HARGAL OILS LIMITED .....APPELLANT;

AND

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

1964
*Nov. 2
1965
Jan. 26

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Oil company—Deductions—Drilling and exploration expenses—Whether deductible by the "predecessor corporation" for same taxation year in which it sold its assets to a "successor corporation"—Income Tax Act, R.S.C. 1952, c. 148, s. 83A(3), (8a).

The business of the appellant was the production of petroleum and the exploring for petroleum and natural gas. During its 1958 fiscal year, it sold its assets to a "successor corporation" within the meaning of s. 83A (8*a*) of the *Income Tax Act*, R.S.C. 1952, c. 148. In its income tax return for that year, the appellant claimed a deduction in respect of its drilling and exploration expenses as it would be normally entitled to do under s. 83A (3) of the Act. The Minister ruled that because of that sale, which brought into operation the provisions of subs. (8*a*), the deduction was not permissible. Both the Income Tax Appeal Board and the Exchequer Court upheld the Minister. The taxpayer appealed to this Court.

Held: The appeal should be dismissed.

When subparagraphs (iii) and (iv) of paragraph (*e*) of subsection (8*a*) are read together the aggregate which is defined in paragraph (*e*) is to consist of expenses not deductible by the "predecessor corporation" in the taxation year in which the property was acquired by the "successor corporation", but which would have been deductible by the "predecessor corporation" in that taxation year but for the provisions of the subsection. In the present case the appellant, pursuant to subs. (3), would have been entitled to deduct the expenses in question had it not been for the words contained in the last paragraph of subs. (8*a*). Reading para. (8*a*) as a whole, it contemplates that only the "successor corporation" was entitled to claim a deduction in respect of the expenses in question, for the taxation year in which the transfer of assets occurred.

Revenu—Impôt sur le revenu—Compagnie de pétrole—Déductions—Dépenses de forage et d'exploration sont-elles déductibles par la «corporation remplacée» pour la même année d'imposition durant laquelle elle

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*PRESENT: Cartwright, Fauteux, Abbott, Martland and Ritchie JJ.

1965

HARGAL OILS LTD. v. MINISTER OF NATIONAL REVENUE

a vendu ses biens à une «corporation remplaçante»—Loi de l'impôt sur le revenu, S.R.C. 1952, c. 148, s. 83A(3), (8a).

La compagnie appelante s'occupait principalement de la production du pétrole et de l'exploration pour la découverte du pétrole et du gas naturel. Durant son année fiscale de 1958, elle a vendu ses biens à une «corporation remplaçante» selon l'expression de l'art. 83A(8*a*) de la *Loi de l'impôt sur le revenu,* S.R.C. 1952, c. 148. Dans son rapport d'impôt pour 1958, la compagnie réclama une déduction pour ses dépenses de forage et d'exploration comme elle avait normalement le droit de le faire en vertu de l'art. 83A(3) de la loi. Le ministre décida que vu cette vente, qui avait fait jouer le paragraphe (8*a*), cette déduction n'était pas permise. La décision du ministre fut confirmée par la Commission d'appel de l'impôt sur le revenu et par la Cour de l'Échiquier.

Arrêt: L'appel doit être rejeté.

Lorsque les sous-paragraphes (iii) et (iv) de l'alinéa (*e*) du paragraphe (8*a*) sont considérés, l'ensemble dont la définition apparaît à l'alinéa (*e*) doit consister dans les dépenses non déductibles de la «corporation remplacée» pour l'année d'imposition durant laquelle les biens ont été acquis par la «corporatioin remplaçante», mais qui auraient été déductibles par la «corporation remplacée» durant cette année d'imposition si ce n'avait été des termes du paragraphe (8*a*). Dans l'espèce, la compagnie appelante aurait eu droit de déduire ses dépenses, en vertu du paragraphe (3), si ce n'avait été des mots que l'on retrouve dans la dernière partie du paragraphe (8*a*). En lisant le paragraphe (8*a*) en entier, il envisage que seule la «corporation remplaçante» avait le droit de réclamer une déduction au sujet de ces dépenses pour l'année d'imposition durant laquelle la cession des biens a eu lieu.

APPEL d'un jugement du juge Dumoulin de la Cour de l'Échiquier[1], confirmant une décision de la Commission d'appel de l'impôt sur le revenu. Appel rejeté.

APPEAL from a judgment of Dumoulin J. of the Exchequer Court of Canada[1], affirming the decision of the Income Tax Appeal Board. Appeal dismissed.

Kenneth E. Meredith, for the appellant.

E. S. MacLatchy, Q.C., for the respondent.

[1] [1963] Ex. C.R. 27, [1962] C.T.C. 534, 62 D.T.C. 1336.

The judgment of the Court was delivered by

MARTLAND J.:—This is an appeal from a judgment of the Exchequer Court of Canada[1], which confirmed the decision of the Income Tax Appeal Board that, for the taxation year 1958, the appellant was not entitled to deduct from its income the amount of $29,136 which it had claimed the right to deduct under the provisions of subs. (3) of s. 83A of the *Income Tax Act*.

The appellant is a public company incorporated in the Province of British Columbia. Its business, during the taxation year which ended on June 30, 1958, was the production of petroleum and the exploring for petroleum and natural gas. Prior to that date and after the calendar year 1952, it had incurred drilling and exploration expenses that were not deductible from its income in previous years in the amount of $95,614.57.

During the fiscal year which ended on June 30, 1958, and prior to that date, the appellant sold its assets to Freehold Gas & Oil Ltd. (N.P.L.), hereinafter referred to as "Freehold". The appellant, in its income tax return for that fiscal year, claimed as a deduction $29,136, the equivalent of its net profit for that year, and relied upon subs. (3) of s. 83A of the *Income Tax Act* to justify such deduction.

The effect of subs. (3) is to enable an oil company to deduct, from its income for the taxation year, exploration and drilling expenses, incurred after the calendar year 1952, to the extent that they were not deductible in computing income for a previous taxation year, in an amount not exceeding its income for the taxation year in question.

It is conceded by the respondent that the appellant's claim for a deduction from income under this subsection would have been valid had it not been for the sale of its assets to Freehold in the taxation year involved. The respondent contends, however, that because of that sale, which brings into operation the provisions of subs. (8a), the deduction was not permissible.

[1] [1963] Ex. C.R. 27, [1962] C.T.C. 534, 62 D.T.C. 1336.

1965

HARGAL OILS LTD. v. MINISTER OF NATIONAL REVENUE

Martland J.

The portions of subs. (8*a*), as it existed at the times material to these proceedings and which are relevant to this appeal, are as follows:

(8a) Notwithstanding subsection (8), where a corporation (hereinafter in this subsection referred to as the "successor 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,

has, at any time after 1954, acquired from a corporation (hereinafter in this subsection referred to as the "predecessor corporation") whose principal business was production, refining or marketing of petroleum, petroleum products or natural gas, exploring or drilling for petroleum or natural gas, or mining or exploring for minerals, all or substantially all of the property of the predecessor corporation used by it in carrying on that business in Canada,

(Paragraphs (*c*) and (*d*) not material.)

there may be deducted by the successor corporation, in computing its income under this Part for a taxation year, the lesser of

(*e*) the aggregate of

(i) the drilling and exploration expenses, including all general geological and geophysical expenses, incurred by the predecessor corporation 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 the predecessor corporation in searching for minerals in Canada,

to the extent that such expenses

(iii) were not deductible by the successor corporation in computing its income for a previous taxation year, and were not deductible by the predecessor corporation in computing its income for the taxation year in which the property so acquired was acquired by the successor corporation or its income for a previous taxation year, and

(iv) would, but for the provisions of paragraph (*b*) of subsection (1), paragraph (*b*) of subsection (2), paragraph (*d*) of subsection (3) and paragraph (*d*) of subsection (8) or of any of those paragraphs or this subsection, have been deductible by the predecessor corporation in computing its income for the taxation year in which the property so acquired was acquired by the successor corporation, or

(Paragraph (*f*) not material.)

and, in respect of any such expenses included in the aggregate determined under paragraph (*e*), no deduction may be made under this section by the predecessor corporation in computing its income for the taxation year in which the property so acquired was acquired by the successor corporation or its income for any subsequent taxation year.

The submission of the appellant is that subpara. (iii) of para. (*e*) of this subsection clearly contemplates the deduction by the appellant of drilling and exploration expenses in the taxation year in which it sold its assets to Freehold because, in defining the "aggregate" which the successor corporation may deduct, it refers to expenses "not deductible by the predecessor corporation in computing its income for the taxation year in which the property so acquired was acquired by the successor corporation." The appellant contends, on the basis of this wording, that the subsection contemplates that the successor corporation cannot include in its aggregate those expenses which the predecessor corporation may itself deduct in respect of its income for the taxation year in which the property was acquired by the successor corporation.

The respondent relies upon the words which follow para. (*f*) of the subsection: "and, in respect of any such expenses included in the aggregate determined under paragraph (*e*), no deduction may be made under this section by the predecessor corporation in computing its income for the taxation year in which the property so acquired was acquired by the successor corporation." The respondent contends that these are the governing words to which meaning must be attributed. As was pointed out in the reasons for the decision of the Income Tax Appeal Board, the words quoted immediately above would have no effect if the contention made by the appellant were to be adopted.

The wording of subs. (8*a*) is complicated and its meaning is far from clear. I have, however, reached the conclusion that the contention of the appellant fails because, while relying on the wording of subpara. (iii) of para. (*e*), it does not take into account the wording of subpara. (iv). When the two subparagraphs are read together, it appears to me that the "aggregate" which is defined in para. (*e*) is to con-

1965

HARGAL OILS LTD. v. MINISTER OF NATIONAL REVENUE

Martland J.

sist of expenses not deductible by the predecessor corporation in the taxation year in which the property was acquired by the successor corporation, but which would have been deductible by the predecessor corporation in that taxation year, "but for the provisions of . . . this subsection."

In the present case the appellant, pursuant to subs. (3), would have been entitled to deduct the expenses in question in the taxation year in question had it not been for the words contained in the last paragraph of subs. (8*a*). They are, therefore, to be included in the aggregate in respect of which Freehold may claim a deduction for the taxation year in question and they may not be deducted by the appellant in computing its income for that year.

In my opinion, therefore, the appellant's argument, based upon the wording of subpara. (iii), fails and, reading subpara. (8a) as a whole, it is my view that it contemplates that only the successor corporation was entitled to claim a deduction, in respect of the expenses in question, for the taxation year in which the transfer of assets occurred. The appeal should, therefore, be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Meredith & Company, Vancouver.

Solicitor for the respondent: E. S. Maclatchy, Ottawa.