CURRENT DEVELOPMENTS IN OIL & GAS INCOME TAXATION

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Federal income taxation is an area of increasing concern to the resource industry. The author deals with current developments in the taxation field as they affect the oil and gas industry. This paper provides a general over-view of 1973 and 1974 case law and departmental bulletins, and possible future effects of, and questions concerning, some of the May 6, 1974 Budget proposals, as they relate to the oil and gas industry.

I was asked earlier this year if I would prepare a paper dealing with current developments in the taxation field and volunteered on the two premises that there would not be a lot of changes or developments once the last energy conference was concluded and that I would have only a short time slot for delivery. It appears that between Victoria, Edmonton, Regina and Ottawa, not necessarily in that order, the first premise is unsound and somehow the organizers of the conference have succeeded in rendering unsound the second premise as well.

The paper will attempt to deal with three principal areas, each in a general way, and details will be left to the footnotes for participants to further explore. The areas to be examined consist of case law in 1973 and 1974, departmental bulletins published in 1973 and 1974, and last, but not least, the effect of some of the changes proposed in the May 6, 1974 Budget.

PART 1 — Case Law

There are a number of cases reported in the last 18 months which have a bearing on resource industry income taxation at the federal level as follows:

Subleases and Similar Transactions:

M.N.R. v. *Clifford Clark*[1]

This is a farming case but may be relevant to the sublease question. In this case, the Court found as facts that Mr. Clark bought cattle near the end of his tax year with an understanding that he would re-sell back to his vendor *after his tax year end* at the same price less commission. It was argued that the Act gave a deduction for cattle purchased as incentives to farmers and hence deductibility followed automatically. On this point the Court, in contrast with the lower Court, found that no deduction was to be permitted and stated the following:

> Counsel for the defendant stressed that the Income Tax Act contains many special provisions whereby concessions are made to farmers. That is so. Farmers are permitted to average their income over a period of five years, they compute their income on a cash basis with special provision being made for delayed wheat payments and for accelerated capital cost allowances.
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> These are special provisions applicable to farmers but the existence of those special provisions does not make general section 12(1)(a) and 137, which are applicable to all taxpayers, inapplicable to farmers.
> Section 12(1)(a) provides as follows:

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[1] (1974) D.T.C. 6242 (Fed. Ct. — Trial Div.).

> 12(1) In computing income, no deduction shall be made in respect of
> (a) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer, . . .
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> It was contended on behalf of the defendant, as I understood the contention, that legal tax reduction is a business end in itself and accordingly because the defendant was admittedly a farmer the transactions in which the defendant engaged as above described were farming transactions and as such were deductible expenses incurred by him. . . .
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> There is no impediment to a taxpayer from so arranging his affairs in accordance with the law as enacted so as to attract a minimum of tax. However, in the present appeal it is crystal clear that the outlay the defendant made in the purchase of cattle in his 1966 and 1967 years and the immediate resale in the next succeeding taxation years to the vendor at the same price by pre-arrangement was for the sole purpose of reducing his tax in those years and was not laid out for the purpose of gaining or producing income from his business of farming within the meaning of section 12(1)(a).

In addition the Court considered the Crown's alternate argument that the deduction, if allowed, would artificially reduce income and as such was to be disallowed under section 137(1) of the Act. On this point the Court stated:

> In view of the conclusion I have reached it is not necessary to express an opinion on the other ground upon which counsel for the plaintiff relied, that is, that the sums of $9,595 and $11,042.39 which the defendant claimed as deductions in his 1966 and 1967 taxation years are not properly deductible since they are expenses which would unduly or artificially reduce the defendant's income in those years contrary to section 137(1) of the Income Tax Act which reads:
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> 137(1) In computing income for the purposes of this Act, no deduction may be made in respect of a disbursement or expense made or incurred in respect of a transaction or operation that, if allowed, would unduly or artificially reduce the income.
>
> If, contrary to the view I have expressed, I had accepted the defendant's submission that the transactions were not ones to which section 12(1)(a) applied, then I would have had no hesitation in holding that these were deductions in respect of expenses incurred in respect of transactions which, if allowed, would unduly or artificially reduce the income of the defendant and that consequently their allowance as deductions is forbidden by the terms of section 137(1).

The reasoning in this case together with the developments in recent years in the pension cases and similar tax shelter situations leads one to the conclusion that in determining deductibility of any particular expense one must consider:

(i) Is it specifically allowed under a statutory provision such as section 66 or former section 83A?;

(ii) Is it laid out to gain or produce income so as to meet the general tests of section 18 (1)(a) — formerly 12(1)(a)?; and

(iii) If allowed, would it artificially reduce income so as to be caught by section 245(1) — former 137(1)?

Under the case law as it has developed recently, it is not enough to find that point (i) is met — you must go on and test the facts against points (ii) and (iii) as well.[2] The *Clark* case today stands for the proposition that tax reduction alone is not a sound basis for deductibility — an outlay designed *solely* to reduce or defer tax does not have the required business end to avoid the shoals of 18(1)(a) let alone 245(1) of the Act. One is still entitled to arrange one's affairs to attract

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[2] *See Shulman* v. *M.N.R.* [1961] C.T.C. 385, *L.D.G. Products Inc.* v. *M.N.R.* [1973] C.T.C. 273 for examples and Tax Shelters in *Report of Proceedings of Twenty-Fifth Tax Conference* — Canadian Tax Foundation.

a minimum of tax but the "one's affairs" must have a business purpose as contrasted solely with a tax reduction or deferral purpose.

The sublease transaction is generally not on all fours with the *Clark* case as there is a profit element in the sublease as the holder, unlike Mr. Clark, gets back more over the term of the sublease than he pays out for the real property interest initially and, in addition, has a risk. The acquisition has the end business purpose of producing income with the tax deduction or deferral being an incident rather than the sole purpose. If the Court can find that the sole purpose is tax reduction or deferral, one should not be overly optimistic about establishing clear deductibility. In this area one factor that may be found to be important is whether the sublessee borrowed money to buy the interest and, if so, did the interest costs exceed the profit element. If it did, perhaps the surplus interest should not be deductible under 18(1)(a) or worse still both interest and 66 acquisition costs are denied under 18(1)(a) or 245(1).

The foregoing assumes that point (i) is met in the usual sublease case and the Department on at least one occasion has suggested informally that this may not always be true. To fall within section 66, the interest acquired must be a right, licence or privilege to enter, drill for or take[3] and this would seem to be clearly satisfied where the sublessee operates the wells, has his own production sale contracts and pays a separate rental for the use and enjoyment of the sublessor's equipment and facilities — acts the same way as if he had bought the lease and rented the equipment.

As one moves from this position to a less active interest one must be prepared to meet the departmental suggestion of it being a "sham" and not within 66 at all. A number of cases have dealt with so-called shams and the recent case of *Chibougamau Lumber Ltd.* v. *M.N.R.*[4] contains the following observation:

> The question of whether or not the agreements are a sham has also been raised, and the case of *M.N.R.* v. *James A. Cameron* [1972] C.T.C. 380; 72 D.T.C. 6325, has been cited, and at page 384(6328) thereof, there is a comment by Lord Justice Diplock in *Snook* v. *London & West Riding Investments Ltd.* (1967) 1 All E.R. 518 at 528.
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> Halfway through that comment he says, with reference to the word "sham":
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> I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.
>
> I think that is a precise statement of, and acceptable definition of, the oft-used and more often abused term "sham".

If in a sublease case one has documents or understandings which significantly detract from the printed provisions of the sublease document (such as sublessee will not drill, sublessor will continue to sell the production, sublessee is not to be novated into unit agreements and operating agreements; there is no need to comply with first right of refusal clauses in title documents) one runs a possible risk of a court finding that the sublease document does not truly represent the actual legal rights and obligations which the parties intended to create. If the Court finds that what actually was intended was something other than what is set forth in the sublease, the result is that one must examine the

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[3] Section 83A(5a) of old Act and section 59 and 66 of the new Act but the definition of resource property is wider under section 66 than existed under section 83A of the old Act.

[4] [1973] C.T.C. 2174 (Tax Review Board).

tax incidents of the real transaction which may or may not be within section 66 or 83A of the old Act.

Section 66 specifically refers to royalty acquisition costs and if one is unable to purchase a sublease and act as he would if he bought the lease outright, it may be better to buy the more passive type of interest represented by a carved out royalty to lessen the risk of the "sham" contention. The royalty acquisition must, as is always the case, meet points (ii) and (iii) above and the reasoning of the *Clark* case for its acquisition cost to be deductible.

Principal Business Tests:

The Act in a number of sub-sections of section 83A of the old Act refers to a principal business corporation,[5] and a recent case has considered the question of a change in business during the tax year. The *M.W.A. Gas and Oil Limited* v. *M.N.R.*[6] case dealt with a construction company which in its 1968 tax year virtually ceased to carry on the construction business and during the last month of its tax year incurred exploration expenses of $55,000 and 83A acquisition costs of $900,000. In each of the following three years its revenue was about $350,000 and the Court observed that "the plaintiff recouped its expenses in three years" — a three year payout looks like a sublease was involved but this issue was not expressly dealt with by the Court as the Minister had admitted that the expenditure of $900,000 was for qualified 83A(5a) rights and, as far as one can tell, no borrowed money was involved in the acquisition.

The sole question before the Court was "what was the company's principal business in the tax year involved?" and the Court looked at the usual tests, i.e. number of employees, activity, income, etc., and concluded that even though it appeared that it had operated actively in oil and gas for only the 12th month of its tax year, had negative income flow from this source and no employees, it still had the qualified principal business. The Court's decision may only be useful in a case where one has a complete discontinuance of a business, a period of inactivity and then the start up and continuation of the oil and gas business. On this point the Court stated:

> On the other hand the plaintiff abandoned its construction business in the 1968 taxation year and became engaged in the oil and gas business in that year.
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> In that year supplementary letters patent were obtained authorizing the plaintiff to carry on an oil and gas business to the exclusion of a construction business and it exercised those changed objects in 1968.
>
> From that time forward the sole business of the plaintiff was that of exploring and drilling for oil and gas and in its 1969, 1970, 1971 and 1972 financial years it derived substantial income from that business. Because that was the sole business from October 1968 on it follows as from that date it was the plaintiff's principal business. . . .
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> There then followed a period of inactivity, but for passive corporate acts, until the oil and gas business was conceived and actively engaged in in October 1968.
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> In the plaintiff's 1968 taxation year its construction business was in its death throes while the oil and gas business was born and in its dynamic infancy reaching maturity in the succeeding year.
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> In my opinion these facts establish that while the construction business had been the plaintiff's principal business that business was superseded by the oil and gas business as the plaintiff's principal business in its 1968 taxation year.

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[5] Section 83A(1), (2), (3), (3b), (3e), (8), (8a) of the old Act and section 66(1), (6), (7), (8) and definitions applicable to joint exploration corporations.

[6] [1974] C.T.C. 140 (Fed. Ct. — Trial Div.).

The statement by the Court that:

Because this was the sole business from October 1968 on it follows *as from that date* it was the plaintiff's principal business.

permits the conclusion that the company was a principal business corporation at:

(i) the time it incurred the 83A expense; and

(ii) at the end of its tax year when it claimed the deduction.

The following questions have not been answered by the Courts to date, namely:

(a) Is it essential to be a principal business company at the end of the tax year involved as it is only then that deductions are claimed? — qualified only when claimed?

(b) Is it necessary to be a principal business company when the 83A expenses are incurred if you qualify at year end? — qualified when claimed as well as when incurred?

(c) Would M.W.A. have been permitted to deduct the 83A expenses if it had spent $900,000 drilling dry holes and surrendered all its leases to the Crown (no flow through to successor corporation as might occur in a sale) in the first six months of its tax year and in last part of the same tax year went *solely* into the construction business? — a principal business when incurred but not when claimed?

Until delineated by further case law, it would appear that one can only be sure when the taxpayer meets the test on two dates, namely (i) the date the expense was incurred and (ii) the tax year end when claimed. As incentive legislation, the key date should be "when incurred" but against this may be the thought that one must look at categorization at the year end when claimed. Fortunately the budget proposals, if adopted, may solve many of these questions for future years by eliminating the principal business requirement of deductibility.

Successor — Predecessor Problems

The Act contains provision where if one principal business company acquires *"all or substantially all"* of the property of another principal business company *"used by it in carrying on in Canada its principal business"* the unused 83A or 66 expenses are only available to the purchaser and then only against production income from such of the lands bought as the vendor had the right to take or remove oil.[7] They cannot be used against cash royalty income or income from subsequent disposition of the properties involved.[8] This has been a rather difficult area and many points are yet to be resolved but the recent case of *Wardean Drilling Co. Ltd.* v. *M.N.R.*[9] should be reviewed in all cases as it demonstrates that a sale for $5,000 can trigger a flow through that the vendor does not want and the purchaser has little chance of utilizing. This case involved the sale of a five per cent interest in an 80 acre tract (net four acres) for $5,000 at a time when the Company had as other assets (a) a 12½% working interest in six Crown leases that it had never explored and which it later surrendered and (b) shares in a uranium exploration subsidiary. The Court seems to be saying that wildcat land holdings since they do not involve

[7] Section 83A(8a) of old Act and sections 66(6) to (9) inclusive of new Act.

[8] Such income is not reasonably attributable to production from a well — the restricting limitation of section 83A(8a).

[9] [1974] C.T.C. 190 (Fed. Ct. — Trial Div.).

active exploration may not count in determining whether "all or substantially all" was sold — On the comparison of the five per cent in 80 acres to 12½% in six leases the Court stated:

> The salient facts which emerge from this comparison of the two properties are that the five per cent interest in leaseholds which was sold to Scurry Rainbow Oil Limited was the sole source of the appellant's revenue. It was an oil producing property on which extensive exploration and drilling had been done. It was considered by Scurry Rainbow Oil Limited to be a desirable property which it sought to acquire and did acquire. There was no exploration or drilling work done on the six Crown leases at any time between their acquisition by the operator in 1957 and the cancellation of those leases in 1966.
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> All that was done by the joint owners, including the appellant, was to pay their proportionate shares of the nominal rent to keep the leases in good standing. The property lay dormant with no effort being made to explore and drill for potential oil or natural gas deposits. When threatened with the revocation of the leases in the event of failure to drill, the leases were allowed to lapse by the joint owners, including the appellant. The appellant offered to sell its interest to Scurry Rainbow Oil Limited but that company declined the appellant's offer.
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> Without purporting to decide the question whether mere ownership of a minor percentage in these Crown leases is use of that property in carrying on the business of exploring or drilling for oil or natural gas by the appellant the evidence is abundantly clear that this business was not actively engaged in and that the prospect of exploration and drilling thereon was remote.
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> As a consequence of the foregoing comparison of the facts relating to the two properties owned by the appellant I am led to the conclusion that the 5% interest in the leaseholds which was sold by the appellant on April 21, 1964 to Scurry Rainbow Oil Limited was a sale of substantially all of the property used by the appellant in carrying on its business in Canada.

The plaintiff tried unsuccessfully to say that the uranium operations were really the parent's business and the value of the subsidiary should be counted in the "all or substantially all" question but the Court refused to impute to the parent the business of the subsidiary as, unlike the *Consolidated Mogul* case,[10] the Court was unable to find any contractual arrangement between the parent and the subsidiary to say that the uranium exploration was really that of the parent. Given the facts that the Company owned an active subsidiary and directly owned $5,000 worth of production, could one argue that the principal business of the Company was managing its investment in the subsidiary *and not a qualified predecessor company at the time of the sale?* — the relevant date for categorization.

If the 30% deduction rule for post budget E & D becomes law the pre-Budget E & D (new Act) and unused 83A's may have higher value to a buyer and one should, at least in smaller acquisitions, seriously consider buying shares rather than assets of active smaller companies and putting income producing properties into the acquired company possibly by the joint-exploration company route if the proper fact situation exists[11] — if the Company is wholly owned one should consider procuring a tax ruling before finalizing the joint-exploration transaction.[12]

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[10] [1968] C.T.C. 429.

[11] An example might exist in the lower court decision in *Sogemines Limited* v. *M.N.R.* [1972] C.T.C. 284 where the principal business was found to be investment and management thereof. Section 83A of the old Act and section 66 of the new Act for definitions of joint exploration corporation and the maximum 10 shareholder rule.

[12] Such a transaction with an active company when wholly owned may conflict with the policy of the roll down rules under section 85 of the new Act where the donee must never have been active. I understand, however, that the department has ruled favourably on wholly owned subsidiaries as qualified joint exploration companies.

If the acquired corporation had ceased before acquisition to actively carry on the oil and gas exploration business, post 1972 E & D may be lost with effect similar to *Wardean Drilling Co. Ltd.* — no use to anyone.[13]

The decision of *Sogemines Development Company Limited* v. *The Queen*[14] illustrates another problem presented by the taxpayer utilizing predecessor deductions *in lieu of those incurred by itself directly.* In that case the purchaser had claimed predecessor deductions in prior years and decreased the use of those it incurred directly only to find later the Court holding that there were no predecessor deductions available as the vendor was not a principal business corporation and as such he had, *without knowing it,* used up in the earlier years those incurred by it directly equal to the disallowed predecessor deductions. The taxpayer in the earlier years had received a Nil assessment but the case illustrates the lack of solace an oil company can place on one of these if it has a pool of mixed deductions. The taxpayer was denied the right to deduct in later years the expenses incurred by it directly since they *were deductible in earlier years* when the predecessor's were determined to be non-deductible.

It is possible that in such a case the taxpayer could lose at both ends if the Minister insisted, namely:

(a) Pay increased tax in earlier years when disqualified deductions are denied;

(b) Pay increased tax in the later years when he is unable to use that which he *could have* used before.

In the *Sogemines* case the earlier years were beyond the four year limitation period but the point should be carefully considered and perhaps always file your return as follows, or to the like effect, "*deduct all we have incurred directly less those of predecessor's that are deductible*".

The Trial Division decision[15] is a useful case as well on the factors to be considered in determining what the principal business of a company is and should be reviewed in conjunction with the *M.W.A.* case above.

Offshore Operations:

During the last few years many of the independent oil companies based in Canada have for various reasons actively pursued exploration in offshore areas of the World and many countries have various methods of participation; ranging from the service contractor arrangement in Indonesia, the loan contractor arrangements in India, concessions with built in tax rates used in many O.P.E.C. and African countries to concessions with royalty held by local companies in the North Sea. Each system or arrangement entails different tax incidents to the Canadian based oil company.

One of the arrangements considered by the Court in *Asamera Oil (Indonesia) Limited* v. *The Queen*[16] was the Indonesian Production Proceeds Sharing Agreement described in the head note of the case as follows:

> The appellant was incorporated in Bermuda in 1962 as a subsidiary of a Canadian company which in 1961 had entered into a contract with an Indonesian state-owned corporation to explore for oil in Indonesia. The parent company was to supply all necessary technical personnel and to purchase whatever equipment and supplies were

[13] Section 66(1).

[14] [1973] C.T.C. 383 (Fed. Ct. of Appeal).

[15] [1972] C.T.C. 284.

[16] [1973] C.T.C. 305 (Fed. Ct. — Trial Div.).

needed for the project. All expenditures were to be billed to the Indonesian company but were not to be paid for except out of production proceeds if any, after which 40% of any further proceeds was to belong to the parent company. In 1962 the parent company's interest in this venture was assigned to the appellant which in the following years under appeal expended some $13,900,000 for equipment, supplies, drilling and exploration costs, etc., pursuant to the contract. This outlay was wholly disallowed as a capital expenditure within paragraph 12(1)(b) by the Minister who at the same time treated the appellant's gross receipts of some $12,200,000 as income. The appellant contended that its outlays were wholly deductible as revenue expenditures under the contract and that it therefore had no taxable income in the years under appeal.

It was argued by the Minister that all outlays were designed to create a capital asset and accordingly were not deductible as business expenses. On this point the Court stated:

Dealing with the Minister's submission that the "right to receive income" is a capital asset, the case of *Gladys Evans* v. *M.N.R.* [1960] C.T.C. 69 at 76; 60 D.T.C. 1047 at 1050, is relevant. Mr. Justice Cartwright (as he then was) in delivering the majority judgment of the Supreme Court said:

. . . I cannot agree that the fact that a bare right to be paid income can be sold or valued on an actuarial basis at a lump sum requires or permits that right, while retained by the appellant, to be regarded as a capital asset. I do not think that in ordinary language a right to receive income such as that enjoyed by the appellant would be described as a capital asset . . .

This is not the case of an oil company owning mineral rights or mineral permits to explore which are exploited and developed by said company. The plaintiff owned nothing in Indonesia; it had no rights in the minerals; it had no property rights in the wells or the equipment; it had been hired to perform services and even its right to receive payment therefor was dependent on the oil production on the subject lands.

I cannot agree that, in these circumstances, the right to receive income can be regarded as a capital asset. I suppose it can be said that every business expense is laid out to acquire a right to income. Any time one person performs a service for another and incurs expense in so doing, there arises a right to income when the service is performed.

If such expenses are not deductible from income, it is hard to think of a case where the expense would be deductible.

The conclusions in the case appear to be sound and are supported by the *Canada Starch, Bowater Paper* and *Elias Rogers* cases,[17] but one must be cautious in applying the case to a situation where the oil company acquires any interest in the wells, lands or facilities on a similar sharing arrangement. The deduction to Asamera was not for D & E but rather under 18(1)(a) as a general business expense and this creates problems if the company does not have sufficient income within five years to use up the business losses created in the initial years.

In addition, it is unlikely that this service income would qualify as "reasonably regarded as attributable to the production of petroleum from wells outside Canada" so as to permit the write-off against it of 100% of foreign E & D.[18]

This point was not in issue as a section similar to the present s. 66(4) was not present in the Act at the time. It is considered by some tax people that to fall within s. 66(4)(b)(A) one must have something more than payment for services such as a proprietary interest in the production as an operator. Under this reasoning, Asamera's income is attributable to services rather than production per se.

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[17] [1968] C.T.C. 466; [1971] C.T.C. 818 and [1972] C.T.C. 601.

[18] Section 66(4) (b) (ii) (A) of new Act.

If Alberta Crown leases were replaced by a similar arrangement Mr. Turner may need to further amend his budget resolution to get at the problem he envisaged in permitting deductions of royalties and mineral income tax.

A number of countries insist on the concession holder having a locally incorporated subsidiary as holder of the concession and this serves to lessen the chances of the parent, with income, from having the foreign E & D to write-off even at ten per cent. A number of solutions have been advanced such as agency, trusts, limited partnerships and illustrative agreements, but planners should consider, among others, such of the following as are relevant to the particular case:

(a) If agency or held in trust, does the local law permit this without approval for a Canadian principal or beneficiary? If not, review carefully the *Richardson Terminals* case[19] as well as *Wardean Drilling* outlined above.

(b) If limited partnership is recognized in the host country, do they tax as we do and what of foreign tax credits?

(c) If the parent is Canadian and the subsidiary is foreign and enters into agency, trust or illustrative agreement after the concession is granted, is a benefit thereby conferred on the parent as shareholder taxable as ordinary income under section 15?

(d) If the subsidiary is resident (even if incorporated offshore) in Canada under the central control and management rules, does the transaction result in a Canadian taxable disposition by the subsidiary of a foreign resource property at fair market value under section 69?[20]

(e) Does the foreign country tax the principal, beneficiary, etc., directly to enable such party to utilize foreign tax credits?[21]

The arrangements are nearly as varied as the number of countries involved and as time goes on the tax incidents *in Canada* to the parent and the subsidiary if resident here will be delineated but this may well take a decade absent legislation or rulings on the many and varied schemes. The *Asamera* result should, if one followed exactly the contract form used there, flow between a parent and a subsidiary in the same way as it did between Asamera and the State-owned corporation in Indonesia. If one does this, keep a close eye on section 15(1) (benefit to shareholder) when you choose the percentage split under the arrangement — preferably get third party evaluations and better still arm's length offers. In addition, attention should be directed to whether the host country taxes the parent directly to enable the tax credit benefit to be claimed as otherwise, at 55% tax rates in the host country, the overall tax bite may exceed 100% — perhaps nothing new for operations in Saskatchewan, but generally to be avoided if possible.

Subsidies, Grants, Incentives:

A number of provinces are giving drilling incentives, decreased royalties and/or grants to encourage the discovery of new reserves and the case of *Radio Engineering Products Limited* v. *M.N.R.*[22] should be considered, the headnote of which is as follows:

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[19] [1971] C.T.C. 42.

[20] Also section 59(1).

[21] Section 126 of new Act the importance of which in these matters cannot be overemphasized.

[22] [1973] C.T.C. 29 (Fed. Ct. — Trial Div.).

Pursuant to an agreement between the appellant and the (former) Department of Defence Production, the taxpayer proceeded with the development of a certain telephone system and in 1961 made outlays to that end exceeding $450,000. In the same year the appellant received a contribution of $450,000 from the Government in respect of the outlays so made pursuant to the contractual agreement. The Minister originally treated the amount in question as forming part of the appellant's income for 1962 but later changed the basis of assessment to delete the sum from income and, instead, to disallow expenses of a corresponding amount in 1961 as not having been incurred for the purpose of earning income from the business within paragraph 12(1)(a). The result was the same as before, being reflected in the assessment for 1962 as a result of a loss carry forward from 1961. The appellant viewed the amount received as a contribution of capital, or alternatively as but a loan, since the agreement envisaged repayment in whole or in part out of future profits if the appellant succeeded in selling the product (which it failed to do).

HELD:

The character of the repayment was that of a contribution towards the costs of the project, rather than a loan or advance, despite the provisions for repayment. Whether reflected as an income receipt or as a reduction of expenses the amount was properly reflected in the appellant's 1962 taxable income. Appeal dismissed.

Another useful case in this area is the decision of *Okalta Oils*[23] where the Court held that Okalta, which received moneys to drill deep tests in Saskatchewan from the Crown shortly after the Second World War repayable out of production, did not incur drilling costs as it was not "out of pocket". Later on in the paper the departmental position on grants and subsidies will be discussed.

Sale of Shares:

In early February of this year the Federal Court of Appeal ruled in the *McKinley* case[24] and held that the 1965 sale of his shares in Siebens Leaseholds Limited, an oil and gas lease broker, constituted an income transaction with the taxable amount being sale proceeds of some $200,000 less original costs of $167. The lower Court[25] had held that it was an income transaction but permitted the deduction from proceeds of book value of the assets in the Company at the time of the sale. The lower Court decision as to the deduction was very difficult to rationalize in light of other decisions but the Appeal Court brings it back in line with the numerous capital vs. income cases in finding that McKinley, from the day he acquired the shares in 1958 until he sold in 1965, was one continuous adventure in the nature of trade, and the book value of assets in the Company was not relevant.

The lower Court decision wherein reference was made to the sale being in essence a financing had been a concern to many planners and advisers who often suggested that the vendor should sell and go into some other business but never back into the oil business — still sound advice unless, of course, one can make a better after tax (ordinary rates) return in the oil and gas business. As the law now stands, however, the case is akin to the *Fraser*[26] and similar cases leaving the familiar questions of primary and secondary intentions and adventure in the nature of trade. It, like the *Fraser* case, however, should force advisers when considering the tax treatment of the sale of shares of private oil companies as contrasted with the sale of assets to pause and ask "was the vendor in acquiring

23 [1955] Ex. C.R. 66.

24 [1974] D.T.C. 6138.

25 [1969] D.T.C. 569 and [1971] D.T.C. 5320.

26 [1964] S.C.R. 657, *M.N.R.* v. *Freund* [1969] S.C.R. 75, *Osler, Hammond and Nanton Ltd.* v. *M.N.R.* [1963] S.C.R. 432.

and later selling the shares carrying out an adventure in the nature of trade rather than making and realizing a true investment?" On this point a review of how the vendor acquired the shares and under what circumstances is of paramount importance — perhaps not dissimilar to many real estate cases involving raw land but to date departmental assessing practice favours the share sale over the asset sale and with capital gains now taxable in part there may be reason to believe such practice will continue.

PART 2 — Departmental Bulletins

During the last 18 months a number of Information Bulletins were published by the Department that are applicable to the oil and gas industry, brief summaries of which are as follows:

Bulletin I.T.-125-October 5, 1973:

This expands on the provisions of section 59 (income when resource properties are sold) and on section 66 (deductions of Canadian and foreign E & D) and some of the points dealt with are as follows:

(a) The Bulletin states that a disposition extends to anything entitling one to proceeds of disposition, i.e. sale, theft, gift, expropriation or destruction. They appear to be taking the definition of disposition used in section 54 which is for capital gains and is stated to be "On this sub-division" so one questions whether the word "disposes" when used in section 59 (a separate sub-division) necessarily has the same meaning. Section 59 refers to when one disposes then the amount receivable is income. If you get paid cash and then agree to dispose, can it be said you do not have a "receivable" to go into income? Many companies under Saskatchewan Bill #42 had freehold mineral title to oil and gas transferred by statute to the Crown on January 1, 1974. Was this a disposition for the purposes of Section 59? If the Company's tax year ends *before* the Minister fixes the discounted cash value, what is the amount of the receivable to be taken into income? It would seem that if the Royalty Certificate alternative is accepted one would, if it is a disposition, take into income the discounted figure and then reserve for amounts not yet paid.[27] Can it be said that the Royalty Certificate when received is payment of an amount (they are negotiable etc. as contrasted with open account indebtedness) so there is nothing to be paid later to set up a reserve with the result that one has:

(i) income in year of expropriation; and

(ii) income in year that royalty is received under 12(1)(g),[28]
double taxation on the transaction? Check 64(1) carefully on this question and companies with year ends prior to December 31, 1974 should do it rather promptly. If one elects neither cash nor royalty prior to tax year end which one, for tax purposes, applies?

For those who owned free title before 1972 and up to expropriation and such title included minerals other than oil and gas do the percentage rules of section 59(3) apply? It would appear that the answer is "yes" but it might be argued that 66(15)(c) does not include real property the principal

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[27] Under section 64(1).
[28] The former section 6(1)(j).

value of which is oil and gas[29] — 66(15)(c) specifically includes real property the principal value of which is a mineral resource, but this, by definition, excludes oil and gas. Why does 66(15)(c) not have a sub-clause dealing with real property the principal value of which is oil and gas? If 66(15)(c)(i) is wide enough to pick it up anyway, would 66(15)(c)(ii) not be wide enough to pick up the items covered by 66(15)(c)(v) without needing 66(15)(c)(v)? If such real property is not covered by 66(15)(c) then its disposition by expropriation should receive capital gain treatment under sub-division C with the gain being proceeds of disposition less adjusted cost base which, in some cases, may result in no taxable gain. It is most unlikely this result was intended but, with the presence of 66(15)(c)(v) in the Act, the argument for capital gain treatment can be made.

(b) The Bulletin states that if one sets up a reserve it must be for unpaid amounts that are not legally due that year. If they are due but unpaid it still must all go into income under section 59 although one may claim a reasonable reserve for bad debts under section 20(1)(2). If the unpaid amount can be accelerated on certain defaults, one should be careful as to waiving a default as the balance, before such waiver, may have been legally due in that tax year and the waiver may not reinstate the reserve rights. Also carefully consider amounts payable "on demand".

(c) The Bulletin carries forward the prior practice[30] of not treating a farmout as a disposition but one must be careful when one deviates from the case where the farmee, at his sole expense, does exploration on the farmout lands. The Bulletin refers to the farmee performing services *"on the property"*. If the farmee gets a working interest in a block of land in Saskatchewan and a block in Alberta by drilling a well on only one of them, was it work "on the property" as contemplated by the Bulletin? This may be very important in non-arm's length transactions where section 69 applies.[31]

Bulletin I.T.-121-September 14, 1973:

This deals with capitalizing, as Canadian E & D deductible under section 66, costs of borrowing money to finance certain E & D expenses. The Bulletin permits a transaction by transaction election to the taxpayer so he can capitalize in some cases and expense in others. If the 30% rule of the May Budget is passed as to

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[29] The definition of "Canadian Resource Property" in section 66(15)(c) is as follows: 'Canadian resource property' of a taxpayer means any property acquired by him after 1971, that is,

(i) any right, licence or privilege to explore for, drill for, or take petroleum, natural gas or other related hydrocarbons in Canada,

(ii) any right, licence or privilege to prospect, explore, drill or mine for, minerals in a mineral resource in Canada,

(iii) any oil or gas well situated in Canada,

(iv) any rental or royalty computed by reference to the amount or value of production from an oil and gas well, or a mineral resource, situated in Canada,

(v) any real property situated in Canada the principal value of which depends upon its mineral resource content (but not including any depreciable property situated on the surface of the property or used or to be used in connection with the extraction or removal of minerals therefrom), or

(vi) any right to or interest in any property described in any of subparagraphs (i) to (v).

[30] The prior practice was thought to be based on the Minister's reply to a question in the House of Commons when section 83A or its predecessor was introduced into law.

[31] This section requires the party disposing to take current market value into income regardless of amount or value received.

deductibility of Canadian E & D, to capitalize would result in a slower write-off but would permit unlimited deferments.

Bulletin I.T.-90-February 9, 1973:

The new Act provided that one could deduct his share of Canadian E & D incurred by an association, partnership or syndicate, if he is a member at the end of such association's partnership's or syndicate's fiscal period. The Act provides no definition of the terms "association, partnership or syndicate" and Bulletin I.T.-90 is an attempt at outlining some guidelines for the taxpayer. The Bulletin suggests that one should look to provincial partnership law and cases for guidance and the tax authorities very graciously say that such law will be "persuasive". One can assume from this that somewhere within the walls of the Department in Ottawa there lurks a Federal common law which may be different than a particular law in force or in effect in a province. If one wishes to avoid some of the badges of partnership property one should endeavour to have the parties refrain from holding assets as tenants in common or joint-tenancy. As one can have partnership as to profits without assets being partnership property, care must be taken to ensure that no facet of the operation is a partnership. If one has a possibility of a partnership and Canadian E & D expenses are involved, one should sell the interest after the end of a fiscal period. The problem, however, is that most arrangements do not specify a fiscal period and if these ultimately are determined to be partnerships, one could reasonably anticipate that certain taxpayers will lose E & D deductibility if they sell their partnership interest at the wrong time.

Bulletin I.T.-53 and I.T.-49:

These bulletins deal with the Federal tax treatment of incentives or grants to industry to acquire capital assets or defray expenses and as a general rule operate to reduce the base from which capital cost is taken or alternatively reduce the amount of deductible expense. A number of schemes exist in the Western Provinces whereby the industry can receive assistance, credits or grants. If under Saskatchewan Bill #42 a party receives a grant of $50,000 in connection with a drilling programme that costs $100,000, is the Company's deduction, under the 30% rule of the Budget 30% of $100,000?; 30% of $50,000?; or could it be 30% of $100,000 with $50,000 going into income resulting in $20,000 of income that year? The general practice outlined in the Bulletin and the *Okalta* decision would suggest 30% of $50,000 but as Ottawa is now threatening to tax what you pay a province, it might not be surprising to see that they also tax that which a province pays to you. Similar questions arise with reduced royalties for new drilling. Is this a grant, the current market value of which must be calculated and used to reduce your Canadian E & D available for use in the year the drilling took place? Or might it be income?

Rulings, Bulletins and Estoppel:

Until recently the Department has not published rulings but one can expect shortly that some will be published and the Foundation might consider making reference to rulings or importance in its proposed newsletter relating to Current Developments. One must be very cautious of using general rulings as the basis of tax decisions unless you are absolutely sure (very difficult to establish) that your facts are the same as the transaction considered in the ruling. A ruling issued on incorrect facts is of no validity and likewise for a ruling used for different facts. One should be wary of using or relying on any ruling that you do not consider is in accordance with the Act. That departmental bulletins, practice and statements, when contrary to the law, are not binding on the Crown is illustrated by the following cases:

(a) the decision of the Supreme Court of Canada in *M.N.R.* v. *Inland Industries Ltd.*[32] dealt with a pension plan where the Department wrote to the taxpayer to the effect that the plan was accepted for registration and that the sum of $202,650 "may be claimed under section 76 of the Income Tax Act", yet the Minister assessed otherwise. The Court was not pursuaded by the Department's mistake in its letters and stated:

> The difference between the wording of this Memorandum and the wording of the actuarial certificate is quite substantial and it is somewhat surprising that, notwithstanding such advice, departmental approval was given to the payments on behalf of the Minister. *However, it seems clear to me that the Minister cannot be bound by an approval given when the conditions prescribed by law were not met.* (Italics added).

(b) The decision of the Federal Court — Trial Division in *E. G. Stickel* v. *M.N.R.*[33] deals with a case where the Department issued a Bulletin, the taxpayer followed it exactly but the Minister assessed otherwise. The Court reviewed earlier decisions on estoppel against the Minister and concluded, after referring to the *Inland Industries* case, as follows:

> It therefore follows that if approval and registration given by the Minister to a pension plan does not give rise to estoppel then a fortiori an information bulletin cannot either. In short, estoppel is subject to the one general rule that it cannot override the law of the land.
> Therefore, the Minister is not precluded from relying on Article VIIIA (Canada-U.S. Convention) to the exclusion of the information bulletin.

(c) The decision of the Exchequer Court in *Woon* v. *M.N.R.*[34] (referred to in *E. G. Stickel* above) dealt with a situation where the Minister had issued a ruling that if a transaction was carried out in a certain way it would only be taxed under a particular section. The taxpayer carried out the transaction in accordance with the ruling but the Minister did not assess as stated in his ruling and on the question of estoppel the Court stated:

> I think it is quite clear that the "ruling" said to have been made in this case, was made without authority and was not in any way binding upon the Crown. There is nothing in the section itself which confers any sort of discretionary powers on the Minister or his officials. Parliament has said that under certain circumstances certain things are deemed to be dividends and manifestly the Commissioner of Taxation had no power to declare otherwise or to settle the limit of taxation thereunder, other than according to the statute itself. In that connection, reference may be made to *Carling Export* v. *The King*, [1931] A.C. 435 at 438 where Lord Thankerton said:
> In their Lordships' opinion it is not to be readily assumed, in a Taxing Act, that Parliament has delegated to a Minister the power to settle the limits of taxation, and such intention must be clearly shown by the terms of the statutory provision.

In conclusion, Departmental rulings, bulletins and letters are useful but one must always bear in mind "If the result is not in accordance with the Act, be careful" — in short, of some use only when you really did not need it anyway.

PART 3 — May 6, 1974 Budget

The three decisions as to estoppel discussed above effectively eliminated rulings and bulletins as useful tools to a tax adviser and the May 6 Budget, if passed, may effectively eliminate the resource tax adviser as most tax advisers work only in areas where income exists or has a possibility of existing. Up to now we are accustomed to thinking in terms of deduction of industry expenses under specific incentive legislation. In the future one should seriously review oil

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[32] [1972] C.T.C. 27.
[33] [1972] C.T.C. 210.
[34] [1950] C.T.C. 263.

and gas company operations in light of the charitable donation provisions of tax legislation — non-profit organizations.

The Carter Commission in the 60's suggested that one tax, at regular rates, every dollar that came to the taxpayer with certain deductions to arrive at profit or gain. The Turner Budget seems to go somewhat further to tax every dollar you pay out (an expenditure tax as contrasted with an income tax) if one is unfortunate enough to have a province as the oil and gas lessor.

Resolutions 7 to 11 of the Budget are somewhat complex in parts but may be summarized as follows:

(a) Amounts payable to a Canadian Government or Crown agency, commission or corporation as a royalty tax, levy, rental or otherwise that can reasonably be regarded as dependent on production in Canada of oil and gas from a well where the taxpayer had the right to take or remove oil are to be included in income if not otherwise included and no deduction is to be permitted for such amounts — Resolutions 7 and 8.

(b) If a taxpayer who has the right to remove oil pays a Canadian Government or Crown agency, commission or corporation above fair market value for oil purchased or sells oil below fair market value, the fair market value only is to be used in calculating cost of sales or proceeds of sale as the case may be — Resolution 9.

(c) Canadian Exploration and Development Expenses incurred after May 6, 1974 are deductible at an annual rate not exceeding 30% of the unclaimed balance[35] — down from 100% — Resolution 10.

(d) For tax years after May 6, 1974, the corporate income tax rate is 50% on Canadian taxable production profits less a deduction from such tax of an amount equal to 10% of total production profits plus, where a taxpayer has income from other sources, tax on those sources at the regular rate.

Also announced with the introduction of the Budget was an advancement to May 1, 1974 (from 1977) of the earned depletion concept (one dollar of depletion for each three dollars spent in exploration) and dropping the maximum depletion rate to 25% (from 33 1/3rd%) or production income.

The proposed revisions have importance to all companies in the resource field but those companies who have losses from non-oil and gas sources must particularly bear in mind that under the budget losses in other businesses of a principal business company will not operate to decrease the 50% tax on taxable production profits from Canadian sources — such profits will be taxed as if there were no other business profit or loss.[36]

It is always dangerous to speculate on a tax resolution before one has the opportunity to read and carefully review the actual words of the Bill implementing the same but the following points or questions have occurred to the writer in reviewing the Budget Resolutions and the Minister's comments thereon:

1. If the Crown lease were amended to correspond with the service type contract considered by the Court in the *Asamera* decision to give the producer only a service fee equal to value of 50% of production, is there any royalty or similar levy to be added into income under Resolution 7? Is the service income taxable production profits under Resolution 11?[37]

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[35] It would appear that pre-May 6 E & D and unused section 83A's can be used up at 100% first before one needs to start on the 30% of the unclaimed balance of post-May 6 E & D.

[36] This seems to follow from the segregation of source provisions of Resolution 11.

[37] It can be argued that it is as it is calculated using production as a factor.

2. Is Panarctic controlled directly or indirectly by a Government so that if one took a farmout from Panarctic paying it a reserved override, the amount of the override goes into income with no deductions? Be wary of farmouts providing for overrides to Texas Gulf Sulphur, the Alberta Energy Corporation, Saskoil, C.N.R. or Petrocan, to name a few.

3. If Imperial Oil sells refined products taken by it from its own crude produced in Alberta to the Department of Highways of Alberta at a volume discount under a long term contract, does it still need to account to Ottawa on the basis of fair market value of spot sales? Is fair market value of heating oil the price the Federal Government paid for offshore heating oil it may still be storing?

4. If Saskatchewan Bill 42 is declared to be *ultra vires* so that payments made were for neither royalty nor tax, are the payments (if not refunded) nothings or ordinary expenses deductible as being laid out to earn income under Section 18(1)(a)? Is the payment like a delay rental? — pay or lose the lease.

5. Does the 30% rule apply to Canadian E & D expenses of a predecessor company that were incurred before May 6, but flowed through after May 6 on asset purchase? — on amalgamation or wind-up?

6. Are Resolutions 7 and 8 in pith and substance taxation measures or for a purpose beyond Federal competence under the B.N.A. Act?[38]

7. Can the metal fabrication and pipeline transmission company with no oil and gas production but Canadian E & D expenses write these off at 30% against fabricating or pipeline sourced income or is it only available to reduce taxable production profits to nil? A change in the definition of principal business?

8. If a farmer lessor is fighting with the lessee, do the proposals in the Budget give him a real stick to wave by merely saying "If you do not accede to my request I will gift the royalty to the Province (getting a tax deduction under Section 110(b) of the Act) and then you will be unable to claim a deduction for your tax purposes"? — double bladed charity — Better still he could

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[38] There are few recent cases questioning the right of the Dominion to levy income taxes, but at some point Dominion legislation ceases to be, in pith and substance, taxation. Resolution 7 would appear to conflict with section 3 of the Act as it appears to create a fictitious source of income — one from which you received nothing. Can it be contended that resolutions 7, 8 and possibly 9 do not constitute laws for the raising of money by a system of taxation but rather are to enter, regulate or unduly interfere with an area reserved exclusively to the Provinces? Is a tax payable by a lessee determined on the amount of a receivable owned by the Province in essence a tax on provincial property that is to be free of tax under section 125 of the B.N.A. Act? Does the answer depend in part on whether the lease provides that a royalty is reserved so that the lessee never owns the lessor's share. One must always be cautious in presuming colourability and that a court would find this as a fact but the point should not be quickly dismissed as a number of cases particularly in 1920 and 1930 deal with limits on the Dominion under the guise of taxation or criminal law to destroy or sterilize powers conferred on a province. The Privy Council in *In Re Insurance Act of Canada* [1932] A.C. 41 referred to the *Reciprocal Insurance* case [1924] A.C. 328 and stated:

> Now as to the power of the Dominion Parliament to impose taxation, there is no doubt, but if the tax as imposed is linked up with an object which is illegal, the tax for that purpose must fail.

For those interested in exploring the point further a good starting point would be Laskin, *Canadian Constitutional Law*, 4th Ed. 636*ff* and 2nd Ed. 653*ff* and 755*ff* as to immunity from tax of provincial property.

sell the royalty to Panarctic or the Alberta Energy Corporation with the same adverse result to the lessee.

9. Resolutions 7 and 8 state that no taxpayer can deduct provincial royalties or mining taxes in calculating income (and must include the same in income) yet Resolution 11 relating to a 10% abatement refers only to corporations. Does this mean that an individual at a 60% tax bracket having production income of $1,000 paying provincial royalties and rentals of $500 must pay $500 to Edmonton and $600 to Ottawa — a loss of $100? Is it the same for partnerships made up of individuals? It seems the answer is "yes".

10. The change from the 100% to the 30% rule severely limits the use of the joint-exploration vehicle to roll properties into a corporation as it creates income at 100% on the disposition but renounceable expenses which are deductible only at 30% annually. The same result would seem to prevail in rolling into a partnership as, absent an election in limited cases, one has 100% income offset by 30% deductibility — decreased flexibility.

The statement by the Minister that the abolition of deductibility of provincial mining taxes was referred to in 1970 by the then Minister of Finance to be operative in 1977 suggests that one should carefully evaluate all statements by Finance Ministers as they may later be utilized as a crutch to support an otherwise weak position. The Minister refers to the increased use by the Provinces of tax and royalty to take extra money out of the oil and gas industry and finds that it is a resource "for all Canadians" and, as such, cannot enure to a province or region alone. The constitutional lawyer might ask if this federal position is correct why the Dominion in 1930 (by amendment to the B. N. A. Act) ever bothered to transfer resources to the Western Provinces — perhaps merely as trustee with the somewhat novel trust terms of "when it is a burden it is yours — when it has value it is ours." If the Minister is objecting to increased royalties and mineral income tax which really deal with recent price increases why would the Budget not provide that royalties at former rates and prices (up to 1973 say) continue to be deductible but increases after that are not?

The Budget proposes a number of other changes that are of less controversial nature but may be of interest to the oil and gas industry if it can survive the effect of Resolutions 7 to 11 inclusive if adopted in their present form.

Among the many so-called housekeeping changes suggested in the Budget are the following:

(a) Resolution 30:— This provides that in the case of expropriation by statutory authority the date of disposition is to be the earlier of the date you accept a settlement, have a court or final order or two years after the taking. This is expressed in the Budget as applying to capital property which raises again the question: Is mineral title the principal value of which is oil and gas content taken under Saskatchewan Bill 42 capital property?

(b) Resolution 41:— This serves to incorporate by reference the definitions of "disposition" and "proceeds of disposition" used for capital property into section 59 dealing with dispositions of resource property and may resolve the Saskatchewan Bill 42 problem against the taxpayer. This resolution also provides that 59(3) property (property that is Resource Property but was not 83A property) must, to get the benefit of the reduced percentages,[39] have been held continuously since before December 31, 1971 and also provides that a post 1971 acquisition of such property from a non-arm's length

[39] 60% into income in 1972 going up five per cent per year thereafter until it reaches 100%.

party results in the purchaser being considered as owning it on December 31, 1971 so he can take advantage of the percentage rules.

(c) Resolution 46(a):— This is rather important as it deletes the principal business test from the successor-predecessor transactions for tax years 1974 and following. As proposed, the *Sogemines* case above mentioned would have produced a different result if the transaction took place in the 1974 tax year. The provisions of s. 66 dealing with successor-predecessor are to be revised to cover amalgamation as well. The definition of E & D expense is amended to permit inclusion of annual payments to preserve a Canadian Resource Property but *excludes* similar payments for foreign resource properties, thus annual rentals or delay rentals on foreign concessions will no longer be included in foreign E & D expense.

(d) Resolution 46(b):— It is somewhat difficult to delineate the scope of this proposed change but I suspect that it may serve to bring into income (or reduce Canadian E & D expenses available) proceeds received when one disposes of shares of a joint-exploration company paid for with renounced expenses or shares acquired under an agreement to incur Canadian E & D expenses, the cost of which are Canadian E & D expenses. It is rather difficult to see how this treatment squares with section 53(2)(e) of the Act where one deducts renounced expenses from the adjusted cost base, suggesting capital gain treatment when sold later, but the final wording may solve the problem. The proposal may have much wider implications (particularly (b)(ii)) and should be thoroughly considered when seismic or other geological or geophysical data is sold.

(e) Roll-Overs:— The Budget has a number of provisions expanding the cases where a taxpayer holding shares of a Canadian oil company as capital property gets a tax-free roll-over such as:
   (i) the 25% requirement on amalgamations with other Canadian companies is removed;
   (ii) the 80% requirement of rolling into a Canadian company is removed; and
   (iii) a share for share exchange involving Canadian companies is given tax free roll-over treatment.

Canadian companies are given expanded tax free roll-over treatment in certain transactions and this could serve to accommodate corporate reorganizations for sound business purposes. The resolutions do not, however, appear to answer the questions as to what happens in all these cases where the shareholder is a broker and holds the shares as inventory and not as capital property. Is there a tax free roll-over to him? In all these situations (roll-in, wind-up, amalgamation, exchange) one may need to consider each shareholder separately and answer "yes" to the question "If this shareholder today sold the shares for cash (instead of amalgamating, rolling-in or exchanging) would he be taxed only on one-half of his capital gain"? If the answer is that he would be taxed as ordinary income (not capital property) read the so-called roll-over sections carefully to be certain they apply in your case.

It is somewhat difficult to adequately summarize the changes proposed in the Budget as they relate to the average oil and gas company operating in Alberta, but the economic effect may be reflected in currently depressed share prices.[40]

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[40] *Note:* This paper was presented at a June, 1974 seminar of The Canadian Petroleum Law Foundation, and all observations and suggestions should be checked against developments subsequent thereto as tax law in Canada often changes rather quickly.