Docket: 2007-133(IT)G

BETWEEN:

DOW CHEMICAL CANADA INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on June 5, 2007, at Calgary, Alberta

By: The Honourable Justice M.A. Mogan

Appearances:

Counsel for the Appellant:	Michel Bourque
Counsel for the Respondent:	Bonnie F. Moon

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2001 taxation year is allowed, with costs, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Disputed Amount ($30,990,628) is not to be included in the computation of income.

Signed at Ottawa, Canada, this 1st day of November, 2007.

"M.A. Mogan"

Mogan D.J.

Citation: 2007TCC668
Date: 20071101
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BETWEEN:

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Appellant,

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REASONS FOR JUDGMENT

Mogan D.J.

[1] The Appellant Corporation was formed on October 1, 2001 when two predecessor corporations amalgamated under the provisions of the *Canada Business Corporations Act*. The Appellant's first taxation year began on October 1, 2001 and ended on December 31, 2001. When the Appellant filed its income tax return for that first taxation year, it reported a net loss for income tax purposes of $35,066,100 and a current-year non-capital loss of $61,604,100.

[2] By Notice of Reassessment dated June 29, 2004, the Minister of National Revenue (the "Minister") adjusted the net income reported by the Appellant for its first taxation year by including the amount of $30,990,628 identified as "unpaid amounts". The Appellant has appealed from that reassessment and claims that the amount $30,990,628 should not be included in computing income for its first taxation year. The only issue in this appeal is whether the Minister is permitted, under subsection 78(1) of the *Income Tax Act*, to include the amount $30,990,628 (the "Disputed Amount") in computing the income of a newly amalgamated corporation (the Appellant) for its first taxation year. There is no mid-way point. The Disputed Amount is either included or excluded.

[3] When the hearing commenced, counsel for both parties filed a Statement of Agreed Facts containing 29 numbered paragraphs and a Joint Book of Documents (18 tabs) containing the documents referred to in the Statement of Agreed Facts ("SAF"). The SAF is Exhibit 1 and the Joint Book of Documents is Exhibit 2. No witness was called to give oral testimony. Exhibits 1 and 2 are the only evidence before the Court. Counsel proceeded directly to argument. Set out below is the complete SAF as in Exhibit 1:

> **A. The Parties**
>
> 1. The Dow Chemical Company ("Dow") was incorporated in 1897 under the laws of the State of Michigan and reorganized in 1947 under the laws of the State of Delaware. A copy of Dow's Restated Certificate of Incorporation as filed on May 18, 2004 is cont6ained in the Joint Book of Documents as Tab 1.
>
> 2. Dow Chemical Canada Inc. ("DCCI") (formerly Dow Chemical of Canada, Limited) was incorporated under the *Canada Business Corporations Act* ("CBCA") on June 5, 1942. A copy of the Letters Patent incorporating DCCI dated June 5, 1942 is contained in the Joint Book of Documents at Tab 2.
>
> 3. Prior to October 1, 2001, Dow held all of the shares of DCCI. A copy of DCCI's shareholder register up to April 30, 1990 is contained in the Joint Book of Documents at Tab 3. For greater certainty, the parties agree that Dow held all of the shares of DCCI up to October 1, 2001 even though the last entry on Tab 3 is dated April 30, 1990.
>
> 4. Union Carbide Corporation ("UCC") was incorporated on November 1, 1917 under the laws of the State of New York. A copy of the Restated Certificate of Incorporation of UCC as filed June 25, 1998 is contained in the Joint Book of Documents at Tab 4.
>
> 5. Union Carbide Canada Inc. ("UCCI") (formerly 965089 Ontario Limited and Union Carbide Chemicals and Plastics Canada Inc.) was incorporated on November 27, 1991 under the lass of the Province of Ontario. A copy of the Articles of Incorporation of 956089 Ontario Limited [*sic*] dated November 27, 1997, copies of all subsequent Articles of Amendment, and a copy of the Articles of Continuance under the CBCA dated September 10, 2001 are all contained in the Joint Book of Documents at Tab 5.
>
> 6. Union Carbide Canada Finance Inc. ("UCCFI") was incorporated on November 18, 1998 under the Alberta *Business Corporations Act*. A copy of the Certificate of Incorporation dated November 18, 1998 is contained in the Joint Book of Documents at Tab 6.

7. On February 6, 2001, Dow acquired control of UCC ("Acquisition of Control").

8. Prior to February 6, 2001, neither Dow nor DCCI was related to UCC or UCCI.

9. On September 10, 2001, UCCI was continued under the provisions of the CBCA.

10. On October 1, 2001, UCCI and DCCI amalgamated under the provisions of the CBCA ("Amalgamation"). The amalgamated entity retained the name Dow Chemical Canada Inc. (Amalco") and a copy of the Certificate of Amalgamation and the Articles of Amalgamation dated October 1, 2001 is contained in the Joint Book of Documents at Tab 7. Amalco is the Appellant in this appeal.

B. Loan Transaction Giving Rise to Issue in Appeal

11. On December 28, 1998, UCC and UCCI entered into an inter-company loan agreement ("Loan") under which UCCI could borrow up to $1,000,000,000 ($CDN) from UCC at a rate of interest of six-month-Libor plus one hundred basis points payable semi-annually. A copy of the Loan is contained in the Joint Book of Documents at Tab 8.

12. On or about March 30, 1999, UCC assigned its interest in the Loan to UCCFI ("Assignment"). A copy of the Assignment is contained in the Joint Book of Documents at Tab 9.

13. At the time UCC and UCCI entered into the Loan as well as at the time UCC assigned the Loan to UCCFI, each of UCC, UCCI and UCCFI was related to each other within the meaning of subsection 251(2) of the *Income Tax Act* (the "*Act*").

14. None of the terms of the Loan, including but not limited to the amount of the Loan, the maturity date of the Loan, and the amount payable on the maturity of the Loan, were changed as a result of the Assignment or the Amalgamation.

15. For the taxation year ending December 31, 2000, UCCI deducted interest in the amount of $30,990,627 under paragraph 20(1)(*c*) of the *Act* in respect of interest accrued on the Loan for the 2000 calendar year (2000 Interest Amount").

16. In the 2001 calendar year, UCCI had taxation years

(a) from January 1, 2001 to February 6, 2001; and

(b) from February 7, 2001 to September 30, 2001.

17. Amalco's first taxation year began on October 1, 2001 and ended on December 31, 2001 ("Amalco's 2001 Taxation Year").

18. At all material times, the 2000 Interest Amount was unpaid and remained outstanding.

C. Assessments, Reassessments and Determinations Leading to the Appeal

19. Amalco mailed its return of income for purposes of Part I of the *Act* for its taxation year ending December 31, 2001 and the Minister of National Revenue received the return of income on or about July 2, 2002 (the "2001 Filed Return"). A copy of Amalco's T2 Corporation Income Tax Return for the taxation year 2001-10-01 to 2001-12-31 is contained in the Joint Book of Documents as Tab 10.

20. In its 2001 Fled Return, Amalco reported, *inter alia*, a net loss of $35,066,100 and a current-year non-capital loss of $61,604,100.

21. On October 25, 2002, the Respondent issued a Corporation Notice of Assessment in which the Respondent revised Amalco's current-year non-capital loss to $61,596,430. A copy of the Corporation Notice of Assessment dated October 23, 2002 is contained in the Joint Book of Documents at Tab 11.

22. On June 16, 2004, the Respondent made adjustments to the 2001 Filed Return and issued a T7W-C indicating revised net income of $17,156,489 and revised taxable income of nil for purposes of Part I of the *Act*. A copy of the T7W-C dated June 16, 2004 is contained in the Joint Book of Documents at Tab 12. One of the adjustments was the addition of the 2000 Interest Amount referred to in paragraphs 15 and 18 above and this is the adjustment that is under appeal. The Respondent also made other adjustments to Amalco's tax under Parts I and I.3 of the *Act* and those adjustments are not relevant to this appeal.

23. On June 29, 2004, the Respondent issued a Notice of Reassessment in respect of Amalco's 2001 Taxation Year to reflect the adjustments described in the preceding paragraph ("Reassessment"). The Reassessment in respect of Amalco's tax under Part 1 of the *Act* indicated nil tax payable. A copy of the Reassessment is contained in the Joint Book of Documents at Tab 13.

24. On September 28, 2004, Amalco filed a Notice of Objection to the Reassessment. A copy of the Notice of Objection is contained in the Joint Book of Documents at Tab 14.

25. On April 5, 2006, the Respondent issued a Notification of Confirmation by the Minister by which the Respondent confirmed the Reassessment including the adjustments resulting in nil tax payable under Part I of the *Act*. A copy of the Notification of Confirmation is contained in the Joint Book of Documents at Tab 15.

26. On or about June 30, 2006, Amalco made a request pursuant to subsection 152(1.1) of the *Act* for the Respondent to determine the amount of Amalco's losses under Part I of the *Act* for Amalco's 2001 Taxation Year. A copy of the request is contained in the Joint Books of Documents at Tab 16.

27. On July 26, 2006, the Respondent issued a Notice of Determination of Amalco's losses for Amalco's 2001 Taxation Year (the "Determination"). The Respondent determined Amalco's current-year non-capital loss to be in the amount of $9,381,511 and that the amount of the 2000 Interest Amount was one of the items that reduced Amalco's current-year non-capital loss for Amalco's 2001 Taxation Year. A copy of the Determination is contained in the Joint Book of Documents at Tab 17.

28. On or about August 30, 2006, Amalco served the Respondent with a Notice of Objection to the Determination. A copy of the Notice of Objection dated August 30, 2006 is contained in the Joint Book of Documents at Tab 18.

29. More than 90 days elapsed from the time Amalco served the Respondent with the Notice of Objection to the Determination to the time Amalco filed a Notice of Appeal in this Honourable Court.

[4] The documents in Exhibit 2 which I have read support the facts set out in the SAF. Therefore, I will decide this appeal only on the SAF subject to certain comments on the Notices of Objections at Tabs 14 and 18 in Exhibit 2. Because there are no facts in dispute, the decision will depend upon the interpretation and application of certain provisions of the *Income Tax Act* (the "*Act*"). In this appeal, the most important provision is paragraph 78(1)(*a*):

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

(*b*) … (not relevant)

[5] The purpose of paragraph 78(1)(*a*) is to limit the period of time when a deductible expense (like interest, rent or royalty) may be accrued (and not paid) if a debtor taxpayer and creditor are not at arm's length, unless the amount accrued is later paid within a reasonable time. Under subsection 78(1), the reasonable time is the debtor taxpayer's two taxation years following the taxation year in which the deductible expense was accrued.

[6] Paragraph 11 of the SAF describes a loan agreement between Union Carbide Corporation ("UCC") (a large corporation in the USA) and Union Carbide Canada Inc. ("UCCI") (an Ontario corporation). Paragraph 12 of the SAF describes the assignment of the loan agreement by UCC to Union Carbide Canada Finance Inc. ("UCCFI") (an Alberta corporation). The SAF does not state who owned the issued shares of UCCI or UCCFI at any time but I infer that both UCCI and UCCFI were, directly or indirectly, wholly owned subsidiaries of UCC. In any event, paragraph 13 of the SAF states that UCC, UCCI and UCCFI were related to each other (i.e. were not at arm's length) under the *Act* at all relevant times.

[7] Because UCCI and UCCFI were not at arm's length throughout the calendar year 2000, the Disputed Amount ($30,990,628), accrued and deducted by UCCI when computing income for 2000, was a deductible expense that satisfied the conditions of subsection 78(1). In other words, as of December 31, 2000, the clock was running with respect to UCCI under subsection 78(1) as to whether it would pay the Disputed Amount before the end of the second taxation year following 2000.

[8] There were two events which, under the *Act*, caused UCCI to have shortened taxation years in the first nine months of the calendar year 2001. First, Dow Chemical Company ("Dow") acquired control of UCC on February 6, 2001 (SAF paragraph 7). Under subsection 249(4), acquisition of control of a corporation changes the end of the taxation year in which control is acquired:

> 249(4) Where at any time control of a corporation (other than a corporation that is a foreign affiliate of a taxpayer resident in Canada and that did not carry on a business in Canada at any time in its last taxation year beginning before that time) is acquired by a person or group of persons, for the purposes of this *Act*,

> (*a*) subject to paragraph (c), the taxation year of the corporation that would, but for this paragraph, have included that time shall be deemed to have ended immediately before that time;
>
> (*b*) a new taxation year of the corporation shall be deemed to have commenced at that time;

As a consequence of subsection 249(4), the first taxation year of UCCI following the calendar year 2000 was the period January 1 to February 6, 2001.

[9] The second event which caused UCCI to have a shortened taxation year in 2001 was its amalgamation with Dow Chemical Canada Inc. ("DCCI") on October 1, 2001 (SAF paragraph 7). Under paragraph 87(2)(*a*), when two or more corporations amalgamate, the taxation years of the predecessor corporations come to an end at the time of amalgamation.

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

As a consequence of paragraph 87(2)(*a*), the second taxation year of UCCI following the calendar year 2000 was the period February 7 to September 30, 2001.

[10] The two events which caused UCCI to have shortened taxation years in the early months of calendar year 2001 are recognized in paragraphs 7, 10 (first sentence) and 16 of the SAF which state:

> 7. On February 6, 2001, Dow acquired control of UCC ("Acquisition of Control").
>
> 10. On October 1, 2001, UCCI and DCCI amalgamated under the provisions of the CBCA ("Amalgamation"). …

16. In the 2001 calendar year, UCCI had taxation years

(a) from January 1, 2001 to February 6, 2001; and

(b) from February 7, 2001 to September 30, 2001.

[11] The fact that the Disputed Amount was unpaid and remained outstanding at all material times (SAF paragraph 18) brings into play subsection 78(1) with respect to UCCI. The Appellant Corporation was formed on October 1, 2001 when UCCI and DCCI amalgamated; and the Appellant retained the name of one of its predecessor corporations. The issue, restated from paragraph 2 above, is whether the Disputed Amount must be included in income in the Appellant's first taxation year which was from October 1, to December 31, 2001.

Arguments of counsel

[12] Counsel for the Appellant argued that subsection 78(1) cannot apply to an amalgamated corporation (like the Appellant) if it is formed prior to the last day of what would otherwise be the second taxation year following the taxation year in which a predecessor corporation became indebted in the circumstances described in that subsection. Within the terms of subsection 78(1), there is no "third taxation year" of UCCI in which the Disputed Amount may be included in computing UCCI's income. Subsection 78(1) should be interpreted with respect to a particular person (UCCI) for which three subsequent taxation years can be identified. UCCI did not have three taxation years after December 31, 2000.

[13] For subsection 78(1) to apply, the debtor and creditor must be persons "not dealing at arm's length" at the time the deductible expense was incurred and at the end of the second taxation year following the taxation year in which the deductible expense was incurred. On the facts of the appeal, the Appellant (as a newly amalgamated corporation) cannot have had any relationship (arm's length or non-arm's length) with the creditor, UCCFI, in the calendar year 2000 when the deductible expense was incurred.

[14] Counsel for the Respondent argued that subsection 87(7), standing alone, is sufficient to uphold the assessment under appeal. The only relevant part of subsection 87(7) follows:

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

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

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

the provisions of this *Act*

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

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

[15] In particular, the Respondent relies on paragraph 87(7)(*d*) to uphold the assessment. Under that paragraph, when a debt of a predecessor corporation becomes a debt of the amalgamated corporation, other provisions of the *Act* apply "as if" the amalgamated corporation had incurred the debt (i) at the time it was incurred by the predecessor corporation; and (ii) under the terms of the predecessor corporation's debt agreement. Even if the amalgamated corporation is "new", it stands in the shoes of its predecessor debtor corporation with respect to the terms of an inherited debt.

[16] The "provisions of this *Act*" referred to immediately after paragraph 87(7)(*b*) include section 78 which requires a deductible expense, incurred but not paid, to be included in the debtor's income if still unpaid after a reasonable time. It is an important condition of section 78 that the debtor taxpayer and creditor be "not dealing at arm's length" at the time when the expense is incurred and at the end of the second taxation year following that time.

[17] The Respondent argues that either subsection 251(3.1) or 251(3.2) will cause the Appellant to be deemed to have been related to its predecessor corporations (in particular, UCCI) immediately before the amalgamation.

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

251(3.2) Where there has been an amalgamation or merger of 2 or more corporations each of which was related (otherwise than because of a right referred to in paragraph 251(5)(*b*)) to each other immediately before the amalgamation or merger, the new corporation formed as a result of the amalgamation or merger and each of the predecessor corporations is deemed to have been related to each other.

Analysis

[18] I find no ambiguity in section 78. The object and purpose of that section are clear. I do find ambiguity in section 87. Specifically, it is difficult for me to determine whether the provisions of paragraph 87(2)(*a*) and subsection 87(7) impose upon a newly amalgamated corporation an obligation under paragraph 78(1)(*a*) to include an amount in income which, but for the amalgamation, would be included in the income of a predecessor corporation.

[19] There is significant merit in the arguments of each party. For the Respondent, subsection 87(7) is aimed at the circumstances of this appeal where a debt of a predecessor corporation has become a debt of the amalgamated corporation. Paragraph 87(7)(*c*) provides a tax-free rollover for the transfer of the debt to the amalgamated corporation; and paragraph 87(7)(*d*) applies "the provisions of this *Act*" as if the amalgamated corporation had incurred the debt when it was incurred by the predecessor corporation. The provisions of this *Act* would, of course, include section 78.

[20] The rule in paragraph 87(2)(*a*) is worth repeating:

(*a*) for the purposes of this *Act*, the corporate entity formed as a result of the amalgamation shall be deemed to be a new corporation the first taxation year of which shall be deemed to have commenced at the time of the amalgamation, and a taxation year of a predecessor corporation that would

> otherwise have ended after the amalgamation shall be deemed to have ended immediately before the amalgamation;

I note in paragraph (*a*) that a taxation year of a predecessor corporation is "deemed to have ended immediately before the amalgamation" but a predecessor corporation itself is not deemed to have ended upon amalgamation.

[21] An important condition in subsection 78(1) is that the debtor of the deductible expense be not at arm's length with the creditor at the time the expense was incurred. Subsection 251(3.1) seems to answer the related persons (i.e. non-arm's length) question with respect to the Appellant and UCCI "immediately before the amalgamation" because Dow was the controlling shareholder of both predecessor corporations at that time, and Dow was the controlling shareholder of the Appellant "immediately after the amalgamation". Under paragraph 251(1)(*a*), related persons are deemed not to deal at arm's length; and under paragraph 251(2)(*c*), any two corporations are related if they are controlled by the same person.

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

[23] Under the statutory provisions reviewed in paragraphs 21 and 22 above, can it be said that the Appellant, even in a hypothetical sense, was related to and, therefore, not at arms' length with UCCFI in the calendar year 2000 when the Disputed Amount was incurred and accrued? It seems to me that the plain language of subsection 87(7) and the arm's length provisions of section 251 do not justify such a determination.

[24] The plain language of subsection 87(7) covers all debts of a predecessor corporation (on revenue account and on capital account) which become debts of the amalgamated corporation. Section 78 is concerned only with deductible expenses when the debtor taxpayer and the creditor are not at arm's length. With respect to all kinds of debt, section 78 is aimed at a narrow target but subsection 87(7) is aimed at a much wider target. I have no reason to conclude that subsection 87(7) was drafted with section 78 in mind. Indeed, if subsection 87(7)

was drafted to bring the concept of section 78 within the rules of amalgamating corporations, I would expect to find additional language in subsection 87(7) much closer to the language of section 78.

[25] Subsection 78(1) refers to a debtor taxpayer who "was not dealing at arm's length" with the creditor "at the time the expense was incurred". Although subsection 87(7) makes no reference to persons not dealing at arm's length, the rules in subsections 251(3.1) and (3.2) cause a newly amalgamated corporation to be deemed to have been related to a predecessor corporation "immediately before the amalgamation" if certain conditions are met. I am satisfied that the conditions in subsection 251(3.1) are met; and that the conditions in subsection 251(3.2) are also met. Therefore, the Appellant is "deemed to have been related to" (and not at arm's length with) both UCCI and DCCI immediately before the amalgamation.

[26] There is, however, a significant distinction between (i) a deemed non-arm's length relationship between the Appellant and each of UCCI and DCCI immediately before the amalgamation, and (ii) whether the Appellant and UCCFI (the creditor) can be deemed to have been related persons back in the calendar year 2000, before Dow acquired control of UCC, and when UCCI and DCCI were at arm's length. In my opinion, the "deeming" rules in subsections 251(3.1) and (3.2) do not cause the Appellant to be related to UCCI or UCCFI back in the calendar year 2000, relatively remote from the time of amalgamation, when UCCI was very much at arm's length with Dow and DCCI.

[27] Following my interpretation of section 87, I have concluded that this appeal must be allowed because the Appellant does not satisfy one of the basic conditions in subsection 78(1). Specifically, the Appellant (upon amalgamation, having inherited the Disputed Amount as a debt of UCCI) was not related to UCCI or UCCFI, in fact or by any deeming rule, during the calendar year 2000 when the Disputed Amount was incurred as a debt of UCCI owing to UCCFI.

[28] There are three propositions which support the conclusion I have just expressed in paragraph 27. First, the assessment under appeal is not consistent with the object and purpose of section 78. Second, there is a distinction between a newly amalgamated corporation and its predecessor corporations. And third, there is a gap in the legislation. I will consider these propositions in order.

[29] First, section 78 provides a period of two taxation years within which the debtor taxpayer may in fact pay the deductible expense before it is included in income for the third taxation year. See paragraph 78(1)(*a*). A taxation year of a

corporation is ordinarily 12 months or at most 53 weeks. See subsections 249(1) and 249.1(1). The first two taxation years of UCCI (the debtor corporation) after December 31, 2000 were shortened by Dow's acquisition of control of UCC on February 6, 2001; and by the amalgamation of UCCI and DCCI on October 1, 2001. See paragraphs 8, 9 and 10 above.

[30] In a hypothetical sense, if Dow had not acquired control of UCC and if there had been no amalgamation, UCCI would have had available the calendar years 2001 and 2002 to pay all or part of the deductible expense to UCCFI before any unpaid amount could be included in income "for the third taxation year" under paragraph 78(1)(*a*). The Appellant and Respondent are in agreement that in the first nine months of 2001, UCCI had two taxation years (SAF paragraph 16).

[31] The Minister relies upon the change of control on February 6, 2001 and the amalgamation on October 1, 2001 to reset the clock with respect to the two taxation years referred to in subsection 78(1). The Appellant acknowledges the two abbreviated taxation years in the first nine months of 2001, but argues (i) that the original debtor taxpayer in subsection 78(1) did not survive the amalgamation to have a third taxation year after September 30, 2001 in which any unpaid amount could be included in income; and (ii) that the Appellant cannot be deemed to have been related to UCCFI in the calendar year 2000 when the deductible expense was incurred.

[32] In *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, [2006] 1 S.C.R. 715, the Supreme Court of Canada restated its position on the interpretation of tax statutes. LeBel J. writing for a unanimous Court stated at paragraphs 23 and 24:

> 23 … Where, as in this case, the provision admits of more than one reasonable interpretation, greater emphasis must be placed on the context, scheme and purpose of the *Act*. Thus, legislative purpose may not be used to supplant clear statutory language, but to arrive at the most plausible interpretation of an ambiguous statutory provision.
>
> 24 Although there is a residual presumption in favour of the taxpayer, it is residual only and applies in the exceptional case where application of the ordinary principles of interpretation does not resolve the issue: *Notre-Dame de Bon-Secours*, at p. 19. …

[33] In my view, the relevant parts of section 87 admit of more than one reasonable interpretation; and the application of ordinary principles of

interpretation does not resolve the issue. The assessment under appeal runs against what I regard as the context, scheme and purpose of section 78 when it (the assessment) allows only nine months to pay the deductible expense. Also, the assessment runs against the residual presumption in favour of the taxpayer.

[34] Second, with respect to the distinction between a newly amalgamated corporation and its predecessor corporations, I refer to the decision of the Federal Court of Appeal in *The Queen (Appellant) v. Pan Ocean Oil Ltd. (Respondent)*, 94 DTC 6412. The corporate taxpayer ("Pan Ocean") was formed by the amalgamation of two Alberta corporations identified as "ALBERTA" and "POOL". The latter corporation (POOL) was itself formed by a number of mergers through which it became the holder of certain oil and gas properties inherited from a prior company. The prior company had incurred Canadian exploration expenses ("CEE") prior to 1972. Pan Ocean attempted to deduct certain of those exploration expenses in its 1974 and 1975 taxation years.

[35] In 1971 and 1972, POOL had deducted in computing income part of the CEE inherited from the prior company. As such, POOL was a "second successor corporation" within the meaning of subsection 83A(8*d*) of the pre-1972 *Act*. The relevant legislation (the new post-1971 *Act* and transitional rule) did not permit the deduction of CEE by a third or subsequent successor corporation. The issue was whether Pan Ocean was a second successor corporation and thereby entitled to the CEE deduction.

[36] When allowing the Crown's (i.e. Revenue Canada) appeal, Hugessen J.A. writing for the Federal Court of Appeal, stated at page 6416:

> Applying the law as I understand it to the facts of the present case, it is clear that this appeal must succeed. It is common ground that POOL was a second successor corporation and that the amalgamation of POOL and ALBERTA is governed by section 87. That being so, the respondent is, for tax purposes, deemed to be a new corporation whose first taxation year is deemed to have commenced at the time of the amalgamation. As a new corporation, the respondent manifestly is not POOL, whatever the situation may be under ordinary corporate law principles.
> …

[37] I will apply the above words of the Federal Court of Appeal to the facts of this case. As a newly amalgamated corporation, the Appellant manifestly is not UCCI. Accordingly, the Appellant's first taxation year from October 1 to December 31, 2001, cannot be regarded as UCCI's "third taxation year" within the meaning of paragraph 78(1)(*a*).

[38] Third, is there a gap in the legislation? Section 87 of the *Act* establishes rules for the amalgamation of two or more Canadian corporations. Section 88 of the *Act* establishes rules for the winding-up of a Canadian subsidiary corporation into its Canadian parent corporation. For convenience, some of the rules in section 87 are incorporated by reference into section 88. The relevant words in paragraph 88(1)(*e*.2) are as follows:

> 88(1) Where a taxable Canadian corporation (in this subsection referred to as the "subsidiary") has been wound up after May 6, 1974 and not less than 90% of the issued shares of each class of the capital stock of the subsidiary were, immediately before the winding-up, owned by another taxable Canadian corporation (in this subsection referred to as the "parent") … the following rules apply:
>
> (*e.2*) paragraphs 87(2)(*c*), 87(2)(*d*.1), 87(2)(*e*.1), 87(2)(*e*.3), 87(2)(*g*) to 87(2)(l), 87(2)(l.3) to 87(2)(*u*), 87(2)(*x*), 87(2)(*z*.1), 87(2)(*z*.2), 87(2)(*aa*), 87(2)(*cc*), 87(2)(*ll*), 87(2)(*nn*), 87(2)(*pp*), 87(2)(*rr*), 87(2)(*tt*) and 87(2)(*uu*), subsection 87(6) and, subject to section 78, subsection 87(7) apply to the winding-up as if the references in those provisions to …

[39] I was concerned with whether the words in paragraph 88(1)(*e*.2) "and, subject to section 78, subsection 87(7) apply to the winding-up" might be an indication that the concept in section 78 was intended to be incorporated into subsection 87(7). After reviewing submissions from counsel, I have concluded that the phrase "subject to section 78" is included in paragraph 88(1)(*e*.2) only because subsection 78(2) contains a specific rule for the winding-up of a corporate taxpayer which has incurred a deductible expense owing to a non-arm's length person, and that expense is unpaid when the corporate taxpayer is wound up. The words in subsection 78(2) illustrate the Minister's problem in this appeal:

> 78(2) Where an amount in respect of a deductible outlay or expense that was owing by a taxpayer that is a corporation to a person with whom the taxpayer was not dealing at arm's length is unpaid at the time when the taxpayer is wound up, and the taxpayer is wound up before the end of the second taxation year following the taxation year in which the outlay or expense was incurred, the amount so unpaid shall be included in computing the taxpayer's income for the taxation year in which it was wound up.

[40] Subsection 78(2) teaches me that the *Act* has anticipated the winding–up of a corporate taxpayer which has incurred but not paid a deductible expense within the context of subsection 78(1). What is absent from the *Act* is a corresponding provision to anticipate the amalgamation of a corporate taxpayer which has incurred but not paid a deductible expense within the context of subsection 78(1). There is ample authority for the proposition that the Courts should not attempt to fill a gap in legislation. See *Trans World Oil & Gas Ltd. v. The Queen*, [1995] 1 C.T.C. 2087 at paragraph 32.

[41] When the Appellant served upon the Minister the Notice of Objection dated August 25, 2006 (Exhibit 2, Tab 18), paragraph 33 of that Objection concluded with the following words:

> … Although the 2000 Interest Amount was unpaid on December 31, 2001, subsection 78(1) requires that it remain unpaid at the end of the second taxation year, which, in the case of Amalco, ended on December 31, 2002. The 2000 Interest Amount could then only be included in Amalco's third taxation year which ended on December 31, 2003.

[42] During argument, I asked counsel for the Appellant (who served the Notice of Objection) if his interpretation of section 87 were to be accepted, would the Appellant ever be required to include the Disputed Amount in income. He said possibly not but added, quite rightly, that we did not need to answer that question in order to decide this appeal. I agree that my question during argument was only hypothetical. The appeal for the Appellant's 2001 taxation year is allowed, with costs, on the basis that the Disputed Amount ($30,990,628) is not to be included in the computation of income.

Signed at Ottawa, Canada, this 1st day of November, 2007.

"M.A. Mogan"

Mogan D.J.

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REASONS FOR JUDGMENT BY:	The Honourable Justice M.A. Mogan
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