Docket: 2004-1284(IT)G

BETWEEN:

BASELL CANADA INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on November 20, 2006, at Montreal, Quebec.

Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the Appellant:	Wilfrid Lefebvre
Counsel for the Respondent:	Yanick Houle Jane Meagher

JUDGMENT

The appeals from the reassessments made pursuant to the *Income Tax Act* ("*ITA*") with respect to the taxation years ending December 31, 1995, December 31, 1996, October 28, 1997, December 31, 1997 and December 31, 1998 are allowed, with costs, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the appellant was entitled to deduct pursuant to subsection 9(1) and paragraph 18(1)(*a*) of the *ITA* the amount of US $16,300,000 (CAN $22,865,640) as a current expense which could be amortized and written off, as was done by the appellant, for each of the taxation years at issue.

Upon consent to judgment, the appeal for the taxation year ending December 31, 1996, with respect to the double inclusion of an amount of $53,277 related to an investment tax credit is also allowed.

Signed at Ottawa, Canada, this 16th day of November 2007.

"Lucie Lamarre"

Lamarre J.

Citation: 2007TCC685
Date: 20071116
Docket: 2004-1284(IT)G

BETWEEN:

BASELL CANADA INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Lamarre J.

[1] The appellant is appealing reassessments made by the Minister of National Revenue ("MNR") with respect to its taxation years ending December 31, 1995, December 31, 1996, October 28, 1997, December 31, 1997 and December 31, 1998.

[2] In so reassessing the appellant, the MNR disallowed deductions claimed by the appellant under subsection 9(1) and paragraph 18(1)(*a*) of the *Income Tax Act* ("*ITA*") with respect to supply contracts and instead treated those amounts as eligible capital expenditures within the meaning of section 14 of the *ITA* and thus as deductible pursuant to paragraph 20(1)(*b*) of the *ITA*. That is the sole issue before this Court.[1]

[3] A Partial Agreed Statement of Facts was filed by the parties. It is reproduced hereunder:

1 There was another issue regarding the taxation year ending December 31, 1996, and having to do with the double inclusion of an amount of $53,277 related to an investment tax credit. The respondent has consented to judgment in favour of the appellant on this point.

PARTIAL AGREED STATEMENT OF FACTS

The parties hereto, by their respective solicitors, admit, for the purposes of this appeal only, the truth of the following facts; the parties may adduce further evidence at trial that is not inconsistent with this Partial Agreed Statement of Facts:

Context

1. The Royal Dutch/Shell Group of Companies and the Montedison Group were the world's leading producers of polypropylene.

2. In 1995, the Royal Dutch/Shell Group of Companies and the Montedison Group agreed to form a new incorporated joint venture, Montell, for their worldwide polypropylene operation.

    See the "Rapport d'activité" of Montell Polyolefins, the 1995 Annual Report of Royal Dutch Petroleum Co./Shell Transport and Trading Co. and the 1995 Annual Report of Montedison (respectively Schedules A, B, and C of the present Statement).

3. At that time, Shell Canada Products Limited, member of the Royal Dutch/Shell Group of Companies, manufactured and commercialized polypropylene in Canada from its production plant in Sarnia, Ontario.

4. At that time, Himont Canada Inc., member of the Montedison Group manufactured and commercialized polypropylene in Canada from its production plant in Varennes, Quebec.

5. As part of this worldwide reorganization, Shell Canada Products Limited agreed to transfer its Contributed Businesses to Himont Canada Inc.

    See the Recitals of the Asset Purchase Agreement dated March 20, 1995 between Shell Canada Products Ltd. and the Appellant (Schedule D of the present Statement) and the Minutes of Regular Meeting of the Board of Directors of Himont Canada Inc. dated March 17, 1995 (Schedule E of the present Statement).

6. Himont Canada Inc. was then renamed Montell Canada Inc. on March 31, 1995 and is now known as Basell Canada Inc. (hereinafter the "Appellant").

Asset Purchase Agreement

7. Pursuant to an Asset Purchase Agreement dated March 20, 1995, the Appellant acquired assets comprising the Contributed Businesses from Shell Canada Products Limited for a purchase price of US $164,000,000, detailed as follows:

- US $144,280,000 corresponding to Can. $202,395,984 (using an exchange rate of 1.4028), for assets;

- US $19,720,000 corresponding to Can $27,663,216 (using the same exchange rate) for the "net working capital", that is for the value of the inventories and the trade accounts receivable less the value of the trade accounts payable, subject to adjustment.

  See the Asset Purchase Agreement dated March 20, 1995 between Shell Canada Products Ltd. and the Appellant (Schedule D of the present Statement) and the General Conveyance dated March 31, 1995 between Shell Canada Products Ltd. and the Appellant (Schedule F of the present Statement).

8. The Appellant added the assets comprising the Contributed Businesses acquired from Shell Canada Products Limited to its already existing polypropylene business in Canada.

9. Prior to the purchase, Himont Canada Inc. had already over Can. $ 207,000,000 in assets used in Varennes, Quebec for the manufacturing and commercialization of polypropylene.

<u>Supply Contracts</u>

10. As part of the acquisition referred to in paragraph 7 of the present statement, the Appellant, by way of assignment and in consideration of an amount of US $16,300,000 (corresponding to Can. $22,865,640), became party to certain Supply Contracts.

    See the Schedule 3 of the Asset Purchase Agreement dated March 20, 1995 between Shell Canada Products Ltd. and the Appellant (Schedule D of the present Statement) and the Assignment of Contracts and Assumption of Liabilities dated March 31, 1995 between Shell Canada Products Ltd. and the Appellant (Schedule G of the present Statement).

11. The Supply Contracts included mainly a contract signed on September 1st, 1991, between Novacor Chemicals (Canada) Ltd. (hereinafter "Novacor") and Shell Canada Chemical Company, a Division of Shell Canada Products Limited (hereinafter the "Novacor Agreement").

    See the Propylene Sale Agreement dated September 1, 1991 between Shell Canada Chemical Company, a Division of Shell Canada Products Ltd. and Novacor Chemicals (Canada) Ltd. (Schedule H of the present Statement).

12. Pursuant to the Novacor Agreement, Novacor had undertaken to sell for a ten-year period agreed upon quantities of propylene to Shell Canada Products Limited for a given price.

13. Propylene constituted the principal raw material in the Appellant's business.

14. In making the said payment of US $16,300,000, (Can. $22,865,640), the Appellant thus became entitled to acquire from Novacor raw material needed in its business for a given price that was advantageous compared to the price on the spot market at that time.

Tax Treatment

15. For both tax and accounting purposes, the Appellant treated the amount of US $16,300,000, (Can. $22,865,640) so paid as current expenses which were initially amortized over the term of the Novacor Agreement because this treatment provided, in the view of the Appellant, a truer picture of its financial affairs.

16. In its taxation year ending on December 31, 1998, the Appellant fully deducted the unamortized balance in accordance with the impairment of assets accounting rules because the given price agreed upon with Novacor for the raw material was not advantageous anymore compared to the price on the spot market:

Taxation year	Dec. 31, 1995	Dec. 31, 1996	Oct. 31, 1997	Dec. 31, 1997	Dec. 31, 1998
Deduction claimed	$2,540,628	$3,387,504	$2,822,920	$564,584	$3,387,504
Deduction claimed for write-off					$10,162,500

17. Considering that the amount of US $16,300,000, (Can. $22,865,640) paid by the Appellant with respect to the Supply Contracts were amounts paid on account of capital which constituted "eligible capital expenditures" within the meaning of Section 14 of the *Income Tax Act*, the Minister reassessed the Appellant to allow a portion of the deductions under paragraph 20(1)b) of the *Income Tax Act*, instead of the deductions claimed:

Taxation year	Dec. 31, 1995	Dec. 31, 1996	Oct. 31, 1997	Dec. 31, 1997	Dec. 31, 1998
Deduction disallowed	($2,540,628)	($3,387,504)	($2,822,920)	($564,584)	($13,550,004)
Deduction allowed under 20(1)(b)	$1,200,446	$1,116,415	$1,038,266	$965,587	$897,996

18. The Appellant duly objected to the reassessments.

19. The Minister maintained his decision and the Appellant appealed to this Court with respect to its taxation years ending December 31, 1995, December 31, 1996, October 28, 1997, December 31, 1997 and December 31, 1998.

Issue

20. The issue to be determined is whether the amount of US $16,300,000, (Can. $22,865,640) paid by the Appellant with respect to the Supply Contracts was a current expense which can be amortized and written off as was done by the Appellant or a payment on account of capital which constitutes an "Eligible capital expenditure" as the Respondent contends.

[4] In 1991, Mr. Steven Mineer, a leader in the supply of olefins, joined Himont Canada — whose plant is located in Varennes, Quebec — in the capacity of raw material purchaser. At trial, he explained that the appellant's business consisted in producing polypropylene in the form of pellets (essentially plastic) that were sold to companies that would then mould them into products to be ultimately sold on the market (Igloo coolers and yogurt containers, to give two examples).

[5] The principal raw material from which the appellant produces the polypropylene is the propylene itself (that comes in the form of a gas). Propylene is probably 95% of the finished product that is sold by the appellant, and in terms of value represents 80% of the product cost. Mr. Mineer explained that the appellant purchases propylene from different sources, treats it and produces pellets that it then sells. The pellets constitute its inventory that is sold in the market place to its customers.

[6] In March 1995, the appellant purchased the assets of Shell Canada Products Limited ("Shell"), which operated the same kind of business in Sarnia, Ontario. The Asset Purchase Agreement entered into between Shell and Himont Canada Inc. (the appellant's predecessor) was filed as Exhibit A-2, Tab D. In section 13 of this agreement, each party undertook to enter into, in particular, a feedstock supply agreement substantially in the form of the agreement thereto attached as Schedule 13(i). Section 2 of the Feedstock Supply Agreement states the following:

> Independently of this Agreement, SHELL will assign its interest in the Novacor Propylene Sale Agreement dated September 1, 1991, as amended (the "Novacor Agreement") . . . [see Exhibit A-2, Tab D, p. 29].

[7] The Propylene Sale Agreement between Novacor Chemicals (Canada) Ltd. ("Novacor") and Shell, which came into effect on September 1, 1991, was filed as Exhibit A-2, Tab H ("Novacor Agreement"). This agreement entitled Shell to purchase from 270 million to 330 million pounds of propylene for the supply of its

plant in Sarnia and to do so under a set of pricing conditions that were related to the contract market for propylene on the US Gulf Coast.

[8] Mr. Mineer explained that Shell (and subsequently the appellant) was expected to purchase a minimum of 270 million pounds and Novacor had an obligation to supply up to a maximum of 330 million pounds.

[9] He said that there was no obligation for Novacor to provide the raw material (propylene) to the appellant on an exclusive basis (this is reflected in clauses 4.01 and 4.02 of the Novacor Agreement).

[10] Mr. Mineer stated that Novacor's total production was estimated at 800 million pounds a year, of which 270 to 330 million pounds were to be allocated to the appellant. In clause 4.02 of the Novacor Agreement, we can see that Novacor also had to supply other customers. He said that the contract with Shell (subsequently assigned to the appellant) constituted roughly 3/8 of Novacor's propylene production.

[11] On the other hand, Shell (and subsequently the appellant) was entitled to source propylene first from its refineries in Montreal and Sarnia as they existed on the effective date of the agreement, but thereafter was required to source it from Novacor under that agreement in preference to all other suppliers of propylene, subject to the terms of its existing written contracts with third-party suppliers as of the effective date of that agreement (September 1, 1991) (see clause 4.01 of the Novacor Agreement).

[12] The pricing mechanism in the Novacor Agreement was linked to a monthly price that was set on the US Gulf Coast, that is, the USGC price referred to in the Contract Price article (i.e. article V) of the agreement. That price is determined by market participants on the Gulf Coast, with discounts being dependent upon volume consumed. In other words, for given volumes of consumption the discount would vary.

[13] Mr. Mineer stated that those contract prices are typically advantageous in comparison to the spot prices on the market. There are no minimum or maximum contract volume obligations when buying from someone in the marketplace.

[14] In agreeing to the assignment of the contract to the appellant (under article XIX of the Novacor Agreement), Novacor was obliged to make the supplies available to the appellant on a contract price basis.

[15] Mr. Mineer explained that the determination was made at the time of the assignment in 1995 that this contractual obligation was worth US 16.3 million dollars.

[16] As a matter of fact, an Assignment of Contracts and Assumption of Liabilities was entered into between Shell and Himont Canada Inc. (the appellant's predecessor) on March 31, 1995 (Exhibit A-2, Tab G). By that agreement, Shell agreed to assign to the appellant the full benefit of the contracts and agreements ("contracts") included in the purchased assets (among which was the Novacor Agreement) and the appellant agreed to assume liability for the performance of Shell's obligations under those contracts (clause B). Consent to the assignment of the contracts was obtained (clause C) and by that assignment Shell sold, transferred and assigned to the appellant all its right, title and interest in and to the contracts, and the appellant agreed to assume, and was to observe and perform, all of Shell's obligations and liabilities under the contracts.

[17] According to the Asset Purchase Agreement, on March 20, 1995 (Exhibit A-2, Tab D), Shell sold its contributed businesses to the appellant for a total amount of US $164,000,000. The price payable for the purchased assets was US $144,280,000. The allocation of that purchase price is found in Schedule 3 to that Asset Purchase Agreement (Exhibit A-2, Tab D, p. 26). The supply contracts at issue in the present case are identified under the Intangible Assets heading and are evaluated at US $16.3 million.

[18] The purchase of Shell's assets and propylene business was approved in the minutes of a regular meeting of Himont Canada Inc. on March 17, 1995 (Exhibit A-2, Tab E). The board of directors approved and authorized the purchase by the appellant of certain property and assets, including plant and equipment then owned and used at Sarnia by Shell for the production and sale of polypropylene, for US $164,000,000.

[19] It was resolved further that the board of directors approved and authorized the entering into of the Feedstock Supply Agreement by the appellant "in order to ensure, among other things, the supply to the Company [the appellant] of certain of its requirements for propylene meeting the specifications described therein".

[20] According to Mr. Mineer, this transaction did not put the appellant in a monopolistic position. He said that the North American polypropylene market has in the order of 18 billion pounds of total capacity. The appellant's share of that

market is approximately 3 billion pounds of capacity, which means that about 15 to 20 per cent of total market capacity is in its production facilities. The Sarnia site that was purchased by the appellant had in the order of 350 million pounds of capacity, that is, two per cent of the total market.

[21] Mr. Mineer acknowledged, however, in cross-examination that there were only two polypropylene plants in Canada, which are now both owned by the appellant. When the appellant purchased the plant in Sarnia, there was no interruption in that plant's operations.

Appellant's argument

[22] Counsel for the appellant did not dispute the fact that by acquiring the assets owned by Shell at its Sarnia operation, the appellant did enlarge the structure of its own business. What counsel argued, however, was that nothing prevented a current expense from occurring at the same time as a capital expense was incurred on acquiring the capital assets of Shell's Sarnia operation. In counsel's view, one has to look at the allocation of the purchase price in order to properly classify each asset so acquired.

[23] Counsel for the appellant submitted that the purchase of the supply contracts was not per se determinative. With respect to the characterization of the payment, counsel relied on the decision of the Supreme Court of Canada in *Johns-Manville Canada v. The Queen,* [1985] 2 S.C.R. 46, in saying that its nature is to be determined from a practical and business point of view, and not on the basis of a juristic classification according to the object of the expenditure.

[24] Here, the US $16.3 million was the upfront payment for the acquisition of raw material. The appellant thus acquired supplies at a price which was considered advantageous at the time. As a matter of fact, the cost of the supplies (the propylene, i.e. the inventory) was made up of two components: 1) the payment that was made regularly on acquisition, the appellant being invoiced monthly at the price fixed under the Novacor Agreement; and 2) a portion of the upfront payment (the US $16.3 million). The US $16.3 million was paid to obtain favourable prices. In order to obtain the raw material, the appellant had to make this advance payment. It contributed to the circulating capital (as opposed to the fixed capital) the very trading assets (the pellets) used by the appellant to earn its income (see *B.P. Australia, Ltd. v. Commissioner of Taxation of the Commonwealth of Australia,* [1965] 3 All. E.R. 209 (Privy Council), at p. 219). In other words, in order to effect the sales, the appellant had to acquire the raw material, which it

obviously did on a recurring basis; the raw material was purchased, processed and then sold: that is to say, it circulated.

[25] Counsel for appellant further submitted that in acquiring the raw material, it was not acquiring the means of production, but was using it. The nature of the benefit sought was to obtain inventory at a reduced price, and this inventory could then generate higher profits.

[26] Counsel suggested that the Court should look at the business or commercial reality of what was sought by the expenditure. In so doing, it should exercise common sense judicial judgment, analyzing various factors in determining whether the expenditure is an income or a capital outlay (reference was made to the reasons of Le Dain J., dissenting, in *M.N.R. v. Canadian Glassine Co. Ltd.*, [1976] 2 F.C. 517 (F.C.A.) (QL) at par. 24). According to counsel for the appellant, a supply contract is not a fixed asset; it is not part of the profit-making structure or organization of an enterprise. The payment for the Novacor Agreement was a payment for the supply and was thus a current expenditure in the circumstances.

Respondent's argument

[27] At the outset, counsel for the respondent stated that the only question to be determined is whether the amount of US $16.3 millions allocated to the right, title and interest in and to the supply agreements was an amount paid on account of income or capital. If it was not on account of capital, as the respondent submitted it was, the respondent does not take issue with the manner in which the appellant chose to amortize the expense, which, according to the appellant, provided a truer picture of its financial affairs.

[28] According to the respondent, the amount of US $16.3 million was an amount paid on account of capital because it was part of the total amount of US $164,000,000 paid by the appellant for the acquisition of Shell's polypropylene business, namely, a refining facility located in Sarnia, Ontario, together with intangible assets, such as an assembled work force, supply agreements, software and goodwill, in order to enlarge its already existing income-earning structure (its polypropylene operations located in Varennes, Quebec). In fact, the appellant doubled the income-earning structure it had at the time. According to the respondent, the entire US $164,000,000 (including the US $16.3 million) was thus an expenditure on account of capital.

[29] Counsel submitted that an expenditure made for the purchase of a business as a going concern is always a capital outlay since it is made to obtain a source of income rather than being made in the course of earning income (for that statement counsel relied on *City of London Contract Corporation v. Styles* (1887), 2 T.C. 239 (C.A.) and *John Smith and Son v. Moore*, [1921] 2 A.C. 13).

[30] Counsel stated that for Canadian tax purposes, the amount paid by a buyer upon the purchase of all or substantially all of the assets of a business is also classified as a capital expenditure rather than a current expense unless that buyer is in the business of purchasing and reselling businesses (relied on in this regard were *Seaboard Advertising Co. v. M.N.R.*, [1966] Ex. C.R. 266 and *Southam Business Publications Ltd. v. M.N.R.*, [1966] Ex. C.R. 1055).

[31] Counsel for the respondent therefore submitted that the amount of US $16.3 million was not part of the cost of carrying on a business but part of the cost of acquiring a business. In the respondent's view, although a price tag was placed on the various assets acquired, the Asset Purchase Agreement clearly stated that the aggregate amount was the consideration for the transaction. In counsel's view, the intent was to sell/purchase as a package the entire polypropylene operation located in Sarnia. The transaction was the purchase of a profit-making structure in order to add to an already existing business structure an enduring asset, and not the purchase of severable disparate parts. In the respondent's opinion, the appellant cannot say that the amount of US $16.3 million was a prepaid expense for its future raw material needs or an expenditure made to acquire inventory, because the amount at issue was not paid to the supplier and no raw material was actually purchased and kept in inventory by the appellant as a result of the payment of that amount. What the appellant obtained, rather, was a right, title and interest in and to supply agreements which entitled it to buy agreed upon quantities of raw material for a specific period of time at a given price that was advantageous compared to the price on the spot market at the time of acquisition. This took place in the process of purchasing a profit-making structure with the consequent procurement of endurable benefits.

Analysis

[32] In my view, an inference cannot be drawn from the documentation provided in evidence and from the testimony of Mr. Mineer that the intent was for the appellant to purchase as a complete package the entire polypropylene operation located in Sarnia. Although the appellant certainly enlarged its profit-making structure in acquiring Shell's business in Sarnia, I tend to agree with the appellant

that the assignment of the Novacor Agreement was a subject matter that stood on its own in the negotiations with Shell. Shell was linked to that agreement and it was wholly in its interest to free itself from it by selling its business. The same cannot be said for the appellant. The appellant could very well have purchased Shell's business without accepting the assignment of the Novacor Agreement if the contract price of the propylene had not been advantageous to it at the time of the transaction. The result would have been that Shell would have had to pay damages to Novacor for not meeting its obligations under that agreement (clauses 4.05(b) and (c) of the Novacor Agreement, Exhibit A-2, Tab H). We can speculate that in that case, Shell would have tried to negotiate a higher price in selling its assets to the appellant, to cover the cost of those damages.

[33] On the other hand, Shell could, for whatever reason, have simply assigned its rights and obligations in and under the Novacor Agreement to the appellant without necessarily selling its business. We can speculate that the price attributed to the agreement might then have been that indicated in the actual transaction, that is, US $16.3 million. In such a case, the expense might very well have been considered by the Minister as an expenditure made in the process of gaining income, as it would not have been incurred in the course of purchasing an income-earning business as a whole.

[34] In accepting the assignment of the Novacor Agreement, the appellant was agreeing to pay for its raw material a price that seemed advantageous at the time. But the appellant was also taking a risk in that the spot price on the market might very well drop below the price fixed in the agreement. As a matter of fact, this happened in 1998 when the appellant decided to deduct the full unamortized balance in accordance with the impairment of assets accounting rules, as the price agreed upon with Novacor was no longer advantageous and the appellant still had to purchase a minimum amount of propylene from Novacor.

[35] Furthermore, a close look at the documentation tends to show that the assignment of the Novacor Agreement was not treated together with the transfer of Shell's business. First, in section 2 of the Feedstock Supply Agreement, it is clearly stated that the assignment of the Novacor Agreement is to be treated independently (see Exhibit A-2, Tab D, p. 29). Second, there was a separate agreement, entitled Assignment of Contracts and Assumption of Liabilities, for, among other things, the transfer of the Novacor Agreement from Shell to Himont Canada Inc. (Exhibit A-2, Tab G). Third, there was a separate resolution of the board of directors of Himont Canada Inc. approving the entering into of the supply agreement separately from the purchase of the assets of Shell's plant (Exhibit A-2,

Tab E). Fourth, a price was specifically allocated for the supply agreements in the Asset Purchase Agreement (Exhibit A-2, Tab D, section 3, and Schedule 3 to that agreement).

[36] All this is an indication to me that the assignment of the Novacor Agreement was not necessarily part of the aggregate price for the acquisition of Shell's profit-making structure. At least, the situation is not as clear-cut as the respondent claims it to be.[2]

[37] The respondent relied largely on the decision of the Privy Council in *John Smith and Son v. Moore*, *supra*. In that case, a taxpayer had acquired his father's coal merchant's business, including certain short-term contracts with collieries for the supply of coal to the business. In his dissenting reasons, Le Dain J. in *M.N.R. v. Canadian Glassine Co.*, *supra*, commented on the *John Smith* case as follows at paragraphs 31, 32 and 33:

> 31 . . . There would appear to be little or no direct authority on the nature of a lump sum payment to obtain a supply contract. In *John Smith and Son v. Moore* [1921] 2 A.C. 13, a taxpayer who had acquired the coal merchant's business of his father attempted unsuccessfully to deduct in the determination of profits an amount of £30,000 which was the value that had been placed in the acquisition on certain short-term contracts with collieries for the supply of coal to the business. The son had not actually disbursed this sum but had paid something less as the net value of the business as a whole. A majority in the House of Lords held that the sum of £30,000 was not a permissible deduction for the purpose of determining profits. Two of the members of the majority, Lord Haldane and Lord Sumner, held that it was in the nature of a capital expenditure — a sum to be employed in fixed capital. The third member of the majority, Lord Cave, rested his conclusion on the view that the business was a continuing one, and that the expenditure for the supply contracts was not made by the business for its trading purposes but by the son out of his own pocket. It was a payment that could have no bearing on the

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[2] As a result, there is a distinction to be made with the cases referred to by the respondent in which the amount at issue was paid as part of the acquisition price of a going concern, without a specific allocation for the particular item in question. I should add that in the *City of London Contract Corporation* and *Seaboard Advertising Co.* cases relied upon by the respondent the taxpayers had acquired customer contracts and business on which their profits were realized; such is not the case here. In *Southam Business Publications Ltd.*, the amount was paid for the circulation records, which were the only valuable thing the vendor had to sell (paragraph 39). It would have been difficult to say, therefore, that the amount was not paid for the acquisition of the business as a going concern. Here, the amount allocated to the supply contract (US $16.3 million) represented only 10 per cent of the total purchase price (US $164 million).

> profits of the continuing business. Viscount Finlay, dissenting, held that the sum in question was a payment for coal.
>
> 32 There has been considerable judicial commentary on the *Smith* case, but the general conclusion would appear to be that in view of its very special facts and the differing reasons for the majority opinions there is little, if anything, in the way of general principle to be drawn from it. See *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1964] A.C. 948, at 962-964; *B.P. Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia* [1966] A.C. 224, at 268-269; *Regent Oil Co. Ltd. v. Strick (Inspector of Taxes)* [1966] A.C. 295, at 322-323 and 353. It cannot be said to be authority for the proposition that a lump sum payment made to a supplier to obtain a supply contract is to be considered a capital expenditure. As Lord Pearce put it in the *B.P. Australia* case (*supra*) at page 269: "One certainly cannot deduce that the result would have been the same if the son had paid £30,000 to the collieries for the contracts."
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> 33 In my opinion a supply contract, whatever its term and however advantageous it may be, is not an asset or advantage in the nature of fixed capital. It cannot be considered in any sense a part of the profit-making structure or organization of an enterprise. It is not productive or generative or distributive of anything. It is what is supplied under it that is used to make profit. The contract is simply evidence of legal obligations with respect to operating transactions. No doubt it is a thing of value to the enterprise but that does not mean that it has the value of fixed capital. Its value is reflected by and is of the same nature as that which is to be supplied under it. In my view a payment for the contract must be considered to be a payment for the supply.
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> (Emphasis added.)

[38] The majority in *Canadian Glassine* did not disagree on this point. In that case, the taxpayer corporation was incorporated to manufacture glassine paper. It had an arrangement with another corporation, Anglo-Canadian, which supplied the taxpayer corporation's pulp requirements on a long-term basis at an advantageous price. That agreement included an undertaking by Anglo-Canadian to construct underground pipelines to convey pulp and steam from its plant to the taxpayer's. The amount paid by the taxpayer to Anglo-Canadian under that agreement was considered by the majority of the court as being paid in consideration of the construction of the pipelines and not for the execution of the supply contracts per se. The majority thus concluded that it was an outlay of capital. Le Dain J. dissented on the basis that the payment was a payment made in advance to obtain the raw material and power and accordingly was an income expense.

[39] The *John Smith* decision had previously been discussed and distinguished on the basis of its own peculiar facts in *Commissioner of Taxes v. Nchanga Consolidated Copper Mines, Ltd.,* [1964] 1 All. E.R. 208 (Privy Council), at pages 213-215:

> The appellant's argument relied largely, as was natural, on the decision of the House of Lords in *John Smith & Son* v. *Moore* (6). It would perhaps be more accurate to say that it relied on the speeches of LORD HALDANE and LORD SUMNER in that case, for of the four lords who took part in the decision VISCOUNT FINLAY dissented and LORD CAVE took a line of approach which is not relevant to the present dispute. . . .
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> It appears clearly from a close study of the speeches of LORD HALDANE and LORD SUMNER that two elements in the case, or rather the combination of those two elements, determined their decision. First, no sum of £30,000 had ever been paid. What was acquired was a business consisting of a variety of assets, among which was the benefit of the contracts, and involving a number of liabilities; the only money that the son had paid was the sum representing the net value of that business. LORD SUMNER said (8):
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>> "He bought a business and its assets at a valuation . . . He bought no coals; the business had none, nor any stock in trade; nor did he acquire any stock in trade in any business sense of the term . . . He did not pay this sum as the consideration for an assignment of the benefit of these contracts to himself; he took no assignment."
>
> It is evident that both the learned lords felt it to be impossible to say that a sum paid to acquire a business as representing the net value of that business, but not specifically allocated to individual assets of the business, was anything but a capital expenditure on a fixed asset. LORD SUMNER regarded the case as being in effect governed by the earlier decisions of *City of London Contract Corpn.* v. *Styles* (9) and *Alianza Co., Ltd.* v. *Bell* (10). And so it was, according to the terms in which he dealt with it. The second feature that was treated as of importance was the fact, alluded to by LORD SUMNER (8), that in paying something in respect of the benefit of the contracts the son had not acquired stock in trade or anything like such stock. It is not difficult to suppose that in a different context a sum paid by a running concern to a trader for the right to take over his supply contracts at fixed prices, if limited to the year of profit ascertainment, might fairly be regarded as part of the cost of acquiring the commodity to be supplied and, as such, chargeable against the gross proceeds of its sale. LORD SUMNER indeed seems to have visualised this, when he said (11) in explanation of the *Styles* decision (9):
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>> "This sum was paid with the rest of the aggregate price to acquire the business and thereafter profits were made in the business; the sum was not paid as an outlay in a business already acquired, in

order to carry it on and to earn a profit out of this expense as an expense of carrying it on."

The *John Smith* decision (12) therefore turned on the combination of two elements as the facts of the case: an aggregate price paid as the net value of a business taken over, and the inclusion in the assets of that business of the benefit of short-term supply contracts which were not in a form allowing them to be treated as analogous to stock in trade. But for the combination of those elements it is not to be assumed that the decision would have been the same, for it is difficult to accept as a sound general proposition that if a man acquires and pays for stock in trade for his own business on the taking over of another he is not entitled to set off against the gross proceeds of realising the stock the identifiable cost of acquiring it. . . .

(Emphasis added.)

(6) [1921] 2 A.C. 13; 12 Tax Cas. 266.
. . .
(8) [1921] 2 A.C. at p. 37; 12 Tax Cas. at p. 295.
(9) (1887), 2 Tax Cas. 239.
(10) [1906] A.C. 18; 5 Tax Cas. 60 and 172.
(11) [1921] 2 A.C. at p. 39; 12 Tax Cas. at p. 296.
(12) [1921] 2 A.C. 13; 12 Tax Cas. 266.

[40] In the present case, the appellant paid a sum of US $16.3 million as consideration for the assignment to it of the benefit of the supply contracts. An amount was specifically allocated to the transfer of the supply contracts. As Viscount Radcliffe said in *Nchanga*, *supra*, at page 215, it is difficult to accept as a sound general proposition that if a man (or a corporation) acquires and pays for stock in trade for his (its) own business on the taking over of another, he (it) is not entitled to set off against the gross proceeds of realizing the stock the identifiable cost of acquiring it.

[41] There is no single test for determining whether a particular expenditure is on income or capital account. In the final analysis, one must exercise common sense judicial judgment in the light of the particular circumstances of each case (cf. *Canadian Glassine*, *supra*, at paragraph 24, which refers to *B.P. Australia Ltd.*, *supra*, cited with approval by the Supreme Court of Canada in *M.N.R. v. Algoma Central Railway*, [1968] S.C.R. 447). The criterion most frequently referred to as an authoritative test is the concept of "an asset or an advantage for the enduring benefit of the trade of the taxpayer" expressed by Viscount Cave in *British Insulated and Helsby Cables, Limited v. Atherton*, [1926] A.C. 205. But as stated in *Nchanga*, *supra*, at page 212, it cannot be supposed that that test gives any warrant for the idea that securing a benefit for the business is prima facie a capital expenditure. Here, although there appeared to be a contractual benefit for a certain

period of time (the Novacor Agreement expired only in 2001), there was no assurance at all of an enduring benefit, as the spot market price could at any time drop below the contract price, which, as mentioned before, did indeed happen in 1998.

[42] Furthermore, the test of whether amounts were payable out of fixed or circulating capital, referred to in the *John Smith* case, was discussed in *B.P. Australia*, *supra*, at page 219: "Fixed capital is prima facie that on which one looks to get a return by one's trading operations. Circulating capital is that which comes back in one's trading operations." An expenditure with fixed capital in mind is viewed as a capital expenditure while an expenditure from circulating capital is not. Although the Supreme Court of Canada in *Johns-Manville*, *supra*, said that this vocabulary has changed, it recognized that the same problem of classification survives (at p. 59). As I said before, it is my view that the appellant made a deliberate choice in accepting the assignment of the Novacor Agreement. In doing so, it took the necessary steps to segregate out of the purchase price to be paid to Shell a specified sum allocated to the supply contract. It is therefore difficult to imagine, to paraphrase *B.P. Australia*, the appellant not accounting for that lump sum as an item in the cost of the production of the polypropylene. As in *B.P. Australia*, it was "in the forefront of the wholesaler's selling costs" (page 219). When the matter is considered from the perspective of the appellant's business, as it must be (see *Pantorama Industries Inc. v. The Queen*, 2005 FCA 135, [2005] F.C.J. No. 635 (QL)), the US $16.3 million expenditure was part of the operating cost to the appellant of obtaining propylene. As stated by Le Dain J. in *Canadian Glassine*, at paragraph 38, the appellant did not obtain for that sum anything that can be regarded as an asset or advantage in the nature of fixed capital. Prima facie, therefore, the US $16.3 million was "circulating capital which [was] turned over and in the process of being turned over yield[ed] a profit or loss; [it was] part of the constant demand which must be answered out of the returns of the trade" (*B.P. Australia*, *supra*, page 219).

[43] I therefore conclude that the US $16.3 million was not in itself a capital expenditure even though it was included in the purchase price of the total assets sold by Shell to the appellant. That particular expenditure was carefully segregated in separate agreements (the Asset Purchase Agreement, Exhibit A-2, Tab D, Schedule 3; the Assignment of Contracts and Assumption of Liabilities, Exhibit A-2, Tab G; and the Feedstock and Return Streams Supply Agreement, Exhibit A-2, Tab D, p. 29; there was also a separate resolution of the board of directors, Exhibit A-2, Tab E) which, in my view, show what the particular expenditure was for (see *Oxford Shopping Centres Ltd. v. The Queen*, 79 DTC

5458, at p. 5464 (F.C.T.D.), confirmed by the Federal Court of Appeal, at 81 DTC 5065).

[44] The appeals are allowed, with costs, on the basis that the appellant was entitled to deduct pursuant to subsection 9(1) and paragraph 18(1)(*a*) of the *ITA* the amount of US $16.3 million (CAN $22,865,640) as a current expense which could be amortized and written off, as was done by the appellant, for each of the taxation years at issue.

[45] Upon consent to judgment, the appeal for the taxation year ending December 31, 1996, with respect to the double inclusion of an amount of $53,277 related to an investment tax credit is also allowed.

Signed at Ottawa, Canada, this 16th day of November 2007.

"Lucie Lamarre"

Lamarre J.

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