BETWEEN:

THE CALGARY & EDMONTON CORPORATION LIMITED ..... APPELLANT;

1954
Mar. 2
1955
June 3

AND

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

Revenue—Income—Income tax—The Income Tax Act, 1948, S. of C. 1948, c. 52, ss. 3, 4, 12(1)(b), 16—Income from business or property—Capital outlay—Indirect payments—Appeal from Income Tax Appeal Board dismissed.

In 1947 one S. granted a lease to the California Standard Co. of all the hydrocarbons (except coal) in certain lands that he then owned but which were to be divided upon the death of his parents into four equal shares among himself and his three sisters. The sisters registered a caveat on the lands and some months later gave an option to an agent of a syndicate of three companies, one of which was the appellant, under which the syndicate became entitled to a lease of the sisters' interest in the hydrocarbons. On September 22, 1948, the California Standard Co. and the syndicate, having reached an understanding and settled their difficulties with the sisters, entered into an agreement whereby the "Standard" lease was approved by the sisters in consideration of a cash payment by the syndicate of $75,000 and payment of 10% of the gross proceeds of the sale of production from the lands until a further $75,000 had been paid to them. By the same agreement one-half undivided interest in the lease granted by S. was vested in the California Standard Co. and the other one-half in the syndicate, each member thereof acquiring a one-third interest in the syndicate's share.

In 1949 and 1950 appellant received its share of the sale of the oil produced and, in accordance with the terms of the 1948 agreement, paid 10% of the amounts so received over to the sisters. Appellant included the amounts in its income tax returns for those years and was assessed accordingly but later objected to the assessments on the ground that through an accounting error its gross income from production for those years was overstated by the amounts paid the sisters. The Minister reviewed and confirmed the assessments which were appealed to the Income Tax Appeal Board and the appeal was dismissed. Hence, the present appeal to this Court.

Held: That the 1948 agreement superseded and replaced the agreement entered into in 1947 between the sisters and the agent of the syndicate. By approving the lease granted by their brother the sisters were not in a position to execute and deliver the lease contemplated by the 1947 agreement.

2. That whatever rights or interest the sisters may have had in the lands or in the oil therein were transferred to the syndicate. Once the 1948 agreement was signed and the cash payment of $75,000 effected the sisters had received full compensation for their rights and

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interest, provided, however, there was no oil and in that event the cash payment was a capital outlay within s. 12(1)(*b*) of the *Income Tax Act*, 1948.

3. That the lands being oil-producing, the proceeds of production became the property of the California Standard Co. and the syndicate, whereupon the sisters became entitled to a further sum of $75,000 payable by the syndicate at the rate of "10% of the gross proceeds of the sale of the petroleum substances produced, sold and marketed from the lands". These words do not purport to give a right or title to a share of the proceeds of production but merely indicate how, when and where the additional sum of $75,000 would be paid to them.

4. That the amounts received by appellant company were instalments of its share of the proceeds from oil production and therefore were income from rights or interest in a property which produced oil and from the ordinary business it carried on of exploring for and producing oil.

5. That the amounts were payments or transfers of money made pursuant to the direction or with the concurrence of appellant company in satisfaction of its obligation to the sisters as a member of the syndicate and were so paid or transferred for its benefit.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Fournier at Winnipeg.

R. A. MacKimmie for appellant.

F. J. Cross for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

FOURNIER J. now (June 3, 1955) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board dismissing the appellant's appeal from its income tax assessments for the years 1949 and 1950, whereby the respondent sought to hold it liable to tax on certain amounts it received from the gross proceeds of the sale of production of oil from lands in which it had an interest.

The facts are not disputed and are found in admitted copies of seven documents filed by counsel for the appellant as exhibits numebered 1 to 7. The only oral evidence adduced was by a geologist who dealt with the nature and condition of the oil in the ground. This evidence had no bearing on the facts involved in this appeal.

On August 24, 1943, Kost Sereda, who was the owner of a quarter section of land in the Leduc area, in the Province of Alberta, transferred it to his son Andrew H. Sereda, in fee simple. The same day the son gave back an encumbrance whereby the lands became charged with the provision of a livelihood for his father and mother. He further encumbered the said lands so that on the death of his father and mother they would be divided in four equal shares. He would retain one share and his three sisters, after complying to the terms of the encumbrance, would each receive a one-fourth in interest in the lands, as owners in fee simple. On February, 8, 1947, Andrew H. Sereda gave a written lease of all the petroleum, natural gas and other hydrocarbons (except coal) within, upon or under the said lands to the California Standard Company. On February 11, 1947, the father gave a written consent to this lease and agreed to the postponement of his caveat. On April 16, 1947, the sisters registered a caveat on the lands. On July 28, 1947, the Court issued an order continuing their caveat. This order was registered the same day in the Land Titles office. They had previously notified the company that they had a three-quarter interest in the property and that the lease was invalid.

On November 7, 1947, the sisters, for a sum of $5,000 and other considerations, gave a 30-day option to George H. Cloakey, acting as agent for Home Oil Company, whereunder Cloakey became entitled to a lease of the sisters' interest in the said hydrocarbons other than coal. This agreement, filed as Exhibit 2, at section 6 thereof, establishes clearly the position of the parties in the event that the difficulties with The California Standard Company were settled. Section 6 reads thus:

> 6. Notwithstanding anything herein elsewhere contained or implied, it is agreed by and between the parties hereto that if, during the continuance of the option hereby granted, the Optionee shall make a settlement with THE CALIFORNIA STANDARD COMPANY and shall as a result of such settlement request the Optionors, by notice in writing given to them or to their said solicitor, to ratify, consent to, approve and/or affirm the Standard lease and the right of the said THE CALIFORNIA STANDARD COMPANY to take, recover and market the petroleum substances from the optioned area thereunder, then and in such case, upon payment to them of the said sum of Seventy-five Thousand Dollars ($75,000) in manner hereinbefore provided for and contemporaneously with such payment, and upon the delivery to them of a

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covenant in writing on the part of the Optionee to pay or to cause to be paid to them Ten per-cent (10%) of the gross proceeds of the sale of the petroleum substances produced, sold and marketed from the optioned area until they shall have received therefrom the sum of Seventy-five Thousand Dollars ($75,000), (payments on account thereof to be made to or for the account of the Optionors, at such place as they shall jointly in writing from time to time appoint, until the said sum of Seventy-five Thousand Dollars ($75,000) shall be fully paid and satisfied), the Optionors shall execute and deliver such documents of consent, approval, affirmation and/or ratification as counsel for the Optionee may reasonably require.

This option was duly exercised and Cloakey assigned all his rights derived therefrom to Home Oil Company, Anglo Canadian Oil Company and the appellant. The three companies were called "The Syndicate".

Meantime, the California Standard Company, through Court action, was seeking to obtain a declaration that their lease was valid. On September 22, 1948, the California Standard Company and the Syndicate having reached an understanding and having settled their difficulties with the three sisters, an agreement was executed by all the parties concerned. The effect of the agreement was to vest a one-half undivided interest in the Andrew Sereda lease of the hydrocarbon (except coal) in the California Standard Company and the other one-half in the Syndicate, each member thereof acquiring a one-third interest in the Syndicate's share.

Clause 5 of this agreement reads as follows:

5. The Syndicate hereby agrees to pay to the claimants the sum of seventy-five thousand ($75,000) dollars in cash on the execution hereof and 10% of the gross proceeds of the sale of production from the said lands until a further sum of seventy-five thousand ($75,000) dollars has been paid to the claimants (sisters) and in consideration thereof the claimants (sisters) hereby ratify, consent to, approve and affirm the said lease and shall join with California Standard Company in obtaining a consent judgment of the said Court declaring the said lease to be valid and to be the first charge upon all the interest of the said Andrew H. Sereda, the said Kost Sereda and the claimants (sisters) in the petroleum and natural gas underlying the said lands.

In my opinion, this agreement superseded and replaced the agreement entered into by the sisters and George H. Cloakey on November 7, 1947, and filed as Exhibit 2, wherein it was agreed by the parties that the said Cloakey was given an option to acquire from the sisters a lease of all their rights, title, estate and interest in or to the petroleum substances within, upon or under the said lands. The

agreement of September 22, 1948, recognized as legal and valid the lease between Andrew Sereda and The California Standard Company. The sisters having consented to, accepted and approved this lease were in no position to execute and deliver to Cloakey the lease contemplated by section 5 of the agreement of November 7, 1947, and annexed thereto.

After the above agreement was duly signed and executed, the companies in which were vested the interests in the lease of the hydrocarbons by an agreement dated October 8, 1948, with the Saskatchewan Federated Co-Operatives Limited, arranged for the production, refining, delivery and marketing of whatever oil found under the leased land. The Co-Operative was to receive 30% of all the moneys realized from the sale of oil and the remaining 70% was to be paid monthly to the companies through the Home Oil Company Limited. On this basis the California Standard Company would receive 35% of the proceeds of production and the Syndicate 35%. The appellant would then receive one-third of the Syndicate's share.

During the taxation years under review, the appellant did receive certain amounts from the proceeds of the sale of production of oil from the said lands. On receipt they were entered in the appellant's books as being part of its income. But as the sisters, according to the terms of the agreement dated September 22, 1948, were entitled to receive $75,000 at the rate of 10% of the gross proceeds of the sale of production, in 1949 they received from the appellant the sum of $8,018.82 and in 1950, $16,981.81.

Having in its income tax returns of 1949 and 1950 included these amounts as income, the appellant was assessed for same. In December 1950, the appellant, through its manager, advised the respondent by letter that an error in accounting procedure had been made and that the appellant's gross income from production had been overstated by the above sums in its income tax returns for 1949 and 1950. Then on June 20, 1952, the appellant gave notice of objection to the assessments dated May 3, 1952, on the ground that through an error in accounting procedure the appellant's income from production for the two above fiscal years was overstated and that no part of these sums was ever in the hands of the appellant. The Minister

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having reconsidered these assessments confirmed them on the ground that they were income within the meaning of sections 3, 4, 5, 6, 16 and 125 of the *Income Tax Act*, Statutes of 1948, chap. 52. These assessments were appealed to the Income Tax Appeal Board and the appeal was dismissed.

The appellant contends that the amounts of $8,018.82 and $16,981.81 included in its income tax returns for the taxation years 1949 and 1950 were not taxable income within the meaning of the Act and the sections referred to by the respondent.

The sections of the *Income Tax Act*, chap. 52, Statutes of Canada 1948, which are pertinent to the dispute are sections 3, 4 and 16. They read as follows:

> 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside of Canada and, without restricting the generality of the foregoing, includes income from all
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> (*a*) business,
>
> (*b*) property, and
>
> (*c*) offices and employments.
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> 4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.
>
> 16. *Indirect payments.*—A payment or transfer of money, rights or things made pursuant to the direction of, or with the concurrence of, a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other person shall be included in computing the taxpayer's income to the extent that it would be if the payment or transfer had been made to him.

For agreeing to and approving of the above mentioned lease of Andrew Sereda to the California Standard Company and the transfer of their rights or interest, if any, in the lands in question to the Syndicate, the sisters were paid $75,000 in cash and were to receive another $75,000 out of the Syndicate's share of the proceeds of production of petroleum from the said lands at the rate of 10% of the gross production.

In my mind, whatever rights or interest the three sisters had in the lands or hydrocarbons, thereon or therein, were transferred, for the aforesaid consideration, to the Syndicate. After signing the above agreement and receiving $75,000 in cash, in my view they had received full compensation for all their rights and interest, if the lands did not contain hydrocarbons or if no oil was produced from the

lands. In that case, the payment by the Syndicate—of which the appellant was a member—was a capital payment under paragraph (*b*) of subsection 1 of section 12 of the *Income Tax Act*.

But the lands having become productive of petroleum, the sisters became entitled to a further sum and the Syndicate became obligated to pay to them a further sum up to a maximum of $75,000, at the rate of 10% of the gross production. This amount of $75,000 was to be paid by the members of the Syndicate out of the proceeds of the production at the rate of 10% of said proceeds. In 1949, ten per cent (10%) of the proceeds to which the appellant was entitled to receive amounted to $8,018.82 and in 1950 to $16,981.81.

The Syndicate of which the appellant was a member received its share of the gross production of petroleum in accordance with the terms of paragraph 2 of Exhibit 5, an agreement signed and agreed to by the sisters, which reads:

> 2. All moneys received by California Standard Company and the Syndicate under the said agreement with the said Co-Operative shall, after the payment of the royalty provided for in the said lease, be divided one-half (½) to California Standard and one-half (½) to the Syndicate.

The sisters having divested themselves of whatever interest they may have had in the lands agreed that the proceeds of the production should go to the California Standard and the Syndicate. They reserved no right in the production of the petroleum. They only agreed that they would be entitled to a further sum of $75,000 if the lands were productive of oil.

In my opinion, the words "ten per cent of the gross production of the leased substances that were produced, sold or marketed" were put in the agreement not to give the sisters a right or title to a share in the proceeds of the production, but merely to indicate how, when and where the sum of $75,000 would be paid to them.

I have come to the conclusion that, even if the sisters had actual rights or interest in the lands or in the petroleum within contained at the time Andrew Sereda leased the said lands with all petroleum to The California Standard Company, or at the time they signed the agreement of September 22, 1948 (Exhibit 5), by the signing of this agreement they transferred to the Syndicate all their rights and

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interest without reservation. For the above mentioned consideration, they renounced to any share in the gross production of hydrocarbons from the said lands and agreed that the lease between Andrew Sereda and California Standard Company was valid. After the signing of this agreement all they were entitled to was a sum of $75,000 if the proceeds of the production of oil from the said lands were such as to meet such obligation on the part of the appellant.

Being of that view, I wish now to examine the appellant's position at the time it received the amounts of $8,018.82 and $16,981.81. The Company amongst its activities is directly or indirectly interested in the exploration, drilling, production and disposal of hydrocarbons. It is one of its business activities. It acquired or leased certain rights, titles and interests in certain lands with the above objects in view. For the acquisition or leasing of the said lands it paid a cash sum and obligated itself to pay a further specified sum if it derived benefit or income from the said lands. The lands were productive of oil and the appellant received in cash its share of the proceeds of the production and sale of oil. Out of the amounts received or out of its other income it met its obligation to pay the share of the amount of $75,000 which it had undertaken to pay under the agreement of September 22, 1948.

I am of opinion that the amounts the appellant received were income within the meaning of section 3 of the *Income Tax Act*. The amounts received were income from its business and from its titles, rights or interests in a property which produced oils and other hydrocarbons.

Furthermore, I find that the aforesaid amounts were received by the appellant pursuant to the agreement of September 22, 1948, and represented instalments of the appellant's share of the proceeds of production of petroleum from the lands mentioned in that agreement.

I also believe that the amounts received by the sisters from the appellant out of the proceeds from the sale of production from the lands in question were payments or transfers of money made pursuant to the direction of or with the concurrence of the appellant to the sisters in satisfaction of its share of the obligation of the Syndicate to the sisters and were paid or transferred for its benefit.

For these reasons, I have found that the amounts of $8,018.82 and $16,981.81 were properly included in the appellant's income tax returns for the years 1949 and 1950 as income and that the Minister of National Revenue was right in deciding that these sums were capital outlays within the meaning of section 12 (1) (*b*) of the *Income Tax Act,* 1948. My conclusion is that the assessments and the decision of the Income Tax Appeal Board should stand.

The appeal is dismissed with costs.

Judgment accordingly.