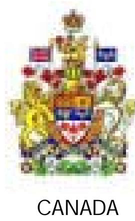
Federal Court of Appeal




Cour d'appel fédérale

**Date: 20100521**

**Docket: A-147-09**

**Citation: 2010 FCA 125**

**CORAM:** **BLAIS C.J.**
**SHARLOW J.A.**
**PELLETIER J.A.**

**BETWEEN:**

**HUSKY OIL LIMITED**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

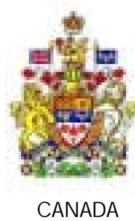
Heard at Calgary, Alberta, on January 13, 2010.

Judgment delivered at Ottawa, Ontario, on May 21, 2010.

REASONS FOR JUDGMENT BY: SHARLOW J.A.

CONCURRED IN BY: BLAIS C.J.
PELLETIER J.A.

Federal Court of Appeal

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**REASONS FOR JUDGMENT**

**SHARLOW J.A.**

[1] This is an appeal of a judgment of the Tax Court of Canada (2009 TCC 118) dismissing an appeal from a reassessment for 1998 under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.). The principal issue in the appeal is whether subsection 87(4) of the *Income Tax Act*, or alternatively subsection 69(4) of the *Income Tax Act*, applies to deem Mohawk Canada Limited ("Mohawk"), a corporate predecessor of the appellant, to have realized a taxable capital gain of approximately $4 million in 1998. Subsections 87(4) and 69(4) are reproduced in an appendix to these reasons.

Statutory framework

[2] The *Income Tax Act* contains a number of provisions that permit a taxpayer to defer the recognition of a capital gain on the disposition of capital property if the disposition occurs in certain circumstances, typically involving a corporate reorganization or restructuring. These provisions are referred to as "rollovers". Where one property is exchanged for another property in a transaction to which a rollover applies, the taxpayer is treated for income tax purposes as having sold the original property for proceeds of disposition equal to its tax cost (in income tax terms, its "adjusted cost base") and acquired the new property for a cost equal to the same amount (thus, the tax cost is "rolled over" to the new property). The capital gain so deferred is recognized when the new property is sold or otherwise disposed of in a taxable transaction.

[3] Subsection 87(4) of the *Income Tax Act* is a rollover provision that applies to the amalgamation of two or more taxable Canadian corporations. It provides, subject to a number of conditions, a rollover for the shareholder of a predecessor corporation who exchanges shares of the predecessor corporation for shares of the amalgamated corporation.

[4] The general rule, set out in paragraph 87(4)(*a*), is that where two or more corporations are amalgamated, a shareholder of a predecessor corporation who receives nothing on the amalgamation except new shares of the amalgamated corporation is deemed to have disposed of the shares of the predecessor corporation (the "old shares") for proceeds of disposition equal to their adjusted cost base, and to have acquired the shares of the amalgamated corporation (the "new shares") at a cost equal to that same amount.

[5] However, by virtue of the exception that follows paragraph 87(4)(*b*) (the "87(4) Exception"), no rollover is available to a shareholder of a predecessor corporation if the following conditions are met: (1) the fair market value of the old shares immediately before the amalgamation exceeds the fair market value of the new shares immediately after the amalgamation, and (2) it is reasonable to regard all or any portion of the excess (referred to in subsection 87(4) as the "gift portion") as a benefit that the shareholder "desired to have conferred" on a person related to the shareholder. In such a case, the shareholder generally is treated as having realized a capital gain on the disposition of the old shares. The amount of the capital gain is determined on the basis of a formula that typically results in the amount of the capital gain being equal to the amount of the "gift portion".

[6] An example will illustrate the operation of the 87(4) Exception. Assume there are two individuals who are father and son, so that they are "related" to each other as that term is defined in the *Income Tax Act*. The father owns all of the shares of FCo, with an adjusted cost base of $1 and a fair market value of $100. The son owns all of the shares of SCo, with an adjusted cost base of $60 and a fair market value of $100. The two corporations amalgamate to form ACo, the shares of which are worth $200. The amalgamation is one to which subsection 87(4) of the *Income Tax Act* applies.

[7] On the amalgamation, the father is issued 20 shares of ACo with a fair market value of $20, and the son is issued 180 shares of ACo with a fair market value of $180. The result of the amalgamation is to shift $80 in fair market value from the father to the son.

[8] The 87(4) Exception cannot affect the son because the pre-amalgamation fair market value of his SCo shares does not exceed the post-amalgamation fair market value of his ACo shares. The son is deemed by paragraph 87(4)(*a*) to have disposed of his SCo shares for their adjusted cost base of $60, so that he realizes no capital gain or loss on the amalgamation. He is deemed by paragraph 87(4)(*b*) to have acquired the ACo shares for the same adjusted cost base, $60, so that if he were to sell his ACo shares for their $180 fair market value, he would realize a $120 capital gain on the sale. That reflects the $40 gain accrued on his SCo shares at the time of the amalgamation, plus the $80 shift in fair market value from the father to the son.

[9] If the entire $80 shift in fair market value is a benefit that the father desired to have conferred on his son, then the 87(4) Exception applies to the father. The "gift portion" is the amount of the shift in value, $80. Pursuant to the formula in paragraph 87(4)(*c*), the father is treated as having realized a capital gain of $80 on the amalgamation (the difference between the deemed proceeds of disposition of $81 and the $1 adjusted cost base of the FCo share). Paragraph 87(4)(*e*) deems the father's adjusted cost base of his ACo shares to be $1 (i.e., the same as the adjusted cost base of his FCo shares). If he were to sell his ACo shares for their fair market value of $20, he would realize a $19 capital gain on the sale.

[10] The 87(4) Exception has a punitive double taxation aspect. As the example above shows, if there had been no amalgamation, and FCo and SCo had each been sold for $100, the father would have realized a capital gain of $99 and the son would have realized a capital gain of $40, for a total of $139. Alternatively, if both the father and the son had sold their shares of ACo after the

amalgamation for $20 and $180 respectively, the father would have a capital gain of $19 and the son would have a capital gain of $120, again for a total of $139. However, because of the 87(4) Exception, the father would also have been taxed on a deemed capital gain of $80 on the amalgamation. The "gift portion" is effectively taxed twice, first on the amalgamation in the hands of the father, and then on the subsequent sale by the son.

[11] The Crown is also relying, in the alternative, on subsection 69(4) of the *Income Tax Act*. In a typical application of subsection 69(4), a corporation sells property for less than its fair market value to or for the benefit of a shareholder. The result is that the corporation's profit or capital gain on the sale (and its resulting tax liability) is less than it would have been on a sale at fair market value. Subsection 69(4) denies the corporation the reduction in its tax liability by deeming the corporation's proceeds of disposition to be the fair market value of the property.

Facts

[12] The transactions that gave rise to this appeal are fully described in the judge's reasons and are summarized below.

*The facts prior to the transactions that gave rise to this appeal*

[13] Before the transactions that resulted in this appeal, there were three corporate groups: the "Balaclava group", "the Husky group", and the "Mohawk group". All relevant members of those corporate groups are taxable Canadian corporations.

[14] The Balaclava group consisted of three corporations: the parent corporation Balaclava Enterprises Ltd. (“Balaclava”), a wholly owned subsidiary of Balaclava named BEL Enterprises Inc. (“BAI”), and a wholly owned subsidiary of BAI named 3470750 Canada Inc. (“347”). At no time was any member of the Balaclava group “related” to any member of either of the other two corporate groups (as the term “related” is defined for income tax purposes).

[15] Balaclava was a minority shareholder of Mohawk, owning common shares and convertible debentures representing in total 23% of the Mohawk shares. In May of 1998, in contemplation of the transactions that gave rise to this appeal, Balaclava transferred its Mohawk shares and convertible debentures to BAI. Balaclava and BAI made a joint election under subsection 85(1) of the *Income Tax Act* so that Balaclava was able to defer recognition of the capital gain that would otherwise have arisen on that disposition.

[16] The Husky group was headed by a corporation named Husky Oil Limited, which I will refer to as “Old Husky”. The appellant, also named Husky Oil Limited, was created by the amalgamation in 1999 of Old Husky and Mohawk. That amalgamation raises no income tax issues that are relevant to this appeal.

[17] Old Husky had a number of subsidiaries but it is necessary at this point to mention only one, HB Acquisition Inc. (“HB Acquisition”), which was created in 1998 as the means for a takeover of Mohawk by Old Husky and BAI. Initially Old Husky owned 10 common shares and BAI owned 1 common share of HB Acquisition.

[18] The Mohawk group was led by Mohawk, which carried on a retail automotive fuel business. There were many other members of the Mohawk group, but for the purposes of this appeal it is necessary to mention only Mohawk's wholly owned subsidiary, Mohawk Lubricants Ltd. ("Lubricants"). Lubricants carried on the business of re-refining and distributing recycled oil.

[19] Mohawk initially owned one common share of Lubricants with an adjusted cost base of $2,552,441. The Mohawk group completed two transactions in early July of 1998, in contemplation of the transactions that gave rise to this appeal. First, Mohawk transferred to Lubricants certain shares of Pound-maker Agventures Ltd., a jade royalty and a jade inventory in exchange for 2,538,740 preferred Lubricants shares. After that transfer, the property of Lubricants (referred to collectively as the "Residual Assets") consisted of the transferred assets and the oil re-refining business. Second, Lubricants paid a series of stock dividends to Mohawk, totalling $4.8 million, by issuing 4.8 million preferred shares to Mohawk. As a result of those two transactions, Mohawk owned 7,338,740 preferred shares of Lubricants with an adjusted cost base of $1 per share. Thus, immediately before the transactions that gave rise to this appeal, Mohawk owned all of the shares of Lubricants with a total adjusted cost base of $9,891,181.

[20] Mr. Hugh Sutherland owned, directly or indirectly, 42% of the Mohawk shares. As mentioned above, BAI owned Mohawk shares and convertible debentures which together represented 23% of the Mohawk shares. The remaining 35% of the Mohawk shares were held widely by the investing public, including employees of Mohawk.

*Events leading up to the transactions*

[21] In 1997 and early 1998, Mohawk was actively soliciting bids for a takeover in order to enhance the trading value of its shares. At that time Mohawk had limited access to capital and its shares were thinly traded. By late April of 1998, Old Husky had expressed its willingness to acquire the Mohawk shares for $103 million. However, Old Husky did not wish to acquire the Residual Assets. Balaclava was willing to acquire the Residual Assets by purchasing the shares of Lubricants, and was also willing to have BAI sell its Mohawk shares to Old Husky, but it did not wish BAI to recognize an immediate capital gain on the sale. After a process of negotiation and planning, a method was devised whereby all of the objectives of the three corporate groups could be met.

*The planned transactions*

[22] In a Joint Bid Agreement dated June 1, 1998, it was agreed that HB Acquisition (controlled by Old Husky with BAI as a minority shareholder) would make a takeover bid for all of the Mohawk shares (except those owned by any member of the Balaclava group) for $7.25 per share. It was a condition of the bid that it be accepted by the owners of 90% of the Mohawk shares sought to be acquired. Mr. Sutherland agreed to accept the bid in relation to his 42% equity interest in Mohawk, and the directors of Mohawk agreed to recommend to the other shareholders that they accept the bid.

[23] In the Joint Bid Agreement, Old Husky agreed that if the requisite number of Mohawk shares were deposited in response to the bid, Old Husky or one of its subsidiaries would subscribe for 103 million shares of HB Acquisition for a total of $103 million, and HB Acquisition would

then take up and pay for all of the deposited shares. The $103 million would more than cover the estimated cost of acquiring all of the Mohawk shares at $7.25 per share, leaving a significant balance available to pay down Mohawk's corporate debt.

[24] Also in the Joint Bid Agreement, BAI agreed that all of its convertible debentures of Mohawk would be converted to Mohawk shares, and that all of its Mohawk shares (which after the conversion would number 2,854,267) would be transferred to HB Acquisition for $7.25 per share ($20,693,436), payable as to $5,193,436 in cash, $5,934,598 by way of a demand promissory note (the "BAI Note"), and $9,565,402 by the issuance of 9,565,402 common shares of HB Acquisition. A joint election would be made under subsection 85(1) of the *Income Tax Act* to defer any capital gain on BAI's disposition of its Mohawk shares to HB Acquisition.

[25] The Joint Bid Agreement also provided for an Option and Put Agreement to be entered into if the bid was accepted by the required number of Mohawk shareholders. Under the Option and Put Agreement, BAI would be granted an option to buy the Lubricants shares from Mohawk for $15.5 million payable in 25 years without interest (subject to a working capital adjustment that can be ignored for the purposes of this appeal). At that time, Lubricants would own the Residual Assets.

[26] The obligation of BAI to pay the stated purchase price was to be evidenced by two promissory notes payable on June 21, 2023 without interest, one in the amount of $9,565,402 and the other in the amount of $5,934,598 (the same face amount as the BAI Note). Mohawk anticipated

that a capital gain would arise on the sale of the Lubricants shares to BAI, but believed that it had enough tax shelter so that no immediate tax liability would arise.

[27] The Joint Bid Agreement stipulated that, if the sale of the Lubricants shares to BAI was completed by September 30, 1998, the BAI Note and the $5,934,598 note issued by BAI to Mohawk as part of the consideration payable for the Lubricants shares would, by means of a stipulated series of transactions, be set off against each other, leaving BAI with the obligation to pay Mohawk $9,565,402 in 2023 without interest.

[28] Balaclava also agreed in the Joint Bid Agreement that no demand for payment of the principal amount of the BAI Note would be made unless the sale of the Lubricants shares was not completed by September 30, 1998.

[29] After the Joint Bid Agreement was entered into and the offering circular was mailed to the shareholders, but before any further transactions occurred, it was discovered that the retail business of Mohawk was more profitable than expected. As a result, Mohawk would incur a tax liability of approximately $1.5 million on its capital gain on the sale of the Lubricants shares to BAI. To deal with this unanticipated tax liability, it was agreed that the Option and Put Agreement would be amended so that Mohawk would not sell the Lubricants shares to BAI. Rather, Lubricants would be amalgamated with 347, a subsidiary of BAI with nominal assets, to form a new corporation ("Lubes Amalco") with a capital structure that would result, in effect, in Mohawk receiving $15.5 million in

2023 by way of the redemption of shares of the amalgamated corporation. That amalgamation (the "Amalgamation") gave rise to this appeal.

[30] Under the amended Option and Put Agreement, it was also agreed that the no-demand clause in the Joint Bid Agreement would be amended to take the new plan into account, so that no demand for payment of the BAI Note would be made before June 1, 2023 unless the Amalgamation did not occur by September 30, 1998. Thus, as long as the Amalgamation occurred before that date, HB Acquisition could not be required to pay the BAI Note until 2023.

[31] The planned transactions were completed substantially in accordance with the revised plan. Those transactions are described below.

*The transactions as completed*

[32] On July 6, 1998, 98.2% of the outstanding Mohawk shares were validly deposited in response to the takeover bid. An indirect wholly-owned subsidiary (Husky Mohawk Holdings Ltd.) subscribed for 103 million common shares of HB Acquisition for $103 million, of which approximately $74 million was used to acquire the tendered Mohawk shares.

[33] At that point, HB Acquisition acquired direct control of Mohawk and Old Husky acquired indirect control of Mohawk, so that each member of the Husky group became related to each member of the Mohawk group. However, it remained the case that no member of the Balaclava group was related to any member of the Husky group or the Mohawk group.

[34] On July 7, 1998, BAI sold all of its Mohawk shares to HB Acquisition, as previously agreed. At that point, HB Acquisition became the sole shareholder of Mohawk. On the same date, the amended Option and Put Agreement was entered into, requiring the parties to enter into the Amalgamation and bringing into effect the agreement that precluded BAI from demanding payment of the BAI Note unless the Amalgamation was not completed by September 30, 1998.

[35] On July 9, 1998, Mohawk and BAI entered into the agreement for the Amalgamation. On August 1, 1998, Lubricants and 347 were amalgamated to form Lubes Amalco, which became the owner of the Residual Assets. It is undisputed that the Amalgamation is one to which subsection 87(4) of the *Income Tax Act* applies.

[36] The following changes in shareholdings occurred on the Amalgamation:

| **Before the Amalgamation** | **After the Amalgamation** | |
|---|---|---|
| BAI owned | | BAI owned |
| All of the shares of 347 | 1 | common share of Lubes Amalco |
| Mohawk owned | | Mohawk owned |
| All of the shares of Lubricants | 7,338,740 | Class A preferred shares of Lubes Amalco |
| | 8,161,260 | Class B preferred shares of Lubes Amalco |
| | 1 | Class C preferred share of Lubes Amalco |

[37] Mohawk's interest in Lubes Amalco was represented by the Class A, B and C preferred shares of Lubes Amalco which were redeemable at Mohawk's call for $15.5 million payable by a non-interest bearing promissory note due June 1, 2023. Thus, in economic terms, Mohawk received

the same consideration on the Amalgamation as it would have received if BAI had purchased the shares of Lubricants for $15.5 million payable in 2023 without interest.

[38] BAI acquired voting control of Lubes Amalco and thereby acquired control of the Residual Assets, subject to the burden of the redemption amount of the Class A, B and C preferred shares totalling $15.5 million payable in 2023. In economic terms, any increase in the value of the Residual Assets would accrue to the benefit of BAI unless Lubes Amalco failed to meet its redemption obligations, in which case the Class A, B and C preferred shares would become voting shares bearing dividends at a stipulated rate. On a winding up of Lubes Amalco, the holders of the Class A, B and C preferred shares were entitled to the redemption amount in preference to the amounts payable to the holders of the common shares.

*The subsequent transactions*

[39] In September of 1998, BAI exchanged its 9,565,403 shares of HB Acquisition for an equal number of shares of a subsidiary of Old Husky named Husky Mohawk Long Term Ltd. (“HMLT”). HMLT then exchanged 9,565,403 shares of HB Acquisition to Old Husky for an equal number of preferred shares of Old Husky. Old Husky thus became the sole shareholder of HB Acquisition while BAI held 9,565,403 preferred shares of HMLT, redeemable at BAI’s call for $1 each.

[40] In November of 1998, Lubes Amalco redeemed the 7,338,740 Class A preferred shares owned by Mohawk for $1 per share, paying the redemption price by issuing a non-interest bearing promissory note in the amount of $7,338,740 (“the Mohawk Note”) payable on June 1, 2023.

[41] Mohawk then assumed the obligation of HB Acquisition to pay the BAI Note, taking as consideration a demand note in the same amount payable by HB Acquisition. BAI assigned the BAI Note to Lubes Amalco in exchange for a non-interest bearing promissory note in the same amount due in 2023. The obligation of Lubes Amalco under the Mohawk Note, as to $5,934,598, was set off against the obligation of Mohawk (as obligor under the BAI Note by virtue of the assumption referred to earlier in this paragraph) to Lubes Amalco. This left Lubes Amalco with an obligation to pay Mohawk $1,404,142 in 2023 without interest.

[42] After these post-amalgamation transactions, Mohawk's investment in Lubes Amalco consisted of the Class B and C preferred shares redeemable in 2023 for $8,161,261, plus the right to be paid $1,404,142 in 2023 without interest. Lubes Amalco still owned the Residual Assets subject to the burden of $15.5 million payable in 2023 (the $1,404,142 debt payable to Mohawk in 2023, the redemption amount of $8,161,261 payable to Mohawk in 2023, and $5,934,598 payable to BAI in 2023 as consideration for the BAI Note).

[43] In 1999, as mentioned above, Old Husky and Mohawk were amalgamated to form the appellant (which I will refer to as "New Husky").

*The reassessment and appeal*

[44] The Minister reassessed New Husky in 2004 to include in Mohawk's 1998 income a taxable capital gain of $4,205,615 on the disposition of the Lubricants shares for deemed proceeds of disposition of $15.5 million. The Minister confirmed the reassessment when New Husky objected.

[45] In the Tax Court the Minister argued that the 87(4) Exception applied to Mohawk on the Amalgamation because: (1) the fair market value of the Lubricants shares immediately before the Amalgamation was $15.5 million; (2) none of the Class A, B and C preferred shares of Lubes Amalco issued on the Amalgamation had any fair market value when issued; (3) the $15.5 million difference in fair market value represented a benefit that Mohawk wished to confer on HB Acquisition; and (4) Mohawk was related to HB Acquisition at the time of the Amalgamation. The Minister argued in the alternative that subsection 69(4) applied because the Lubricants shares had been appropriated for less than fair market value consideration for the benefit of Mohawk's then parent corporation, HB Acquisition.

[46] New Husky appealed to the Tax Court, without success, and now appeals to this Court.

## Analysis

*Determinations of fair market value*

[47] The reassessment under appeal is based on two valuations. One is the pre-amalgamation fair market value of the Lubricants shares. The other is the post-amalgamation fair market value of the Class A, B and C preferred shares of Lubes Amalco. The Minister assumed that these fair market

values were $15.5 million and zero, respectively. The judge concluded at paragraph 53 of his reasons that, there being no evidence to rebut either assumption, they must stand as fact.

[48] In respect of the pre-amalgamation fair market value of the Lubricants shares, the judge referred in paragraphs 49 and 50 of his reasons to some oral evidence of Mr. Robert Lindsay, a senior vice-president of Balaclava and a director of Mohawk, and to one paragraph from the offering circular as providing support for that assumption. It seems to me that those items of evidence, on a fair reading, establish that "$15.5 million" was routinely used to refer to the purchase price actually agreed for the Residual Assets which, according to the original plan, was $15.5 million payable in 2023 without interest.

[49] When the terms of that sale were agreed to, the parties to the proposed sale transaction (that is, the Balaclava group on one side and Mohawk on the other side) dealt with each other at arm's length. That normally justifies a presumption that the fair market value of the property being sold is equal to the fair market value of the agreed consideration, unless there is some evidence to the contrary. As I understand the evidence, the parties in fact had agreed at the outset that the price to be paid for the Lubricants shares would be $15.5 million payable in 2023 which is consideration that necessarily is valued at less than $15.5 million. That would suggest that the fair market value of the Lubricants shares was not $15.5 million but some lesser amount, namely, the value in 1998 of $15.5 million payable in 2023 without interest.

[50] However, the judge adopted a different interpretation of the evidence, which has not been challenged. Therefore, I would not determine this appeal on the basis that the judge made a palpable and overriding factual error in accepting as fact the Minister's assumption that the pre-amalgamation fair market value of the Lubricants shares was $15.5 million.

[51] As to the post-amalgamation fair market value of the Class A, B and C preferred shares of Lubes Amalco, the judge properly took judicial notice of the fact that the fair market value of a right to receive a sum of money in the future without interest is less than the stated sum. He concluded that the fair market value of such a right was zero because that was what the Minister assumed and there was no expert valuation evidence to rebut that assumption.

[52] The record contains no evidence as to the fair market value, in 1998, of a stated sum payable in 2023. However, it would have been open to the judge to take judicial notice of the fact that the present value of a sum of money payable in 25 years without interest, while undoubtedly less than the stated sum, is probably more than zero. The judge could also have considered that the Class A, B and C preferred shares of Lubes Amalco carried certain rights on the winding up of Lubes Amalco that gave them some value. Those considerations would have been sufficient to rebut, on a *prima facie* basis, the assumption of the Minister that the Class A, B and C preferred shares of Lubes Amalco had no fair market value when issued. The Minister would then have borne the onus of establishing what the fair market value was. In the absence of any evidence on that point, the judge could have concluded on these facts that the reassessment was not justified on the basis of the 87(4) Exception.

[53] However, it would appear that this approach was not suggested to the judge in argument, and it has not been raised in this appeal. Therefore, I would not determine this appeal on the basis that the Minister has not discharged the onus of proving the post-amalgamation fair market value of the Class A, B and C preferred shares.

[54] The focus of the argument for Mohawk is not that the Minister used the wrong values, but that the Minister has relied on two specific anti-avoidance provisions that have no application to the facts of this case. I turn now to those issues.

*The 87(4) Exception*

[55] As explained above, when Lubricants and 347 were joined by the Amalgamation, the Residual Assets that comprised the property of Lubricants became the property of Lubes Amalco. I presume that the Residual Assets were the only property of Lubes Amalco at that time, since there has been no suggestion that 347 contributed anything to the Amalgamation except its nominal capital. If, as the Minister assumed, the Lubricants shares were worth $15.5 million before the Amalgamation, it must also be the case that the Residual Assets were worth $15.5 million at that time. And if, as the Minister assumed, the Class A, B and C preferred shares of Lubes Amalco issued to Mohawk on the Amalgamation had no fair market value, the economic result of the Amalgamation was to shift to Lubes Amalco, and thus to BAI, the entire $15.5 million fair market value of the Residual Assets. That is the typical situation addressed by the 87(4) Exception.

[56] However, the Crown does not and cannot assert that the 87(4) Exception applied on the basis of a benefit that Mohawk conferred on BAI. No benefit that Mohawk might have conferred on BAI would be caught by the 87(4) Exception because BAI was not related to Mohawk.

[57] Rather, the Crown relies on the argument, which the judge accepted, that the Amalgamation benefitted Old Husky (and thus HB Acquisition) because the Amalgamation enabled the completion of the whole series of transactions to achieve what Old Husky wanted to achieve. The judge explains this conclusion as follows at paragraph 58 of his reasons:

> 58 Why did Mohawk Canada agree to accept the preferred shares in Lubes Amalco in exchange for the shares it gave up in Mohawk Lubricants? The short answer is that Mohawk Canada had no independent say in the matter. The evidence shows that Husky wanted the Retail Business [the business of Mohawk]. It was unwilling to purchase the Residual Assets. Balaclava wanted to liquidate its position in Mohawk Canada and was willing to accept the Residual Assets in lieu of an additional cash payment of $15.5 million provided that the Residual Assets could be acquired on a pre-tax basis. Mohawk Canada was compelled to give effect to the amalgamation and exchange its shares in Mohawk Lubricants for the preferred shares in Lubes Amalco, because the amalgamation was the means by which the Residual Assets could be transferred to Balaclava, supposedly on a tax-free basis. The amalgamation was a condition *sine qua non* that paved the way for HMLT's and Husky's acquisition of Mohawk Canada. Both of these entities gave undertakings to Balaclava that they would cause Mohawk Lubricants to amalgamate with 347 and Mohawk Canada gave effect to this promise for the benefit of HB Acquisition and Husky. In my opinion, the 87(4) Exception is designed to prevent this very result by providing that the shareholder of the predecessor corporation must act in its own interest and not for the benefit of a related party, such as a controlling shareholder.
>
> 59 It should also be noted that the amalgamation benefited HB Acquisition and Husky in another way. Under the Amended

> Option and Put Agreement, HB Acquisition could have been compelled to acquire the securities it issued to BAI for $15.5 million if the Residual Assets were not transferred to Balaclava through the completion of the amalgamation on or before September 29, 1998. HB Acquisition's obligation to pay this amount was supported by a guarantee given by Husky. Both of these contingent obligations were terminated on completion of the amalgamation. Following the amalgamation, BAI was compelled to exchange its common shares of HB Acquisition for preferred shares in HMLT, which have terms and conditions similar to securities held by Husky in Lubes Amalco. I infer from the fact that BAI exchanged the shares in HB Acquisition for preferred shares in HMLT that provided no annual return to it that it was satisfied that it had received the $15.5 million of value attributable to the Residual Assets through the completion of the amalgamation.

[58] I do not accept the opinion of the judge that the 87(4) Exception is designed to compel the shareholder of a predecessor corporation to “act in its own interest and not for the benefit of a related party such as a controlling shareholder.” In my view, the objective of the 87(4) Exception is more specific. It is intended to deter a taxpayer from using the device of a corporate amalgamation to shift part or all of the value of a predecessor corporation to the amalgamated corporation if, but only if, a person related to the taxpayer has a direct or indirect interest in the amalgamated corporation that will be enhanced by the shift in value. Before dealing more fully with that point of interpretation, however, I will comment on the factual conclusions stated by the judge in the two paragraphs quoted above.

[59] In my view, the record does not support the judge’s impression that Old Husky’s business objective would not have been achieved without the Amalgamation. The Amalgamation was not proposed until after the takeover bid was mailed. By that time, all parties were bound by the Joint

Bid Agreement, which included the original Option and Put Agreement by which BAI would purchase the Lubricants shares for $15.5 million payable in 2023 without interest.

[60] The parties agreed to the Amalgamation, not to facilitate the entire series of transactions, but only to defer tax on the capital gain on the disposition of the Lubricants shares, thereby saving Mohawk (and indirectly HB Acquisition) an immediate $1.5 million tax liability. Even on the Crown's view of the facts it would be irrational to conclude that HB Acquisition would agree to give away $15.5 million in assets to achieve a $1.5 million tax saving, and the Crown does not take that position.

[61] In any case, even if the Amalgamation was a critical step in the completion of a contractual arrangement between Mohawk, Old Husky and Balaclava that for some reason was particularly advantageous to Old Husky, it would not follow that the 87(4) Exception could be applied. I reach that conclusion based on my interpretation of the relevant words of subsection 87(4).

[62] Subsection 87(4) is reproduced in full in the Appendix to these reasons, but I set out here the language of subsection 87(4) that explains when the 87(4) Exception applies (my emphasis):

> 87 (4) . . . where the fair market value of the old shares immediately before the amalgamation exceeds the fair market value of the new shares immediately after the amalgamation and *it is reasonable to regard any portion of the excess (in this subsection referred to as the "gift portion") as a benefit that the*

> 87. (4) . . . lorsque la juste valeur marchande des anciennes actions immédiatement avant la fusion est supérieure à la juste valeur marchande des nouvelles actions immédiatement après la fusion et *qu'il est raisonnable de considérer une partie quelconque de cet excédent (appelée la « partie donnée » au présent paragraphe) comme un avantage*

| | |
|---|---|
| *shareholder desired to have conferred on a person related to the shareholder . . .* | *que l'actionnaire désirait voir conféré à une personne à laquelle il est lié . . .* |

[63] As I understand these words, the benefit contemplated by the 87(4) Exception must be all or part of the shift in value represented by the “gift portion”. The benefit to which this provision refers cannot be the tax saving resulting from the amalgamation itself.

[64] The supposed shift in value represented by the “gift portion” in this case accrues to the benefit of Lubes Amalco and thus to the benefit of BAI through its ownership of the only common share of Lubes Amalco. If BAI had been related to Mohawk, the 87(4) Exception would apply to the full amount of the “gift portion”, which is $15.5 million. If BAI had two equal shareholders and one of them had been related to Mohawk, then the 87(4) Exception would apply as to 50% of the $15.5 million. If BAI had a 5% shareholder that was related to Mohawk, then the 87(4) Exception would apply as to 5% of the $15.5 million. If any person related to Mohawk had a direct or indirect interest in Lubes Amalco, BAI or Balaclava, and that interest was enhanced in value because of supposed shift in value from Mohawk to Lubes Amalco, the 87(4) Exception would apply to the portion of the $15.5 million reflected in that enhanced value.

[65] The undisputed fact, however, is that there is no person related to Mohawk who stands to benefit in that way from the supposed $15.5 million shift in value to BAI, and for that reason, the 87(4) Exception cannot apply.

[66] I conclude that the application of the 87(4) Exception in this case is based on an interpretation that the words of the 87(4) Exception cannot reasonably bear, and that is not consistent with its purpose as disclosed by those words. It follows that the reassessment under appeal cannot be justified by the 87(4) Exception, and Mohawk's proceeds of disposition of the Lubricants shares are not determined by the deeming rule in paragraph 87(4)(*c*). As it is undisputed that the Amalgamation was an amalgamation to which subsection 87(4) applied, Mohawk's proceeds of disposition of the Lubricants shares are determined by the deeming rule in paragraph 87(4)(*a*). As a result, Mohawk's proceeds of disposition were equal to its adjusted cost of the Lubricants shares, which is $9,891,181. It follows that Mohawk was not required to recognize any capital gain on their disposition.

*Minister's alternative argument, subsection 69(4)*

[67] New Husky argues that, because Mohawk disposed of the Lubricants shares in an amalgamation to which subsection 87(4) applies, subsection 69(4) cannot apply. I agree.

[68] Subsection 69(4), when it applies, denies a corporation the tax saving resulting from an appropriation of corporate property. It achieves that result by deeming the corporation to have received proceeds of disposition for the appropriated property in an amount equal to the fair market value of that property. If subsection 69(4) were applied in this case, Mohawk's deemed proceeds of disposition of the Lubricants shares would be $15.5 million.

[69] In an amalgamation to which subsection 87(4) applies, the shareholders of each of the predecessor corporations dispose of their shares in exchange for shares of the amalgamated corporation. Paragraph 87(4)(*a*) deems the proceeds of disposition of the shares of the predecessor corporation to be equal to their adjusted cost base unless the 87(4) Exception applies, in which case paragraph 87(4)(*c*) deems the proceeds of disposition to be either the fair market value of the shares, or the total of the adjusted cost base of the shares and the “gift portion”, whichever is less. In this case, for the reasons stated above, the 87(4) Exception does not apply. Paragraph 87(4)(*a*) therefore deems Mohawk’s proceeds of disposition of the Lubricants shares to be equal to their adjusted cost base, which is $9,891,181.

[70] A statutory deeming rule creates a statutory fiction. It implicitly admits that a thing is not what it is deemed to be but decrees that it must be taken, for some particular purpose, as if it were that thing (*R. v. Verrette*, [1978] 2 S.C.R. 838 at pages 845-6).

[71] If subsection 69(4) can be applied to the disposition of shares to which paragraph 87(4)(*a*) also applies, the result in many cases (and certainly in this case) would be two statutory deeming rules creating two different statutory fictions. That cannot be. One of the provisions must be interpreted to override the other.

[72] In my view, the specific provisions of subsection 87(4) must trump the more general rule in subsection 69(4). In other words, where a corporation is amalgamated with another corporation in an amalgamation to which subsection 87(4) applies, the deemed proceeds of disposition of the

shares of each predecessor corporation must be determined under paragraph 87(4)(*a*) unless the 87(4) Exception applies, in which case the deemed proceeds of disposition must be determined under paragraph 87(4)(*c*). In either case, there is no room for the application of subsection 69(4).

*Other comments*

[73] Underlying the Crown's position in this case is an unstated premise that it is improper for a taxpayer to attempt to defer the recognition of a capital gain on the disposition of property by means of an agreement of one kind or another to postpone for 25 years the right to receive the consideration in cash. That may be a valid premise. However, the anti-avoidance provisions of the *Income Tax Act* relied on in this case are intended only to deter a taxpayer from disposing of property for less than its fair market value to or for the benefit of a related party or in a non-arms' length transaction. In addition, it could be argued that it is unfair and fiscally unsound to require a taxpayer to recognize a larger capital gain than it actually realized in an arm's length bargain.

[74] The validity of the Crown's apparent premise need not be determined in this case. I note, however, that this issue could have been raised and judicially determined if the Minister had reassessed on the basis of the general anti-avoidance rule in section 245 of the *Income Tax Act*, rather than the specific anti-avoidance rules on which it relied.

Conclusion

[75] For these reasons, I would allow the appeal with costs in this Court and in the Tax Court. I would set aside the judgment of the Tax Court and, making the order the judge should have made, I

would allow the appellant's income tax appeal for 1998 and refer this matter back to the Minister for reassessment in accordance with these reasons.

"K. Sharlow"
J.A.

"I agree
Pierre Blais C.J."

"I agree
J.D. Denis Pelletier J.A."

## APPENDIX

## *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)

### Subsection 87(4)

87. (4) Where there has been an amalgamation of two or more corporations after May 6, 1974, each shareholder (except any predecessor corporation) who, immediately before the amalgamation, owned shares of the capital stock of a predecessor corporation (in this subsection referred to as the "old shares") that were capital property to the shareholder and who received no consideration for the disposition of those shares on the amalgamation, other than shares of the capital stock of the new corporation (in this subsection referred to as the "new shares"), shall be deemed

(*a*) to have disposed of the old shares for proceeds equal to the total of the adjusted cost bases to the shareholder of those shares immediately before the amalgamation, and

(*b*) to have acquired the new shares of any particular class of the capital stock of the new corporation at a cost to the shareholder equal to that proportion of the proceeds described in paragraph 87(4)(*a*) that

(i) the fair market value, immediately after the amalgamation, of all new shares of that particular class so acquired by the shareholder,

is of

(ii) the fair market value, immediately after the amalgamation, of all new shares so acquired by the shareholder,

except that, where the fair market value of the old shares immediately before the

87. (4) En cas de fusion de plusieurs sociétés après le 6 mai 1974, chaque actionnaire (à l'exclusion d'une société remplacée) qui était propriétaire, immédiatement avant la fusion, d'actions du capital-actions de l'une des sociétés remplacées (appelées les « anciennes actions » au présent paragraphe), constituant pour lui des immobilisations, et qui n'a reçu, en contrepartie de la disposition de ces actions lors de la fusion, que des actions du capital-actions de la nouvelle société (appelées les « nouvelles actions » au présent paragraphe), est réputé :

*a*) avoir disposé des anciennes actions pour un produit égal au total des prix de base rajustés, pour lui, de ces actions immédiatement avant la fusion;

*b*) avoir acquis les nouvelles actions d'une catégorie donnée du capital-actions de la nouvelle société à un coût égal à la fraction du produit visé à l'alinéa *a*) représentée par le rapport entre :

(i) d'une part, la juste valeur marchande, immédiatement après la fusion, de toutes les nouvelles actions de cette catégorie donnée qu'il a acquises à cette occasion,

(ii) d'autre part, la juste valeur marchande, immédiatement après la fusion, de toutes les nouvelles actions qu'il a acquises à cette occasion;

toutefois, lorsque la juste valeur marchande des anciennes actions immédiatement avant la fusion est supérieure à la juste valeur marchande des nouvelles actions immédiatement après la fusion et qu'il est

amalgamation exceeds the fair market value of the new shares immediately after the amalgamation and it is reasonable to regard any portion of the excess (in this subsection referred to as the “gift portion”) as a benefit that the shareholder desired to have conferred on a person related to the shareholder, the following rules apply:

(*c*) the shareholder shall be deemed to have disposed of the old shares for proceeds of disposition equal to the lesser of

(i) the total of the adjusted cost bases to the shareholder, immediately before the amalgamation, of the old shares and the gift portion, and

(ii) the fair market value of the old shares immediately before the amalgamation,

(*d*) the shareholder’s capital loss from the disposition of the old shares shall be deemed to be nil, and

(*e*) the cost to the shareholder of any new shares of any class of the capital stock of the new corporation acquired by the shareholder on the amalgamation shall be deemed to be that proportion of the lesser of

(i) the total of the adjusted cost bases to the shareholder, immediately before the amalgamation, of the old shares, and

(ii) the total of the fair market value, immediately after the amalgamation, of all new shares so acquired by the shareholder and the amount that, but for paragraph 87(4)(*d*), would have been the shareholder’s capital loss from the disposition of the old shares

that

(iii) the fair market value, immediately after the amalgamation, of the new shares of that class so acquired by the shareholder

raisonnable de considérer une partie quelconque de cet excédent (appelée la « partie donnée » au présent paragraphe) comme un avantage que l’actionnaire désirait voir conféré à une personne à laquelle il est lié, les règles suivantes s’appliquent :

*c*) l’actionnaire est réputé avoir disposé des anciennes actions pour un produit de disposition égal au moindre des montants suivants :

(i) le total des prix de base rajustés supportés par lui, immédiatement avant la fusion, des anciennes actions et de la partie donnée,

(ii) la juste valeur marchande des anciennes actions immédiatement avant la fusion;

*d*) la perte en capital subie par l’actionnaire lors de la disposition des anciennes actions est réputée nulle;

*e*) le coût supporté par l’actionnaire de nouvelles actions d’une catégorie quelconque du capital-actions de la nouvelle société acquises par lui lors de la fusion est réputé être la fraction du moindre des montants suivants :

(i) le total des prix de base rajustés supportés par lui, immédiatement avant la fusion, des anciennes actions,

(ii) le total de la juste valeur marchande, immédiatement après la fusion, de toutes les nouvelles actions ainsi acquises par lui et du montant qui, sans l’alinéa *d*), aurait constitué la perte en capital subie par l’actionnaire lors de la disposition des anciennes actions,

représentée par le rapport entre :

(iii) d’une part, la juste valeur marchande, immédiatement après la fusion, de toutes les nouvelles actions de cette catégorie

is of

(iv) the fair market value, immediately after the amalgamation, of all new shares so acquired by the shareholder,

and where the old shares were taxable Canadian property of the shareholder, the new shares shall be deemed to be taxable Canadian property of the shareholder.

ainsi acquises par lui,

(iv) d’autre part, la juste valeur marchande, immédiatement après la fusion, de toutes les nouvelles actions ainsi acquises par lui;

en outre, lorsque les anciennes actions étaient des biens canadiens imposables de l’actionnaire, les nouvelles actions sont réputées faire partie de ses biens canadiens imposables.

## Subsection 69(4)

69. (4) Where at any time property of a corporation has been appropriated in any manner whatever to or for the benefit of a shareholder of the corporation for no consideration or for consideration that is less than the property’s fair market value and a sale of the property at its fair market value would have increased the corporation’s income or reduced a loss of the corporation, the corporation shall be deemed to have disposed of the property, and to have received proceeds of disposition therefor equal to its fair market value, at that time.

69. (4) Lorsque le bien d'une société est attribué de quelque manière que ce soit à un actionnaire de la société, ou à son profit, à titre gratuit ou pour une contrepartie inférieure à sa juste valeur marchande, et que la vente du bien à sa juste valeur marchande aurait augmenté le revenu de la société, ou réduit sa perte, la société est réputée avoir disposé du bien au moment de son attribution et en avoir reçu un produit de disposition égal à sa juste valeur marchande à ce moment.

**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

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| **DOCKET:** | A-147-09 |

**APPEAL FROM A JUDGMENT OF THE HONOURABLE MR. JUSTICE HOGAN DATED FEBRUARY 24, 2009, NO. 2006-421(IT)G**

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| **STYLE OF CAUSE:** | Husky Oil Limited v. Her Majesty The Queen |
| **PLACE OF HEARING:** | Calgary, Alberta |
| **DATE OF HEARING:** | January 13, 2010 |
| **REASONS FOR JUDGMENT BY:** | Sharlow J.A. |
| **CONCURRED IN BY:** | Blais C.J.<br>Pelletier J.A. |
| **DATED:** | May 21, 2010 |

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