent must be treated as would be the case if it had itself incurred the liability to pay the outstanding interest and, when so treated, the respondent must bring that amount into income in its 2001 taxation year.

[39] For these reasons, I would allow the appeal with costs here and below, set aside the decision of the Tax Court Judge and giving the judgment that he ought to have rendered, I would confirm the Notice of Determination issued by the Minister on the basis that the amount of $30, 990, 628 was properly included in the computation of the respondent's income for its 2001 taxation year..

"Marc Noël"

J.A.

"I agree,
Pierre Blais J.A."

"I agree,
John M. Evans J.A."

APPENDIX “A”

251(2) For the purpose of this Act, “related person”, or persons related to each other, are

…

(*c*) any two corporations

(i) if they are controlled by the same person or group of persons,

…

251(2) (2) Pour l’application de la présente loi, sont des «personnes liées » ou des personnes liées entre elles :

[…]

c) deux sociétés :

(i) si elles sont contrôlées par la même personne ou le même groupe de personnes,

[…]

251(3) Where two corporations are related to the same corporation within the meaning of subsection 251(2), they shall, for the purposes of subsections 251(1) and 251(2), be deemed to be related to each other.

251(3) Lorsque deux sociétés sont liées à une même société au sens du paragraphe (2), elles sont, pour l’application des paragraphes (1) et (2), réputées être liées entre elles.

251(3.1) Where there has been an amalgamation or merger of two or more corporations and the new corporation formed as a result of the amalgamation or merger and any predecessor corporation would have been related immediately before the amalgamation or merger if the new corporation were in existence at that time, and if the persons who were the shareholders of the new corporation immediately after the amalgamation or merger were the shareholders of the new corporation at that time, the new corporation and any such predecessor corporation shall be deemed to have been related persons.

251(3.1) Lorsqu’il y a eu fusion ou unification de plusieurs sociétés et que la nouvelle société formée à la suite de la fusion ou l’unification ainsi que toute société remplacée auraient été liées immédiatement avant la fusion ou l’unification, si la nouvelle société avait existé à ce moment et si les personnes qui étaient les actionnaires de la nouvelle société immédiatement après la fusion ou l’unification avaient été les actionnaires de la nouvelle société à ce moment, la nouvelle société toute société remplacée sont réputées avoir été des personnes liées.

[My emphasis]

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-545-07

(APPEAL FROM A JUDGMENT OF MOGAN D.J. OF TAX COURT OF CANADA DATED NOVEMBER 1, 2007 NO. 2007TCC668).

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DATED:	July 4, 2008

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