

**Date: 20070209**

**Dockets: A-434-05  
A-435-05**

**Citation: 2007 FCA 38**

**CORAM: NOËL J.A.  
SHARLOW J.A.  
RYER J.A.**

**Docket: A-434-05**

**BETWEEN:**

**TRI PACIFIC GAS CORPORATION**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

**Docket: A-435-05**

**BETWEEN:**

**RAY ROTH**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

Heard at Calgary, Alberta, on January 24, 2007.

Judgment delivered at Ottawa, Ontario on February 9, 2007.

**REASONS FOR JUDGMENT BY:**

**RYER J.A.**

**CONCURRED IN BY:**

**NOËL J.A.**

**SHARLOW J.A.**

**Date: 20070209**

**Dockets: A-434-05  
A-435-05**

**Citation: 2007 FCA 38**

**CORAM: NOËL J.A.  
SHARLOW J.A.  
RYER J.A.**

**Docket: A-434-05**

**BETWEEN:**

**TRI PACIFIC GAS CORPORATION**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

**Docket: A-435-05**

**BETWEEN:**

**RAY ROTH**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

**REASONS FOR JUDGMENT**

**RYER J.A.**

**INTRODUCTION**

[1] These are appeals from two decisions of Bell J. of the Tax Court of Canada (2005 TCC 484) in which he disallowed a deduction of \$363,552 claimed by the appellant, Tri Pacific Gas

Corporation ("Tri Pacific"), in respect of its taxation year that ended on March 31, 1998 and upheld the inclusion of \$371,726 in the income of the appellant, Ray Roth ("Roth"), as a shareholder benefit, in respect of his 1998 taxation year.

[2] The appeals were consolidated by order of this Court, dated January 27, 2006, with the appeal of Tri Pacific (A-434-05) being designated as the lead appeal. These reasons will be filed in A-434-05 and a copy of them will be filed in A-435-05.

### **FACTS**

[3] Mr. Roth is an individual of considerable experience in the petroleum industry. He was employed by a non-resident corporation that was involved in the construction of a liquefied natural gas ("LNG") facility that was owned by the Indonesian government oil and gas corporation ("Pertamina"). After the conclusion of that employment in 1978, Mr. Roth undertook an arrangement with Pertamina for the promotion of another LNG project in Indonesia (the "Pertamina LNG Project"), in the course of which he claims to have incurred costs of various types. He also says that he incurred certain engineering and design costs that related to another project involving drilling off the east coast of East Kalimantan, Indonesia (the "East Kalimantan Drilling Project"). Mr. Roth claims that he incurred costs totalling \$371,726 between April of 1978 and the end of 1981 in relation to those two projects. He says he would have been reimbursed by the other parties to those arrangements if those projects had come to fruition, but that did not happen. In late 1981, Mr. Roth resumed Canadian residence and undertook employment with an Edmonton based corporation.

[4] In late 1991, Tri Pacific was incorporated, initially under another name, with Mr. Roth and another individual, Mr. Ron Cripps, as equal shareholders. Tri Pacific was set up to exploit a potential interest of an Asian group in a new LNG project that was to produce LNG on the west coast of Canada, for shipment to Southeast Asia.

[5] The financial statements of Tri Pacific as at March 31, 1993 show an asset called "Pre Development Costs" in the amount of \$455,353.60 and a liability called "Loans Payable" in the amount of \$540,000. Included in both amounts is the \$371,726 of costs that Mr. Roth said that he had incurred in relation to the Pertamina LNG Project and the East Kalimantan Drilling Project. Both amounts became part of the Tri Pacific financial statements as the result of a journal entry in June of 1992.

[6] In relation to the liability portion of the 1992 journal entry, Mr. Roth testified that a promissory note was prepared and initialled but not executed, by him. That document was not produced as evidence. No other documents were produced to support the journal entry. Mr. Roth testified that he had receipts for all his costs at one time, but they had been given to the accountants for Tri Pacific and could not be found after a search.

[7] In November of 1994 BAS Ventures Inc., ("BAS Ventures"), a nominee and agent for a number of persons (including Tri Pacific), and Capital Projects Group Inc. entered into a joint venture arrangement (the "Pac-Rim JV") to evaluate the feasibility of building an LNG plant at Kitimat, B.C. (the "Kitimat LNG Project") for the purpose of exporting LNG to Southeast Asia. At

approximately the same time, the Pac-Rim JV entered into a Management Agreement with Tri Pacific to obtain management services, and in particular the full-time services of Mr. Roth, in relation to the feasibility evaluation segment of the Kitimat LNG Project. The Management Agreement acknowledged that Tri Pacific had incurred certain "prior period costs of \$371,146.00" and that those costs would be paid to Tri Pacific if the Kitimat LNG Project reached certain milestones.

[8] In 1997, the interest in the Pac-Rim JV that was held by BAS Ventures was sold to Pac-Rim LNG Inc., Bechtel Enterprises International, Ltd., Phillips Petroleum Canada Ltd. and Daewoo Corporation. The agreement specified that the "Purchased Interest" was a 5% equity interest in the Pac-Rim JV, which related to the Kitimat LNG Project. The purchase price of the "Purchased Interest" was \$4.5 million, of which US \$1 million was paid and the balance, including an amount referred to as representing a reimbursement of certain development costs incurred by the selling party, was never paid because it was contingent upon the attainment of a financing milestone that was never reached. As a consequence of this sale, Tri Pacific received a payment of \$586,601.20 as its share of the purchase price.

[9] In computing its income for its 1988 fiscal period, Tri Pacific included, as ordinary income, the amount of \$586,601.20 and claimed a deduction, on account of "Predevelopment costs" in the amount of \$474,326. Of this amount, the Minister, on reassessment, permitted a deduction of \$110,774 and denied the balance of \$363,552 on the basis that this portion of such "Predevelopment costs" had not been incurred by Tri Pacific.

[10] Tri-Pacific made a payment of an amount in excess of \$500,000 to Mr. Roth in 1998. He included no portion of that payment in computing his income for that year on the basis that the amount received represented a repayment of indebtedness owing to him by Tri Pacific. On reassessment, the Minister included \$371,726 of that payment in his income for 1998 as a shareholder benefit pursuant to subsection 15(1) of the *Income Tax Act*, R.S.C. 1985, c.I (5<sup>th</sup> Suppl.) (the "ITA").

[11] Both Tri Pacific and Mr. Roth appealed their respective reassessments and the matters came before Bell J. of the Tax Court for adjudication.

### **TAX COURT DECISION**

[12] Bell J. dismissed both appeals. He held that Tri Pacific was not permitted to deduct the \$363,552 of "Predevelopment Costs" since that amount represented costs that had been incurred by Mr. Roth prior to 1982 and had not been incurred by Tri Pacific. Bell J. went on to hold that the \$363,552 amount did not represent the cost of any property that had been transferred by Mr. Roth to Tri Pacific at the time of the 1992 journal entry. He found that there was no documentation in evidence that supported such a transfer and that any knowledge that Mr. Roth possessed had not been reduced to writing or put into electronic form. This lead him to conclude that what Mr. Roth possessed was essentially information, ideas, knowledge or know-how, none of which was exclusive to him.

[13] Based upon the decision of this Court in *Manrell v. R.* 2003 FCA 126, Bell J. concluded that, as a matter of law, whatever Mr. Roth may have had, it did not constitute property within the meaning of that term in the ITA. In reaching that conclusion, Bell J. emphasized that the know-how that Mr. Roth possessed was not exclusive to him and that it had not been formalized into some marketable form, in contrast to the know-how that was the subject matter of the sale to Pac-Rim LNG Inc., Bechtel Enterprises International, Ltd., Phillips Petroleum Canada Ltd. and Daewoo Corporation that occurred in 1997. In that regard, counsel to Tri Pacific advised the Court that what had been sold in 1997 was "Economic studies, models, engineering studies, models, expertise, know-how".

[14] Bell J. concluded that the 1992 journal entry did not give Mr. Roth a legally enforceable right to receive \$371,726 from Tri Pacific because the purported transfer of property that allegedly gave rise to the liability of Tri Pacific to pay that amount was a legal nullity. He also held that the promissory note, which was initialed but unexecuted, was unenforceable. In absence of a legally enforceable right to repayment of a liability owing by Tri Pacific to Mr. Roth, Bell J. concluded that the payment of \$371,726 by Tri Pacific constituted a shareholder benefit that validated the reassessment of Mr. Roth, pursuant to subsection 15(1) of the ITA.

### **ANALYSIS AND DECISION**

[15] The appellants contended that Mr. Justice Bell made several errors of law in his decision but the main issue underlying their contentions was whether or not any property was transferred by Mr. Roth to Tri Pacific. That issue was further refined when counsel for the appellants conceded, at the

hearing, that the initialed but unexecuted promissory note was a legal nullity and that only know-how was the subject of the alleged transfer. According to the appellant, Bell J. erred in not finding that the 1992 journal entry had the effect of recognizing the transfer of know-how by Mr. Roth to Tri Pacific and the legal obligation of Tri Pacific to pay the amount of \$371,726 as a consequence of such transfer.

[16] In my view, Bell J. was correct when he concluded that, for income tax purposes, Mr. Roth's "know-how" was not property that was capable of being transferred by Mr. Roth or acquired by Tri Pacific and as a result, the liability portion of the 1992 journal entry could not be treated as having created or established a legally enforceable right on the part of Mr. Roth to be paid \$371,726 as the cost of property acquired by Tri Pacific.

[17] The inevitable results of these findings are:

- a. that Tri Pacific could not claim a deduction of, or in respect of, the cost of any property acquired from Mr. Roth, and therefore Bell J.'s decision to deny the \$363,522 deduction that was claimed by Tri Pacific in computing income for its 1998 taxation year was correct; and
- b. that Mr. Roth could not claim that the receipt of \$371,726 from Tri Pacific in 1998 constituted the repayment of a corresponding amount of indebtedness that was owed to him by Tri Pacific, and therefore Bell J.'s decision to uphold the inclusion of \$371,726 in the 1998 income of Mr. Roth, pursuant to subsection 15(1) of the ITA, was correct.



[18] The appellants also advanced a number of other arguments, but none of those arguments need to be addressed. Given the conclusion that Tri Pacific did not acquire any property from Mr. Roth and did not become indebted to him, those additional arguments must fail.

[19] For these reasons, I would dismiss both appeals with costs.

"C. Michael Ryer"

---

J.A.

"I agree.

Marc Noël, J.A."

"I agree.

K. Sharlow, J.A."

**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

**DOCKETS:** A-434-05 / A435-05

**STYLE OF CAUSE:** TRI PACIFIC GAS CORPORATION v. HMTQ /  
RAY ROTH v. HER MAJESTY THE QUEEN

**PLACE OF HEARING:** CALGARY, ALBERTA

**DATE OF HEARING:** JANUARY 24, 2007

**REASONS FOR JUDGMENT BY:** RYER J.A.

**CONCURRED IN BY:** NOËL J.A.  
SHARLOW J.A.

**DATED:** FEBRUARY 9, 2007

**APPEARANCES:**

James Dunphy  
Jonathan D. Warren

FOR THE APPELLANT

George F. Body

FOR THE RESPONDENT

**SOLICITORS OF RECORD:**

Warren Tettensor Amantea LLP  
Calgary, Alberta

FOR THE APPELLANT

John H. Sims, Q.C.  
Department of Justice

FOR THE RESPONDENT