Docket: 2011-1404(IT)G

BETWEEN:

DEVON CANADA CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Motion heard on September 16, 2013 at Toronto, Ontario.

Before: The Honourable Justice Robert J. Hogan

Appearances:

Counsel for the Appellant:	Al Meghji Pooja Samtani Edward Rowe
Counsel for the Respondent:	Josée Tremblay Marie-France Camiré Ryan Gellings

---

ORDER

Upon the Appellant bringing a motion for determination, before hearing, of the following question of law pursuant to paragraph 58(1)(*a*) of the *Tax Court of Canada Rules* (*General Procedure*):

> whether, by operation of paragraphs 66.7(10)(*j*) and 66.7(10)(*c*) of the *Income Tax Act*, following the acquisition of control of Home Oil . . . and the transfer of the [Anderson Properties] by the [Anderson Partnership] to the [Devon Partnership], the proportionate share of income earned from the [Anderson Properties] owned through the Devon Partnership, allocated to the Anderson Partnership and further allocated to Home Oil, may reasonably be regarded as having been attributable to production from a particular resource property owned before the acquisition time by an original owner for purposes of subsections 66.7(1) to (5).

And upon having heard the submissions of counsel and having read the materials filed;

The motion is allowed and the above question is decided as set out in the reasons for order attached hereto. Costs on this motion are left to the discretion of the trial judge.

Signed at Ottawa, Canada, this 18th day of December 2013.

"Robert J. Hogan"

Hogan J.

Citation: 2013 TCC 415
Date: 20131218
Docket: 2011-1404(IT)G

BETWEEN:

DEVON CANADA CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR ORDER

Hogan J.

I. Introduction

[1] The Appellant has brought this motion pursuant to paragraph 58(1)(*a*) of the *Tax Court of Canada Rules (General Procedure)*. Following an earlier hearing, the following question of law (the "Question") was set down for determination by a motion judge:

> whether, by operation of paragraphs 66.7(10)(*j*) and 66.7(10)(*c*) of the *Income Tax Act*, following the acquisition of control of Home Oil . . . and the transfer of the [Anderson Properties] by the [Anderson Partnership] to the [Devon Partnership], the proportionate share of income earned from the [Anderson Properties] owned through the Devon Partnership, allocated to the Anderson Partnership and further allocated to Home Oil, may reasonably be regarded as having been attributable to production from a particular resource property owned before the acquisition time by an original owner for purposes of subsections 66.7(1) to (5).

II. Factual Background

[2] The facts are not in dispute. Anderson Exploration Ltd., the parent corporation of Home Oil Company of Canada ("Home Oil"), was acquired by Devon Acquisition Corporation on October 15, 2001 (the "Acquisition of Control"). Home Oil

was continued by amalgamation as the Appellant, Devon Canada Corporation (“Devon Canada”).

[3] Prior to the Acquisition of Control, Home Oil owned its resources properties (the “Anderson Properties”) through a partnership of which it was a direct member, the Anderson Exploration Partnership (the “Anderson Partnership”).

[4] Following the Acquisition of Control, the Anderson Partnership transferred all of its resource properties (the “Transfer”) to a subsidiary partnership, the Devon Canada Partnership (“Devon Partnership”). The Transfer did not alter Home Oil’s proportionate interest in the Anderson Partnership.

[5] The Minister of National Revenue (the “Minister”) reassessed Home Oil, denying its claim for successor deductions in respect of the Anderson Properties, which claim was made after the Transfer. The claim was denied on the basis that paragraph 66.7(10)(*j*) ceased to apply on the transfer of the property to the second level partnership.

III. Issue

[6] The Question concerns the interpretation and application of section 66.7 of the *Income Tax Act* (the “Act”), commonly referred to as the successor rules. More specifically, the Question addresses the matter of whether a corporate partner can continue to deduct “successored” resource expenses against income from resource properties that have been transferred from a partnership of which that partner is a direct member to a subsidiary partnership following an acquisition of control.

IV. Overview of the Provisions at Issue

[7] Generally, the successor rules permit a subsequent owner of resource properties to deduct against income from the transferred properties the unused resource expenses incurred by the transferor.

[8] Section 66.7 permits a corporation (a “successor”) which acquires all or substantially all of the resource properties of a vendor (an “original owner”) to claim the unused resource expenses of the original owner (“‘successored’ expenses”) against income from the production from the properties and income in the form of proceeds from the disposition of the properties acquired from the original owner. The specific rules allowing different types of resource deductions are set out in

subsections 66.7(1) to (5).[1] "Successored" expenses may be deducted to the extent of a successor's income that "may reasonably be regarded as attributable" to production from the properties that are acquired.[2]

[9] The successor rules in the context of the acquisition of a resource property are optional, as a joint election by the successor and original owner must be made in order for the rules to apply.[3] If assets are sold to an unrelated person and an election is not made, the vendor retains its resource expense pools and may deduct them freely.

[10] The successor rules automatically come into play when a corporation is the subject of an acquisition of control. The successor rules in the context of an acquisition of control are found in subsection 66.7(10) of the Act, which provides:

> (10) Where at any time after November 12, 1981
>
> (*a*) control of a corporation has been acquired by a person or group of persons, or
>
> (*b*) a corporation ceased on or before April 26, 1995 to be exempt from tax under this Part on its taxable income,
>
> for the purposes of the provisions of the *Income Tax Application Rules* and this Act (other than subsections 66(12.6), (12.601), (12.602), (12.62) and (12.71)) relating to deductions in respect of drilling and exploration expenses, prospecting, exploration and development expenses, Canadian exploration and development expenses, foreign resource pool expenses, Canadian exploration expenses, Canadian development expenses and Canadian oil and gas property expenses (in this subsection referred to as "resource expenses") incurred by the corporation before that time, the following rules apply:
>
> (*c*) the corporation shall be deemed after that time to be a successor (within the meaning assigned by subsection 29(25) of the *Income Tax Application Rules* or any of subsections (1) to (5) that had, at that time, acquired all the properties owned by the corporation immediately before that time from an original owner thereof,
>
> . . .

[1] Specifically subsection 66.7(1) Successor of Canadian exploration and development expenses; subsection 66.7(2) Successor of foreign exploration and development expenses; subsection 66.7(3) Successor of Canadian exploration expense; subsection 66.7(4) Successor of Canadian development expense; and subsection 66.7(5) Successor of Canadian oil and gas property expense.

[2] As per clauses 66.7(1)(*b*)(i)(C) and 66.7(2)(*b*)(i)(B), and subparagraph 66.7(2.3)(*b*)(i), and clauses 66.7(3)(*b*)(i)(C), 66.7(4)(*b*)(i)(B) and 66.7(5)(*b*)(i)(B).

[3] As per paragraph 66.7(7)(*c*) or (*e*), or 66.7(8)(*c*) or (*e*).

(*d*) a joint election shall be deemed to have been filed in accordance with subsections (7) and (8) in respect of the acquisition,

(*e*) the resource expenses incurred by the corporation before that time shall be deemed to have been incurred by an original owner of the properties and not by the corporation.

[11] Upon an acquisition of control, paragraph 66.7(10)(*c*) deems the corporation to be a successor to itself for the purposes of claiming deductions provided for by subsections 66.7(1) to (5), as it is considered to have acquired all of the resource properties it owned immediately before that time from an original owner thereof. Under paragraph 66.7(10)(*e*), the resource expenses incurred by the corporation are deemed to have been incurred by an original owner of the property.

[12] By deeming the corporation to be a successor to itself, subsection 66.7(10) effectively places the corporation in the same position as that which it would have been in had it acquired all of its resource properties from another corporation which had incurred the resource expenses and which owned the resource properties. The primary implication is that any unused resource expenses become deductible solely against income that "may reasonably be regarded as attributable" to the resource properties owned by the corporation immediately prior to the acquisition of control.[4] By streaming expenses to particular properties, the change-of-control successor rules prevent trading in unused resource expenses.

[13] Following the introduction of the acquisition of control provisions in 1983, it was unclear whether unused resource expenses were deductible following an acquisition of control in circumstances where the resource properties were owned through a partnership.

[14] In 1987, Parliament adopted relieving legislation to address this uncertainty.[5] Paragraph 66.7(10)(*j*) is a "look-through rule" which enables a corporate partner to deduct against its proportionate share of the income and proceeds from the partnership resource expenses it incurred with respect to the partnership resource properties. Paragraph 66.7(10)(*j*) provides as follows:

---

[4] See clauses 66.7(1)(*b*)(i)(C) and 66.7(2)(*b*)(i)(B), subparagraph 66.7(2.3)(*b*)(i), and clauses 66.7(3)(*b*)(i)(C), 66.7(4)(*b*)(i)(B) and 66.7(5)(*b*)(i)(B).

[5] David M. Sherman, *Department of Finance Technical Notes* (2011) at page 557, and Department of Finance *Technical Notes to a Notice of Ways and Means Motion Relating to Income Tax* (Ottawa: Department of Finance, June 1987).

> (*j*) where that time is after January 15, 1987 and at that time the corporation was a member of a partnership that owned a Canadian resource property or a foreign resource property at that time
>
> (i) for the purpose of paragraph (*c*), the corporation shall be deemed to have owned immediately before that time that portion of the property owned by the partnership at that time that is equal to its percentage share of the total of amounts that would be paid to all members of the partnership if it were wound up at that time, and
>
> (ii) for the purposes of clause 29(25)(*d*)(i)(B) of the *Income Tax Application Rules*, clauses (1)(*b*)(i)(C) and (2)(*b*)(i)(B), subparagraph (2.3)(*b*)(i) and clauses (3)(*b*)(i)(C), (4)(*b*)(i)(B) and (5)(*b*)(i)(B) for a taxation year ending after that time, the lesser of
>
> (A) its share of the part of the income of the partnership for the fiscal period of the partnership ending in the year that may reasonably be regarded as being attributable to the production from the property, and
>
> (B) an amount that would be determined under clause (A) for the year if its share of the income of the partnership for the fiscal period of the partnership ending in the year were determined on the basis of the percentage share referred to in subparagraph (i),
>
> shall be deemed to be income of the corporation for the year that may reasonably be attributable to production from the property.

[15] Where a corporation is a member of a partnership that owns resource properties at the time of an acquisition of control, subparagraph 66.7(10)(*j*)(i) deems that corporate partner to have owned its proportionate share of the partnership's resource properties immediately prior to the acquisition of control. This deemed ownership places the corporate partner within the ambit of paragraph 66.7(10)(*c*), and this, in turn, enables the successor to avail itself of the deductions provided for in subsections 66.7(1) to (5).

[16] Subparagraph 66.7(10)(*j*)(ii) prescribes a limit on the amount "that may reasonably be attributable to production" from the "successored" property for purposes of the streaming restrictions provided for in subsections 66.7(3), 66.7 (4) and 66.7 (5) of the Act. Specifically, where the resource properties in question were held in a partnership at the time of the acquisition of control of the corporate partner, the corporation's "share of the partnership income" . . . "that may reasonably be regarded as attributable to the production from the property" is equal to the lesser of: (i) the corporation's share of the partnership income in the year that "may reasonably be regarded as attributable to the production from the property"; and (ii) the amount that would be determined under (i) if it was determined by reference to the

corporation's proportionate share of the partnership income at the time of the acquisition of control.

Position of the Parties

A. *Appellant's Position*

[17] The Appellant takes the position that paragraph 66.7(10)(*j*) continues to apply so as to allow Home Oil to deduct "successored" resource expenses notwithstanding the transfer of the Anderson Properties from the Devon Partnership to the Anderson Partnership. To support its position, the Appellant relies on the following grounds:[6]

> (i) Home Oil continued to receive its share of production income from the Anderson Properties after the [Transfer] as it had received prior to the [Transfer], as computed under subparagraph 66.7(10)(*j*)(ii);
>
> (ii) although the Anderson Partnership earned income through the Devon Partnership after the [Transfer], it remained income that "may reasonably be regarded as being attributable to the production from" the Anderson Properties for purposes of subparagraph 66.7(10)(*j*)(ii); and
>
> (iii) subsection 96(1) of the Act, which preserves the source and location of the income from each partnership activity (including the ownership of property), conclusively confirms the foregoing.

[18] In response to the argument raised in the Respondent's Memorandum of Fact and Law, the Appellant argued orally that the successor rules did not cease to apply following the Transfer. More specifically, the Appellant noted that subparagraph 66.7(10)(*j*)(i) deemed Home Oil to have been the owner of its proportionate share of the Anderson Properties immediately before the Acquisition of Control and that nothing occurred subsequently to terminate this deemed ownership. The deemed ownership brought Home Oil within the ambit of paragraph 66.7(10)(*c*) and enabled it to become a deemed successor to itself, having acquired its proportionate share of the Anderson Properties and the associated resource expenses from an original owner thereof.

[19] The Appellant argued that there was nothing in the Act that subsequently terminated this deemed successorship with regard to the Anderson Properties. The Appellant acknowledged that, following the Acquisition of Control, Home Oil's deduction was limited by the requirement of having income that may "reasonably be regarded as attributable to" production from the Anderson Properties.

---

[6] Appellant's Memorandum of Fact and Law at paragraph 13.

B. *Respondent's Position*

[20] In her written submissions and in her oral submissions at the hearing, the Respondent reframed the issue, asking whether the acquisition by a partnership of Canadian resource properties of another partnership triggers the application of the successor rules. The successor rules, argued the Respondent, come into play only upon the occurrence of one of two triggering events: (i) an acquisition of control of the corporation; and (ii) an acquisition of all or substantially all of the resource properties by a corporation. Since a transfer of resource properties from a partnership to a subsidiary partnership does not trigger the successor rules, the Respondent reasoned that any unused resource expenses of the Appellant must expire.

[21] It is significant to note that the Respondent articulated a different position in its Reply filed with this Court on July 11, 2011 (the "Original Reply"). There, the Respondent argued that the "look-through rule" in paragraph 66.7(10)(*j*) operates only where a corporation is a direct member of a partnership that owns resource property, and not where the property is owned by a subsidiary partnership. More specifically, the Respondent stated that as a result of the Transfer, the Anderson Partnership had "divested itself of its assets used for the purpose of producing oil and gas and, therefore, was not generating income attributable in any manner to production from Canadian resource property".[7] Without income reasonably attributable to production from the Anderson Properties, the Respondent argued, the Appellant's deduction was limited under subparagraph 66.7(10)(*j*)(ii) to nil.

V. <u>Analysis</u>

[22] The analysis is complicated by the fact that the Respondent has framed the issue raised by the Question as being "whether the acquisition by a partnership of Canadian resource properties from another partnership triggers the application of the successor rule provided for by subsection 66.7(10) of the Act."[8] I find that this constitutes a mischaracterization of the Question. It is also a departure from the basis of the Minister's reassessment and from the position put forward in the Respondent's Original Reply.

[23] In my opinion, the Question is more appropriately framed as being whether a corporate partner can continue to deduct "successored" resource expenses against income from a resource property that has been transferred from a partnership of which it is a direct member to a subsidiary partnership following an acquisition of

[7] Respondent's Original Reply at paragraph 14(hh).
[8] Respondent's Memorandum of Fact and Law at paragraph 11.

control. The answer turns on whether income earned through the subsidiary partnership remains income that "may reasonably be regarded as being attributable to the production from" the resource property for the purposes of subparagraph 66.7(10)(*j*)(ii).

[24] Both parties urged me to adopt a textual, contextual, and purposive interpretation of the relevant provisions; therefore, a review of the current law will be instructive. The modern approach to statutory interpretation was articulated by the Supreme Court of Canada in *Canada Trustco Mortgage Co. v. Canada*:[9]

> It has been long established as a matter of statutory interpretation that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": see *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804, at para. 50. <u>The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole</u>. . . .
>
> [Emphasis added.]

[25] In *Canada Trustco Mortgage*, the Supreme Court also stated that where the words of a statute are precise and unequivocal, the ordinary meaning of those words plays a dominant role. Conversely, where the words may support more than one reasonable meaning, recourse must be had to a greater extent to the context and purpose of the statute:[10]

> . . . When the words of a provision are precise and unequivocal, the ordinary meaning of the words plays a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.

[26] In *Canada Trustco Mortgage*, the unanimous Court further added that the Act must be interpreted in such a way as to achieve consistency, predictability and fairness.

Did the Resource Expenses Expire When the Anderson Properties Were Transferred to the Devon Partnership?

---

[9] 2005 SCC 54, at paragraph 10.
[10] *Ibid.*, [2005] 2 S.C.R. 601.

[27] The Respondent argued that when a property is transferred in a way that does not trigger the application of the successor rules, “successored” resource expenses expire.

[28] While I accept that a transfer of property from a partnership to a subsidiary partnership following an acquisition of control does not trigger the successor rules, I do not believe that this results in the expiry of the “successored” resource expenses. The Respondent did not point to anything in the Act that mandates such a result.

[29] The Respondent’s interpretation is also at odds with the Canada Revenue Agency’s (the “CRA”) administrative position. The CRA has stated that resource expenses are deductible where a corporation is the subject of an acquisition of control and subsequently transfers the resource property to a partnership of which it is a member. A transfer of a “successored” resource property to a partnership is not one of the two triggering events; however, contrary to the Respondent’s position herein, the resource expenses remain deductible according to the CRA.[11]

[30] Paragraph 66.7(10)(*j*) applies to situations where a corporation “was a member of a partnership that owned a Canadian resource property or a foreign resource property” at the time of an acquisition of control. Subparagraph 66.7(10)(*j*)(i) deems the corporate partner to have owned immediately before that time its proportionate share of the partnership’s resource properties. Therefore, under paragraph 66.7(10)(*j*), Home Oil was deemed to own its proportionate share of the Anderson Properties immediately prior to the Acquisition of Control.

[31] This deemed ownership operates for the purposes of paragraph 66.7(10)(*c*), which then deems the corporate partner to be a successor to itself by virtue of its being deemed to have acquired the resource properties from an original owner thereof. This in turn allows the successor to avail itself of the deductions provided for in subsections 66.7(1) to (5). Paragraph 66.7(10)(*c*) operates continuously after the time of the acquisition of control, stating that “the corporation shall be deemed *after that time* to be a successor . . . that had, at that time [i.e., the time of the acquisition of control], acquired all the properties owned by the corporation immediately before that time [i.e., the same moment as that at which subparagraph 66.7(10)(*j*)(i) deems the corporation to have owned its share of the partnership properties] from an original owner thereof.” The Act says “acquired,” it does not say “acquired and has not disposed of.”

---

[11] Question 2 of the 1991 Canadian Tax Foundation Round Table, Revenue Canada Round Table, document No. 2M033A (October 30, 1992) – Taxnet.Pro Position subsequently clarified in CRA document No. 9406435, “Successor Rule – Income From Particular Property” (March 31, 1994) and CRA document No. 9328657, “Successor Rule Re Partnership and Change of Control” (October 7, 1993) – Taxnet.Pro.

[32] Therefore, once the corporate partner is deemed to own the partnership properties under subparagraph 66.7(10)(*j*)(i), it is deemed continuously by paragraph 66.7(10)(*c*) to be a successor that acquired the partnership properties from an original owner. Successor status is established immediately prior to the acquisition of control. A subsequent event must occur to terminate this successor status.[12]

[33] In summary, the Respondent's position in this case is based on the misconstruction that the deemed ownership concept applicable to property owned by a first-tier partnership as set out in paragraph 66(10)(*j*) ceases to operate if the property is transferred to a second-tier partnership. This is manifestly incorrect. For the change of control provisions to operate properly, the streaming restrictions must continue to operate from year to year. The impact is that if the corporation fails to earn income from those properties because the resource is depleted or the income is earned by another taxpayer that is subject to tax, then the corporation will be unable to deduct its resource expenses existing at the time of the change of control. As a result, while the corporate partner will remain a successor indefinitely, if it loses its connection with the resource property it will no longer have income "that may reasonably be regarded as attributable" to property, and its maximum deduction under subparagraph 66.7(10)(*j*)(ii) would be nil.

[34] While Home Oil remained at all times a successor with respect to the Anderson Properties and was therefore entitled to deduct resource expenses in accordance with subsections 66.7(1) to (5), its deduction will be limited according to the extent to which its income "may reasonably be regarded as attributable to . . . production from" the Anderson Properties.[13]

[35] There is no specific requirement that the partnership continue to directly own the property at the time the "successored" resource expenses are deducted. I agree with the Appellant that the Respondent's position requires me to read into subparagraph 66.7(10)(*j*)(ii) after the phrase "for a taxation year ending after that time" additional words such as these: "but only where the party continues to hold

---

[12] Successor status could be terminated if the property were acquired in circumstances where the successor rules in subsections 66.7(1) to (5) apply or in circumstances where the avoidance rule under subsection 66.7(16) applies. It is significant to note that neither party raised the application of subsection 66.7(16).

[13] This is consistent with the CRA's position. See CRA document No. 2006-0169051I7, "Successor Pool Issues" (October 10, 2006 – Taxnet.Pro), which addresses the matter of income from resource properties transferred to a partnership following an acquisition of control. On this question, the CRA noted: "It is not necessary that the partner own the particular property in the taxation year in which it seeks to deduct an amount on account of its successor pool; however, the partnership must have either production income or proceeds of disposition from the successored property that is allocated to the partner in the year."

such properties throughout the taxation year." The Supreme Court of Canada has admonished against reading words into the Act in this way.[14]

Can Income Derived From Property Held in a Subsidiary Partnership Be Reasonably Regarded as Attributable to the Resource Property?

[36] A textual, contextual and purposive interpretation of paragraph 66.7(10)(*j*) supports the conclusion that income attributable to property transferred by a corporate partner from a partnership of which it was a direct member to a subsidiary partnership following an acquisition of control remains income that "may reasonably be regarded as being attributable to the production from" the resource property for the purposes of subparagraph 66.7(10)(*j*)(ii).

[37] The phrase "may reasonably be regarded as attributable to" is not defined in the Act, and the successor provisions are only now, for the first time, being judicially considered. The Respondent did not provide any arguments on the wording. The Appellant, for its part, submitted that the wording chosen by Parliament is broad enough to include income derived from properties owned by a subsidiary partnership. To support its argument, the Appellant pointed to case law which considered comparable wording.

[38] In *729658 Alberta Ltd. v. The Queen*,[15] this Court considered the wording "reasonably be attributed" then contained in subsection 55(2). Justice Woods held that the term suggested a fair and moderate allocation of the amount:

> . . . The *Canadian Oxford Dictionary* defines the words "reasonable" and "attribute" as follows:
>
> **reasonable 1** having sound judgment; moderate; ready to listen to reason. **2** in accordance with reason; not absurd. **3a** within the limits of reason; fair moderate (*a reasonable request*). **b** inexpensive; not extortionate. **c** fairly good, average (*the food here is reasonable*).
>
> **attribute 1** regard as belonging or appropriate to (*a poem attributed to Shakespeare*). **2** ascribe to; regard as the effect of a stated cause (*the delays were attributed to heavy traffic*). **1a** a quality ascribed to a person or thing. **b** a characteristic quality. **2** a material object recognized as appropriate to a person, office or status (*a sceptre is an attribute of majesty*). **3** *Grammar* an attributive adjective or noun.

---

[14] *Ludco Entreprises Ltd. v. Canada*, 2001 SCC 62, [2001] 2 S.C.R. 1082, at paragraph 38.
[15] 2004 TCC 474, 2004 DTC 2909, at paragraph 28.

> These definitions suggest that the allocation should be fair and moderate. They do not require that there be an averaging or proration.

[39] The Appellant also referred to a document in which the Minister considered the meaning of the phrase "can reasonably be considered to relate" in the context of subsection 152(4.3). This subsection permits the Minister to reassess outside of the normal reassessment period in circumstances in which the reassessment "can reasonably be considered to relate to" the matter specified in the subsection. With regard to this, the Minister has stated:[16]

> . . . the term used in the provision, "can reasonably be considered to relate", is not specifically defined in the Act so its interpretation relies on its "ordinary" meaning. We note, first of all, that the term is not one that suggests mathematical precision. Both the words "reasonably" and "relate" provide a broad scope for interpretation. The Oxford Dictionary includes the following relevant definitions:
>
> . . .
>
> Traditionally, the use of the word "reasonable" in the context of the administration of the Act allows for some considerable latitude. It is our view that as long as the connection between two things or actions is easily discernible then the two things or actions could reasonably be considered to be related.

[40] In the absence of arguments from the Respondent on the language at issue, I find that the previous interpretations of comparable phrases support the Appellant's position and that the phrase "reasonably be regarded as attributable to . . . production" can be interpreted so as to include income allocated to Home Oil by the Devon Partnership.

[41] Paragraph 66.7(10)(*j*) applies to partnerships and their members. Thus, the Act's tax treatment of partnerships and their members is part of the context within which paragraph 66.7(10)(*j*) should be interpreted.

[42] The scheme of the Act, like Canadian common law, recognizes that a partnership is not a separate legal person; rather, it is a relationship between two or more persons carrying on business in common with a view to profit. Since the Act imposes taxes on "persons", a partnership is not subject to an entity-level tax. Instead, a partnership is treated as a conduit or flow-through for income tax purposes, and its income or losses are calculated in the aggregate and then allocated to its members.

---

[16] CRA document No. 9524846, "Consequential assessment" (November 14, 1995 – Taxnet.Pro).

[43] Section 96 in Part I, Division B, Subdivision j (Partnerships and Their Members) of the Act sets out the general rules governing the computation and taxation of partnership income. Although a partnership is not a person for the purposes of the Act generally, section 96 requires that income of the partnership be computed "as if" the partnership were a separate person[17] and "as if" each partnership activity, including ownership of property, were carried on by the partnership as a separate person.[18] Income is therefore calculated in the aggregate at the partnership level and then allocated to the partners in accordance with each member's interest in the partnership. The original source of income from each partnership activity is preserved in the hands of the partners.

[44] The CRA has accepted section 96 as applying to preserve the source of income in the hands of the corporate partner where resource property is owned by a corporation at the time of an acquisition of control and there is a subsequent transfer to a partnership.[19]

[45] In a tiered partnership, the source and location of income is preserved through each level of partnerships until the income is ultimately recognized by, and taxed in the hands of, the corporate or individual partners. This is supported by subsection 102(2) which provides that, in the context of computing the income of partnerships, "a reference to . . . a taxpayer who is a member of a particular partnership shall include a reference to another partnership that is a member of the particular partnership."[20]

[46] In *Fredette v. The Queen*,[21] this Court confirmed that income retains its source and its character in a tiered partnership structure. Since an interest in a partnership is not itself a source of income, the source and characterization of the income from each partnership activity must be preserved through all of the tiers, each partnership acting as a flow through, until the income is ultimately taxed in the hands of the corporate or individual partner. In this regard, Justice Archambault of this Court noted:[22]

---

[17] Paragraph 96(1)(*a*).

[18] Paragraph 96(1)(*c*).

[19] Question 2 of the 1991 Canadian Tax Foundation Round Table, Revenue Canada Round Table, document No. 2M033A (October 30, 1992) –Taxnet.Pro Position subsequently clarified in CRA document No. 9406435, "Successor Rule – Income From Particular Property" (March 31, 1994) and CRA document No. 9328657, "Successor Rules Re Partnership and Change of Control" (October 7, 1993) –Taxnet.Pro.

[20] Subsection 102(2) provides:

> Member of a partnership
>
> (2) In this subdivision, a reference to a person or a taxpayer who is a member of a particular partnership shall include a reference to another partnership that is a member of the particular partnership.

[21] 2001 DTC 621.

[22] *Ibid.*, at paragraph 50, footnote 16, page 633.

> . . . In other words, the partner's source of income is the same as the partnership's. In addition, elsewhere in the Act there is no provision creating the fiction that the income of a partner is earned from an "interest in a partnership". It must therefore be concluded that the partner derives his income from the activities of the partnership itself, not from the property (the interest in the partnership) and that the interest expenses incurred by that partner to finance his contribution were incurred to obtain that business income . . . .

[47] Section 96 preserves the source of partnership income in the hands of the partners. Subsection 102(2) preserves the source in cases where the income is earned through tiered partnerships. Accordingly, I find that the provisions of the Act governing partnerships and their members support the Appellant's contention that income derived from properties held by a subsidiary partnership retains its source up through the first-tier partnership and ultimately to the corporate partner.

[48] At trial, the Respondent took the position that section 96 does not apply to paragraph 66.7(10)(*j*). More specifically, the Respondent argued that section 96 operates only for the limited purpose of computing a partnership's income and therefore does not apply to the determination of income that can "reasonably be regarded as being attributable" under paragraph 66.7(10)(*j*), as this is a notional calculation used simply to establish a ceiling for the deduction.

[49] Several times during argument, I asked counsel for the Respondent to explain how income "reasonably . . . regarded as being attributable" was to be calculated under her interpretation; however, no clear answer was provided. During the hearing of the motion, the Respondent recognized that, prior to an acquisition of control, income of a partnership retains its character when flowing up to the partners, under subsection 96(1), and that subsection 102(2) preserves this state of affairs in a tiered partnership structure. The Respondent did not explain why subsections 96(1) and 102(2) should cease to operate entirely following an acquisition of control.

[50] Common law principles similarly do not support the Respondent's position as, under the common law, the individual and corporate partners collectively own the property used in the partnership and would thus clearly have income reasonably attributable to that property.

[51] Only the members of a partnership that are legal persons are ultimately taxed on the income produced by the partnership activities. Home Oil is taxed on income from the Anderson Properties by virtue of section 96, but under the Respondent's interpretation it does not have income reasonably attributable to the properties.

[52] I conclude that the Respondent's position is inconsistent with the scheme of the Act since it ignores section 96 and the iterative nature of the partnership income

calculation, and as it also fails to provide an alternative method for income calculation under subparagraph 66.7(10)(*j*)(ii).

[53] The Respondent further argued that if section 96 is the basis of the calculation then subparagraph 66.7(10)(*j*)(ii) is rendered meaningless. However, I find that subparagraph 66.7(10)(*j*)(ii) still serves a purpose by ensuring that, should the corporation subsequently increase its partnership interest, its maximum deductions under the successor rules will be limited to the corporation's percentage interest in the partnership at the time of the acquisition of control.

[54] A purposive analysis of the provision in light of its legislative history also favours the Appellant's position. Paragraph 66.7(10)(*j*) was introduced to ensure that successor deductions would be available to corporate members of partnerships that held resource properties at the time of an acquisition of control. The successor rules apply only to resource expenses and thereby recognize that in the resource sector there is often a significant period between the time when expenses are incurred and the time when income is generated from the resource properties.

[55] Until 1983, upon an acquisition of control, undeducted resource expenses could be used provided the acquired properties had active business income under subsection 66(11) of the 1971 Act.[23] To further guard against loss trading in "successored" expenses, more extensive change-of-control provisions were enacted in 1983. The effect of these was to treat the corporation as a successor to itself, and thenceforth unused resource expenses became deductible only against income from the resource properties the corporation held immediately prior to the acquisition of control. In effect, the losses were streamed to the particular properties.

[56] Following the introduction of the acquisition-of-control rules, it was not clear that the rules operated efficiently in circumstances where property was owned through a partnership.

[57] Parliament subsequently adopted relieving legislation to address this issue:[24]

> As a result of this new paragraph [66.7(10)(*j*)], the successor rules will permit the resource expenses of a corporation that is a member of a partnership that were incurred before a change of control or tax-exempt status of the corporation to be deducted by it to the extent of its share of the partnership income from resource properties owned at the time of change for a taxation year ending after the change. This share is the lesser of

---

[23] *An Act to Amend the Income Tax Act*, S.C. 1970-71-72, c. 63, subsection 66(11) subsequently amended by *An Act to amend statute law relating to income tax (No.2)*, S.C. 1980-81-82-83, c. 140, subsection 33(2).

[24] David M. Sherman, *Department of Finance Technical Notes* (2011) at page 557 and Department of Finance, *Technical Notes to a Notice of Ways and Means Motion Relating to Income Tax* (Ottawa: Department of Finance, June 1987).

> (a) the corporation's share of the income of the partnership for the fiscal period of the partnership ending in the taxation year of the corporation that may reasonably be regarded as attributable to the production from the resource property of the partnership, and
>
> (b) the corporation's share determined in (a) calculated on the basis of its share of income at the time of the change of status of the corporation.

[58] By treating the corporate partners as the owners of the resource properties, paragraph 66.7(10)(*j*) ensures that the corporation that incurred the expenses through a partnership structure can still use them following an acquisition of control. I find that the Respondent's interpretation is directly at odds with this purpose, as it would deny the deduction of expenses by the very taxpayer that incurred them and that continues to pay tax on the income from the properties.

[59] Parliament's intention that resource expenses not become stranded when properties remain within a wholly owned corporate group is similarly reflected in paragraphs 66.7(10)(*g*), (*h*) and (*i*). These provisions permit a successor to designate in favour another member of the wholly owned corporate group, for the purpose of accessing the "successored" expenses, income from the "successored" properties following an acquisition of control.[25]

[60] Parliament has legislated to enable a form of tax consolidation within a wholly owned corporate group so that "successored" expenses do not become stranded. Under the Respondent's interpretation, resource expenses cannot be used even though the property has not left the wholly owned corporate group. In fact, no taxpayer would ever be able to deduct the "successored" expenses. I find that this is inconsistent with Parliament's intent.

VI. Conclusion

[61] In conclusion, I find that following the transfer of the Anderson Properties to the Devon Partnership, the proportionate share of income earned from the Anderson Properties, determined in accordance with clauses 66.7(10)(*j*)(ii)(A) and (B) and allocated to the Anderson Partnership, and further allocated to Home Oil, may reasonably be regarded as having been attributable to production for the purposes of subsections 66.7(1) to (5). The amount of such income is a matter to be determined by the trial judge on the basis of his evidentiary findings.

---

[25] David M. Sherman, *Department of Finance Technical Notes* (2011) at pages 556-557.

[62] Costs on this motion are left to the discretion of the trial judge.

Signed at Ottawa, Canada, this 18th day of December 2013.

"Robert J. Hogan"

Hogan J.

CITATION:	2013 TCC 415
COURT FILE NO.:	2011-1404(IT)G
STYLE OF CAUSE:	DEVON CANADA CORPORATION v. THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	September 16, 2013
REASONS FOR ORDER BY:	The Honourable Justice Robert J. Hogan
DATE OF ORDER:	December 18, 2013

APPEARANCES:

Counsel for the Appellant:	Al Meghji Pooja Samtani Edward Rowe
Counsel for the Respondent:	Josée Tremblay Marie-France Camiré Ryan Gellings

COUNSEL OF RECORD:

For the Appellant:

Name:	Al Meghji
Firm:	Osler, Hoskin & Harcourt LLP Toronto, Ontario
For the Respondent:	William F. Pentney Deputy Attorney General of Canada Ottawa, Canada