Federal Court of Appeal | Cour d'appel fédérale

Date: 20190327

Docket: A-333-17

Citation: 2019 FCA 57

CORAM: **NADON J.A.**
STRATAS J.A.
BOIVIN J.A.

BETWEEN:

PLAINS MIDSTREAM CANADA ULC

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Vancouver, British Columbia, on September 11, 2018.

Judgment delivered at Ottawa, Ontario, on March 27, 2019.

REASONS FOR JUDGMENT BY: NADON J.A.

CONCURRED IN BY: STRATAS J.A.
BOIVIN J.A.

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REASONS FOR JUDGMENT

NADON J.A.

I. Introduction

[1] Before us is an appeal of a decision of Hogan J. (the Judge) of the Tax Court of Canada (TCC) (2017 TCC 207) in dockets 2012-4907(IT)G and 2013-1522(IT)G, dated October 6, 2017, pursuant to which he dismissed the appellant's appeal in respect of the Minister of National Revenue's (the Minister) reassessments of its income for taxation years 1995 and 1996. More

particularly, the Minister denied the appellant an interest deduction of $4,788,456 for each taxation year at issue. (Prior to trial, as I will explain later in these reasons, the appellant reduced the amount which it was seeking as a deduction.) The main issue in this appeal is the interpretation of subsection 16(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act) pursuant to which the appellant claims (in combination with paragraph 20(1)(*c*) of the Act) to be entitled to an interest deduction for the years at issue. Because of its importance to the debate before us, it is useful to immediately reproduce the provision at issue:

16.(1) Where, under a contract or other arrangement, an amount can reasonably be regarded as being in part interest or other amount of an income nature and in part an amount of a capital nature, the following rules apply:	**16.(1)** Les règles suivantes s'appliquent dans le cas où, selon un contrat ou un autre arrangement, il est raisonnable de considérer un montant en partie comme des intérêts ou comme un autre montant ayant un caractère de revenu et en partie comme un montant ayant un caractère de capital :
(*a*) the part of the amount that can reasonably be regarded as interest shall, irrespective of when the contract or arrangement was made or the form or legal effect thereof, be deemed to be interest on a debt obligation held by the person to whom the amount is paid or payable; and	***a*)** la partie du montant qu'il est raisonnable de considérer comme des intérêts est, quels que soient la date, la forme ou les effets juridiques du contrat ou de l'arrangement, considérée comme des intérêts sur un titre de créance détenu par la personne à qui le montant est payé ou payable;

[2] For the reasons that follow, I would dismiss the appeal.

II. Facts

[3] Although the parties proceeded before the TCC on a Partial Agreed Statement of Facts (the Agreed Statement of Facts), it will be useful nonetheless to provide a summary of the

relevant facts which give rise to the issue now before this Court. The summary will provide the context necessary to understand the interpretation issue which we must decide.

[4] The appellant, Plains Midstream Canada ULC, is the successor by amalgamation to BP Canada Energy Company (BPCEC) which itself is the successor to Amoco Canada Petroleum Company Ltd. (Amoco). The appellant acquired BPCEC in 2012.

[5] On February 16, 1981, Dome Petroleum Limited (Dome Petroleum), an oil and gas company, along with Dome Canada Limited (Dome Canada), over which Dome Petroleum had effective control, concluded a contract (the Formal Contract) with the Arctic Petroleum Corporation of Japan (APCJ), a Japanese corporation owned, for all intents and purposes, by the Japanese government.

[6] Pursuant to the Formal Contract, APCJ, *inter alia*, provided a loan in the amount of $400 million (the Exploration Loan) to Dome Petroleum and Dome Canada which they were to use to fund exploration of oil and gas in the Beaufort Sea. The $400 million loan was not repayable to APCJ until December 31, 2030, subject to the triggering of two early repayment conditions, the commencement of commercial production in the Beaufort Sea (which never occurred) and an Event of Default (Event of Default) as defined in the Formal Contract. In the case of an Event of Default, APCJ could demand immediate repayment of the $400 million.

[7] Amongst other things, the Formal Contract also imposed significant continued obligations on Dome Petroleum and Dome Canada with regard to the drilling, development and oil production activities in the Beaufort Sea.

[8] Pursuant to the Formal Contract, Dome Petroleum and Dome Canada were jointly and severally liable for all of the obligations owing to APCJ, including the obligation to repay the $400 million. However, the Formal Contract provided that APCJ could first look to Dome Petroleum for the performance of the terms and conditions thereunder, including the repayment of the $400 million.

[9] After entering into the Formal Contract with APCJ, Dome Petroleum and Dome Canada concluded, on March 2, 1981, a separate agreement (the Joint Venture Agreement) which provided that liability for repayment of the Exploration Loan would be allocated between the two parties as follows: $225 million to Dome Canada and $175 million to Dome Petroleum. APCJ was not a party to the Joint Venture Agreement.

[10] During the course of 1987, it became obvious that because of serious financial troubles, Dome Petroleum and its subsidiaries would require debt relief. Thus, in April 1987, Amoco Corporation, the U.S. parent of Amoco, made it known that it intended for its Canadian subsidiary to acquire Dome Petroleum.

[11] On May 12, 1987, Amoco and Dome Petroleum established an arrangement agreement for the purchase of Dome Petroleum by way of a Plan of Arrangement pursuant to the *Canada*

Business Corporations Act, R.S.C. 1985, c. C-44. The Plan of Arrangement was complicated and required Amoco to accomplish a number of things before the Plan of Arrangement could be effective. In particular, the Plan of Arrangement required the consent of Dome Petroleum's major creditors, including APCJ and Dome Canada.

[12] Dome Canada was renamed Encor Energy Corporation (Encor) and Dome Petroleum decided to sell its shares in Encor to raise funds to pay its creditors. Amoco, the prospective purchaser of Dome Petroleum, approved the sale of the Encor shares. On December 8, 1987, Dome Petroleum sold the Encor shares for approximately $398 million.

[13] For Amoco, the Formal Contract constituted a serious obstacle to its acquisition of Dome Petroleum. This is because, following the sale of the Encor shares, Encor would be an entity independent of Dome Petroleum. However, both Encor and Dome Petroleum remained jointly and severally obligated to APCJ under the Formal Contract.

[14] Thus, if either Dome Petroleum or Encor became insolvent or committed an Event of Default under the Formal Contract, the $400 million Exploration Loan would become fully repayable. In such circumstances, APCJ would be entitled to look to both Dome Petroleum and Encor for repayment with the right to first look to Dome Petroleum for repayment. The risk, in all of the circumstances, was unacceptable to Amoco and, thus, it was not prepared to acquire Dome Petroleum unless a solution to the risk of cross-defaults could be found. To complicate matters, Encor was a creditor of Dome Petroleum and Amoco needed its consent to the Plan of Arrangement.

[15] Other difficulties arose from the Formal Contract. First, Dome Petroleum was already in default under the Formal Contract and, as a result, Amoco required APCJ to relieve it from its prior default. Second, Amoco required other accommodations to the Formal Contract from APCJ. Third, Amoco required APCJ's consent under the Plan of Arrangement. Consequently, Amoco was in need of Encor's cooperation and support in order to convince APCJ to accept the proposed accommodations. Without APCJ's agreement and accommodations, Amoco was not prepared to acquire Dome Petroleum.

[16] In order to eliminate or, at the very least, minimise the risk of cross-defaults arising from the Formal Contract and under Dome Petroleum's other credit facilities, Amoco and Encor concluded an agreement dated November 28, 1987 (the Settlement Agreement) and a further agreement (the Indemnity and Subrogation Agreement) which became effective immediately after the Plan of Arrangement on September 1, 1988. Pursuant to these Agreements, Amoco undertook to assume Encor's joint and several obligations under the Formal Contract, including Encor's obligation under the Joint Venture Agreement to repay $225 million to APCJ. In consideration for its agreement to assume Encor's joint and several obligations under the Formal Contract, Amoco received from Encor $17.5 million and other consideration. In addition, Encor provided to Amoco full subrogation of its rights under the Formal Contract.

[17] Encor also agreed, as a condition of the Settlement Agreement, to vote in favor of the Plan of Arrangement. It further agreed to cooperate with Amoco with regard to the renegotiation of the terms of the Formal Contract with APCJ.

[18] On August 29, 1988, Dome Petroleum, Encor and Amoco entered in an agreement with APCJ (the Accommodation Agreement) which relieved the parties of all defaults under the Formal Contract. In addition, certain of the terms of the APCJ contract were modified. As a result, Amoco obtained the accommodations it needed to proceed with the acquisition of Dome Petroleum, including APCJ's consent to the Plan of Arrangement.

[19] Thus, upon the execution of the Accommodation Agreement, Amoco became a party to the Formal Contract and became jointly and severally liable with Dome Petroleum and Encor for the performance of all obligations, including the repayment, by the year 2030, of the $400 million owed to APCJ.

[20] On September 1, 1988, three days after the execution of the Accommodation Agreement, the Plan of Arrangement was approved. Pursuant to the Plan, Amoco acquired Dome Petroleum for $5.1 billion.

[21] On February 28, 1992, Amoco, Dome Petroleum and APCJ concluded an agreement (the Release Agreement) pursuant to which APCJ released Encor from its obligations under the Formal Contract. Consequently, Amoco and Encor terminated the Indemnity and Subrogation Agreement.

[22] Thus, Amoco was no longer liable to repay to APCJ the $225 million which, under the terms of the Joint Venture Agreement, had been designated to be on Encor's account. Amoco's obligations under the Formal Contract, including the repayment of the $400 million owing to

APCJ, now arose because it was a party in its own right to the Formal Contract, jointly and severally liable under that contract.

[23] I should point out here that in his reasons, the Judge refers to the Settlement Agreement, the Encor Indemnity and Subrogation Agreement, the Accommodation Agreement and the Release Agreement as the Key Transactions or the Key Agreements.

[24] Before turning to the TCC's decision, I wish to offer a few words concerning the appellant's arguments in support of the deductions it claims. This will assist in understanding the TCC's decision.

[25] The deductions sought by the appellant stem from the difference (*i.e.*, $207.5 million) between the $225 million portion of the Exploration Loan repayable to APCJ that Amoco assumed pursuant to the Settlement Agreement and the Indemnity and Subrogation Agreement and the $17.5 million paid by Encor to Amoco. The appellant says, relying on paragraph 16(1)(*a*) of the Act, that the difference of $207.5 million constitutes an amount "… that can reasonably be regarded as interest…irrespective of when the contract or arrangement was made or the form or legal effect thereof…". Before trial, the appellant took the position that it was entitled to an annual interest deduction in the sum of $4,788,456, the aforesaid mathematical difference of $207.5 million divided by 43 years, *i.e.*, the period from 1987 to 2030 during which the loan was outstanding. Thus, the appellant allocated $4,788,456 to each of its taxation years.

[26] However, shortly before the trial began, the appellant changed its position. It reduced the amount sought to an annual deduction of $1,043,700. The appellant arrived at this amount by applying, on an annual basis, an implicit interest rate of 5.964% to the $17.5 million paid by Encor to Amoco pursuant to the Settlement Agreement and the Indemnity and Subrogation Agreement. No evidence was adduced explaining why this particular interest rate was chosen, nor was any evidence presented demonstrating the prevailing rates of interest at the relevant time.

[27] It is important to point out that both before the TCC and before this Court, the appellant conceded that the annual deduction of $1,043,700 claimed for each taxation year did not constitute interest payable to either APCJ or to Encor. In its view, that fact was of no relevance to the determination which had to be made under subsection 16(1) of the Act. In other words, the appellant says that the fact that it has not paid nor will ever pay interest to APCJ or to Encor is not a factor which this Court should consider in determining the issue of its deductions under subsection 16(1). According to the appellant, what matters is that the amount claimed as a deduction in economic substance is interest. It argued that, *inter alia*, the situation was akin to a defeasance transaction.

[28] More particularly, the appellant says that the $207.5 million differential reflects the time value of money and that subsection 16(1) of the Act allows it to recast the Key Transactions in a way that reflects their economic substance.

[29] I now turn to the TCC's decision.

III. The Tax Court of Canada's Decision

[30] After setting out the relevant facts, the contextual background, the parties' positions and his key factual findings, the Judge framed the principal issues before him as follows (at paragraphs 47 and 48 of his reasons):

> [47] Is the amount claimed by the Appellant in connection with the Key Transactions deemed to be interest under subsection 16(1) of the *ITA*? If the answer is yes, is the amount then deductible as interest under paragraph 20(1)(c) of the *ITA*?
>
> [48] This matter involves addressing the issue of whether it is possible to have an asymmetrical application of subsection 16(1)(a) of the *ITA* which would allow an amount to be classified as deemed interest for the debtor and capital for the creditor.

[31] In order to make sense of the Judge's rationale in concluding as he did, it is important to set out his findings concerning the appellant's submission that the differential of $225 million constitutes interest under paragraph 16(1)(*a*) because it reflects the time value of money and that paragraph 16(1)(*a*) allows the recasting of the Key Transactions by reference to their economic substance.

[32] First, the Judge found that the Settlement Agreement, the Encor Indemnity and Subrogation Agreement and the Release Agreement were agreements entered into on account of capital. In so finding, the Judge made the point that the parties, as set out in their Agreed Statement of Facts, were in agreement that Amoco's objective in concluding the aforesaid agreements was to bring to fruition the Plan of Arrangement.

[33] Thus, in the Judge's view, there could be no doubt that the acquisition by Amoco of all of Dome Petroleum's issued and outstanding shares constituted the acquisition of capital assets. Hence, the expenses incurred by Amoco in connection with the aforesaid agreements did not constitute running expenses and that "[t]his is particularly true with respect to the Appellant's undertaking to Encor to repay $225 million owed to APCJ under the exploration loan instead of Encor" (Reasons, paragraph 31).

[34] Second, the Judge stated that the appellant had not been entirely candid in response to questions in discovery about the treatment of the Key Transactions in its financial records. He went on to address the appellant's arguments that the economic impact of the Key Transactions was similar to that resulting from a defeasance transaction.

[35] This led the Judge to briefly review the concepts of legal defeasance and "in substance defeasance". He then opined that "…the economic consequence, impact or substance of the transactions was quite different than that of a legal or 'in substance' defeasance" (Reasons, paragraph 36).

[36] In coming to this view, the Judge found that the appellant had failed to produce any reliable evidence to establish either the manner in which the Key Transactions had been treated in its financial statements or that its accounting treatment of the Key Transactions had been made in accordance with generally accepted accounting principles (GAAP). The Judge also pointed out that no expert evidence had been led by the appellant to establish that it had in fact treated, in its accounts, the Key Transactions in the manner in which it claimed to have treated them.

[37] As a result, the Judge drew a negative inference against the appellant concerning its accounting treatment of "…its assumption of Encor's duties and obligations under the Formal Contract" (Reasons, paragraph 37).

[38] Third, while recognizing that the $17.5 million received from Encor had no doubt been a factor in concluding the Indemnity and Subrogation Agreement, the Judge found that Encor had provided other consideration to Amoco: Encor had given its consent to the Plan of Arrangement and agreed to cooperate in negotiations with APCJ which culminated in an acceptable Accommodation Agreement (Reasons, paragraph 38).

[39] In making this finding, the Judge remarked that the appellant had "offered no explanation as to how the value of this approval affected the alleged accounting treatment of the Key Transactions" (Reasons, paragraph 38).

[40] The Judge went on to find that the appellant had received additional indirect consideration from Encor. Because the prospective purchasers of the Encor shares were, in all likelihood, aware of the positive impact resulting from the Settlement Agreement and the Indemnity and Subrogation Agreement, Amoco obtained a better price for the Encor shares and hence, required less debt to fund its acquisition of Dome Petroleum. Thus, the Judge concluded, at paragraph 41 of his reasons, that:

> [41] … [t]he Appellant's assessment of the economic substance of the Key Transactions as being a so-called defeasance transaction does not account for all of the above. The impact, consequences and economic substance of the Key Transactions are far removed from the characteristics, impact and consequences of a defeasance transaction.

[41] Lastly, the Judge noted that the Settlement Agreement and the Encor Indemnity and Subrogation Agreement had led to the Accommodation Agreement with APCJ which relieved both Encor and Dome Petroleum from past defaults under the Formal Contract and the adoption of better terms which, in the end, "protected the value of Amoco's investment in Dome Petroleum and paved the way for the execution of the Release Agreement eliminating the risk of cross-defaults" (Reasons, paragraph 42). The Judge also wrote at paragraph 43 of his reasons:

> [43] I surmise from the evidence that the elimination of the risk of cross-defaults was of paramount importance because it would make the financing of the Appellant's and Dome Petroleum's activities less expensive. Undoubtedly, this constituted real value or consideration for the Appellant.

[42] Finally, the Judge found that repaying Encor's share of the $400 million to APCJ was not the only obligation which Amoco agreed to assume when it concluded the Settlement Agreement and the Indemnity and Subrogation Agreement with Encor. In his view, Amoco had agreed to perform all of Encor's duties and obligations arising under the Formal Contract. Also, Amoco had "received from Encor more things of value than $17.5 million for its agreement to assume all of Encor's liabilities and duties under the Formal Contract" (Reasons, paragraph 45). The Judge concluded his findings at paragraph 46 of his reasons:

> [46] The evidence clearly establishes that APCJ had advanced $400 million, and that its joint and several debtors were obliged to repay this amount in 2030. The entire $400 million constituted capital, or the principal owed to APCJ, in accordance with the definition of "principal amount" under the *ITA*. The Appellant does not dispute this factual finding. As noted earlier, the Appellant's position is that the application of subsection 16(1) of the *ITA* allows for an amount to be treated as interest for the debtor and principal or capital for the creditor.

[43] I now turn to the Judge's interpretation of subsection 16(1) of the Act. First, he referred to the Supreme Court of Canada's decision in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601 [*Canada Trustco*] to instruct himself on how to interpret the section. In *Canada Trustco*, in paragraphs 10-13, the Supreme Court made it clear that although the Act, like all other statutes, was to be interpreted in a textual, contextual and purposive manner, more emphasis often must be given to the text of the Act because of the particularity of many of its provisions and the need for consistency, predictability and fairness to taxpayers.

[44] With those principles in mind, the Judge turned to the text of subsection 16(1) and concluded that it was "…Parliament's intention that both parties [to a contract or other arrangement] receive symmetrical treatment. In other words, the amount is deemed to be interest for both parties" (Reasons, paragraph 58). The Judge also formed the view that the words "can reasonably be regarded" found in subsection 16(1) simply meant that the determination that an amount was interest had to be reasonable in the light of the relevant circumstances surrounding the transaction at issue.

[45] The Judge then turned to a contextual analysis of the provision which meant, in his view, that he had to look at the history and purpose of the provision and its interaction with other provisions of the Act. First, he looked at the context of subsection 16(1). He noted that when an amount was found to be interest pursuant to paragraph 16(1)(*a*), that amount was taxable to the creditor under paragraph 12(1)(*c*) and was deductible by the debtor under paragraph 20(1)(*c*). In his opinion, that supported his view that symmetrical treatment of an amount as interest was Parliament's intention. To buttress that view, the Judge referred to other provisions of the Act,

namely subsection 214(2) and subsection 12(9), which also point to Parliament's intention of symmetrical treatment. These observations led him to conclude at paragraph 68 as follows:

> [68] Finally, as noted earlier, it is unthinkable that Parliament would have intended the asymmetrical treatment proposed by the Appellant as this would open the door to transactions in which one party receives a tax benefit and the other party receives a non-taxable payment, resulting in a one-sided tax expenditure. Explicit language would have been expected in this regard, as is the case with subsection 12(9) of the *ITA* and section 16.1 of the *ITA*.

[46] The Judge then turned to the historical context of subsection 16(1). In his view, the historical context fully supported the principle of symmetrical treatment. At paragraph 83 of his reasons, he wrote:

> [83] To promote an interpretation of subsection 16(1) that would allow interest to be recognized by one party but not the other seems antithetical to the inherently symmetrical nature of interest and to the intent of the provision. Absent an explicit indication from Parliament that symmetry was intended to be deviated from, the interpretation of subsection 16(1) suggested by the Appellant runs counter to the statement made by Justice Rothstein that "an interpretation of the Act that promotes symmetry and fairness through a harmonious taxation scheme is to be preferred over an interpretation which promotes neither value". From the foregoing review of the history of subsection 16(1) and paragraph 20(1)(*k*), there appears to be no indication that Parliament intended that symmetry was to be deviated from as suggested by the Appellant.

[47] The Judge then turned to the purpose of subsection 16(1) and concluded that the subsection constituted an anti-avoidance provision, the purpose of which was to capture interest in situations where a transaction did not characterize or identify an amount as constituting interest to be paid by one person to another but where, in all of the circumstances, that amount should be regarded as interest.

[48] The Judge then turned his attention to the case law put before him by the parties. In particular, he closely examined the decisions of both the TCC and of this Court in *Lehigh Cement Limited v. The Queen*, 2009 TCC 237, rev'd 2010 FCA 124, [2011] 4 F.C.R. 66 [*Lehigh Cement*]. In his view, the appellant's understanding of *Lehigh Cement* was incorrect. In other words, *Lehigh Cement* did not support the appellant's contention that it was entitled to a deduction pursuant to subsection 16(1) of the Act. The Judge concluded this part of his reasons by saying that he had considered the other cases referred to him by the parties and these cases were not relevant to the determination of the issues before him.

[49] Lastly, the Judge addressed the appellant's arguments that the impact or consequences of the Key Transactions were similar to those of a defeasance transaction. At paragraph 100 of his reasons, the Judge set out his understanding of the appellant's position:

> [100] As noted earlier, the Appellant says that the impact or consequences for the Appellant are similar to those of a so-called defeasance transaction. In short [the appellant] received $17.5 million as consideration for its repaying a much larger sum in 2030. The difference between the two amounts represents the time value for the use by the Appellant of the $17.5 million received from Encor. I do not agree with the Appellant's interpretation of the economic impact or consequences of the Key Transactions. The facts of the case show that the economic impact, consequences and substance of the Key Transactions are far removed from the characteristics and consequences of a defeasance transaction.

[50] Thus, the Judge was unable to accept the appellant's contention, saying that the economic impact, consequences and substance of the Key Transactions could not be likened to the characteristics and consequences of a defeasance transaction. To support that conclusion, the Judge reviewed the Key Transactions, the Formal Contract and the Plan of Arrangement which led him to opine that no part of the $400 million payable in 2030 to APCJ could be regarded "as

compensation for the use of money" (Reasons, paragraph 105), adding that the $400 million constituted the repayment of capital owed to APCJ.

[51] The Judge further observed, at paragraph 106 of his reasons, that his understanding of the Key Transactions showed that the appellant had received from Encor "much more than $17.5 million…" and that it had undertaken to do "much more than repay $225 million in 2030."

[52] At paragraph 107 of his reasons, the Judge set out his conclusion concerning the appellant's defeasance transaction argument:

> [107] In summary, the Appellant's approach places too much weight on its construction of the alleged economic substance of the Settlement Agreement. The broad interpretation of the scope of the application of subsection 16(1) of the *ITA* proposed by the Appellant is not consistent with a textual, contextual and purposive interpretation of subsection 16(1) of the *ITA*.

[53] The Judge ended his reasons by remarking that the accounting evidence adduced at trial by the appellant was "insufficient and unreliable" (at paragraph 108):

> [108] In closing, I observe that the Appellant's position [that the amount of $400 million becomes due as a result of the passage of time] appears to be aligned with the way in which it claims the Key Transactions are to be characterized under generally accepted accounting principles. As noted earlier, the accounting evidence presented at trial was insufficient and unreliable. In any event, it is well recognized that GAAP serve different purposes than that intended by Parliament in enacting provisions of the *ITA*. Accounting principles are meant to ensure that companies report their earnings on a consistent and reliable basis so that investors may make well informed decisions when choosing to invest in companies in the same industry. In contrast, the *ITA* contains a detailed set of rules that serve to define how the federal tax burden is to be shared among taxpayers. These rules are constantly changing to take into account, *inter alia*, Parliament's prevailing views of the concepts of fairness and progressivity and the need to stimulate certain economic activities and certain well regarded social activities.

[54] As a result, the Judge dismissed the appellant's appeal from the Minister's reassessments with costs.

IV. Analysis

A. *The Standard of Review and the Issues before us*

[55] I begin, as I must, with a few words on the standard of review applicable to the issues before us.

[56] It is trite law that questions of law are to be reviewed under the standard of correctness and that questions of fact are to be reviewed under the palpable and overriding error standard. As to mixed questions of fact and law, they are also subject to the palpable and overriding error standard unless there is an extricable question of law. In such a case, the correctness standard will apply to the question of law (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 at paragraphs 8, 10 and 37) [*Housen*].

[57] There is no dispute between the parties that the *Housen* standards are to be applied. However, there is disagreement about which standard applies on each issue in this case.

[58] The appellant says that all questions before us in this appeal are questions of law and, thus, reviewable for correctness. In its view, since the appeal turns entirely on the Judge's erroneous interpretation of subsection 16(1), the palpable and overriding error standard does not apply.

[59] The respondent takes a different view of the matter. It says that interpreting subsection 16(1), and more particularly the words "reasonably be regarded," requires an objective review of the relevant facts and circumstances. Thus, according to the respondent, the Judge was bound to examine and assess the Key Transactions in order to determine whether the differential of $207.5 million constituted an amount that could "reasonably be regarded as interest" and thus "be deemed to be interest on a debt obligation held by the person to whom the amount is paid or payable…" Consequently, the respondent submits that the Judge's assessment of the Key Transactions and his findings in regard to these transactions are to be reviewed on the palpable and overriding error standard.

[60] According to the respondent, the appellant has mischaracterized the Judge's interpretation of subsection 16(1). In paragraph 29 of its Memorandum of Fact and Law, the appellant articulates the Judge's conclusion as follows: "even if it is reasonable to regard a taxpayer as having made a payment that is partly interest and partly capital, subsection 16(1) cannot apply unless it is also reasonable to regard the payment as being partly interest and partly capital in the hands of the recipient." In the respondent's view, the Judge made no such determination. Instead, he found that it could not be reasonable to regard an amount as constituting interest unless the amount was interest for both parties to a transaction. In other words, the amount could only be interest under subsection 16(1) if it was interest for Amoco on the one hand and APCJ and/or Encor on the other.

[61] I agree with the respondent's position. Although the appellant couches its appeal as raising only questions of law, the reality is that the appeal raises both questions of law and mixed

questions of fact and law. There can be no doubt that the interpretation of subsection 16(1) is subject to correctness review but the question of whether or not the $207.5 million is interest is, at best for the appellant, a mixed question of fact and law that requires a proper understanding of the provision, the legal understanding of interest, and their application to the relevant facts. Put another way, determining whether the $207.5 million constitutes interest within the meaning of subsection 16(1) requires an inquiry and an assessment of the Key Transactions and of the evidence as a whole. Without such an inquiry, a determination under subsection 16(1) is not possible.

[62] To complete my thoughts on the foregoing, I wish to refer to the Supreme Court of Canada's decision in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, [2016] 2 S.C.R. 23 [*Ledcor*]. At paragraph 21 of *Ledcor*, the Court reiterated the principle it had enunciated in *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633 [*Sattva*], that the interpretation of contracts gives rise to questions of mixed fact and law. In *Sattva*, it held that principles of contracts interpretation had to be applied "to the words of the written contract, considered in the light of the factual matrix" (*Sattva*, paragraph 50).

[63] Thus, in my view, the issue before us in this appeal is whether the Judge erred in finding that no portion of the $207.5 million differential could be regarded as interest under subsection 16(1). This raises both questions of law and questions of mixed fact and law. Hence, we must first determine, on the standard of correctness, whether the Judge properly interpreted subsection 16(1) and second, whether, on the palpable and overriding error standard, his application of the provision to the relevant facts warrants intervention on our part.

B. *The Grounds of Appeal*

[64] Before setting out my reasons as to why I conclude that the appellant cannot succeed on its appeal, I must explain in greater detail the grounds upon which the appellant relies in challenging the Judge's decision.

[65] The appellant says that the Judge applied the wrong test for the application of subsection 16(1). It argues that the words "contract or other arrangement" found in subsection 16(1), by reason of subsection 33(2) of the *Interpretation Act*, R.S.C. 1985, c. I-21, must be read, in the circumstances of this case, as "contracts or other arrangements".

[66] Thus, in the appellant's view, the Key Agreements constitute these "contracts or other arrangements" and pursuant to these arrangements, Amoco received $17.5 million from Encor in 1988 and was obligated to repay to APCJ $225 million in 2030.

[67] Then, turning to the words "an amount can reasonably be regarded as being in part interest", the appellant says that once an amount is found to be interest, paragraph 16(1)(*a*) applies. The appellant also argues that regardless of the time when the contracts were made and regardless of their form or legal effect, the amount is deemed to be "interest on a debt obligation held by the person to whom the amount is paid or payable…". The appellant concludes, "[t]hus, subsection 16(1) imposes tax consequences on the basis of the economic or commercial substance of an obligation to pay an amount, where the amount would not be interest under the traditional legal test for interest" (Appellant's Memorandum of Fact and Law, paragraph 45).

[68] Thus, according to the appellant, the $17.5 million which Amoco received from Encor is capital and the $207.5 million difference is interest. In the appellant's words, this is the case because "Amoco assumed a non-interest-bearing debt with a principal amount of $225 million and received only $17.5 million in exchange. The difference between the two reflects the time value of money and the benefit Amoco received from having the use of $17.5 million for 42 years." (Appellant's Memorandum of Fact and Law, paragraph 53).

[69] For the sake of completeness, I also reproduce paragraphs 54 and 55 of the appellant's Memorandum of Fact and Law which read as follows:

> 54. Specifically, the $17.5 million was computed as the amount that Amoco would have required to defease the debt it assumed from Encor. In other words, $17.5 million invested in 1988 with a stable rate of return (in this case 5.964%) would have grown to $225 million in 2030.
>
> 55. Had Amoco received $17.5 million from Encor in 1988 and promised to pay Encor $225 million in 2030 such that Encor could repay APCJ, the $207.5 million difference would obviously be interest to Amoco (either under subsection 16(1) or under general principles).

[70] The appellant submits that the fact that Amoco agreed to pay the $225 million to APCJ, and not to Encor, does not affect its "economics." In its view, there can be no doubt that in making their Agreements, both Amoco and Encor considered the time value of the $17.5 million. Thus, the appellant says that it is entirely reasonable to find that the $207.5 million is interest from Amoco's perspective.

[71] The above reasoning leads the appellant to argue that the Judge omitted to consider the aforesaid circumstances in determining the issue under subsection 16(1), adding that the Judge

erred in holding that the $207.5 million could only be regarded as interest to Amoco if it could also be regarded as interest payable to APCJ and/or Encor. In other words, the appellant says that the Judge required symmetry when symmetry was not required for the operation of the subsection, adding that there was no authority for the Judge's determination. To the contrary, the appellant asserts that there is clear authority to the effect that a taxpayer's liability is not dependant on another taxpayer's liability unless one can find a specific rule to that effect. In support of this submission, the appellant refers to cases where that principle was affirmed, namely by the Supreme Court of Canada in *Canada v. Antosko*, [1994] 2 S.C.R. 312 [*Antosk*o] at paragraph 41 and by this Court in *RCI Environment Inc. v. Canada*, 2008 FCA 419, [2008] F.C.J. No. 1762 [*RCI*] where Noël J.A. (as he then was) said at paragraph 51 of his reasons:

> [51] In my opinion, the opinion expressed by the TCC judge is convincing. Beyond the statutory language, which is plain and clear on the specific point we are concerned with, no logic can justify that the tax treatment of a taxpayer should be determined according to the circumstances relating to another taxpayer. In my view, the question is sufficiently clear to allow us to say that the majority opinion expressed by this Court in *Goodwin Johnson*, cited above, according to which the quality of the amount should be analyzed on the basis of the payer, is no longer good law (see *Miller v. Canada (A.G.)*, 2002 FCA 370, paragraphs 8 to 10).

[72] Contrasting the circumstances of this case, where it relies on the economic character and impact of the Key Transactions to argue that the $207.5 million is interest under subsection 16(1), the appellant says that the Judge's approach to symmetry could only be correct if the contracts or arrangements at issue were restricted to two parties. In such a case, the rights and obligations flowing from the contracts or arrangements between them would be "the mirror of each other" (Appellant's Memorandum of Fact and Law, paragraph 63), which is clearly not the case in this appeal.

[73] Thus, the appellant says that in the asymmetrical circumstances of this case, symmetry is not a condition to the application of subsection 16(1), adding that: "… consistent with *RCI* and *Antosko*, subsection 16(1) applies to each individual party based on the economic effect to that party of the terms of the legal agreements it is a party to, and not based on the circumstances of another party to the arrangement." (Appellant's Memorandum of Fact and Law, paragraph 67).

[74] The appellant goes on to discuss the case law, which it says supports its position that symmetry is not a requirement under subsection 16(1): *Lehigh, Rodmon Construction Inc. v. R.* 63 DTC 5038 (FCTD) at paragraph 9; *Gestion Guy Ménard Inc. and Guy Ménard v. The Minister of National Revenue*, 93 DTC 1058 (TCC) at paragraph 24 and *Edward J. O'Neil v. The Minister of National Revenue*, 91 DTC 692 (TCC) at paragraph 25. Later, the appellant argues that the Judge misinterpreted the deeming provision of subsection 16(1). The appellant says that the Judge made a number of wrongful assumptions in concluding that there could not be an interest deduction under subsection 16(1) unless there was an equivalent interest inclusion.

[75] More particularly, the appellant challenges three propositions made by the Judge which can be found at paragraphs 58, 65 and 82 of his reasons:

> [58] More importantly, for the reasons that follow, I am of the view that both the creditor's and debtor's perspectives must be considered, contrary to the position advanced by the Appellant. The language used in subsection 16(1) of the *ITA* stating that the payment is "deemed to be interest on a debt obligation held by the person to whom the amount is paid or payable" reflects Parliament's intention that both parties receive symmetrical treatment. In other words, the amount is deemed to be interest for both parties.
>
> …
>
> [65] That provision covers debt obligations issued at a discount and interest coupons and debt obligations purchased at a discount. This may occur, for

> example, in a transaction where interest coupons are stripped from and sold separately from the bond by a financial intermediary. If, as suggested by the Appellant, subsection 16(1) of the *ITA* was intended to apply differently when considered from the perspective of the creditor and debtor, subsection 12(9) of the *ITA* would, to a large extent, be unnecessary. I also observe that the outcome may not be the same under both provisions. Subsection 16(1) of the *ITA* deems a reasonable amount to be interest. Subsection 12(9) of the *ITA* mandates the inclusion of interest determined in a prescribed manner.
>
> …
>
> [82] Paragraph 20(1)(k) was repealed because symmetry as to the character of the payment was preserved for both parties by the new rule. If the payment is made in the circumstances described in paragraph 20(1)(c), the debtor can deduct it. The creditor, unless tax-exempt, must include the deemed interest in income.
>
> [Emphasis in original]

[76] The appellant submits that the Judge's above propositions are incorrect, and says that its view is supported by the drafting history of the provisions. Specifically, the appellant says, *inter alia*, that the Department of Finances, *Explanatory Notes to Draft Legislation and Regulations Relating to Income Tax Reform* (April 1988) and a paper by Jacques Sasseville entitled, "Implementation of the General Anti-Avoidance Rule" in *Income Tax Enforcement, Compliance and Administration*, 1988 Corporate Management Tax conference (Toronto: Canadian Tax Foundation, 1988, 4:1-16), shed light on the true purpose of the words "deemed to be interest on a debt obligation held by the person to whom the amount is paid or payable…".

[77] A technical discussion of the provision at issue and of the repealed former paragraph 20(1)(*k*) in 1988 leads the appellant to say that prior to the 1988 amendments, paragraph 20(1)(*k*) did require an income inclusion as a necessary condition to a deduction under subsection 16(1), but that the repeal of paragraph 20(1)(*k*) and a revision of subsection 16(1) did away with that requirement.

[78] Thus, the appellant says, relying on statutory interpretation rules to the effect that when clear language is taken out of a provision and replaced by language that does not so clearly dictate the same result, "the new language represents a change" (Appellant's Memorandum of Fact and Law, paragraph 101, relying, *inter alia*, on Ruth Sullivan in *Sullivan on the Construction of Statutes*, 6th edition at 664-6, and on the Supreme Court's decisions in *R. v. Potvin*, [1989] 1 S.C.R. 525 at paragraph 23, and in *Marche v. Halifax Insurance Co.*, 2005 SCC 6, [2005] 1 S.C.R. 47 at paragraphs 23-26). The appellant says that it is clearly an error to read into subsection 16(1), as it now reads, a requirement similar to the repealed and modified provisions.

[79] The appellant concludes its argument on the merits of the appeal with a number of propositions which, in its view, make it self-evident that it is entitled to the deductions sought under subsection 16(1): it used the $17.5 million as general funds (*i.e.*, for the purpose of earning income); the $17.5 million was received by it in consideration for its assumption of a commercial debt obligation; an amount, *i.e.*, $17.5 million, was selected to allow Amoco to "defease" the obligation to repay to $225 million to APCJ; and finally there is good reason to accept, unless there is evidence to the contrary, that Amoco acquired the $17.5 million with the intention of producing income for its business.

[80] I have not been persuaded by the appellant's arguments which, in my respectful view, fly in the face of commercial and legal reality. More particularly, I am of the opinion that the judge made no reviewable error in concluding that $207.5 million differential does not constitute interest and hence that it cannot be deducted under paragraph 20(1)(*c*) of the Act.

[81] In *Canada Trustco*, the Supreme Court, at paragraph 10 held that where the words of a statute were precise and unequivocal, the courts were to give the ordinary meaning of the words used by Parliament: "… a dominant role in the interpretive process." The full paragraph 10 of *Canada Trustco* reads as follows:

> [10] It has been long established as a matter of statutory interpretation that "the words of an Act are to be read 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": see *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804, at para. 50. The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.

[82] Thus, where the words of a statute are clear and unequivocal, as is the case here, we are to give to the ordinary meaning of the words used by Parliament a dominant role in interpreting the provision at issue. For ease of reference, I again reproduce subsection 16(1):

16. (1) Where, under a contract or other arrangement, an amount can reasonably be regarded as being in part interest or other amount of an income nature and in part an amount of a capital nature, the following rules apply:	**16. (1)** Les règles suivantes s'appliquent dans le cas où, selon un contrat ou un autre arrangement, il est raisonnable de considérer un montant en partie comme des intérêts ou comme un autre montant ayant un caractère de revenu et en partie comme un montant ayant un caractère de capital :
***a*)** the part of the amount that can reasonably be regarded as interest shall, irrespective of when the contract or arrangement was made or the form or legal effect thereof, be	***a*)** la partie du montant qu'il est raisonnable de considérer comme des intérêts est, quels que soient la date, la forme ou les effets juridiques du contrat ou de l'arrangement,

deemed to be interest on a debt obligation held by the person to whom the amount is paid or payable; and	considérée comme des intérêts sur un titre de créance détenu par la personne à qui le montant est payé ou payable;

[83] As a result, I begin with a textual interpretation of the provision. Such an interpretation leads me to conclude that the judge did not err in determining that symmetry was a requirement of subsection 16(1). In my view, the words of the provision cannot be interpreted otherwise.

[84] Subsection 16(1) provides that where, under a contract or other arrangement, an amount can be reasonably regarded as part interest and part capital, the part that can reasonably be regarded as interest, shall "be deemed to be interest on a debt obligation held by the person to whom the amount is paid or payable…". This can only mean, with respect to the contrary view, that the amount which can reasonably be regarded as interest must necessarily be regarded as interest by the recipient of the amount, that is the person to "whom the amount is paid or payable…". It is implicit, if not express, in the words of the provision that the amount which can reasonably be regarded as being interest is an amount that is paid or payable to a person. In other words, in the present matter, the differential of $207.5 million must, from the perspective of either APCJ and/or Encor, be regarded as interest. Failing such a finding, the $207.5 million cannot constitute interest under subsection 16(1).

[85] Put differently, paragraph 16(1)(*a*) is there to deal with situations where no explicit provision for interest can be found in a contract or other arrangement but that, in the light of all relevant circumstances, an amount paid or payable to a person "can reasonably be regarded as interest". In such a case, the amount shall "be deemed to be interest on a debt obligation held by

the person to whom the amount is paid or payable…". Consequently, the amount deemed to be interest on the debt obligation shall be treated as interest both to the payor and the payee and will be subject to the tax consequences that arise under the Act. Thus, subsection 16(1) cannot find application unless it is reasonable to regard the amount at issue as interest to the recipient.

[86] To find otherwise would require us to read out the final words of subsection 16(1), instead of reading it as presently written. Accepting the appellant's submission would require us to ignore the plain text of the provision. In so finding, I again reiterate that the appellant does not claim that Amoco had any obligation to pay interest to anyone, whether to APCJ or Encor. It simply asserts that the $207.5 million constitutes interest from its economic point of view.

[87] The key words of subsection 16(1) are "an amount can reasonably be regarded as being in part interest…". The words "can reasonably be regarded" simply mean that the Judge had to determine the existence of interest by closely examining the relevant circumstances and, in particular, the Key Transactions. There is no dispute that the Judge conducted this inquiry.

[88] The word "interest", which appears in the subsection, is not defined by the Act. However, in *Saskatchewan (Attorney General) v. Canada (Attorney General)*, [1947] S.C.R. 394 [*Saskatchewan*], the Supreme Court defined interest, at paragraph 47, in the following terms:

> [47] … the return or consideration or compensation for the use or retention by one person of a sum of money, belonging to, in a colloquial sense, or owed to, another.

[89] That definition was more recently reiterated by the Supreme Court in *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622 [*Shell*] at paragraph 30. It is also interesting to note that the Oxford English Dictionary defines interest as: "money paid for the use of money lent, or for delaying the repayment of a debt" (*The Concise Oxford Dictionary*, 10th ed., edited by Judy Pearshall, Oxford University Press, p. 737).

[90] Thus, interest is an amount paid by one person to another as the cost of using the other person's money. Hence, symmetry is the essence of interest and consequently there cannot be interest if no amount is paid or payable by one person to another. Thus it is because interest is, by its nature, symmetrical that the Judge was correct in interpreting subsection 16(1) in the way that he did. In other words, an amount is not interest if it does not have the character of interest to both the recipient and the payor. It is a two-way street. How can it be otherwise?

[91] I therefore conclude that it cannot be seriously argued on a textual interpretation that the Judge erred in interpreting subsection 16(1). Both in writing and orally, the appellant suggested that for the purpose of subsection 16(1), interest was not to be understood as interest in the usual sense. I cannot accept this submission as I see no basis for that proposition in the wording of subsection 16(1). To the contrary, the words of the provision lead me to conclude, as the Judge did, that interest is to be understood in its usual sense, as defined in the *Concise Oxford Dictionary* and as explained by the Supreme Court in *Saskatchewan* and *Shell*.

[92] Notwithstanding the fact that a textual interpretation leads to only one possible conclusion, *Canada Trustco* suggests that we should nonetheless consider both the context and

the purpose of the provision. This exercise is necessary because of what my colleague Stratas JA says at paragraph 24 of his reasons in *Hillier v. Canada (Attorney General*), 2019 FCA 44:

> [24] Even where, as here, the words of the legislative provision seem to be precise and unequivocal, we still must examine legislative purpose and context: *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4 (CanLII), [2006] 1 S.C.R. 140 at para. 48. This is to ensure that we are not mistaken in our understanding of the meaning of the legislative text. On occasion, words that, at first glance, seem clear, can admit of ambiguity after broader examination: *Montréal (City) v. 2952-1366 Québec Inc.*, 2005 SCC 62 (CanLII), [2005] 3 S.C.R. 141 at para. 10; *Canada Trustco*, above at para. 47.

[93] In the present matter, as I have already indicated, the judge closely examined the purpose and context of subsection 16(1) (see paragraphs 61 – 84 of the Judge's reasons), and concluded that both the context and the purpose supported the view that symmetry was a necessary requirement of the provision. I agree entirely with that part of the Judge's analysis, and adopt it for the purpose of these reasons.

[94] In criticizing the Judge's interpretation of subsection 16(1), the appellant argues that the Judge erred because he found, by reason of his application of the notion of symmetry to the provision, that a taxpayer was entitled to a deduction under the provision only if another taxpayer was entitled to an income inclusion. In my view, the Judge made no such finding. Rather, his determination is that there can be no interest if the amount at issue is not interest to both parties to a contract or other arrangement. What the tax consequences of such a finding will be, in any given case, is beside the point. Whether a tax deduction to a taxpayer will lead to a tax inclusion for another taxpayer is not what the Judge had in mind when he found that symmetry was a requirement for the application of subsection 16(1).

[95] I therefore conclude that the Judge did not err in his interpretation of subsection 16(1). The question then is whether he made a palpable and overriding error in applying the provision to the relevant circumstances so as to determine whether the $207.5 million could, in whole or in part, be reasonably regarded as interest. In my view, the Judge made no such error.

[96] First, on the basis of his understanding of subsection 16(1) and of the meaning of interest, the Judge had no difficulty finding that the $207.5 million was an amount that could not reasonably be regarded as interest for the purpose of the provision. In other words, because the $207.5 million was not, in his view, interest from the perspective of both Amoco and APCJ and/or Encor, it was not interest under subsection 16(1). That determination on my understanding of subsection 16(1) is unassailable.

[97] Second, notwithstanding his understanding of subsection 16(1), the Judge closely examined the Key Transactions in order to determine whether or not the $207.5 million differential was interest by reason of its economic character or effect, *i.e.* that the amount reflected compensation for the use of the $17.5 million over 43 years. The Judge found that it did not constitute interest. More particularly, he found that on the evidence before him, the economic impact, consequences and substance of the Key Transactions did not have the characteristics or consequences of a defeasance transaction. He further found that Amoco had received from Encor greater compensation than the payment of $17.5 million (Reasons, paragraphs 36-43).

[98] The Judge also found that the evidence adduced by the appellant in support of its theory of the case was not satisfactory. In making that finding, the Judge criticized the appellant’s

evidence concerning its accounting treatment of the $17.5 million, pointing to the appellant's failure to produce any witness, and in particular, its failure to produce experts' testimony, to explain the manner in which the Key Transactions had been treated in its financial statements.

[99] The respondent says that the appellant has not challenged these findings. I need not decide this contention as I am entirely satisfied that the appellant has not shown that, in making these findings, the Judge made any palpable and overriding error.

[100] Before concluding, I should say that like the Judge, I have found none of the cases on which the appellant relies in support of its theory of the case to be relevant. They are all distinguishable on their facts. Also, because of the conclusion I arrive at in respect of subsection 16(1), I need not address the arguments raised by the parties concerning paragraph 20(1)(*c*) of the Act. Finally, I wish to add that I am in total agreement with the Judge that the evidence led by the Appellant in support of its theory of the case is clearly insufficient to meet the objective sought.

V. Conclusion

[101] For these reasons, I would dismiss the appeal with costs.

"M Nadon"

J.A.

"I agree.
David Stratas J.A."

"I agree.
Richard Boivin J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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