Docket: 2012-4907(IT)G
2013-1522(IT)G

BETWEEN:

PLAINS MIDSTREAM CANADA ULC,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on June 20, 21 and 22, 2017, at Calgary, Alberta

Before: The Honourable Justice Robert J. Hogan

Appearances:

Counsel for the Appellant:	Gerald Grenon Al Meghji Edward Rowe
Counsel for the Respondent:	Carla Lamash Mary Softley

JUDGMENT

The Appellant's appeal in respect of its 1995 and 1996 taxation years is dismissed in accordance with the attached Reasons for Judgment.

The parties will have until October 20, 2017 to arrive at an agreement on costs, failing which they must file their written submissions on costs no later than October 25, 2017. Such submissions are not to exceed five pages.

Signed at Ottawa, Canada, this 6th day of October 2017.

"Robert J. Hogan"

Hogan J.

Citation: 2017 TCC 207
Date: 20171006
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PLAINS MIDSTREAM CANADA ULC,

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REASONS FOR JUDGMENT

Hogan J.

I. OVERVIEW

[1] After an ill-fated drilling program in the Arctic, Dome Petroleum Limited ("Dome Petroleum") found itself in financial difficulty. By the mid-1980s it was clear that the reserves it had discovered were not commercially viable. By 1987 it had become obvious to all that Dome Petroleum and its subsidiaries required debt relief, otherwise they could not survive as going concerns.

[2] Amoco Canada Petroleum Company Ltd. ("Amoco"), the predecessor to Plains Midstream Canada ULC (the "Appellant"), which had resource properties in similar locations to those held by Dome Petroleum, felt that this was an opportune time to acquire Dome Petroleum provided Dome Petroleum could settle its existing debts on favourable terms.

[3] Amoco identified one specific debt that was particularly problematic. Dome Petroleum and Dome Canada Limited ("Dome Canada"), a public company in which Dome Petroleum had a significant interest, were parties to an agreement with the Arctic Petroleum Corporation of Japan ("APCJ") that provided for exploration and development in the Beaufort Sea (the "Formal Contract"). A key part of the Formal Contract was a $400 million exploration loan that was advanced to Dome Petroleum and Dome Canada in 1981 and was repayable in 2030. Both

Dome companies were jointly and severally liable for the entire $400 million exploration loan and for the performance of all obligations contracted under the Formal Contract.

[4] After reaching an agreement with APCJ, Dome Petroleum and Dome Canada entered into a joint venture agreement whereby they stipulated, as between themselves, that Dome Petroleum was liable for an amount of $175 million of the exploration loan, while Dome Canada was liable for an amount of $225 million. Through a series of transactions described in the Partial Agreed Statement of Facts (“PASOF”), reproduced in its entirety in Appendix A to these reasons, Dome Canada became an entity wholly independent from Dome Petroleum save for its joint and several obligations under the Formal Contract. Following the transactions Dome Canada was renamed Encor Energy Corporation (“Encor”).

[5] Amoco viewed certain features of the Formal Contract as significant obstacles to a successful takeover of Dome Petroleum. After completion of the transactions, Dome Petroleum and Encor would be independent entities. However, unless this situation was addressed with APCJ, they would remain joint and several obligors under the Formal Agreement. In that case, if either party became insolvent, the exploration loan would become fully repayable. APCJ could look to either party for payment. This risk of default also extended to Dome Petroleum’s other credit facilities. The evidence shows that Amoco was unwilling to acquire Dome Petroleum without the adoption of a multi-step plan (“Plan”) to initially mitigate and eventually eliminate the risk of cross-defaults imposed by the terms of the Formal Contract and under Dome Petroleum’s other credit agreements.

[6] The Plan was executed in stages over a period of time stretching from 1988 to 1992. The first steps of the Plan involved Amoco agreeing to assume Encor’s obligations under the Formal Contract, including, as between Encor and Dome Petroleum, Encor’s obligation to repay $225 million out of the $400 million payable to APCJ under the exploration loan in 2030 at the latest. Encor paid Amoco $17.5 million to assume Encor’s obligations under the Formal Contract and provided Amoco with additional consideration. As a condition of that transaction, Encor was to agree to vote in favour of Dome Petroleum’s Plan of Arrangement. Encor’s consent to certain key transactions (defined below) was essential to the completion by the Appellant of the subscription for, or acquisition of, the shares of Dome Petroleum. For example, in addition to agreeing to vote in favour of the Plan of Arrangement, Encor agreed to cooperate with Amoco in the renegotiation of the terms of the Formal Contract with APCJ, which included cooperation in connection with the long negotiations that ultimately led to the release of Encor as

a joint and several debtor under the Formal Contract.[1] It was only in 1992 that the risk of cross-default was eliminated as a result of APCJ releasing Encor as a joint and several obligor under the Formal Contract.

[7] The Settlement Agreement, the Encor Indemnity and Subrogation Agreement, the Accommodation Agreement and the Release Agreement together with the obligations imposed on the parties by the Formal Contract are collectively hereinafter referred to as the (“Key Transactions” or “Key Agreements”)[2]. All of the other defined terms in these reasons for judgment have the meaning ascribed to them in the PASOF unless otherwise indicated.

[8] Initially, for tax purposes the Appellant attempted to deduct as interest on a straight-line basis the difference between the amount owed by it under the exploration loan ($225 million) and what it viewed as the consideration received by it from Encor ($17.5 million) calculated over 43 years.[3]

[9] In 1995 and 1996, the taxation years at issue, the Appellant was in a loss position. As a result, the only way that the Appellant could compel the Minister to address the validity of its interest deductions was to request loss determinations.

[10] The Minister, in issuing loss determinations for each of those years, denied the Appellant a deduction for the interest that it had claimed.

[11] Although the Appellant had initially claimed an interest deduction on a straight-line basis, shortly before trial, the Appellant reduced its interest deduction claim to $1,043,700. This amount was determined by applying a simple interest rate of 5.964% to the $17.5 million that Amoco received from Encor.

[12] The central question to resolve in this appeal is whether the Appellant is entitled to deduct the amount it now claims under the combined operation of subsection 16(1) and paragraph 20(1)(c) of the *Income Tax Act*[4] (the “*ITA*”).

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[1] In paragraph 34 of the PASOF, the parties emphasize that the Plan of Arrangement may not have been completed if APCJ had not given its approval. Other documents provided by the parties also emphasize this potential outcome. In paragraphs 44 and 45 of the PASOF, the parties emphasize that Encor’s approval of the Plan of Arrangement was also required.

[2] The use of this term is not meant to diminish the importance that I attach to the other transactions entered into by Amoco and Dome Petroleum in connection with the acquisition.

[3] The difference is $207.5 million

[4] *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) subsection 152(1.1).

[13] For the reasons that follow, I am of the opinion that the amounts claimed by the Appellant as interest deductions in 1995 and 1996 in connection with the Key Transactions are not deductible under the provisions that it has relied upon.

II. POSITIONS OF THE PARTIES

A. Appellant's position

[14] The Appellant argues that it is entitled to deduct the difference between its $17.5 million receipt and its $225 million liability under the exploration loan (the "Difference") because that amount reflects the time value of money, and paragraph 16(1)(a) of the *ITA* allows the Key Transactions to be recast by reference to their economic substance. As regards economic substance, I infer that the Appellant is referring to the purpose and economic impact or consequences of the Key Transactions as contrasted with their form and legal characterization.

[15] The Appellant acknowledges that it can deduct only the amount that can reasonably be regarded as simple interest paid in the years in dispute. Under paragraph 20(1)(d) of the *ITA*, compound interest can only be deducted if and when paid in 2030.

[16] The Appellant argued that the net present value of $225 million was determined by the parties to the Settlement Agreement to be equivalent to the $17.5 million it received from Encor. The Appellant alleged that the latter amount was recorded on its financial statement as the initial liability assumed by it under the Formal Contract which treatment was based on the economic substance of the Key Transactions.

[17] The Appellant argues that the case law confirms that it can apply subsection 16(1) of the *ITA* strictly by reference to the impact of the transactions from the Appellant's perspective. In other words, the transactions can result in an amount that can be deemed to be interest to the Appellant but can also be a repayment of principal to APCJ. In essence, subsection 16(1) of the *ITA* does not require symmetry for the payer and payee. According to the Appellant, once an amount is deemed to be interest through the operation of subsection 16(1) of the *ITA*, the amount is then deductible under subsection 20(1)(c) of the *ITA* if the conditions of that provision are satisfied.

[18] The Appellant in its pleadings presented an alternative argument. Initially it claimed that, on the basis of the legal concept of interest, the amount it deducted as

interest was deductible solely under paragraph 20(1)(c) of the *ITA*. However, at the outset of the trial, the Appellant conceded that, to succeed in its appeal, it needed to fit that amount within subsection 16(1) of the *ITA* before subsection 20(1)(c) of the *ITA* could be applied.

B. Respondent's position

[19] Unsurprisingly, the Respondent advanced a contrary view. The Respondent argues that the Appellant's interpretation of subsection 16(1) of the *ITA* is too broad; this provision cannot be used to recast transactions solely by reference to what might be viewed as their economic substance considered in the abstract. According to the Respondent, the Appellant's interpretation of subsection 16(1) of the *ITA* does not align with the wording, context or purpose of the provision, as outlined below. All of the relevant facts and circumstances surrounding the agreements that give rise to the alleged blended payments must be considered.

[20] The Respondent argues that subsection 16(1) of the *ITA* dictates symmetrical tax treatment for both the payer and payee. If this provision applies, it deems an amount to be interest for both parties to the transaction. The wording of the provision and the scheme of the *ITA* lead to this conclusion. The Respondent submits that all of the relevant facts and circumstances demonstrate that there are no blended payments to be made by the Appellant to APCJ. Furthermore, the Appellant is not bound to make blended payments to Encor.

[21] Lastly, even if subsection 16(1) of the *ITA* applies, the Respondent submits that the amount deemed to be interest under subsection 16(1) of the *ITA* is not deductible under paragraph 20(1)(c) of the *ITA* because the conditions outlined in that provision are not satisfied.

III. CONTEXTUAL BACKGROUND AND KEY FACTUAL FINDINGS

[22] In the late 1970s Dome Petroleum, reached out to strategic parties to fund its planned oil exploration and development activities in the Beaufort Sea and share the risks and rewards of those activities. During the same period, the Japanese government was willing to invest in oil exploration and development activities in order to secure a long-term supply of petroleum for Japan. It agreed to advance $400 million, subject to performance of the obligations and duties contracted by

Dome Canada and Dome Petroleum under the Formal Agreement. The exploration loan was only one of the features of the Formal Contract.

[23] The exploration loan was to be spent on a five-year exploration program in the Beaufort Sea that began in 1980 and would cost a total of $1 billion to $1.5 billion. The Formal Contract imposed significant obligations on Dome Petroleum and Dome Canada with respect to their drilling, development and oil production activities in that area. The exploration loan was to be repaid at the latest on December 31, 2030, subject to the triggering of early repayment conditions. Interest was payable contingent on the production of oil, of which there has been none to date.

[24] The evidence shows that Dome Petroleum had to establish a unique corporate structure to carry out its oil exploration and development activities in the Beaufort Sea because of regulatory constraints imposed under the ill-conceived National Energy Program. To satisfy foreign ownership restrictions, Dome Canada became a public Canadian corporation. Dome Petroleum's interest could not exceed 47%. Drilling and development activities would be carried out by both entities to ensure compliance with the law. APCJ was not indisposed toward this arrangement because it had required both Dome Petroleum and Dome Canada to be joint and several obligors under the Formal Contract. I surmise that Dome Petroleum viewed the joint and several credit risk to be acceptable because it enjoyed effective control over Dome Canada's operations.

[25] As noted above, this credit risk was unacceptable to Amoco because Dome Petroleum planned to sell its interest in Encor to satisfy the demand of its creditors affected by the Plan of Arrangement. Dome Canada would become an independent entity pursuing its own business plan without the influence of Dome Petroleum. The risk of cross-default was equally unacceptable to Encor for the same reasons.[5]

[26] Encor was a creditor of Dome Petroleum. Its consent to the Plan of Arrangement was required. Dome Petroleum was in default under the Formal Contract; it required APCJ to relieve it of its prior defaults. More importantly, the Appellant required APCJ's consent under the Plan of Arrangement. It required

[5] Encor was soon to be in a position to exert considerable pressure on Dome Petroleum. The Appellant was well aware of the fact that, once Encor became a separate entity (a sale was imminent), Encor would be in a strong position to dictate terms because its approval of the Plan of Arrangement was required. I also infer that the creditors of Dome Petroleum wanted to maximize the value of the shares of Encor. The proceeds of sale from the disposition of the Encor shares were used by Dome Petroleum to repay some of its debt.

Encor's cooperation in order to present to APCJ a transaction acceptable to it in order to gain its approval.

[27] It was against this backdrop that Dome Petroleum agreed to assume Encor's obligations under the Formal Contract and hold it harmless as regards any damage resulting from the breach of any of its performance obligations thereunder. This was done through the execution of the Settlement Agreement and the Encor Indemnity and Subrogation Agreement.

[28] Amoco, Dome Petroleum and Encor reached an agreement with APCJ to be relieved of all defaults under the Formal Contract prior to the date of execution of the Plan of Arrangement. This is reflected in the Accommodation Agreement. Upon the execution of that agreement, Amoco became jointly and severally liable for the performance of all obligations and duties imposed under the Formal Contract.

[29] While the combination of the above agreements mitigated the risk of cross-default for Amoco, Encor and Dome Petroleum, it did not eliminate it altogether. If any of the parties became insolvent, the reimbursement of the exploration loan would be accelerated. This could extend to each of the parties' other credit facilities, thus increasing the cost of financing. The risk of cross-default was only entirely eliminated in 1992 when APCJ was persuaded to release Encor. At that time, the Settlement Agreement and the Encor Indemnity and Subrogation Agreement were terminated because they had served their purpose.

[30] At trial, the Appellant presented what can best be described colloquially as a Hail Mary argument. It alleged that the amounts in issue were deductible as income expenses under section 9 of the *ITA*. My questions to counsel during oral argument appear to have caused the Appellant to experience a change of heart. Approximately two weeks after the end of the trial, the Appellant's counsel advised the Court that it had withdrawn this argument from my consideration. While this is the case, I believe a few observations are nonetheless warranted with respect to this theory.

[31] The overwhelming evidence establishes that the Settlement Agreement, the Encor Indemnity and Subrogation Agreement and the Release Agreement were entered into on account of capital. The parties, in the PASOF, agree that the ultimate objective of Amoco in entering into these agreements was to complete the Plan of Arrangement. In other words, the purpose of those transactions was to allow Amoco to complete the acquisition of all of the issued and outstanding

shares of Dome Petroleum, which are undisputedly capital assets in the hands of Amoco.[6] Therefore, in this context, the expenses incurred by Amoco with respect to the implementation and execution of those agreements were not running expenses. This 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.[7]

[32] The read-ins from the discovery transcript confirm the Respondent's allegation that the Appellant engaged in a time-consuming game of cat and mouse with respect to questions posed on the accounting treatment adopted by it to reflect the impact of the Key Transactions on its financial statements. The Appellant engaged in a clear strategy of obfuscation by refusing to answer most questions on the grounds of irrelevance. When answers were reluctantly given, they were models of obscurity.

[33] The Appellant argued that the economic impact or consequences of the Key Transactions, considered together, were akin to those produced under a so-called "defeasance transaction". In financial circles, it is common knowledge that there are two types of defeasance transactions: legal defeasance transactions and "in substance" defeasance transactions. Legal defeasance refers to transaction steps that can be carried out to free the debtor of its obligation to repay a debt. The terms and conditions of the transaction steps to be taken to achieve that result are spelled out in the trust indenture by which the debt is governed. Typically the mechanics of the transaction call for the debtor to place high-quality marketable government securities irrevocably in a special-purpose trust. The trust receives the securities in consideration of its assumption of the debt. If the terms and conditions of the transaction are carried out in compliance with the indenture, the debtor is relieved of its debt.[8]

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[6] See for example paragraph 51 of the PASOF.

[7] This liability was assumed as a capital liability in connection with the gaining for approval for the Plan of Arrangement on terms and conditions satisfactory to the Appellant.

[8] For the transaction to work properly, it is essential that the trust not be subject to tax on the investment income that it earns, otherwise there will be a cash shortfall. Typically the trust indenture provides either that the cash flow generated from the securities will be sufficient to pay all taxes owed, leaving enough cash flow for debt-service purposes, or the trust is structured to avoid tax and a legal opinion is given confirming this. In Canadian tax-planning circles, tax planners often rely on the effect of subsection 75(2) of the *ITA*. If the settlor of the trust (the original debtor) has a small reversionary interest in the trust, tax planners believe that the net income of the trust is imputed back to the settlor, subject to the application of other provisions of the *ITA*. The settlor then uses its own tax deductions to offset the income imputed to it, thereby saving cash tax payable. I surmise that this technique is used because tax practitioners are not confident that subsection 16(1) of the *ITA* would apply to allow what otherwise is debt principal to be recast as deemed interest.

[34] A defeasance transaction is attractive to a debtor when interest rates have increased substantially.[9] The debtor can purchase marketable securities that generate more interest than that paid on the debt. Because the debt is settled for a lesser amount than its face value, a gain can be recorded on the debtor's balance sheet. Often, a debtor will enter into this type of transaction to improve its debt-to-equity ratio.

[35] An "in substance" defeasance refers to a transaction that is carried out in a similar manner to a legal defeasance. The key distinction is that the debtor is not released from its obligation to repay the debt because the steps of the transaction and the legal effects thereof are not provided for under the indenture. Generally speaking, under the accounting principles applicable to the periods at issue in this matter, an "in substance" defeasance could be accounted for in a similar manner to a legal defeasance because the ultimate economic consequence to the debtor was viewed to be the same. The placing of marketable securities irrevocably in a special purpose trust provides a high degree of certainty that the original debtor will not be called upon to pay the debt. The trust has no other activities than the performance of its debt service obligations. The cash flow from the marketable securities is earmarked specifically to service the debt assumed by the trust.[10]

[36] Considering the above, I speculate that Encor was seeking to record an accounting gain in connection with the transactions, although, as can be seen from what is stated below, the economic consequence, impact or substance of the transactions was quite different than that of a legal or "in substance" defeasance. I further speculate that Amoco may have recorded the transactions for accounting purposes as it claims to have done to facilitate Encor's desired tax and accounting outcome.

[37] The problem is that the Appellant produced no reliable evidence to establish how the Key Transactions were accounted for on its financial statements and to demonstrate that its alleged accounting treatment was in accordance with generally accepted accounting principles ("GAAP"). The chief financial officer or controller of the Appellant was not called to explain how the transactions were recorded for financial statement purposes. The scant documentary evidence produced by the Appellant was unreliable. No expert evidence was led by the Appellant to justify the accounting treatment that it alleged that it had adopted. In light of all of this, I draw a negative inference as to the correctness of the accounting treatment that the

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[9] Such a transaction is particularly attractive if the debtor has excess cash on hand that is not required in the business.

[10] The same tax concerns as those commented on in footnote 8 are relevant here.

Appellant alleged it had adopted to account for its assumption of Encor's duties and obligations under the Formal Contract.[11]

[38] While the $17.5 million played a role in Amoco's decision to enter into the Settlement Agreement and the Encor Indemnity and Subrogation Agreement, the evidence shows that Amoco received additional consideration from Encor. Encor was a creditor of Dome Petroleum that was affected by the Plan of Arrangement. By entering into the Settlement Agreement and the Encor Indemnity and Subrogation Agreement, Amoco gained Encor's approval of the Plan of Arrangement. Encor also agreed to cooperate in the negotiations that led to the execution of the Accommodation Agreement on terms and conditions satisfactory to the Appellant. The Appellant offered no explanation as to how the value of this approval affected the alleged accounting treatment of the Key Transactions.

[39] The Appellant also received, indirectly, additional consideration. The shares of Encor were sold by Dome Petroleum to raise funds to pay Dome Petroleum's creditors. They were sold on December 8, 1987 for approximately $398 million. Amoco and Encor entered into the Settlement Agreement on November 28, 1987. I surmise that the purchasers of the Encor shares were well aware of the impact of the Settlement Agreement and the Encor Indemnity and Subrogation Agreement when they closed that transaction.

[40] In a memorandum dated September 3, 1987,[12] N.J. Rubash, Executive Vice-president (Int'l.) Amoco Production Company who was charged with oversight of the negotiation and implementation of the Key Transactions wrote:

> . . . Amoco's plan for acquiring Dome assumed that the Encor shares will be sold to raise cash and pay off some of the debt which will arise as part of the acquisition. It was anticipated that, before they were sold , the value of Encor's share[s] would be increased by a couple of dollars per share by a negotiation which would do away with Encor's joint and [several] obligations regarding Dome's C$175 million share portion of the Arctic Loan. Further enhancement in

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[11] The Appellant's acquisition of Dome Petroleum was carried out through a series of complex transactions. Dome Petroleum benefited from debt relief. It appears the transactions were carried out to mitigate forgiveness-of-indebtedness income for tax purposes. I speculate that the Appellant was required to use the principles of purchase price accounting to reflect the impact of its acquisition. The Appellant was in a position to bring this evidence to the Court. It chose not to do so. Instead, it sought to rely on a CRA letter drafted early in the process, when section 9 of the *ITA* was not being raised by the Appellant. The letter simply recites what the Appellant alleged to be part of the accounting treatment it adopted with respect to its assumption of Encor's liabilities. As treatment under section 9 of the *ITA* was not then being sought by the Appellant, it is wrong to believe that the Minister accepted the Appellant's alleged accounting treatment at that time.

[12] Exhibit A-1, Agreed Book of Documents, Tab 37, at p. 2.

> the share price should arrive if Encor was freed of its obligation to repay its own C$225 million share of principal under the Arctic Loan Agreement . . .

[41] While the Encor shares were sold prior to the completion of the Plan of Arrangement, I believe it is reasonable to infer that the above agreements had a favourable impact on the price negotiated by Dome Petroleum for the Encor shares. I surmise that Amoco was comfortable with this transaction. The result was that Amoco likely had to take on less debt to fund its purchase of Dome Petroleum. The 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.

[42] In addition, as noted earlier, the risks of cross-default also loomed large in Amoco's consideration of why to enter into and how to structure the Key Transactions. The execution and coming into force of the Settlement Agreement, the Encor Indemnity and Subrogation Agreement and the Accommodation Agreement were carefully choreographed under the Plan of Arrangement to occur immediately prior to, but to be conditional upon, the successful completion of the Plan of Arrangement. The execution of the Settlement Agreement and the Encor Indemnity and Subrogation Agreement facilitated the execution of the Accommodation Agreement by relieving the parties of all past defaults under the Formal Agreement and led to the adoption of more favourable terms. All of this 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.

[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.

[44] The terms of the Formal Contract stipulated that the $400 million exploration loan was to be repaid on December 31, 2030, subject to the applicability of any early repayment conditions, which were contingent on the production of oil. It is clear that to date there has been no commercial production of oil in the Beaufort Sea. As a result, the conditions of the exploration loan contingent on production (early repayment and remuneration) never came to fruition.

[45] Beyond the repayment of the exploration loan, the Formal Contract also set out obligations with regard to the continued exploration for oil in the Beaufort Sea. By agreeing to assume Encor's obligations under the Formal Contract, the Appellant became liable for the performance of all of the duties and obligations under the Formal Contract. In summary, it agreed to do much more than repay $225 million in 2030. The evidence also shows that it 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.

[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.

IV. <u>ISSUES</u>

[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.

V. <u>ANALYSIS</u>

A. Application of Section 16 of the *ITA*

[49] At trial, the parties advanced conflicting positions on how to properly apply subsection 16(1) of the *ITA*. For ease of reference I have reproduced the relevant parts of subsection 16(1) of the *ITA*, which states:

> **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:

> (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.

[50] I will now outline my view on the proper scope of the application of subsection 16(1) of the *ITA*. Before I do so, a brief overview of the principles of statutory construction that I will apply to determine the proper meaning of paragraph 16(1)(a) of the *ITA* is useful.

[51] The modern approach to statutory construction, which involves a textual, contextual and purposive analysis or, more precisely, which looks at the grammatical and ordinary sense of a provision with reference to its entire context, its purpose and the intention of Parliament, was described in the Supreme Court of Canada decision *Canada Trustco Mortgage Co. v. Canada*. The unanimous court provided an overview of the history of the approaches to statutory interpretation and added that the *ITA* must be interpreted in such a way as to achieve consistency, predictability and fairness. [13]

[52] In *Canada Trustco*, the Supreme Court also stated that, where a provision contains words with unequivocal meaning, the ordinary meaning of those words plays a dominant role and that, where on the other hand the words may support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role and the focus shifts towards the *ITA*'s harmonious whole. [14]

(1) Text of Subsection 16(1) of the *ITA*

[53] The wording of subsection 16(1) of the *ITA* sheds light on the intent of that provision.

[54] The preamble to subsection 16(1) of the *ITA* begins with the phrase "where, under a contract or other arrangement". This phrase requires the Court to identify and examine the "contract or other arrangement" that provides for what can reasonably be considered to be blended payments of capital and interest.

[55] The phrase "can reasonably be regarded" requires the Court to take into account all of the relevant circumstances, including, in the instance case, the terms and conditions of the Key Agreements.

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[13] C*anada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601.
[14] *supra 13*.

[56] The phrase "irrespective of when the contract or arrangement was made or the form or legal effect thereof" requires the Court to take into account the economic impact or consequences of all of the above. This latter factor is what the Appellant relies upon in arguing that the economic substance of the arrangement is that the Appellant received $17.5 million in consideration of its agreeing to pay $225 million to APCJ in 2030. The Difference represents compensation for the use of the $17.5 million over the period, or in other words, compensation for the time value of money, which is the key reason why interest is paid.

[57] While I agree with the Appellant that the economic substance of the Key Transactions must be considered, all of the other relevant factors and circumstances must also be taken into account. The proper weight to be accorded to the various factors is to be determined on a case-by-case basis. In summary, the economic substance of the Key Transactions cannot be considered in the abstract.

[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 <u>person to whom</u> 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.

[59] Finally the phrase "can reasonably be regarded" signifies that the characterization of the payment as interest and principal must simply be reasonable having regard to all of the relevant circumstances that must be taken into account in coming to that determination.

[60] A textual interpretation of subsection 16(1) of the *ITA*, which provides for symmetrical treatment, does not favour the Appellant's position, as no part of the amount that is due by the Appellant can reasonably be regarded as interest that is payable to APCJ under the terms and conditions of the exploration loan. Nor, for that matter, was the Appellant required to make blended payments to Encor under the Settlement Agreement or the Encor Indemnity and Subrogation Agreement.

(2) <u>Contextual Analysis</u>

[61] A contextual analysis of subsection 16(1) of the *ITA* includes looking at the history of the subsection, its stated purpose and its interactions with other provisions of the *ITA*. The notion of a harmonious whole includes an analysis of

the underlying mechanics of the *ITA*, as the interpretation of a deeming rule must be logically consistent with the rest of the *ITA*. I will now embark on that analysis

(i) Context of Subsection 16(1) Within the ITA

[62] Subsection 16(1) is found in Part I of the *ITA*. When paragraph 16(1)(a) of the *ITA* applies, a portion of the blended payment that can reasonably be regarded as interest is taxable to the creditor under paragraph 12(1)(c) of the *ITA* and is deductible by the debtor under paragraph 20(1)(c) of the *ITA* provided that the other conditions stated in paragraph 20(1)(c) of the *ITA* are satisfied.[15]

[63] Subsection 214(2) of the *ITA* provides that, where a payment would have resulted in an inclusion of an amount in income deemed interest under Part I of the *ITA* if Part I applied to a non-resident creditor, the amount is deemed to have been paid or credited as interest to the non-resident person. The above reinforces the view that Parliament intended symmetrical treatment of the amount as interest.

[64] Other provisions found in Part I of the *ITA* support this view. For example, subsection 12(9) of the *ITA* specifically provides for asymmetrical treatment by deeming amounts determined in respect of certain “prescribed debt obligation[s]” to be interest deemed to accrue in the year for the holder of the debt obligation. Subsection 12(9) of the *ITA* applies to the holder of the debt obligation; it does not affect the characterization of the payment for the debtor.

[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.

[66] The broad interpretation proposed by the Appellant would also cause conflict with other provisions of the *ITA*. For example, lease payments under a so-

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[15] In many cases, the deemed interest will not be deductible. For example, this will be the case if deemed interest arises in connection with the purchase of a principal residence. The important point is that Parliament intended the same amount to be deemed interest for both parties.

called capital lease could be construed as payments of interest and principal under the Appellant's theory on the basis that, from an economic substance standpoint, the transaction could be construed as a sale of equipment for a balance of sale. In such a case the lease payments could be regarded as blended payments of interest and principal.

[67] Compare this result to the elective tax treatment provided for under section 16.1 of the *ITA*, a more specific provision that allows rental payments to be recharacterized as blended payments of principal and interest only for the lessee. When an election is made under that provision, the rental payments are no longer deductible for the lessee. Instead the lessee is entitled to claim capital cost allowance with respect to the leased property, which is deemed to have been acquired at cost equal to its fair market value at the commencement of the lease. The rental payments are deemed to be blended payments of principal and of interest calculated at a prescribed rate. From a lessee's perspective, the ability to make or not make the election would become somewhat meaningless if subsection 16(1)(a) of the *ITA* applied automatically to recharacterize the rental payments made by the lessee as blended payments of interest and capital. Would a lessee be able to use a "reasonable rate" to calculate the interest payment or would he be bound to use a prescribed rate if the parties agreed to make the election? If the lessee could use a "reasonable rate", this could be reason enough not to make the election. As a last point, I observe that subsection 16(1) of *ITA* does not state how the debtor's cost of property acquired in consideration of the assumption of a liability by the purchaser should be determined. Should the cost be limited to the net present value of the property acquired assuming the liability is interest-free or provides for contingent interest?

[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*.

(ii) Historical Context of Subsection 16(1) of the ITA

[69] Part of the exercise of statutory interpretation involves looking at the history of the statute in question in order to see if anything can be gleaned from it with the respect to the intention of Parliament.

[70] Section 7 originally existed as section 3(2) of the *Income War Tax Act* (first added in 1942), which read as follows:

> 3(2) Where under any existing or future contract or arrangement for the payment of money, the Minister is of opinion that
>
> > (a) payments of principal money and interest are blended, or
> >
> > (b) payment is made pursuant to a plan which involves an allowance of interest
>
> whether or not there is any provision for payment of interest at a nominal rate or at all, the Minister shall have the power to determine what part of any such payment is interest and the part so determined to be interest shall be deemed to be income for the purposes of this Act.

[71] The above shows that the provision was intended as an anti-avoidance provision, targeting situations where taxpayers reclassified interest payments as capital payments in order to avoid tax. Specifically, it is stated in the 1942 budget speech (at page 15):

> Legislation will be introduced to prevent tax avoidance in certain directions. For example, it is proposed that income received from oil or gas wells organized on the so-called royalty basis shall be deemed to be income received by the person or persons actually operating the oil or gas wells on behalf of the royalty holders and taxed at that point. Also, when property is sold on an instalment basis the capital payments shall be deemed to include interest at a reasonable rate in cases where there is no interest provided for or where the interest provided for is unduly low.

[72] The purpose of the provision was expanded on during the 1942 parliamentary debates concerning the provision:[16]

> Mr. GIBSON: The object of this section is to close the door to tax avoidance, which is possible when arrangements are entered into whereby payments of capital are made without interest being paid at all. Cases of the kind have come to light, and it is to provide that a fair rate of interest will be deemed to be included in those payments, so that a man may not buy a property and over a period of ten, fifteen or twenty years pay so much in the way of capital payments, without interest.
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> Mr. HANSON (York-Sunbury): We will say in the case of a family arrangement, or a business?

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[16] *House of Commons Debates*, 18th Parl., 3rd Sess., vol. 5 (July 21, 1942), at 4461-4462.

> Mr. GIBSON: Well, when a purchaser is buying property and possibly paying a slightly lower price, paying it all in capital payments, because the vendor will not have to pay income tax on the mortgage interest. In that case he might be willing to accept a slightly lower sum, in order to avoid the payment of income tax.
>
> . . .
>
> Mr. BENCE: Does the Minister mean to say that he will arbitrarily fix a certain proportion of the capital payments, which will be taken to be interest, even though there is no actual calculation of interest at all?
>
> Mr. GIBSON: Yes

[73] It is clear from the parliamentary debates and the budget speech that, from its inception, the provision was intended to apply as an anti-avoidance provision in order to prevent the recipients of interest income from reclassifying the interest payments as being on capital account in order to avoid the payment of tax (capital gains not being taxable at the time). This would appear to be a narrower interpretation than what is suggested by the Appellant.

[74] This provision was amended in 1948, so that it then read:

> S. 7 of the 1948 *Income Tax Act*
>
> **7.** Where a payment under a contract or other arrangement can reasonably be regarded as being in part a payment of interest or other payment of an income nature and in part a payment of a capital nature, the part of the payment that can reasonably be regarded as a payment of interest or other payment of an income nature shall, irrespective of when the contract or arrangement was made or the form or legal effect thereof, be included in computing the recipient's income.

[75] The provision as then drafted addressed the tax consequences for the recipient of the payment. It was silent as to the consequences for the payer. I observe that, after the change was enacted, taxpayers were granted the ability to deduct the deemed inclusion in income under section 7. This took the form of paragraph 11(1)(ca). Added in 1951,[17] paragraph 11(1)(ca) read as follows:

> Deductions allowed.
>
> (ca) such part of a payment

[17] S.C. 1950-51, c. 51, subsection 3(1).

> (i) repaying borrowed money used for the purpose of earning income from a business or property (other than property the income from which would be exempt), or
>
> (ii) for property acquired for the purpose of gaining or producing income therefrom or for the purpose of gaining or producing income from a business (other than property the income from which would be exempt),
>
> made by the taxpayer in the year as is by section 7 required to be included in computing the recipient's income for a taxation year.

This provision allowed a deduction by the payer of the amount deemed by section 7 to be included in income, if the payment was made in connection with an income-earning purpose (as anything on capital account was generally not taxable at the time). The intent in enacting this new provision was discussed in the parliamentary debates that year:[18]

> Mr. Johnston: I should like to ask a question with respect to section 3 on page 2 concerning the repaying of borrowed money. It seems to me that the only deduction that would be allowed from income tax would be the interest on that borrowed money.
>
> Mr. Abbott: This is a relieving section. There was a little lack in the law. In certain types of contracts there is an attributed interest content, and that is required to be included as income by the person who receives it.
>
> Mr. Johnston: What it refers to is the attributed interest content.
>
> Mr. Abbott: That is correct. Taking the reverse situation, if I as a lender under these circumstances am required to include it in my income, the man who is paying it to me can include it as an expense. That is the effect of the section. It is a relieving section. It seemed the sensible thing to do.

[76] The above indicates that symmetrical tax treatment was intended when the deemed income was received on income account and payment was made by the debtor in connection with an income-earning process.

[77] Section 7, is a slightly amended form, became in 1971 subsection 16(1) of the *ITA*, which in turn was replaced in 1983 by the following version of subsection 16(1):

> Income and capital combined

[18] *House of Commons Debates*, 21st Parl., 4th Sess., vol. 5 (June 13, 1951) at 4052.

> Where a payment under a contract or other arrangement can reasonably be regarded as being in part a payment of interest or other payment of an income nature and in part a payment of a capital nature, the part of the payment that can reasonably be regarded as a payment of interest or other payment of an income nature shall, irrespective of when the contract or arrangement was made or the form or legal effect thereof, be included in computing the recipient's income [from property] [for the taxation year in which it was received to the extent that it was not otherwise included in computing the recipient's income].

[78] The principal change was to the last part of the provision, which stipulates that the inclusion in income from property will only occur where no other provision of the *ITA* requires the interest to be included in income. The 1982 technical notes specifically provide the example of subsections 12(3) and (4) of the *ITA*, where accrued interest income on a debt obligation that is included in income under one of those subsections will not also be required to be included in income under subsection 16(1) when the interest is actually paid. The provision was again silent as to its impact for the payer.

[79] The treatment of the payer was instead dealt with by the (then) contemporary iteration of paragraph 11(1)(ca), paragraph 20(1)(k). Paragraph 20(1)(k) worked similarly to the previous version of the provision by stipulating that the portion of a blended payment that was included in the recipient's income from property pursuant to subsection 16(1) of the *ITA* would be deductible in computing the payer's income from business or property where the payment was with respect to borrowed money used for the purpose of earning income or for property acquired for the same purpose.

[80] That iteration of subsection 16(1) of the *ITA* was in turn replaced in 1988, which was in essence nearly identical to the current version of that provision, the main change being that part of the blended payment became explicitly characterized as being interest on a debt obligation, rather than just income from property. Looking at the Department of Finance technical notes,[19] it would appear that the catalyst for the change was a desire to have income from property caught under section 16 of the *ITA* classified specifically as interest for both parties.

[81] The 1988 Department of Finance technical notes give the example of subsection 12(3) of the *ITA*, which requires corporations, partnerships and certain

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[19] The 1988 technical notes read in part as follows: ". . . Subsection 16(1) is amended to provide that the part of a blended payment that can reasonably be regarded as interest will be treated as interest on a debt obligation rather than simply included as income from property. This amendment clarifies that other rules—such as those contained in subsection 12(3) which require corporations, partnerships and certain trusts to include interest in their income on an accrual basis—will be applicable to the interest portion of a blended payment".

trusts to include interest in their income on an accrual basis, and which, it is stated is applicable to the interest portion of a blended payment. Because categorizing something as interest triggers interactions with all of the provisions of the ITA that pertain to interest (unless they are explicitly excluded), and since this was a conscious choice by Parliament, this is a strong indication that the intended effect of these interactions is that the same amount of the blended payments is to be deemed to be interest for both parties. When subsection 16(1) of the *ITA* was amended in 1988, paragraph 20(1)(k) was repealed. As pointed out by the Appellant in its written submissions, the technical notes relating to the repeal of paragraph 20(1)(k) stated:

> paragraph 20(1)(k) is repealed as a consequence of the amendment to subsection 16(1). By reason of this amendment, subsection 16(1) <u>deems</u> the interest portion of a blended payment to be interest on a debt obligation. Therefore, the general rules applicable to the deduction of interest will apply to that part of the payment and paragraph 20(1)(k) is no longer necessary.[20]
>
> [Emphasis added]

[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.

[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”.[21] 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.

(3) <u>Purpose of Subsection 16(1) of the *ITA*</u>

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[20] Department of Finance Technical Notes relating to the repeal of paragraph 20(1)(k), 1988.
[21] *Daishowa-Marubeni International Ltd. v. Canada,* 2013 SCC 29, [2013] 2 S.C.R. 336, at para. 43.

[84] In summary, considering all of the above, subsection 16(1) of the *ITA* is an anti-avoidance provision that is intended to apply where a contract or agreement does not explicitly identify an amount owed by one person to another as being interest and that amount can reasonably be regarded, considering all the relevant circumstances, to be interest for both parties. The classic example of a situation where the provision applies is a purchase and sale of property financed by a balance of sale payable to the seller in equal instalments over the term of the agreement, without explicit recognition of the interest and principal components of the instalment payments.

(4) Consideration of the Case Law Cited by the Parties

[85] In their oral and written submissions both parties referred me to the Tax Court's decision in *Lehigh Cement Limited*.[22] Unsurprisingly, the parties draw different conclusions from that case.

[86] The facts of the case are relatively straightforward. Lehigh Cement Limited ("Lehigh"), a Canadian corporation, borrowed funds from a consortium of Canadian banks to finance its operations. Through a series of transactions the loan was acquired by a related non-resident corporation. As a result, interest paid or credited on the loan gave rise to the payment of Part XIII tax by the non-arm's length recipient of the interest.

[87] In a bid to qualify for the withholding tax exemption provided for, at the time, under subparagraph 212(1)(b)(vii) of the *ITA*, the terms and conditions of the loan were modified and the right to interest coupons totalling approximately $49.5 million was sold to a foreign bank (the "Foreign Bank") for approximately $42.7 million.

[88] With respect to the years at issue, the Minister relying on subsection 16(1) of the *ITA* disallowed substantially all of the interest deducted by Lehigh on the theory that $42.7 million represented the payment of capital to the Foreign Bank. Inconsistently, the Minister also assessed Lehigh for having failed to withhold Part XIII tax on the full amount that it had paid to the Foreign Bank, including the

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[22] *Lehigh Cement Limited v. The Queen*, 2009 TCC 237 (*Lehigh Cement*). This decision was appealed to the Federal Court of Appeal (the "FCA") 2010 FCA 124, [2011] 4 F.C.R. 66. The FCA did not address the issue that concerned the application of subsection 16(1) of the *ITA* under Part I of the *ITA*. The appeal dealt solely with the Tax Court's finding that the GAAR applied to deny the application of a withholding tax exemption to the interest paid by Lehigh to a foreign bank.

portion of the payments that the Minister considered to be capital under Part I of the *ITA*.

[89] The Part XIII tax was assessed on the theory that Parliament intended the withholding tax exemption to apply only when the principal amount of the loan was also payable to a non-resident arm's length lender.

[90] The Tax Court of Canada ("TCC") allowed the appellant's appeal on the first issue, ruling that subsection 16(1) of the *ITA* did not apply so as to allow all or part of the payments made to the Foreign Bank to be recharacterized as non-deductible capital payments for Lehigh. The TCC ruled against the appellant on the second issue, holding that the GAAR applied to deny the Foreign Bank the benefit of the exemption provided for in subparagraph 212(1)(b)(vii) of the *ITA*.

[91] The appellant appealed the TCC's ruling on the GAAR. The FCA allowed the appeal, concluding that the exemption applied to the full amount of the payments received by the Foreign Bank. As a result, Lehigh could not be assessed a penalty of 10% of the withholding tax that the Minister assumed Lehigh failed to withhold on the interest it paid or credited to the foreign bank.

[92] The Appellant in its written submission draws the following conclusions from the TCC's decision in *Lehigh Cement*:

> 32. This Court rejected the Crown's paragraph 16(1)(a) argument in *Lehigh Cement* because "[i]n the corporate mind of [Lehigh], the whole of each quarterly amount . . . was interest"[23] and not capital. The Court explained that:
>
>> the Minister was looking at the 20 quarterly amounts through the eyes of BBL. The Minister chose the wrong point of view because BBL is not before the Court. Only [Lehigh] is challenging the reassessments and it views the quarterly amounts as exclusively interest.[24]
>
> 33. It is clear from *Lehigh Cement* that in determining whether paragraph 16(1)(a) applies to a particular taxpayer, the determination of whether an amount can reasonably be regarded as being in part interest and in part capital must be made from the perspective of the particular taxpayer and not from the perspective of the counterparty to the relevant debt.

[23] *Lehigh Cement* (TCC) at para. 17.
[24] *Lehigh Cement* (TCC) at para. 21.

> 34. <u>It is also evident that, had BBL</u> been before the Court, <u>the Court would have found</u> that section 16 deemed the amounts it received to be partly interest and partly principal for the purpose of determining BBL's taxes.[25]
>
> 35. The reason it mattered which "point of view" was employed is that the result would have been different if BBL had been the party before the Court. It would not matter which "point of view" was applied if the nature of the amount for the purpose of section 16 was fixed with the original contract for debt, and applied to new parties to the debt regardless of whether the amounts that they paid or received to become party to the debt reflected the time value of money. However, as the case demonstrates, the nature of an amount does not fix the nature to taxpayers later becoming party to the contract; BBL had become party to the debt through assignment, and treatment from its "point of view" would not have been the same as Lehigh's.
>
> [Emphasis added]

[93] With respect, I do not agree with the Appellant's analysis of *Lehigh Cement*, particularly its speculation on the outcome of the case[26] had the Foreign Bank been before the Court.

[94] As is often the case under Part XIII of the *ITA*, the Minister assessed Lehigh, the interest payer, for its failure to withhold Part XIII tax rather than the interest recipient, the Foreign Bank, for the Part XIII tax it owed under paragraph 212(1)(b) of the *ITA*. Interest payers incur a penalty under Part XIII only if they fail to deduct or withhold the tax owed by the non-resident recipient of the interest payment. In short, the payment must be interest or deemed interest to the payee for it to attract Part XIII tax. Section 215 of the *ITA* is clear on this matter. The relevant parts of that provision read as follows:

> 215(1) When a person pays, credits or provides, or is deemed to have paid, credited or provided, an amount <u>on which</u> an income tax <u>is payable</u> under this Part, or would be so payable if this Act were read without reference to subparagraph 94(3)(a)(viii) and to subsection 216.1(1), the person shall, notwithstanding any agreement or law to the contrary, deduct or withhold from it the amount of the tax and forthwith remit that amount to the Receiver General on behalf of the non-resident person on account of the tax and shall submit with the remittance a statement in prescribed form.
>
> . . .

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[25] While BBL was not before the Court on the question of the application of paragraph 16(1)(a) of the *ITA*, it was indirectly before the Court with respect to the question of the application of Part XIII tax to the payments that were made or credited to BBL by Lehigh. I comment further on this issue in paragraphs 93 to 97.

[26] See paragraph 34 of the Appellant's written submissions cited above.

> (6) Where a person has failed to deduct or withhold any amount as required by this section from an amount paid or credited or deemed to have been paid or credited to a non-resident person, that person is liable to pay as tax under this Part on behalf of the non-resident person the whole of the amount that should have been deducted or withheld, and is entitled to deduct or withhold from any amount paid or credited by that person to the non-resident person or otherwise recover from the non-resident person any amount paid by that person as tax under this Part on behalf thereof.[27]

[Emphasis added]

[95] Paragraph 212(1)(b) of the *ITA* clearly imposes the Part XIII tax on the non-resident recipient of the interest payments. The relevant part of that provision reads as follows:

> 212(1) Every non-resident person shall pay an income tax of 25% on every amount that a person resident in Canada pays or credits, or is deemed by Part I to pay or credit, to the non-resident person as, on account or in lieu of payment of, or in satisfaction of,
>
> . . .
>
> (b) interest that . . .

[Emphasis added]

[96] The Appellant's submission that the outcome in *Lehigh Cement* would have been different had the Foreign Bank been before the Court is incorrect. It is implicit in the TCC's decision, that the full amount paid to the Foreign Bank was interest, otherwise its finding that section 215 of the *ITA* applied to the full payment made by Lehigh is incorrect. Under the Appellant's theory, at most, the calculation of Lehigh's liability under subsection 215(6) of the *ITA* should have been based on interest payments of only $5.8 million had the Court's finding that the GAAR applied been correct.

[97] The Appellant's conclusion is also inconsistent with the FCA's decision. In *Lehigh Cement*, the FCA concluded that the TCC was wrong in applying the GAAR and that all the payments received by the Foreign Bank were interest that was exempt from Part XIII tax by virtue of paragraph 212(1)(b)(vii) of the *ITA*. In

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[27] The payer is entitled to recover from the non-resident payee Part XIII tax paid on the latter's behalf under subsection 215(6) of the *ITA*. This means that the payment must be interest for the payee in order for the payer to be liable for failure to withhold tax and to have a right to recover the tax from the non-resident payee.

summary, both the TCC and the FCA found that subsection 16(1) of the *ITA* did not operate to recharacterize the payments received by the Foreign Bank as blended payments of principal and interest.[28] The payments remained interest for both parties.

[98] As a final note on the Appellant's analysis of *Lehigh Cement*, I observe that its theory would place an unfair burden on Canadian resident taxpayers under section 215 of the Act. Pursuant to that section, Canadian taxpayers are authorized to withhold Part XIII tax on interest that is paid or credited to non-residents where no exemption applies. How would a Canadian taxpayer be able to accurately determine the amount of Part XIII tax due by a non-resident payee where the payee purchased interest coupons from a non-resident lender? The outcome or result of the latter transaction would only be known with certainty by the parties to the transaction. This in my view serves as further confirmation that Parliament intended that the deeming rule in subsection 16(1) of the *ITA* apply symmetrically to both parties.

[99] I have carefully considered the other cases cited by both parties. As is often the case, the outcomes in those cases are largely fact-dependent. Those cases are not of particular relevance to the determination of the outcome of this matter.

B. Consideration of the Relevant Circumstances and Factors

[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 it 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.

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[28] If the Appellant's theory was correct, it would mean that the TCC's decision on the Part XIII tax would be wrong for two reasons. First, Lehigh could have been assessed under section 215 of the *ITA* only with respect to a small portion of the payments that it made to the Foreign Bank. Secondly, as decided by the FCA, that small amount would not be subject to Part XIII tax by virtue of the exemption provided for in subparagraph 212(1)(b)(vii) of the *ITA*. The FCA decision clearly points out that the Part XIII tax is owed by the interest recipient. In that case, the Part XIII tax was not due because the full amount paid or credited to BBL was interest that was free of withholding tax by virtue of subparagraph 212(1)(b)(vii) of the *ITA*. Subsection 16(1) did not recharacterize the payments in the hands of BBL.

[101] First, the Appellant gained Encor’s consent to the Plan of Arrangement, which was required in order for the Appellant to complete the acquisition of Dome Petroleum on terms and conditions that it considered to be favourable.

[102] Secondly, the Settlement Agreement allowed the Appellant to mitigate the risk of cross-default, which if triggered, could lead to an acceleration of all of the debt securities issued by the Appellant and/or Dome Petroleum under the Plan of Arrangement. Encor’s cooperation, which was secured under the Settlement Agreement, paved the way for successful negotiations between the Appellant and Encor on the one hand and APCJ on the other. These ongoing negotiations culminated in APCJ agreeing to release Encor from all of its obligations under the Formal Contract. This was of significant value to the Appellant because it eliminated the risks associated with the prospect of cross-default. Encor’s cooperation in engaging in negotiations with APCJ also allowed the Appellant to secure APCJ’s waiver of Dome Petroleum’s past defaults under the Formal Contract and to secure more favourable terms and conditions on an ongoing basis. The evidence shows that all of the above was necessary in order to gain APCJ’s approval of the Plan of Arrangement. The evidence shows that the Appellant would not have proceeded with the transaction unless the latter outcome was secured.

[103] The Settlement Agreement does not create obligations on the Appellant to make payments to Encor. There are no blended payments to be considered under that agreement. The Appellant simply commits to performing Encor’s obligations under the Formal Contract and to indemnifying and holding Encor harmless as regards any damage that it suffers from the Appellant’s failure to do so.

[104] The Encor Indemnity and Subrogation Agreement simply spells out in greater detail what happens if the Appellant fails to meet the performance duties and obligations imposed on it under the Formal Contract. By becoming a party to the Formal Contract, the Appellant undertook to do more than repay APCJ the amount owed to it under the Exploration Agreement. The Accommodation Agreement adds the Appellant to the Formal Contract as a party having joint and several obligations thereunder.

[105] Finally, when the Appellant became a party to the Formal Contract, it became obligated jointly and severally to pay $400 million to APCJ in 2030. This is an immediate obligation in the sense that the amount is due by the Appellant immediately upon the execution of the Accommodation Agreement. There is no contingency as to that payment. The Appellant simply benefits from a term for

repayment. The amount does not become due as a result of the passage of time. APCJ advanced $400 million and, unless a condition for early repayment is triggered or the obligation is otherwise settled by consent between the parties, APCJ will receive in 2030 the principal of $400 million that it advanced. No part of that payment can be regarded as compensation for the use of money. That entire amount is the payment of capital owed to APCJ.

[106] All of the above demonstrates that the Appellant received much more than $17.5 million from Encor and undertook to do much more than repay $225 million in 2030.

[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*.

[108] In closing, I observe that the Appellant's position 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.

[109] The Appellant suggested that if I ruled against it, it would mean that the payment of the Difference is a so-called "tax nothing". This argument is often made by taxpayers to gain the sympathy of the Court, but, as is the case here, it is rarely proven to be an accurate assessment of the situation.

[110] In obiter, I observe that the Appellant may one day argue, in the right circumstances, that the Difference is a capital expense incurred by the Appellant in connection with and as a result of the acquisition by it of the Dome Petroleum

shares.[29] Because the full amount was due (although not due and payable or immediately exigible) one could assert that the assumed liability forms part of the Appellant's cost of the shares of Dome Petroleum, for example, in much the same way that legal expenses incurred but not yet paid in connection with the execution of a purchase and sale agreement for shares are included in the cost of those shares.[30] Having concluded that subsection 16(1) of the *ITA* does not apply, I am unaware of any provision in the *ITA* that requires a taxpayer to discount its obligation to pay a future principal amount when the liability to pay entails full recourse to the taxpayer.

[111] As a result of the above, it is certainly open to the Appellant to argue that the full amount of the Difference forms part of its cost of the shares of Dome Petroleum.[31] I can readily understand, however, why the Appellant chose not to go down that path as the tax treatment claimed by it and denied by the Minister was much more favourable to it.

[112] For all of the above reasons, the Appellant's appeal is dismissed. The parties will have until October 20, 2017 to arrive at an agreement on costs, failing which they must file their written submissions on costs no later than October 25, 2017. Such submissions are not to exceed five pages.

Signed at Ottawa, Canada, this 6th day of October 2017.

"Robert J. Hogan"

Hogan J.

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[29] For example, this question could arise if the Appellant were to dispose of the shares of Dome Petroleum or if the Appellant became the object of an acquisition of control and the shares were worth less at that time than their adjusted cost base (the "ACB").

[30] The Appellant entered into the Settlement Agreement and the Encor Indemnity and Subrogation Agreement because this was required in order for it to acquire Dome Petroleum on terms and conditions acceptable to it. In this context, the liability was assumed in the course and as a consequence of a transaction carried out on account of capital. The assumed liability is intrinsically related to the acquisition of the shares of Dome Petroleum. See *Daishowa-Marubeni International Ltd.*, *supra* 22, at para. 26.

[31] I observe that section 80 of the *ITA* would operate properly if the Appellant at a later date was successful in having its obligation to repay $225 million settled for a lesser amount and succeeded in establishing that the Difference must be included in the ACB of its shares of Dome Petroleum. Subject to the ordering rules in section 80 of the *ITA*, this additional ACB of the shares of Dome Petroleum would offer the Appellant the opportunity to offset a "forgiven amount" against the ACB of the shares, assuming they still existed.

APPENDIX A

2012-4907(IT)G
2013-1522(IT)G

TAX COURT OF CANADA

BETWEEN:

PLAINS MIDSTREAM CANADA ULC
(SUCCESSOR BY AMALGAMATION TO BP CANADA ENERGY COMPANY)

Appellant

- and –

HER MAJESTY THE QUEEN

Respondent

<u>Partial Agreed Statement of Facts</u>

For the purposes of this trial, the appellant and respondent (the **"Parties")** admit the following facts and agree that their admission of facts shall have the same effect as if the facts had been proved formally and accepted by the court as true, with the following caveats:

1. If a party has admitted a fact in response to a request to admit served on it by the adverse party, the adverse party has the right to rely on the admitted fact in the response to the request to admit. The parties do not believe there is any inconsistency between the facts in the Partial Agreed Statement of Facts and those admitted in responses to request to admit, and agree that both the facts as stated in the Partial Agreed Statement of Facts and those admitted in

responses to a request to admit should be treated as true. To any extent there may be inconsistency between a response to a request to admit and this agreed statement of facts, the party who served the request to admit has the right to insist that the response to the request to admit prevails.

2. The Parties acknowledge that certain facts in the agreed statement of facts are summaries of the terms of contractual agreements. The Parties acknowledge that these facts are more properly summaries of contractual interpretation. The Parties are not intending to usurp the role of the Court in respect of questions of law or mixed fact in law. The Parties have included these agreed facts for the Court's convenience. The Parties acknowledge that the Court is not bound by the parties' interpretation of contracts, as the Court must draw its own legal conclusions based upon its interpretation of the contracts.

The parties each reserve the right to adduce additional evidence that is relevant and probative of any issue before the Court and not inconsistent with the facts admitted herein.

The parties agree that, if an opposing party has made a statement of position at examinations for discovery, the other party can refer the Court to that statement of position in oral argument without the necessity of a formal read-in.

The following definitions will be used:

"Amoco" means individually and collectively as the context requires Amoco Canada Petroleum Company Ltd. and its successors named Amoco Canada Petroleum Ltd. and Amoco Canada Petroleum Company

"APCJ" means the Artic Petroleum Corporation of Japan

"**Dome Canada"** means Dome Canada Limited

"Dome Petroleum" means Dome Petroleum Limited

"Encor" means Encor Energy Corporation Inc.

<u>1980 to 1982</u>

1. In the late 1970s and early 1980s, Dome Petroleum and the Japanese government had a mutual desire to explore, discover and produce petroleum in the Beaufort Sea. The Japanese were seeking to obtain a long term supply of petroleum from stable markets. At around this time, Dome Petroleum had interests in the Beaufort Sea and was looking for capital to support petroleum exploration in this area.

2. The Japan Nation Oil Corporation (**"JNOC")** and Dome Petroleum entered into a Letter of Intent, dated August 22, 1980 **("Letter of Intent")**, regarding the exploration and development of petroleum in the Beaufort Sea. The Letter of Intent is **Document 1** of the Agreed Book of Documents.

3. The Letter of Intent was amended by a Side Letter of Amendment dated December 23, 1980 between JNOC and Dome Petroleum, which letter is referred to as **Document 2** of the Agreed Book of Documents.

4. In October of 1980, the Government of Canada introduced the National Energy Policy **("NEP"**).

5. As a result of the NEP, it was obvious to Dome Petroleum that it would need to increase its Canadian content to qualify for and take advantage of the government incentives being offered under the NEP and also in order to obtain future production licenses.

6. Dome Petroleum determined that Dome Canada could be used to realize the benefits under the NEP as Dome Canada was a qualifying company under the NEP that could conduct the exploration programs in the Beaufort Sea.

7. In or around December of 1980, Dome Petroleum proposed to JNOC that Dome Canada become a party to the formal contract that was being negotiated, and JNOC agreed.

8. APCJ was formed to administer the formal contract contemplated by the Letter of Intent.

9. APCJ was a Japanese company incorporated under the laws of Japan. It was owned 80% by JNOC and its subsidiaries and 20% by several Japanese private sector corporations.

10. The formal contract contemplated by the Letter of Intent was finalized effective February 16, 1981 between APCJ, Dome Petroleum and Dome Canada (the "**Formal Contract**"). The Formal Contract is **Document 3** of the Agreed Book of Documents.

11. The Formal Contract contains the rights and obligations of the parties by which APCJ, Dome Petroleum and Dome Canada were to participate in the exploration and development of the Beaufort Sea.

12. Among other things, the Formal Contract provided that APCJ would advance $400,000,000 which was to be used by Dome Petroleum and Dome Canada to fund exploration of petroleum in the Beaufort Sea (the **"$400,000,000 Amount**"). The $400,000,000 Amount is also referred to in the Formal Contract as the "**Exploration Loan**".

13. The $400,000,000 Amount was advanced by APCJ to Dome Petroleum and Dome Canada in accordance with the Schedule in Article 4.01 of the Formal Contract.

14. Pursuant to the Formal Contract, among other things,

    a. Dome Petroleum and Dome Canada were jointly and severally liable for all representations, warranties, duties and obligations owing to APCJ under the Formal Contract;

    b. Dome Petroleum and Dome Canada were jointly and severally liable for all duties and obligations owing to APCJ in respect of the $400,000,000 Amount;

    c. APCJ was entitled to look to Dome Petroleum in the first instance for the performance of all terms and conditions under the Formal Contract; and

    d. APCJ was entitled to demand from Dome Petroleum full payment of the $400,000,000 Amount.

15. Pursuant to the Formal Contract, the $400,000,000 Amount was to be repaid by Dome Canada and Dome Petroleum by December 31, 2030. The Formal Contract provided for earlier repayment of the $400,000,000 Amount if

there was commencement of commercial production, as those terms were defined by the Formal Contract **("Commencement of Production"),** in the Beaufort Sea or an Event of Default within the meaning of the term "Event of Default" in the Formal Contract occurred.

16. If there was Commencement of Production, Dome Petroleum and Dome Canada were required to repay the $400,000,000 Amount out of 20% of their net proceeds of production from Exploration Fields, as that term was defined in the Formal Contract.

17. If there was no Commencement of Production or a specified event of default under the Formal Contract, then the $400,000,000 Amount would have to be repaid December 30, 2030.

18. Pursuant to the Formal Contract, as full and complete consideration to APCJ making the Exploration Loan, APCJ was entitled to "remuneration" as defined by the Formal Contract (**"Remuneration"**), if there was Commencement of Production in the Beaufort Sea.

19. Remuneration was only payable if and when there was Commencement of Production in the Beaufort Sea.

20. The deduction that the appellant is seeking in the within appeals does not relate to any amount payable as Remuneration under the Formal Contract.

21. If there was no Commencement of Production, then no Remuneration would have to be paid.

22. There has been no Commencement of Production in the Beaufort Sea.

23. Dome Petroleum, Dome Canada and APCJ entered into a letter agreement dated February 16, 1981, which letter is referred to as **Document 4** of the Agreed Book of Documents. In this letter, APCJ confirmed that an event of default as defined in Article 29.01(d) of the Formal Contract would need to be with respect to a substantial obligation under the Formal Contract or would have to materially adversely affect the rights of APCJ before it would be considered a breach of contract.

24. Dome Petroleum and Dome Canada entered into an agreement called the Joint Venture Agreement, dated March 2, 1981, whereby Dome Petroleum

and Dome Canada agreed to allocate the $400,000,000 Amount for exploration as follows: $225,000,000 to Dome Canada and $175,000,000 to Dome Petroleum. The Joint Venture Agreement is referred to as **Document 12** of the Agreed Book of Documents.

25. APCJ was not a party to the Joint Venture Agreement between Dome Petroleum and Dome Canada.

<u>1987 and 1988</u>

26. Immediately prior to December 8, 1987, Dome Petroleum held a 42.1 per cent interest in Dome Canada.

27. As a result of name changes in 1986 and 1987, Dome Canada was renamed Encor.

28. Amoco Corporation was the U.S. parent of Amoco.

29. In or around April of 1987, Amoco Corporation announced its intention to have its Canadian subsidiary, Amoco, acquire Dome Petroleum.

30. Amoco had its own interests in the Beaufort Sea, saw great potential for hydrocarbon development in the Beaufort Sea, wanted to capitalize on Dome Petroleum's holdings in the Beaufort Sea and wanted to be a major player in the future development in the Beaufort Sea.

31. Amoco decided to acquire Dome Petroleum by way of a plan of arrangement pursuant to the *Canada Business Corporations Act.*

32. 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. This Arrangement Agreement is referred to as **Document 13** of the Agreed Book of Documents.

33. Pursuant to the Arrangement Agreement, certain creditors of Dome Petroleum had to approve the plan of arrangement contemplated by the Arrangement Agreement. (The plan of arrangement contemplated by the Arrangement Agreement will be referred to as the "**Plan of Arrangement".)**

34. If APCJ would not have given its approval, the Plan of Arrangement may not have been completed.

35. Amoco believed the Formal Contract required accommodation to enhance the commercial viability of future projects in the Beaufort Sea, and it was a condition of the Arrangement Agreement that Amoco had to reach an accommodation with APCJ concerning the Formal Contract.

36. Amoco needed to negotiate terms with APCJ to obtain APCJ's approval for the Plan of Arrangement.

37. If Amoco could not have reached an accommodation with APCJ, Amoco may not have completed the purchase of Dome Petroleum.

38. Amoco began negotiating with APCJ in July of 1987 for APCJ's approval of the Plan of Arrangement.

39. APCJ was reluctant to change the Formal Contract. APCJ wished to keep as close an alignment with the terms and conditions of the original Formal Contract as possible and without the need for Japanese political action or intervention. APCJ demanded that the original terms of the Exploration Loan be observed.

40. APCJ would not agree to enter into a new agreement between Amoco and APCJ.

41. In 1988, APCJ also would not agree to release Encor from its obligations under the Formal Contract.

42. Dome Petroleum sent out a "Notice of Special Meeting, Notice Concerning Application and Information Circular Application and Proxy Statement pertaining to a proposed Plan of Arrangement involving Dome Petroleum and Amoco" dated April 26, 1988. Pages 56 and 57 of this Notice are referred to as **Document 14** of the Agreed Book of Documents.

43. The statements made by Dome Petroleum in Document 14 of the Agreed Book of Documents are true and accurate. (Subject to the caveat that the document is a summary and, to the extent it is reporting the terms of contractual agreements, the terms of the legal contracts should be preferred, and to the caveat that the document is not complete.)

44. Encor was also a creditor of Dome Petroleum pursuant to the Encor Credit Ship Facility.

45. Pursuant to the Arrangement Agreement, Encor also had to approve the Plan of Arrangement.

46. Encor played a pivotal role in various aspects of the Amoco's acquisition of Dome Petroleum and Amoco wished to negotiate with Encor on several fronts. Amoco desired to make an agreement with Encor to meet several of its objectives in its acquisition of Dome Petroleum.

47. Encor had joint liability with Dome Petroleum and Encor also had a separate loan to Dome Petroleum so Encor had to approve the Arrangement Agreement. Dome Petroleum was also a shareholder of Encor.

48. Encor was also seeking to move their business away from exploration in the Beaufort Sea and concentrate in building businesses in Western Canada. Encor was looking to sell its interests in the Beaufort Sea, and Amoco was looking to acquire those interests.

49. Amoco and Encor entered into an Amoco Canada/Encor Agreement dated November 28, 1987 (the "**Settlement Agreement**"), which agreement is referred to as **Document 15** of the Agreed Book of Documents.

50. Pursuant to the Settlement Agreement, Amoco and Encor agreed, among other things, that:

    1. Amoco would assume all of Encor's liabilities and obligations under the Formal Contract and indemnify and save harmless Encor from and against such liabilities and obligations;

    2. Encor would:

        a. transfer certain properties to Amoco (or its designee) in return for a $1,400,000 payment from Amoco; and

        b. Encor would pay Amoco $17,500,000 for the assumption in 50(1.) above (the **"17.5 Million Payment"**);

    3. The performance of the obligations in subparagraphs 50(1.) and 50(2.) above were interdependent and were to occur at the closing of the Plan of Arrangement and were to occur as part of the closing of the Plan of Arrangement.

    4. The performance of the obligations in subparagraph 50(2.) above were to occur after the completion of the exchange of Dome Petroleum's

indebtedness to Encor under the Encor Credit Ship Facility for cash and junior notes of Amoco.

51. The Settlement Agreement was entered into by Amoco as a step necessary to reach accommodation with APCJ and to obtain APCJ's approval for the Plan of Arrangement.

52. The ultimate objective of Amoco in entering into the Settlement Agreement was to complete the Plan of Arrangement.

53. The obligations in subparagraphs 50(1.) and 50(2.) above were interdependent as one without the other would not have reached Amoco's objectives to reach accommodation with APCJ and to obtain APCJ's approval for the Plan of Arrangement and to enable the conclusion of the Plan of Arrangement.

54. Encor agreed to sell all of its interests in the Beaufort Sea because Encor was seeking to move its business away from exploration in the Beaufort Sea and concentrate in building businesses in Western Canada. Encor, Dome Petroleum and Amoco had overlapping property interests in Western Canada and the rationalization/exchange of some of those properties would help both Amoco and Encor reach their respective objectives. Encor was a willing seller as they no longer wanted to be in that (Beaufort) business, and Amoco was a willing buyer, but the purchase and sale of the Encor lands was also part of bigger rationalization of mutual properties.

55. The Settlement Agreement was part of the more comprehensive arrangement Amoco was making to acquire Dome Petroleum (of which Encor also had a vested interest in the outcome). Therefore Amoco and Encor agreed that the Settlement Agreement needed to be completed for the Dome Petroleum acquisition by Amoco which was ultimately completed through the Plan of Arrangement. The Settlement Agreement was conditional on Amoco's acquisition of Dome Petroleum.

56. The Settlement Agreement was dependant on the overall purchase of Dome Petroleum through a successful execution of the Arrangement Agreement for it to make any sense for Amoco to take on obligations that would not be beneficial to them without the purchase of Dome. Amoco was an oil

company looking for hydrocarbons, not a financing vehicle looking to refinance debt.

57. Amoco and Encor arrived at the $17.5 Million Payment as a negotiated sum between a buyer and seller targeted on what would be regarded as an agreed fair market value.

58. From Amoco's perspective, the $17.5 Million Payment was arrived at as an amount enough to cover the cost of defeasing $225,000,000.

59. On December 8, 1987, Dome Petroleum sold its common shares in Encor to TransCanada Pipelines Ltd. or to TCPL Energy Limited for approximately $398,000,000.

60. Amoco and Encor entered into a Collateral Agreement, dated December 31, 1987, which is referred to as **Document 16** of the Agreed Book of Documents**.** The parties entered into this Collateral Agreement to confirm and clarify the parties' agreement with respect to their respective positions for Canadian income tax purposes regarding the Settlement Agreement and reporting thereon.

61. After 13 months of negotiation, Amoco obtained APCJ's approval for the Plan of Arrangement in August of 1988.

62. Dome Petroleum, Encor, APCJ, Provo and Amoco entered into an agreement dated August 29, 1988 which addressed the accommodation that Amoco sought with APCJ and to obtain the approval of APCJ for the Plan of Arrangement (the "**Accommodation Agreement"**). The Accommodation Agreement is referred to as **Document 17** of the Agreed Book of Documents.

63. The Arrangement Agreement required that accommodation with ACPJ be reached and, as part of the accommodation, ACPJ required that Amoco became jointly and severally liable with Dome Petroleum and Encor under the Formal Contract.

64. The Accommodation Agreement was entered into by the parties with the understanding that a Plan of Arrangement was being executed, and it was necessary to fulfil the condition of Amoco in the Arrangement Agreement that an accommodation be reached with APCJ.

65. Pursuant to the Accommodation Agreement, among other things:

1. Amoco became a party to the Formal Contract and became jointly and severally liable with Dome Petroleum and Dome Canada (Encor) for their obligations under the Formal Contract;

2. Amoco and Dome Petroleum agreed to jointly and severally perform active exploration and development of Beaufort Sea Lands, as Lands was defined in the Formal Contract;

3. The parties confirmed that Dome Petroleum would acquire all of Encor's interest in the Lands (the "**Encor Lands"**);

4. Dome Petroleum would carry out active exploration and development of the Encor Lands, and the Encor Lands remained subject to the full obligations of the Formal Contract;

5. The parties acknowledged that the Accommodation Agreement did not release or vary any of Encor's obligations and liabilities to APCJ under the Formal Contract;

6. Remuneration under the Formal Contract was amended to be a 5% gross overriding royalty to the extent of gross production revenues from the Beaufort Sea exploration fields but only on Commencement of Production; and

7. With respect to the Exploration Loan, nothing in the Accommodation Agreement constituted the making of a new loan or· the effective repayment and readvance or the settlement or compromise of the Exploration Loan, and the obligation to repay the Exploration Loan remained in full force and effect and unamended in accordance with the terms of the Formal Contract.

8. If the Plan of Arrangement was not completed, the Accommodation Agreement would be null and void.

66. Amoco, Dome Petroleum and Encor entered into an "**Amending Agreement"** dated August 29, 1988, which agreement is referred to as **Document 18** of the Agreed Book of Documents. This Amending Agreement changed the date and time of the Accommodation Agreement to be effective. The new time was a result of the sequence of events as described/required by the Plan of Arrangement. The original time as indicated in the original Accommodation Agreement (8:00 a.m.) did not align with the rest of the finalized Plan of Arrangement steps, so the

time needed to be adjusted (to 10.55 a.m.) to meet the proper sequencing.

67. Amoco and APCJ signed a letter agreement dated August 29, 1998, which letter is referred to as **Document 19** of the Agreed Book of Documents. This letter agreement specified in more detail the exploration activities that Amoco would carry out to meet the obligations of Article 3.01 of the Accommodation Agreement.

68. Amoco and Dome Petroleum entered into an Indemnity Agreement dated August 31, 1988 (the "**Dome Indemnity Agreement"),** which document is referred to as **Document 20** of the Agreed Book of Documents.

69. Amoco and Dome Petroleum entered into the Dome Indemnity Agreement because, or partly because, as part of the Accommodation Agreement, ACPJ required that Amoco became jointly and severally liable with Dome Petroleum and Encor under the Formal Contract.

70. Pursuant to the Dome Indemnity Agreement, as between Dome Petroleum and Amoco, Dome Petroleum was to be liable for all obligations to pay the principal, Remuneration or other amounts payable under the Formal Contract for which Dome Petroleum was primarily liable. The Dome Indemnity Agreement further provided that if Amoco became liable to pay any such amount to APCJ, Dome Petroleum was required to indemnify Amoco.

71. The Dome Indemnity Agreement was to be effective when the Accommodation Agreement became effective and would be null and void if and when the Accommodation Agreement became null and void.

72. The Dome Indemnity Agreement and the Accommodation Agreement became effective at 10:55 a.m. on September 1, 1988.

73. The Plan of Arrangement was approved by the Alberta Court of Queen's Bench and made effective September 1, 1988. The Plan of Arrangement is referred to as **Document 21** of the Agreed Book of Documents.

74. Pursuant to the Plan of Arrangement, Amoco acquired Dome Petroleum for $5.2 billion CDN.

75. As part of the Plan of Arrangement, the following steps, amongst others, occurred:

a. Pursuant to Article 4.10 of the Plan of Arrangement, at 10:30 a.m., in accordance with the Settlement Agreement, Encor paid to Amoco the 17.5 Million Payment;

b. Pursuant to Article 4.15, at 10:55 am., a number of corporations were amalgamated and continued under the name Dome Petroleum;

c. Pursuant to Article 4.20 of the Plan of Arrangement, at 11:15 a.m., in accordance with the Settlement Agreement, Amoco paid $1.4 million to Encor and Encor's properties were transferred from Encor to Dome Petroleum pursuant to a Conveyance of Properties from Encor to Dome Petroleum, dated September 1, 1988, which Conveyance is referred to as **Document 22** of the Agreed Book of Documents.

76. As a result of the acquisition, Dome Petroleum became a wholly owned subsidiary of Amoco.

77. Amoco and Dome Petroleum entered into a reimbursement agreement made on 11:15 am of the effective date of the Plan of Arrangement, being September 1, 1988 (**"Reimbursement Agreement")**. The Reimbursement Agreement is referred to as **Document 23** of the Agreed Book of Documents.

78. The Reimbursement Agreement was made to require Dome Petroleum to reimburse Amoco for the $1.4 million that Amoco paid for Encor's interests in the Beaufort Sea (as required under 4.20(ii) of the Plan of Arrangement) but Amoco directed that the properties be transferred from Encor to Dome Petroleum.

79. Amoco and Encor entered into an agreement (the "**Encor Indemnity and Subrogation Agreement")** on the effective date of the Plan of Arrangement, being September 1, 1988. The Encor Indemnity and Subrogation Agreement is referred to as **Document 24** of the Agreed Book of Documents**.**

80. In the Encor Indemnity and Subrogation Agreement, it was acknowledged that Amoco and Encor were entering into this agreement to provide, pursuant to the Plan of Arrangement, for, amongst other things:

a. the assumption by Amoco of all duties, liabilities and obligations of Encor pursuant to the APCJ Documents (as that term was defined in the Encor Indemnity and Subrogation Agreement);

b. indemnification of Encor by Amoco against any and all liability pursuant to or in connection with the APCJ Documents; and

c. the subrogation of Amoco to all of Encor's rights under the APCJ Documents.

81. The consideration for the Indemnity and Subrogation Agreement was the $17.5 Million Payment from Encor to Amoco.

82. Pursuant to the Encor Indemnity and Subrogation Agreement, Amoco and Encor agreed that the agreement would terminate once Encor was released from the APCJ Documents.

83. Amoco, for tax purposes, treated the receipt of the $17.5 Million Payment received from Encor as a non-taxable capital receipt.

84. In 1989, Dome Petroleum amalgamated with another corporation and became Amoco Canada Resources ("**ACR").** ACR was a wholly-owned subsidiary of Amoco.

1992 Agreements

85. Amoco, ACR (as successor to Dome Petroleum), Encor and APCJ entered into an amendment agreement on February 28, 1992, and stated to be effective on September 1, 1988, (the **"1992 Amendment Agreement"**) which is referred to as **Document 25** of the Agreed Book of Documents. The 1992 Amendment Agreement was made because the Accommodation Agreement, made August 29, 1988 was a side agreement between the parties to amend the original Formal Contract. The purpose of the 1992 Amendment Agreement was to set forth the amendments to the Formal Contract that resulted from the Accommodation Agreement and to clarify the intent of the Accommodation Agreement in relation to the Formal Contract.

86. Amoco, ACR, Encor and APCJ entered into a release agreement dated February 28, 1992 ("**Release Agreement**"), which is referred to as **Document 26** of the Agreed Book of Documents.

87. The Release Agreement provided that Encor ceased to be a party to the APCJ Contracts, as APCJ Contracts was defined in the Release Agreement; that APCJ released Encor from its obligations, claims and liabilities under the APCJ Contracts; and that Encor acknowledged that APCJ owed no obligations to Encor.

88. Amoco, ACR and Encor also entered into an agreement titled **"Termination of Amoco Indemnity"** dated February 28, 1992, which agreement is referred to as **Document 27** of the Agreed Book of Documents.

89. Pursuant to the Termination of Amoco Indemnity, the parties agreed that, amongst other things,

1. the Encor Indemnity and Subrogation Agreement was terminated;
2. Amoco and Encor each released each other from their obligations and liabilities under the Encor Indemnity Agreement; and
3. Amoco and ACR released Encor from any claims, obligations, duties and liabilities arising out of the APCJ Contracts.

<u>General</u>

90. Neither party is aware of the whereabouts of any of the key persons directly involved with: the negotiations in 1980 or 1981 of the Formal Contract; the signing of the Formal Contract; the acquisition by Amoco of Dome Petroleum; the negotiation and signing of the 1987/1988 Agreements referred to in this Partial Agreed Statement of Facts; the negotiation and signing of agreements between APCJ, Amoco, Encor and Dome Petroleum's successor in 1992.

<u>Subsequent Events</u>

91. There has been no commercial production in the Beaufort Sea in accordance with the Formal Contract to date.

92. The appellant, and its predecessors, have not paid any amount to APCJ to repay the $400,000,000 Amount advanced under the Formal Contract or paid any amount to APCJ as Remuneration or as interest.

93. No party to the Formal Contract or Accommodation Agreement has paid any of the $400,000,000 Amount or paid Remuneration to APCJ as Remuneration is defined in the Formal Contract or Accommodation Agreement and no interest has been paid to APCJ by any of the parties to the Formal Contract or Accommodation Agreement.

Amoco's Tax Treatment and the Minister's Treatment

94. In each of the 1995 and 1996 taxation years, for the purpose of computing its income tax, Amoco deducted $4,788,456, computed as follows:

   a. Amount of Expense to Maturity = $207,500,00 ($225,000,000 minus $17,500,000)

   b. Number of Years to Maturity = 43.33 (September 1, 1988 to December 31, 2030);

   c. Number of Months to Maturity = 520 (43.33 years x 12 months/year);

   d. Expense per Month = $399,038 ($207,500,000 divided by 520); and

   e. Expense per Year = $4,788,456 ($399,038 x 12).

95. The Minister did not allow any deduction for the amount claimed by Amoco.

96. BP Canada Group ULC on behalf of the Appellant filed Notices of Objection to Loss Determinations for 1995 and 1996, which Notices of Objection is referred to as **Documents 28 and 29** respectively of the Agreed Book of Documents.

AGREED as to form and content June ____, 2017	AGREED as to form and content June ____, 2017
OSLER, HOSKIN & HARCOURT LLP	**ATTORNEY GENERAL OF CANADA**
Per: ______________________________	Per: ______________________________
Counsel to Plains	Counsel for Her Majesty the

Midstream (successor to BP Canada Energy Company)	Queen

CITATION:	2017 TCC 207
COURT FILE NO.:	2012-4907(IT)G 2013-1522(IT)G
STYLE OF CAUSE:	PLAINS MIDSTREAM CANADA ULC v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Calgary, Alberta
DATE OF HEARING:	June 20, 21 and 22, 2017
REASONS FOR JUDGMENT BY:	The Honourable Justice Robert J. Hogan
DATE OF JUDGMENT:	October 6, 2017

APPEARANCES:

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