FARMERS MUTUAL PETROLEUMS LIMITED ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

1967
*May 19, 23
Oct. 3

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Deductions—Legal expenses incurred in defending title to mineral rights—Drilling and exploration expenses paid under agreement—Whether deductible—Income Tax Act, R.S.C. 1952, c. 148, ss. 12(1)(a), (b), 83A(3).

Following its incorporation in 1949, the appellant company acquired mineral rights from land owners who had previously granted leases of their petroleum and natural gas rights to oil companies. The land owner transferred to the appellant his interest in the mineral rights, including the benefits from his lease, in return for one share of the appellant's capital stock for each acre transferred and also a trust certificate as evidence that the appellant thereafter held in trust for the land owner one fifth of the mines and minerals and the benefits therefrom. When oil was discovered in 1955, many of the land owners instituted actions in the Courts for declarations that the agreements had been induced by fraudulent misrepresentations and were therefore void. About 250 such actions were begun. The appellant successfully defended these actions. A royal commission recommended that a Board be constituted for the purpose of achieving the renegotiation of the contracts, if possible. The appellant sought to deduct from its income for the years 1959 and 1960 the legal expenses it incurred in defence of its title to the minerals, as well as those involved in opposing legislation proposed by the royal commission and in making representations to the Board. The appellant argued that these legal expenses were deductible as having been incurred to protect a right to income. The trial judge confirmed the Minister's position that they were not deductible and held that they were a payment on account of capital.

A second issue in this appeal involved an arrangement between the appellant and Scurry-Rainbow Oil Ltd., a major shareholder in the appellant company, which had acquired a beneficial interest in certain Crown petroleum and natural gas permits held jointly by other companies. The owners of these permits had covenanted that all drilling and exploration costs would be shared by them in proportion to their respective interests. By its agreement with Scurry-Rainbow Oil Co., the appellant agreed to pay all such costs incurred by the former company in return for a percentage of the joint permits. The question in issue was as to whether the moneys so paid by the appellant were deductible as being "drilling and exploration expenses" incurred within the meaning of s. 83A(3) of the Act. The trial judge held that they were not deductible. The company appealed to this Court.

*PRESENT: Cartwright, Martland, Ritchie, Hall and Spence JJ.

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Held: The appeal should be dismissed.

As to the Legal Expenses.

The object and purpose of the lawsuits was to compel the restoration to the land owners of the mineral rights purchased by the appellant. Those rights were items of fixed capital and were so regarded by the appellant. The legal costs of the litigation were incurred to preserve capital assets and therefore s. 12(1)(*b*) of the Act prevented their deduction. This case could not be distinguished from the case of *M.N.R. v. Dominion Natural Gas Co. Ltd.*, [1941] S.C.R. 19. The same consideration applied in respect to the legal expenses involved in opposing the proposed legislation and in appearing before the Board.

As to the Exploration Costs.

The payments made by the appellant were not in respect of expenses which it had incurred in respect of exploration or drilling. They were payments of expenses which had been incurred by another and were made, not to meet a liability of the appellant for the cost of exploration or drilling, but made for the acquisition of an interest in the lands. In these circumstances, the payments could not be deducted under s. 83A(3) of the Act.

Revenu—Impôt sur le revenu—Déductions—Dépenses légales encourues pour défendre titre à des droits minéraux—Paiements en vertu d'un contrat de dépenses de forage et d'exploration—Sont-ils déductibles—Loi de l'impôt sur le revenu, S.R.C. 1952, c. 148, arts. 12(1)(a), (b), 83A(3).

A la suite de son incorporation en 1949, la compagnie appelante a acquis des droits miniers des propriétaires de terrains qui avaient antérieurement loué à des compagnies d'huile les droits au pétrole et au gaz naturel s'y trouvant. Ces propriétaires ont transféré à l'appelante leurs intérêts dans les droits miniers, ainsi que les bénéfices relevant de leurs baux, moyennant une action du capital de l'appelante pour chaque acre cédé et aussi un certificat de fiducie comme preuve que l'appelante détenait dorénavant en fiducie pour le propriétaire du terrain un cinquième des mines et des minéraux ainsi que les bénéfices en découlant. Lorsque l'on fit la découverte d'huile en 1955, plusieurs des propriétaires des terrains ont institué des actions devant les Cours pour faire déclarer que les contrats passés avec l'appelante avaient été obtenus par des représentations frauduleuses et étaient en conséquence nuls. 250 de ces actions furent instituées, et la compagnie appelante s'est défendue avec succès. Une Commission royale a recommandé la constitution d'une Régie dans le but de renégocier les contrats, si possible. La compagnie appelante a tenté de déduire de son revenu pour les années 1959 et 1960 les dépenses légales encourues pour défendre son titre aux minéraux ainsi que celles encourues pour combattre la législation proposée par la commission royale et pour faire des représentations devant la Régie. L'appelante a soutenu que ces dépenses légales étaient déductibles comme ayant été encourues pour protéger un droit à un revenu. Le juge au procès a confirmé la position prise par le Ministre à l'effet qu'elles n'étaient pas déductibles et a jugé qu'elles étaient un paiement à compte de capital.

Une deuxième question dans cet appel se rapportait à une entente entre l'appelante et Scurry-Rainbow Oil Ltd., un actionnaire principal de la

compagnie appelante, qui avait acquis un intérêt dans certaines licences de pétrole et de gaz naturel détenues en commun par d'autres compagnies. Les propriétaires de ces licences avaient convenu que tous les frais de forage et d'exploration seraient partagés par eux en proportion de leurs intérêts respectifs. En vertu de son entente avec Scurry-Rainbow Oil Co., la compagnie appelante a convenu de payer tous les frais encourus par la première compagnie moyennant un pourcentage dans les licences communes. La question à débattre était de savoir si les sommes payées par l'appelante étaient déductibles comme étant des «dépenses de forage et d'exploration» déboursées dans le sens de l'art. 83A(3) de la Loi. Le juge au procès a jugé qu'elles n'étaient pas déductibles. La compagnie en appela devant cette Cour.

Arrêt: L'appel doit être rejeté.

Quant aux dépenses légales.

L'objet et le but des poursuites judiciaires étaient de forcer la restitution, en faveur des propriétaires des terrains, des droits miné-raux que l'appelante avait obtenus. Ces droits étaient un item de capital fixe et étaient considérés ainsi par l'appelante. Les frais légaux des procès ont été encourus pour protéger des biens en capital et, en conséquence, l'art. 12(1)(*b*) de la Loi en empêchait la déduction. On ne peut pas distinguer cette cause de celle de *M.N.R. v. Dominion Natural Gas Co. Ltd.*, [1941] R.C.S. 19. La même règle devait s'appliquer aux dépenses légales encourues pour combattre la législation proposée et pour comparaître devant la Régie.

Quant aux frais d'exploration.

Les paiements faits par l'appelante n'étaient pas des dépenses qu'elle avait encourues relativement à l'exploration ou le forage. Il s'agissait de paiements de dépenses qui avaient été encourues par une autre compagnie et qui avaient été faits, non pas pour rencontrer une obligation de l'appelante de payer les frais de l'exploration ou du forage, mais plutôt pour acquérir un intérêt dans un terrain. Dans ces circonstances, les paiements ne pouvaient pas être déduits sous l'art. 83A(3) de la Loi.

APPELS de deux jugements du Juge Cattanach de la Cour de l'Échiquier du Canada[1], en matière d'impôt sur le revenu. Appels rejetés.

APPEALS from two judgments of Cattanach J. of the Exchequer Court of Canada[1], in an income tax matter. Appeals dismissed.

J. H. Laycraft, Q.C., and *Sheldon Chumir*, for the appellant.

D. G. H. Bowman and *J. London*, for the respondent.

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[1] [1966] Ex. C.R. 1126, [1966] C.T.C. 283, 66 D.T.C. 5225.

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The judgment of the Court was delivered by

MARTLAND J.:—These are appeals from judgments of the Exchequer Court[1] which refused to permit the appellant, in computing its income, in the years 1959 and 1960, to deduct, in respect of legal expenses, the respective amounts of $80.10 and $10,623.43, and in respect of expenses claimed by the appellant as exploration and drilling expenses, the respective amounts of $53,273.38 and $143,581.10.

The facts involved in respect of these two matters are distinct from each other, so I will deal with each of the items separately.

Legal Expenses:

The appellant was incorporated under the laws of the Province of Saskatchewan on December 1, 1949, for the object, inter alia, of acquiring mineral rights and exploring for petroleum and natural gas.

Following its incorporation the appellant began a vigorous and successful campaign to acquire mineral rights from land owners. The system followed by the appellant was to acquire the fee simple title to minerals from land owners who had previously granted leases of their petroleum and natural gas rights to major oil producing companies. Those leases were uniform and standard. They were for a period of ten years providing to the land owner an annual rent of ten cents per acre and reserving a royalty of 12½ percent to the land owner in the event of a producing well or wells being brought into existence.

The land owner transferred to the appellant his entire estate and interest in the mineral rights, including all benefits from the existing lease. In return, he received one share of the capital stock of the appellant for each acre transferred and a trust certificate as evidence that the appellant thereafter held in trust for him one-fifth of the mines and minerals and the benefits therefrom.

In this manner the appellant acquired the mineral rights in approximately 750,000 acres in Saskatchewan and issued

[1] [1966] Ex. C.R. 1126, [1966] C.T.C. 283, 66 D.T.C. 5225.

approximately 2,500 trust certificates. The appellant received as income four-fifths of the rentals payable thereon and four-fifths of any royalties from producing lands.

In 1955 when oil was discovered in south eastern Saskatchewan many of the land owners instituted actions in the Court of Queen's Bench of Saskatchewan for declarations that the agreements between them and the appellant were induced by fraudulent misrepresentation and were accordingly void, and for orders revesting in the land owners the mineral rights and the interest in the leases which had been transferred and assigned to the appellant. In all about 250 such actions were begun, the pleadings being virtually identical in all cases.

The appellant successfully defended such of those actions as came to trial so that it remained possessed of the mineral rights and benefits under the contracts above described. None of the lands involved nor any of the actions commenced were lost by the appellant nor did the appellant lose any of the income which it was receiving from the lands. The legal expenses so incurred by the appellant constitute part of the amounts that were claimed by it as a deduction from income and that were disallowed by the Minister.

After the appellant had succeeded in some cases in the courts, many of the land owners formed a mineral owners' protective association to advocate and obtain legislative relief. A "Royal Commission on Certain Mineral Transactions" was appointed by the Saskatchewan Government to inquire into allegations that many owners of freehold mineral rights in Saskatchewan had been deprived of such rights by means of fraud or misrepresentation. This Commission recommended that a Board be constituted for the purpose of achieving, if possible, the voluntary re-negotiation of contracts whereby the owners were deprived of their freehold mineral rights through misrepresentation, whether innocent or fraudulent.

The Mineral Contracts Re-negotiation Act, 1959, was enacted to implement the recommendations of the Commission. Further legislation of a similar tenor was proposed in 1960.

The appellant employed counsel to make representations on its behalf opposing the proposed legislation, suggesting

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variations in the terms thereof and making representations to the Board later established pursuant to legislation enacted with respect to contracts entered into by it which were sought to be re-negotiated.

The learned trial judge confirmed the Minister's position and held that the legal expenses incurred were a "payment on account of capital" made "with a view of preserving an asset or advantage for the enduring benefit of a trade".

The decision of the learned trial judge was based upon the judgment of this Court in *Minister of National Revevenue v. Dominion Natural Gas Company Limited*[2]. Counsel for the appellant sought to distinguish the *Dominion* case and also contended, in the alternative, that that case would have been decided differently today on the same facts in view of changes which have since occurred in the relevant provisions of the *Income Tax Act*.

The relevant provisions of the *Income Tax Act*, R.S.C. 1952, c. 148, are as follows:

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,

(*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part,

. . .

Section 12(1)(*a*) and (*b*) were derived from s. 6(1)(*a*) and (*b*) of the *Income War Tax Act*, R.S.C. 1927, c. 97, which provided as follows:

6. (1) In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of

(*a*) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income;

(*b*) any outlay, loss or replacement of capital or any payment on account of capital or any depreciation, depletion or obsolescence, except as otherwise provided in this Act.

Counsel for the appellant advanced the proposition that legal expenses incurred to protect a right to income are deductible regardless of whether the protection of that right also involves preserving a capital asset. The appellant, he said, immediately upon its acquisition of title to the

[2] [1941] S.C.R. 19, [1940] 4 D.L.R. 657.

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mineral rights from a land owner had the right to receive and retain as its income four-fifths of the acreage rental payable by the lessee of the mineral rights. The legal expenses incurred were to protect that income. In the *Dominion* case, that which was protected was a franchise which, in itself, did not produce income.

In my opinion, this proposition is not valid, because it is directly contrary to the intent of paras. (*a*) and (*b*) of s. 12 when read together. To be deductible for tax purposes an outlay must satisfy at least two basic tests:

(1) It must be made for the purpose of gaining or producing income (s. 12(1)(*a*)).

(2) It must not be a payment on account of capital (s. 12(1)(*b*)).

Both of these tests must be satisfied concurrently to justify deductibility. In *British Columbia Electric Railway Company v. Minister of National Revenue*[3], Abbott J. said at p. 137:

> Since the main purpose of every business undertaking is presumably to make a profit, any expenditure made "for the purpose of gaining or producing income" comes within the terms of s. 12(1)(*a*) whether it be classified as an income expense or a capital outlay.
>
> Once it is determined that a particular expenditure is one made for the purpose of gaining or producing income, in order to compute income tax liability it must next be determined whether such disbursement is an income expense or a capital outlay.

It can certainly be said that the appellant, in resisting the lawsuits launched against it, was seeking to protect its income, because it was seeking to protect the assets from which its income was derived. It can, therefore, be argued that the expenses were properly deductible under s. 12(1)(*a*). This is not contested by the respondent. The object and purpose of the lawsuits, however, was to compel the restoration to the land owners of the mineral rights which the appellant had purchased. The learned trial judge has found, and the evidence establishes, that those rights were items of fixed capital, and were so regarded by the appellant. At the time the litigation occurred, the sum total of the mineral rights acquired by the appellant, all of which were of the kind involved in the litigation,

[3] [1958] S.C.R. 133, [1958] C.T.C. 21, 77 C.R.T.C. 29, 58 D.T.C. 1022, 12 D.L.R. (2d) 369.

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represented all of the appellant's capital assets. The appellant did not trade in them, but intended to retain them perpetually.

It was to protect those capital assets from attack that the legal costs of the litigation were incurred, and, to quote the words of Dixon J. (later Chief Justice) in *Hallstroms Pty. Ltd. v. Federal Commissioner of Taxation*[4], referring to the costs of defending title to land:

> Next to the outlay of purchase money and conveyancing expense in acquiring the title to land, it would be hard to find a form of expenditure in relation to property more characteristically of a capital nature.

The fact that the leases acquired by the appellant, along with the mineral rights, were more immediately connected with the production of income than was the franchise involved in the *Dominion* case does not affect the matter in principle. It is relevant in relation to the application of s. 12(1)(*a*), but in relation to s. 12(1)(*b*) we must ask the question, was this outlay for the purpose of preserving a capital asset? In my opinion it clearly was and, if that is so, s. 12(1)(*b*) prevents its deduction.

With respect to the second submission respecting the *Dominion* case, while s. 12(1)(*a*) of the present Act is less restrictive than was s. 6(1)(*a*) of the *Income War Tax Act*, s. 12(1)(*b*) of the *Income Tax Act* is essentially the same as was s. 6(1)(*b*) of the *Income War Tax Act*. In my opinion, for the reasons which I gave in the recent case of *British Columbia Power Corporation Limited v. Minister of National Revenue*[5], the *Dominion* case has established the proposition that legal expense incurred with a view of preserving an asset of advantage for the enduring benefit of the trade is a capital expenditure and is not deductible.

I agree with the learned trial judge that the legal expenses involved in opposing the proposed legislation and in appearing before the Board created by such legislation are subject to the same considerations. They are not different in kind from the costs of the litigation in the courts.

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[4] (1946), 72 C.L.R. 634 at 650.

[5] [1968] S.C.R. 17 [1967] C.T.C. 406, 67 D.T.C. 5258, 65 D.L.R. (2d) 1.

Exploration and Drilling Expense

Scurry-Rainbow Oil Limited, hereinafter referred to as "Scurry", became a major shareholder in the appellant. Scurry was the successor in title to Canadian Pipe Line Producers Ltd. in respect of an agreement, dated May 19, 1954, to which the latter company was a party along with Canada Southern Petroleum Ltd., West Canadian Petroleum Ltd., Trans Empire Oils Ltd. and British Empire Oil Co. Ltd. Under the terms of that agreement the entire legal and beneficial interest in certain Crown petroleum and natural gas permits covering approximately 1,500,000 acres in British Columbia would be held jointly by the parties. The beneficial interest acquired by Scurry was 22 percent of the reservations covered by the agreement.

Canada Southern Petroleum Ltd. had been named as manager-operator under the terms of the agreement, but it was succeeded by Phillips Petroleum Corporation, hereinafter referred to as "Phillips". Under the agreement the parties agreed to conduct a seismic program, and, contingent upon its results, to drill a well for the joint account and at the joint expense of the parties in proportion to their interests. The manager-operator was given sole and exclusive management and control of the exploration, drilling and production operations on the land.

The parties had the right to receive progress information and to inspect and examine the books and records of the manager-operator. There was also provision for meetings and consultation and for surrender, sale or assignment of all or part of a party's interest in the lands.

Paragraph 11 of the agreement governed the matter of costs and expenses:

11. *COSTS AND EXPENSES*

The parties hereto mutually covenant and agree with one another that all exploration costs, drilling costs, completion costs, abandonment costs, production costs, and all other costs and expenses of every nature and kind chargeable to the joint account hereunder incurred in respect to any and all operations carried on hereunder in respect to any of the lands described in the Permits set out in Schedule "A" shall be borne and paid by the parties hereto in proportion to their respective interest in the lands and Permits upon which such exploration, drilling or producing operations are carried on, as such interests appear in Schedule "B" hereof. Subject to the further provisions of this Agreement, Manager-Operator shall initially advance and pay all costs and expenses incurred in connection with the said lands and shall charge the Joint-Operators with their proportionate share thereof upon the cost and expense basis provided for in

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the attached Accounting Procedure. Joint-Operators agree that they will promptly reimburse the Manager-Operator for Joint-Operators' proportionate share of all such costs and expenses within the time limited by the said Accounting Procedure.

On January 2, 1959, Scurry and the appellant entered into an agreement, which, after certain preliminary recitals referring to the agreement of May 19, 1954, read as follows:

> AND WHEREAS the parties hereto desire to enter into this Agreement whereby Farmers Mutual shall have the right to acquire certain interests in the said lands subject to the terms and conditions as hereinafter provided.
>
> NOW THEREFORE THIS AGREEMENT WITNESSETH that Farmers Mutual hereby agreed to pay all costs which may be incurred by Scurry-Rainbow in the performance of its obligations with respect to the seismic program referred to herein. Scurry-Rainbow agrees that upon the completion of the said seismic program on the said lands and the payment by Farmers Mutual of all costs which would have been incurred by Scurry-Rainbow on this seismic program, Farmers Mutual shall have earned an undivided Three (3%) Percent interest in the said lands and the interests owned by Scurry-Rainbow and Farmers Mutual shall thereafter be:
>
> SCURRY-RAINBOW OIL LIMITED .....19% interest
> FARMERS MUTUAL PETROLEUMS LTD. ..... 3% interest
>
> Scurry-Rainbow agrees to execute any and all further documents required in order to vest the interest aforesaid in Farmers Mutual in the event that the seismic program herein is completed. After Farmers Mutual shall have earned the Three (3%) Percent interest referred to herein, Scurry-Rainbow agrees to grant and hereby grants to Farmers Mutual the option to earn an additional Eight (8%) Percent interest in the said lands on the condition that Farmers Mutual agrees to pay and pays Scurry-Rainbow's entire cost of drilling the well referred to herein. After the said well shall have been drilled and Scurry-Rainbow's share of the costs paid by Farmers Mutual, Scurry-Rainbow agrees to execute any and all further documents required in order to vest the Eight (8%) Percent interest in Farmers Mutual.

Under the terms of the 1954 agreement, Phillips, as manager-operator, conducted a seismic program and carried on a drilling program. Phillips invoiced Scurry for its proportionate share of these expenses. On receipt of an invoice, Scurry would usually send an invoice to the appellant for the amount Scurry was required to pay to Phillips, and Scurry would pay Phillips. On two occasions Scurry sent the Phillips' invoice to the appellant, which paid Phillips directly.

On October 5, 1959, the appellant elected to exercise its option, under its agreement with Scurry, to earn the additional 8 per cent interest in the lands by paying Scurry's entire cost of drilling the well.

Section 83A(3) of the *Income Tax Act*, at the relevant times, provided as follows:

83A. (3) A corporation whose principal business is

(*a*) production, refining or marketing of petroleum, petroleum products or natural gas, or exploring or drilling for petroleum or natural gas, or

(*b*) mining or exploring for minerals,

may deduct, in computing its income under this Part for a taxation year, the lesser of

(*c*) the aggregate of such of

(i) the drilling and exploration expenses, including all general geological and geophysical expenses, incurred by it on or in respect of exploring or drilling for petroleum or natural gas in Canada, and

(ii) the prospecting, exploration and development expenses incurred by it in searching for minerals in Canada,

as were incurred after the calendar year 1952 and before the end of the taxation year, to the extent that they were not deductible in computing income for a previous taxation year, or

(*d*) of that aggregate, an amount equal to its income for the taxation year

(i) if no deduction were allowed under paragraph (*b*) of subsection (1) of section 11, and

(ii) if no deduction were allowed under this section,

minus the deductions allowed for the year by subsections (1), (2) and (8a) of this section and by section 28.

The question in issue is as to whether the moneys paid by the appellant pursuant to its agreement with Scurry were deductible in computing the appellant's income tax, as being "drilling and exploration expenses . . . incurred by it on or in respect of exploring or drilling for petroleum or natural gas in Canada". The learned trial judge held that they were not deductible by the appellant. His reasons for so holding are summarized in his judgment as follows:

The submission on behalf of the appellant, as I understand it, is that by the agreement between Scurry and the appellant dated January 2, 1959 the appellant reimbursed Scurry for its outlay for exploration and drilling expenses. Since an expense cannot be incurred by a party who is truly reimbursed, therefore it cannot be said that the expenses were incurred by Scurry but rather they must have been incurred by the appellant which was out of pocket in the precise amount of the expenses and that Scurry was merely the conduit between the appellant and the manager-operator.

In my opinion the agreement between Scurry and the appellant is not susceptible of such interpretation. The substance of that transaction, as I see it, was that the appellant purchased an interest in lands from Scurry and that the price to be paid therefor was determined and measured by the cost of the exploration and drilling expenses incurred by Scurry. It was a condition precedent to any payment to Scurry by the appellant that Scurry should have incurred exploration and drilling expenses and I can

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entertain no doubt that the money paid by the appellant to Scurry was in consideration for a transfer of an interest in land from Scurry to the appellant although that consideration was measured by the yardstick of the costs incurred by Scurry. What Scurry received was payment for an asset sold by it to the appellant and accordingly Scurry was not reimbursed for the exploration expenses incurred by it. Conversely what the appellant paid for and received was the transfer of an interest in lands and therefore did not pay for exploration and drilling expenses.

I am in agreement with these conclusions. Exploration and drilling expenses were incurred in respect of the work carried on by Phillips as manager-operator under the 1954 agreement. This work was done by Phillips on behalf of all the parties to that agreement as well as on behalf of itself, and a portion of the expense was incurred by Phillips, as agent for Scurry.

The 1954 agreement contained provision for an assignment of interest by the parties to it, but there was no assignment of interest effected by Scurry in favour of the appellant. The appellant did not acquire any contractual rights under that agreement, and Phillips had no right to require the appellant to assume any obligation to pay any part of the exploration and drilling expenses which, as manager-operator, Phillips had incurred.

The 1959 agreement between Scurry and the appellant, after referring to the 1954 agreement, recites that the parties "desire to enter this agreement whereby Farmers Mutual shall have the right to acquire certain interests in the said lands". The obligation of the appellant was to pay "all costs which may be incurred by Scurry in the performance of its obligations with respect to the seismic program referred to herein". The appellant was thereby to acquire a 3 percent interest in the lands. It also obtained an option to earn an additional 8 percent interest by paying Scurry's entire cost of drilling the well.

The position is, therefore, that the appellant did not itself incur exploration or drilling costs in respect of land in which it had an interest. What it did do was to pay for a contractual right to acquire an interest in lands on which exploration and drilling had taken place by paying expenses already incurred by Scurry in connection therewith. The payments made by the appellant were not in respect of expenses which it had incurred in respect of exploration or drilling. They were payments of expenses which had been

incurred by another and were made, not to meet a liability of the appellant for the cost of exploration or drilling, but made for the acquisition of an interest in the lands.

In these circumstances, in my opinion, the payments made by the appellant cannot be deducted, under s. 83A(3), in computing its income for tax purposes.

In my opinion, both appeals should be dismissed with costs.

Martland J.

Appeals dismissed with costs.

Solicitors for the appellant: Chambers, Saucier, Jones, Peacock, Black, Gain & Stratton, Calgary.

Solicitor for the respondent: D. S. Maxwell, Ottawa.