Docket: 2003-4491(IT)G

BETWEEN:

NEWMONT CANADA CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on December 1, 2, 3, 4, 7, 8 and 9, 2009,
at Toronto, Ontario.
Before: The Honourable Justice Steven K. D'Arcy

Appearances:

Counsel for the Appellant:	John M. Campbell, David W. Chodikoff and Tarsem S.Basraon
Counsel for the Respondent:	Wendy Burnham and Deborah Horowitz

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JUDGMENT

The appeals with respect to the assessments made under the *Income Tax Act* for the Appellant's 1988, 1989, 1990, 1991, 1992, 1993, 1994 and 1995 taxation years and its taxation year ending July 18, 1996, are dismissed.

Costs are awarded to the Respondent.

Signed at Ottawa, Canada, this 8th day of March 2011.

"S. D'Arcy"

D'Arcy J.

Citation: 2011 TCC 148
Date: 20110307
Docket: 2003-4491(IT)G

BETWEEN:

NEWMONT CANADA CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

D'Arcy J.

[1] The Appellant has appealed notices of reassessment issued in respect of each of its taxation years ending between December 31, 1988 and July 18, 1996.

[2] There are three issues in this appeal:

1) Whether section 80.2 of the *Income Tax Act* (the "*Act*") applied to 50% of the approximately $29 million of mining tax the Appellant deducted when determining the amount of a royalty payment it was required to make in each of its taxation years ending between December 31, 1988 and July 18, 1996.

2) Whether the Appellant was entitled to deduct $7.25 million under either section 9 or subparagraph 20(1)*(p)*(ii) of the *Act* for a loan it made to a third party that was not repaid.

3) Whether the Appellant was entitled to deduct approximately $157,000 by virtue of subparagraph 20(1)*(p)*(i) of the *Act*.

[3] During the five days of testimony, I heard from the following five witnesses:

- Mr. Joseph Baylis, former Vice-president, Investor Relations and General Counsel of the Appellant;

- Mr. Michael Proctor, former Vice-president, Finance of the Appellant;

- Mr. Walter Zaverucha, a consultant who provides services with respect to land title reviews;

- Ms. Paula Kember, a former assistant controller of Corona Corporation; and

- Mr. Gordon MacGibbon, a large file case manager with the Canada Revenue Agency.

[4] I found all of the witnesses to be credible.

[5] Before addressing the issues in this appeal, I will review the history of the Appellant and the Golden Giant Mine.

History of the Appellant and the Golden Giant Mine

[6] During most of the relevant period, the Appellant was a public company, Hemlo Gold Mines Inc. The company's main activities were the operation of the Golden Giant Mine in Northern Ontario and exploring for minerals, particularly gold, in Canada and the United States.

[7] The Golden Giant Mine was an extremely successful gold mine located in the Marathon area of Northern Ontario. It was adjacent to two other gold mines, the David Bell Mine and the Page Williams Mine.

[8] Two prospectors (Donald McKinnon and John Larche) staked mining claims in the Thunder Bay area in 1980 (the “M&L Claims”). Two exploration companies, Goliath Gold Mines Ltd. ("Goliath") and Golden Sceptre Resources Ltd. ("Golden Sceptre"), eventually held the M&L claims, which included the area that became the Golden Giant Mine.[1]

[9] On November 10, 1982, a Noranda company, Noranda Exploration Company Limited ("Norex") entered into an agreement (the "Golden Giant Agreement") with Goliath and Golden Sceptre pursuant to which Norex would earn a 50-percent interest in the M&L Claims by completing an exploration program on the claimed property, constructing the Golden Giant Mine, financing all capital costs and

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1 Joint Book of Documents, Exhibit A2, page 228.

bringing the mine into production within two years of the date of the Golden Giant Agreement.[2]

[10] When developing the Golden Giant Mine, Norex determined (sometime in the latter half of 1983) that the best location for the mine shaft was on a piece of property that was referred to as the "Quarter Claim." As a witness for the Appellant noted, a shaft is normally drilled through waste rock, not through ore, such as gold ore. Norex could not find a waste rock area within the area covered by the M&L Claims. However, it was able to locate what it believed was such an area on the adjacent David Bell Mine site. Teck Corporation and International Corona Resources Ltd. (jointly referred to as "Teck/Corona") owned the rights to the David Bell Mine.[3]

[11] As a result, on January 25, 1983, Norex entered into an agreement (the "Quarter Claim Agreement") with Teck/Corona pursuant to which Norex was granted the option to acquire a 100% undivided interest in the Quarter Claim subject to, among other things, a 50% net profits royalty in favour of Teck/Corona[4] (the "Quarter Claim Royalty"). It is the Quarter Claim Royalty that has given rise to the first issue herein.

[12] Norex's interest in the M&L Claims vested on March 25, 1985[5] and the first gold from the Golden Giant mine was poured in April 1985.[6]

[13] Norex's interest in the Quarter Claim vested in 1986.[7] The Court was not provided with the actual date the Quarter Claim vested.

[14] In early 1987, the interests in the Golden Giant Mine held by Goliath, Golden Sceptre, and Norex, including Norex's interest in the Quarter Claim, "were merged" into a new company, Hemlo Gold Mines Inc.[8] Hemlo Gold Mines then became a public company.

[15] Hemlo Gold Mines (through its subsidiary HGM Inc.) operated the Golden Giant Mine through all of the years under appeal with the exception of 1995 and 1996.

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2 Exhibit R1 and Joint Book of Documents, Exhibit A2, page 228.

3 Transcript of Proceedings ("Transcript"), pages 311-313.

4 Joint Book of Documents, Exhibit A3, pages 318 and 320.

5 Transcript, page 318.

6 Joint Book of Documents, Exhibit A2, page 228.

7 Transcript, pages 264-266.

8 Joint Book of Documents, Exhibit A2, page 228. A subsidiary of Hemlo Gold Mines, HGM Inc., acquired ownership of the Golden Giant Mine, including the Quarter Claim.

[16] In 1995, Hemlo Gold Mines, HGM Inc. and a numbered company merged to form a new company called Hemlo Gold Mines Inc. In 1996, Hemlo Gold Mines Inc. merged with an arm's length corporation, Battle Mountain Gold Ltd., and the name of the company was changed to Battle Mountain Canada Ltd.[9] Newmont Mining Corporation acquired the company in 2001 and its name was changed to Newmont Canada Ltd.

[17] For ease of reference, I will refer to the Appellant and its predecessors (from the date of the 1987 amalgamation) as Hemlo Gold.

[18] In addition to operating its mines, Hemlo Gold carried out exploration activities and invested in numerous third-party entities. On April 21, 1988, it entered into an agreement with a junior exploration company, Windarra Minerals Ltd. ("Windarra"). Pursuant to the agreement, Hemlo Gold, in 1988 and 1999, made an equity investment in Windarra of $9.271 million and loaned Windarra $8.25 million (the "Windarra Loan").[10]

[19] On November 6, 1992, Hemlo Gold entered into a settlement agreement with Windarra (the “1992 Settlement Agreement”) which had the effect of extinguishing $7.25 million of the Windarra Loan.[11] The second and third issues relate to the 1992 Settlement Agreement.

[20] I will first consider the issue relating to section 80.2 of the *Act*.

Issue 1: The Quarter Claim Issue

[21] It is the Appellant's position that section 80.2 of the *Act* applies in each of the years under appeal to reduce Hemlo Gold's income by 50% of the Ontario mining tax paid or payable by Hemlo Gold in respect of the Quarter Claim.

[22] The Respondent does not agree.

Summary of the Law

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9 Transcript, pages 298-300.

10 Joint Book of Documents, Exhibit A2, pages 269, 280, 303, 317 and 318, Exhibit A3, pages 209-212.

11 Joint Book of Documents, Exhibit A3, pages 308-312.

[23] Section 80.2 of the *Act* was a provision that addressed certain concerns that Parliament had with respect to reimbursements of certain Crown charges.[12] Appendix A to these Reasons contains the wording of section 80.2 as it read prior to February 1990 and as it read after January 1990.

[24] In the publication entitled *Canadian Resource Taxation* the general operation of section 80.2 is described as follows:[13]

> Paragraphs 12(1)(*o*) and 18(1)(*m*) must be read in conjunction with section 80.2. Under section 80.2, if a Crown charge under paragraph 18(1)(*m*) or 12(1)(*o*) is reimbursed by the taxpayer under the terms of a contract and the taxpayer is resident in Canada or carrying on business at the time of such payment, the reimbursement paid by the taxpayer is deemed to be an amount paid by the taxpayer under paragraph 18(1)(*m*) and the recipient who is reimbursed is deemed not to have received the amount. The provision ensures non-recognition of the receipt by the party that is reimbursed and ensures recognition of the Crown charge by the taxpayer making the reimbursement.

[25] The following example of the general application of section 80.2 was provided in a paper delivered by Mr. Christopher R. Post at the 2005 Prairie Provinces Tax Conference:[14]

> . . . In the absence of a provision like 80.2, it would have been fairly easy for oil and gas producers to plan their way around crown charges not being deductible by reimbursing other taxpayers for such amounts.
>
> For example, say Taxpayer A holds the mineral rights to a particular property and Taxpayer B farms-in to that property, and Taxpayer A continues to have the obligation to pay the crown charges on all oil and gas production. If Taxpayer B agrees to reimburse Taxpayer A for all the crown charges related to production, the payment by Taxpayer B for crown charges would become deductible for tax purposes but for 80.2. . . . 80.2 deems the person making the reimbursement (Taxpayer B in the example above) not to have made the actual payment "but to have paid an amount described in 18(1)(m) equal to the amount" of the payment. In other words, the one making the reimbursement is considered for income tax purposes to have made a payment directly to the crown. In this example, the payment for crown charges made by Taxpayer B are not deductible for tax purposes,

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12 The provision was repealed for taxation years that began after 2006. The Department of Finance has indicated that it will repeal the provision repealing section 80.2.

13 Brian R. Carr and C. Anne Calverly, *Canadian Resource Taxation*, **looseleaf** (Toronto: Carswell: released in 2009-1) at 3.3.2(2).

14 Christopher R. Post, "Significant Recent Amendments Regarding Interest Deductibility, Restrictive Covenants and Reimbursed Crown Charges", 2005 Prairie Provinces Tax Conference (Toronto: Canadian Tax Foundation, 2005).

> under the rules as originally introduced, which is consistent with the intent of 12(1)(o) and 18(1)(m).
>
> As well, 80.2 deems the one receiving the reimbursement (Taxpayer A in the example) not to have received anything for tax purposes. As a result Taxpayer A would have no income or loss—which is consistent with the cash position and the intent of the legislation.

[26] Counsel for the Appellant and Respondent both argued that section 80.2 is not an anti-avoidance rule, but rather is a relieving provision. This depends upon whom one is considering; in the example that Mr. Post provided, the provision is a relieving provision to taxpayer A but an anti-avoidance provision to taxpayer B.

[27] Prior to February 1990, the following conditions had to be satisfied before section 80.2 applied:

- A taxpayer, under the terms of a contract, reimburses another person for an amount paid or that became payable by that other person, and

- Such amount was included in the income of that other person or denied as a deduction in computing the income of that other person by virtue of paragraph 12(1)*(o)* or paragraph 18(1)*(m)*, as the case may be, and

- The person was resident in Canada or carrying on business in Canada at the time of the reimbursement.

[28] After January 1990, the conditions that had to be satisfied were as follows:

- A taxpayer under the terms of a contract, pays to another person an amount (referred to as the "specified payment") that may reasonably be considered to have been received by the other person as a reimbursement, contribution or allowance in respect of an amount (referred to in paragraph (*b*) as the "particular amount") paid or payable by the other person,

- The particular amount is included in the income of that other person or denied as a deduction in computing the income of that other person by reason of paragraph 12(1)*(o)* or paragraph 18(1)*(m)*, as the case may be; and

- The person was resident in Canada or carrying on business in Canada at the time of the reimbursement.

[29] Both parties noted that the difference between the pre-February and post-January 1990 wording of the section did not affect the application of the section to the issues in this appeal.

[30] When making their arguments, counsel for the Appellant and counsel for the Respondent focused on two issues: whether the deduction of Ontario mining taxes was denied by paragraph 18(1)*(m)* and whether there was a reimbursement. In fact, counsel for the Respondent argued that, if I accept the Respondent's position with respect to paragraph 18(1)*(m)*, there is no need to consider the issue of whether or not there was a reimbursement.

[31] While I accept that, based on the evidence before me, these are the only two issues, it is clear from the wording of section 80.2 that one must first determine if there was a reimbursement before considering whether paragraph 18(1)*(m)* applies. It is only if a reimbursement is received in respect of an "amount" that one is required to determine if the deduction of the "amount" is denied under paragraph 18(1)*(m)*. The application of paragraph 18(1)*(m)* is irrelevant if a reimbursement of an "amount" did not occur.

[32] In determining whether there was a qualifying reimbursement within the meaning of section 80.2 of the *Act*, I will first consider the wording of section 80.2 as it applied to payments made after January 1990 since that would include most of the years under appeal. I will then consider whether the change in wording affected the application of the section.

[33] I will begin by considering the meaning of the word reimbursement as it is used in section 80.2.

[34] The Appellant argued that reimbursement is a context-specific term, but did not provide a definition.

[35] Counsel for the Respondent argued, citing *Westcoast Energy*,[15] that in order for a payment to qualify as a reimbursement, the payee must have a legal right to claim the amount. They also cited Associate Chief Justice Rossiter who, in *Alberta Power*,[16] stated in paragraph 94: "What is contemplated is a situation where one party is forced to pay an amount that is properly the liability of another party and

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[15] *Westcoast Energy Inc. v. Canada*, [1991] 3 F.C. 302 (QL) (FCTD) at paras. 44 and 46; affirmed [1992] F.C.J. No. 225 (QL) (FCA).

[16] *Alberta Power (2000) Ltd. v. Canada*, 2009 TCC 412, [2009] T.C.J. No. 328 (QL).

is therefore entitled to be reimbursed the funds from the second party." Finally, they argued that in order for there to be a reimbursement there must have been an amount paid by a reimbursing party.

[36] As the Supreme Court of Canada has stated, statutory interpretation of fiscal legislation should be done ". . . according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. . . ."[17]

[37] The word reimburse, in the ordinary sense, is defined by the *Canadian Oxford Dictionary*[18] as follows:

> 1. repay (a person who has expended money). 2. repay (a person's expense).

[38] Webster's dictionary[19] provides a similar definition. The word is defined as "1: to pay back to someone. . . 2: to make restoration or payment of an equivalent to." *Black's Law Dictionary*[20] defines reimbursement as "1. Repayment. 2. Indemnification."

[39] In *Westcoast Energy*, the Federal Court, after considering a number of examples of the word reimbursement in different legal relationships, stated at paragraph 46:

> 46 In all of the examples of the word reimbursement, there exists a flow of benefits between the respective parties. The person who benefits is under a legal obligation to pay back the amount expended. . . .[21]

[40] In *Canada Safeway*,[22] the Federal Court of Appeal noted that the term "reimbursement" has to be interpreted by reference to the context in which it is used and from which it can acquire greater and appropriate specification.

[41] In my view, the word reimbursement, as used in section 80.2 of the *Act*, means the payment by a person of an amount to a third party as repayment of or indemnification for an amount paid or payable by the third party.

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17 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, at para. 10.

18 *The Canadian Oxford Dictionary*, 2d ed., *sub verbo* "reimburse".

19 *Webster's Ninth New Collegiate Dictionary*, *sub verbo* "reimburse".

20 *Black's Law Dictionary*, 9th ed., *sub verbo* "reimbursement".

21 *Supra*, note 15.

22 *The Queen v. Canada Safeway Limited*, 98 DTC 6060, at page 6063.

[42] I agree with counsel that the difference between the pre-February and post-January 1990 wording of section 80.2 does not affect the determination of whether there was a qualifying reimbursement within the meaning of section 80.2. The pre-February 1990 wording refers to a taxpayer who "reimburses another person for an amount" while the post-January 1990 wording refers to a taxpayer who pays to another person "an amount . . . that may reasonably be considered to have been received by the other person as a reimbursement, contribution or allowance in respect of an amount". In both instances the section, in my view, refers to payments by a person of an amount to a third party as repayment of or indemnification for an amount paid or payable by the third party.

Summary of the Relevant Facts

[43] Mr. Proctor testified that the president of Norex, Mr. Harvey, and the secretary of Norex, Mr. Ivany, negotiated the Quarter Claim Agreement.[23] Neither of these individuals testified at the hearing. In fact, I did not hear testimony from anyone who was involved in negotiating the Quarter Claim Agreement.

[44] One of the witnesses for the Appellant agreed that the Quarter Claim Agreement was essentially an option to acquire property.[24] Under the agreement, Norex was granted the option to acquire a 100% undivided right, title and interest in and to the Quarter Claim subject to the paramount rights of the Crown, an existing 3% royalty,[25] and the Quarter Claim Royalty.[26]

[45] Under the terms of the Quarter Claim Agreement, Norex was deemed to have exercised its option to acquire the 100% undivided interest in the Quarter Claim once it fulfilled its contractual obligations with respect to exploring the Quarter Claim and commenced sinking the shaft for the mine, and once its interests, under the Golden Giant Agreement, in the M&L Claims (including the Golden Giant Mine) vested.[27]

[46] The Quarter Claim Agreement also provided for the following rights and obligations:[28]

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[23] Transcript, pages 421-422. Mr. Ivany was also the general counsel of Noranda, the parent company.

[24] Transcript, pages 251-252.

[25] The 3% royalty, referred to as a smelter royalty, was payable by Teck/Corona to certain prospectors and financial backers; Transcript, page 262.

[26] Joint Book of Documents, Exhibit A3, page 318.

[27] *Ibid.*, pages 318-319.

[28] *Ibid.*, pages 316 and 317.

- Norex was given permission to sink the shaft for the Golden Giant Mine and agreed to explore the Quarter Claim and act as operator if the Quarter Claim was mined.

- Norex agreed to provide hoisting capacity of 500 tons per day for any gold ore (or other material) mined in the Quarter Claim and to reserve milling capacity of 500 tonnes per day for the mined gold ore.[29]

- Norex agreed to allow Teck reasonable access to the shaft and shaft site in order for Teck to explore and exploit the David Bell Mine.[30]

- Teck/Corona agreed that once it obtained a surface and mineral lease for the David Bell mine (including the property where the Quarter Claim was located), it would take all necessary steps to create a separate lease for the Quarter Claim for the benefit of Norex.[31]

[47] The Quarter Claim agreement contains a clause that states the following:[32]

> T/C [Teck/Corona] and Norex recognize and agree that due to the early stage of development of the Corona Property [the David Bell Mine] and the Golden Goliath Property [the Golden Giant Mine] they are unable to agree with certainty as to some of the matters set out in this letter on which, however, they have nevertheless reached a basic understanding. In connection with those matters and as further exploration and development work is carried out on those properties they will use their best efforts to reach definitive agreements. In the meantime Norex and T/C agree that this letter and the agreements set out herein will bind them to the fullest extent possible. From time to time Norex and T/C will settle and enter into more formal agreements at the request of either Norex or T/C.

[48] Mr. Baylis noted that some of the matters that were subsequently agreed to were:[33]

- A change in the area conveyed. (The area was enlarged to accommodate the mineshaft).[34]

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29 Norex also agreed to provide Teck with an additional 500 tonnes per day of milling capacity, apparently for gold ore mined at the David Bell Mine. This additional milling capacity was never used by Teck. Transcript, page 208.

30 As discussed previously, the Quarter Claim was located on a Teck/Corona property that included the David Bell Mine. This property was adjacent to the Golden Giant Mine.

31 See also Transcript at pages 260-261.

32 Joint Book of Documents, Exhibit A3, page 317.

33 Transcript, pages 207-210.

- A reduction in the mining rate from the agreed 500 tons per day, after several years, due to rock mechanics and stresses on the shaft.[35]

- Agreements on how costs relating to the Quarter Claim were to be tracked and recorded.

- Agreements on mining practices and plans relating to mining the boundary between the Quarter Claim and the David Bell Mine.

[49] There were two written amendments to the Quarter Claim Agreement. The first amending agreement (the "1983 Amending Agreement") was signed on December 1, 1983[36] (ten months after the parties entered into the Quarter Claim Agreement). It appears from the recitals that the purpose of the amendment was to address Norex's request that Teck/Corona grant it an immediate conveyance of the Quarter Claim.

[50] The second amending agreement was entered into on July 4, 1995 (the "1995 Amending Agreement").[37] Mr. Baylis explained that the amendments were required once it was no longer technically feasible to mine the Quarter Claim at the agreed rate of 500 tons per day. The 1995 Amending Agreement provided for a deemed gold production rate and deemed unit production costs that were to be used in the calculations of payments to Teck/Corona under the Quarter Claim Agreement, including the Quarter Claim Royalty.[38]

[51] Mr. Baylis, during cross-examination, stated that Norex received in 1986 "a conveyance of the Quarter Claim, subject to the rights of Teck and Corona and the paramount rights of the Crown and the numbered company for a net smelter interest."[39] It appears that this conveyance was the lease referred to in the 1983 Amending Agreement, which was converted to a fee simple interest in 1989.[40]

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[34] Mr. Baylis described this additional property as a dimple. He also noted that the option of extending the Quarter Claim to include the dimple was provided for in the Quarter Claim Agreement. See Transcript, page 210.

[35] This was eventually included in one of the written amendments to the Quarter Claim Agreement. The amendments will be discussed shortly.

[36] Joint Book of Documents, Exhibit A3, pages 342-345.

[37] Joint Book of Documents, Exhibit A3, pages 346 to 354.

[38] Transcript, page 211.

[39] Transcript, page 265.

[40] During cross-examination, Mr. Baylis noted that the leases were converted under the *Mining Act* to patents; this appeared to have the effect of granting Hemlo Gold a fee simple interest in the Quarter Claim, Transcript, pages 266-267.

[52] I will now turn to the Quarter Claim Royalty. When negotiating the Quarter Claim Agreement neither of the parties imagined or believed that the Quarter Claim contained valuable gold or other mineral reserves. The parties only discovered that the property contained valuable gold reserves after they drilled the shaft and explored the deeper portions of the Quarter Claim.[41] As a result, Hemlo Gold paid substantial amounts to Teck/Corona in respect of the Quarter Claim Royalty.

[53] Norex had agreed to pay Teck/Corona the Quarter Claim Royalty in consideration of the grant of the option with regard to the Quarter Claim. The Quarter Claim Agreement states that the royalty will be payable to Teck/Corona after Norex has recouped its capital outlays in connection with the mining of the ore, but not including capital costs relating to the shaft. The calculation of the royalty is set out in Schedule D to the Quarter Claim Agreement.[42]

[54] Schedule D was described as boilerplate, a template that was used by Noranda in hundreds of agreements. It was used whenever Noranda (including Norex) "did a joint venture agreement of any sort."[43]

[55] Schedule D required Norex to establish a Royalty Account to which it was to debit the following:[44]

1) Preproduction costs (expenditures on exploration, development and construction made solely for the benefit of the Quarter Claim and made prior to the commencement of commercial operations).

2) Operating losses from the Quarter Claim.

3) Post-production capital expenditures (capital costs for the Quarter Claim incurred after production commenced).

4) Interest charges on month-end balance in Royalty Account.

5) Reserve charges (amount calculated based upon estimated costs of rehabilitating and restoring the Quarter Claim).

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41 Transcript, pages 312-313.
42 Joint Book of Documents, Exhibit A3, page 320.
43 Transcript, pages 430-431.
44 Joint Book of Documents, Exhibit A3, pages 335-341.

[56] Schedule D required Norex to first apply any net profits from the Quarter Claim to the reduction of the amounts debited to the Royalty Account. It stated that "[w]hile there is any debit balance in the Royalty Account, Norex shall retain all Net Profits."[45] Whenever the Royalty Account did not have a debit balance, net profits were to be distributed 50% to Norex and 50% to Teck/Corona.

[57] Mr. Proctor noted that, at the time the agreement was entered into, it was assumed that there would be "a lot of debits to the Royalty Account and, therefore, it would take some time, even if the mine was earning money, for the earnings to have offset the capital that had previously had [*sic*] been debited."[46]

[58] As discussed previously, the parties realized significant profits from mining the Quarter Claim. The actual point at which the Royalty Account went to a credit balance is not clear. Mr. Proctor was vague on this point. He first thought it was 1989,[47] but then on redirect was taken to the 1987 financial statements of Hemlo Gold (its first financial year), which show a royalty being paid to Teck/Corona in 1987.[48] It is not clear, based upon the evidence before me, if Hemlo Gold paid a royalty in 1986. The Court was only provided with Quarter Claim Royalty statements for the 1991, 1992, 1993 and 1995 fiscal years.[49] I was not provided with royalty statements for any year prior to 1991, even though Mr. Proctor referred to the statements as crucial documents.[50]

[59] Further, the Court was not provided with evidence with respect to the magnitude of the preproduction costs, the post-production capital expenditures, or the operating losses (if there were any) at the commencement of operations. In addition, the point in time at which the Royalty Account went from a debit balance to a credit balance was not provided to the Court.

[60] Mr. Proctor appeared to imply during his testimony that there were no capital costs that were subject to the Quarter Claim Agreement.[51] However, an exhibit filed by the Appellant with respect to the calculation of mining taxes shows preproduction

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45 Joint Book of Documents, Exhibit A3, page 335.

46 Transcript, page 426.

47 *Ibid*., page 428.

48 *Ibid*., page 458.

49 Exhibits A14, A15 and A16. The Court was provided with an operating statement for the 1989 fiscal year (Exhibit A13); however, the document did not contain a calculation of the Quarter Claim Royalty.

50 Transcript, page 372.

51 *Ibid*., pages 363-364.

expenditures of $1.676 million in 1986 and post-production expenditures of approximately $184,000 and $904,000 in 1986 and 1987 respectively. The exhibit does not provide the preproduction expenses incurred prior to 1986.[52]

[61] Mr. Proctor explained how Hemlo Gold and Teck/Corona determined the income attributable to the Quarter Claim. The Quarter Claim was not a separate mine; it was part of the Golden Giant Mine. Mr. Proctor referred to the Quarter Claim as a mine within a mine.[53]

[62] The gold ore mined from the Quarter Claim was commingled with the gold ore from the remainder of the Golden Giant Mine and thus could not be separately identified when it arrived at the processing mill. Therefore, the parties had to agree on a method for determining the income realized from mining the Quarter Claim.[54]

[63] Mr. Proctor noted that the first step was for the parties to determine the amount of gold ore removed from the Quarter Claim[55]. Hemlo Gold then determined the quality of the ore (from sampling the mined ore) and the metallurgical recovery in the mill. It then used the information so obtained and the net realizable value of the gold to determine the revenue for a specific period for the gold mined from the Quarter Claim.[56]

[64] Costs were determined based upon the overall costs of the Golden Giant Mine, including the mill and administrative costs. The costs were allocated to the Quarter Claim based upon either tons mined or tons milled. Mr. Proctor noted that Hemlo Gold and Teck/Corona identified certain costs of the Golden Giant Mine (mainly administrative costs) that were not allocated to the Quarter Claim.[57]

[65] Mr. Proctor also discussed an issue that arose when calculating the amount of the deduction in respect of the Ontario mining tax. Mr. Proctor noted that Noranda was the operator of the Golden Giant Mine during its development stage. During that period, Noranda used the available write-offs arising from the Golden Giant Mine to

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52 Exhibit A17, fourth page.

53 Transcript, page 362. See also Hemlo Gold Annual Report 1992, Joint Book of Documents, Exhibit A3, pages 12 and 13.

54 Transcript, pages 361 and 362.

55 This was done by the engineering and survey department, based upon preproduction drilling and surveying the void left when the ore was removed.

56 Transcript, pages 364–366. Mr. Proctor explained that gold producers normally recognized revenue based upon the net realizable value of the gold once it reached a saleable state as opposed to the actual sale price of the gold.

57 *Ibid*., pages 366-368.

reduce the mining tax payable in respect of its other operations in Ontario. As a result, Hemlo Gold, once it started operating, had fewer write-offs available to it than it would have had if it had been the operator during the development stage of the Golden Giant Mine.[58]

[66] As a result, Hemlo Gold, for the purposes of the calculation of the Quarter Claim Royalty, calculated in October 1988 a "notional mining tax." This calculation was explained in an October 4, 1988 letter from Mr. Proctor to the assistant controller of Teck Corporation as follows:[59]

> . . . As discussed previously, the "notional" tax payable represents the tax that would have been payable by the Golden Giant Mine (consisting of the #1 Deposit and the Quarter Claim), if the mine had been built and operated by a separate free-standing company having no other operations or exploration activities in Ontario.
>
> . . .
>
> I have allocated the “notional” tax to the Quarter Claim based upon its direct contribution to the cumulative notional numbers. . . .

[67] The letter goes on to calculate the first amount deducted in respect of mining taxes. It was deducted in 1988 in respect of income earned prior to December 31, 1987.

Application of Law to the Facts

[68] I must, based upon the wording of section 80.2 of the *Act*, determine if Teck/Corona, under the terms of the Quarter Claim agreement, paid an amount to Hemlo than can reasonably be considered to have been received by Hemlo as a reimbursement, contribution or allowance in respect of Ontario mining taxes paid or that became payable by Hemlo.

[69] This requires me to determine, in the first instance, if Teck/Corona paid an amount to Hemlo Gold as repayment of or indemnification for an amount paid or payable by Hemlo Gold.

[70] The Appellant's counsel argued, "that the application of Teck-Corona's share of revenues from the Quarter Claim to [Hemlo Gold's] liability, as operator, for mining taxes on the Quarter Claim was a reimbursement of 50 per cent of the Quarter

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58 Transcript, pages 378-379.

59 Exhibit A17, page 1.

Claim mining taxes."[60] In the alternative, the Appellant's counsel submitted "that the deduction of the Quarter Claim mining taxes, in determining the net distributable profits [under the Quarter Claim Agreement], constituted a reimbursement for the purpose of section 80.2."[61]

[71] I do not accept the Appellant's arguments. Teck/Corona did not pay an amount to Hemlo as a reimbursement under the Quarter Claim Agreement. The only payment made by either party was the payment of the Quarter Claim Royalty by Hemlo Gold to Teck/Corona.

[72] Hemlo Gold obtained a 100% undivided interest in the Quarter Claim.[62] It was the evidence of the Appellant that Hemlo Gold first acquired this interest by way of lease, and then subsequently converted the interest to a fee simple interest. The Quarter Claim was part of the Golden Giant Mine.

[73] In the course of operating the Golden Giant Mine (including the Quarter Claim), Hemlo Gold incurred various expenses, including mining taxes. Hemlo Gold recovered these expenses by earning income from the Golden Giant Mine. If revenue from the Golden Giant Mine did not exceed the expenses of the mine then Hemlo Gold incurred a loss. If the revenue exceeded the expenses then Hemlo recovered its expenses and earned a profit.

[74] Once the profit calculated from the revenue and costs allocated to the Quarter Claim exceeded any debit balance in the Quarter Claim Royalty account, Hemlo Gold was required to share 50% of such calculated profit with Teck/Corona.

[75] At no time was Teck/Corona under a contractual obligation to reimburse Hemlo Gold for the expenses incurred to mine the Quarter Claim (including the mining taxes). No royalty was payable if the expenses allocated to the Quarter Claim exceeded the revenue allocated to the Quarter Claim. In such a situation, Hemlo Gold incurred, on its own account, any loss incurred in respect of the mining of the Quarter Claim.

[76] If the Quarter Claim was profitable (and mining tax was paid), but the amount of profit did not exceed the amount of any debit balance in the Quarter Claim

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60 Transcript of Argument, page 8.

61 *Ibid.*

62 Subject to the paramount right of the Crown, the Quarter Claim Royalty and the existing net smelter royalty.

Royalty account[63] then the costs allocated to the Quarter Claim, including the mining tax, were borne entirely by Hemlo Gold.

[77] The allocation of revenue from the Golden Giant Mine to the calculation of the Quarter Claim Royalty was not the payment of an amount by Teck/Corona. Hemlo Gold as the owner and operator of the Golden Giant Mine (including the Quarter Claim) realized all revenue from mining the Golden Giant Mine. This revenue was not the revenue of Teck/Corona. Teck/Corona was only entitled to receive an amount as a royalty. Further, such royalty was only payable if the Royalty Account showed a credit balance.

[78] The Appellant argued: "Teck/Corona had an interest in the revenues from the Quarter Claim because Teck/Corona continued to have an interest in the land and minerals by reason of the Quarter Claim agreement and the registration of that agreement on title."

[79] It was the Appellant's position that, because of this interest, the application of Quarter Claim revenues to the Appellant's liability for mining taxes as operator of the Quarter Claim was a reimbursement for the purposes of section 80.2 of the *Act*.

[80] The foundation of the Appellant's argument was its position that the Quarter Claim Royalty created an interest in land.

[81] The Appellant provided the Court with three cases to support its position: the Supreme Court of Canada's decision in *Bank of Montreal v. Dynex Petroleum Ltd* ("*Dynex*"),[64] the decision of the Alberta Court of Queen's Bench in *Vandergrift v. Coseka Resources Ltd.* ("*Vandergrift*")[65] and the decision of the Ontario Superior Court of Justice in *St. Andrew Goldfields Ltd. v. Newmont Canada Ltd.* ("*St. Andrew*").[66]

[82] The Supreme Court of Canada found in the *Dynex* case that certain royalties could constitute an interest in land. In his decision, Major J. quoted Virtue J. of the Alberta Court of Queen's Bench as follows (as paragraph 22):

> Virtue J. in *Vandergrift, supra*, at p. 26, succinctly stated:

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63 Which the parties believed, at the time the Quarter Claim Agreement was entered into, to be a real possibility.

64 [2002] 1 S.C.R. 146.

65 (1989), 67 Alta L.R. (2d) 17.

66 [2009] O.J. No. 3266 (QL).

> . . . it appears reasonably clear that under Canadian law a "royalty interest" or an "overriding royalty interest" can be an interest in land if:
>
> 1) the language used in describing the interest is sufficiently precise to show that the parties intended the royalty to be a grant of an interest in land, rather than a contractual right to a portion of the oil and gas substances recovered from the land; and
>
> 2) the interest, out of which the royalty is carved, is itself an interest in land.

[83] The Supreme Court of Canada did not determine whether the royalty at issue was an interest in land. It referred the matter back to the trial judge for determination.

[84] Virtue J., however, did make such a determination in *Vandergrift*. In finding that the royalty at issue therein did not create an interest in land, Virtue J. stated the following:[67]

> In reading the agreement one is struck by the fact that the first reference to the nature of the interest to be conveyed uses the expression "royalty on all petroleum substances recovered from the lands," not petroleum within, upon and under the lands, but, those substances "recovered" from the lands. The next reference, in para. 2, is to a royalty on "petroleum substances found". Again, the reference is not to petroleum substances within, upon or under the lands, but to substances "found" within, upon or under the lands. The other references in [the] agreement are to [a] royalty in terms of "a share of production", "petroleum substances sold", "petroleum substances produced". Taken as a whole, I am of the view that the agreement conveys a contractual right to the payment of a royalty on petroleum substances produced from the lands, that is, a share of the petroleum after it has been removed, rather than on [*sic*] interest in land.

[85] In the third case provided by the Appellant, the *St. Andrew* decision, Roberts J. determined that the royalty at issue was not an interest in land. He acknowledged that royalty interests could be interests in land "if the language used in describing the interest is sufficiently precise to show that the parties intended the royalty to be a grant of an interest in land, rather than a contractual right to a portion of the substances recovered from the land, and the interest, out of which the royalty is carved, is itself an interest in land."[68]

[86] Relying on the Supreme Court of Canada's decision in *Dynex*, he stated that it is the intention of the parties, judged by the language creating the royalty, that

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67 *Supra*, footnote 65, at paragraph 40.

68 *Supra*, footnote 66, at paragraph. 98.

determines whether they intended to create an interest in land or to create contractual rights only.[69]

[87] Roberts J. then noted that the use of the words "covenants and agrees to pay" and "produced" in the description of the royalty before him was the "first indication that the parties intended to create only contractual rights to the payment of a royalty and not an interest in land."[70]

[88] The Quarter Claim Royalty is provided for on page 7 of the Quarter Claim Agreement.[71] The actual wording is as follows:

> As consideration for the grant of the option, Norex agrees to pay T/C [Teck/Corona] a 50% Net Profits royalty on ore mined from the Optioned Property. The royalty will be payable to T/C after Norex has recouped its capital outlays in connection with the mining of that ore, but not including Shaft costs all as more fully described in Schedule D hereto.

[89] The use of the word "mined" is similar to the use of the word "recovered" in *Vandergrift* and the word "produced" in *St. Andrew*. The words indicate an intention to create only contractual rights to the payment of a royalty and not an interest in land.

[90] Further, the remainder of the agreement, particularly the calculation of the net profit royalty, indicates an intention to grant a contractual right to the payment of a royalty.

[91] The court in its decision in *St. Andrew* referred to two other factors that may be relevant when determining whether the parties intended to create contractual rights or an interest in land:

- whether the royalty holder retains a right to enter upon the lands to explore for and extract the minerals

- whether the owner of the lands is in complete control of its interest in the lands acquired with the only right in the royalty holder being to share in the revenues produced from the minerals extracted from the lands.[72]

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69 *Ibid.*, paragraph 100.
70 *Ibid.*, paragraph 101.
71 Joint Book of Documents, Exhibit A3, page 320.
72 *Supra* footnote 66, at paragraph 103.

[92] The Quarter Claim Agreement did not grant Teck/Corona the right to enter upon the Quarter Claim to explore for and extract minerals. Teck/Corona was granted reasonable access to the shaft located on the Quarter Claim in order to explore and exploit its David Bell Mine property[73] and access to the Quarter Claim to view the work being carried on there.[74] However, neither right of access gave Teck/Corona the right to mine the Quarter Claim.

[93] Further, Hemlo Gold controlled the Quarter Claim. Once the option was granted, it acquired a 100% undivided beneficial interest in the Quarter Claim.[75] It is clear from the Quarter Claim Agreement and the evidence before me that Hemlo Gold was, at all times after it acquired the beneficial interest, in complete control of the mining of the Quarter Claim. Hemlo Gold was the sole operator of the Golden Giant Mine, which included the Quarter Claim.

[94] The Quarter Claim Agreement does contain clauses that require Hemlo Gold to mine the Quarter Claim at a certain rate and to reserve certain hoisting and milling capacity for the Quarter Claim. The purpose of such clauses was to protect Teck/Corona's contractual rights to the Quarter Claim Royalty.

[95] The clauses did not affect the daily mining operations at the mine. There are no provisions in the Quarter Claim Agreement that grant Teck/Corona any control over the daily operation of the mine. With regard to situations where any control issue may have arisen, the Quarter Claim Agreement clearly states that Hemlo Gold was in control. For example, when discussing the mining of the boundaries between the Quarter Claim and adjacent properties, the Quarter Claim Agreement states the following: "Provided that Norex complies with sound mining practice it shall have sole discretion as to which mining method to utilize on the Optioned Property."[76] In dealing with Teck/Corona's rights of access, the Quarter Claim Agreement states: "Norex shall retain the right to overall supervision and regulation of all personnel utilizing the Shaft."[77]

[96] While there was evidence before me that Hemlo Gold co-ordinated various activities with Teck/Corona to ensure the efficient and safe operation of the

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73 Joint Book of Documents, Exhibit A3, pages 316 and 325.

74 *Ibid*., page 327.

75 Subject to the paramount rights of the Crown, the existing 3% royalty, and the Quarter Claim Royalty.

76 Joint Book of Documents, Exhibit A3, page 326.

77 *Ibid*., page 325.

Golden Giant Mine and the David Bell Mine,[78] there was no evidence before me to suggest that Hemlo Gold was not in complete control of the operation of the Golden Giant Mine.

[97] In summary, both of the above-stated factors indicate an intention to grant a contractual right to the payment of a royalty.

[98] The Appellant also placed a great deal of emphasis on the registration on title of notice of the Quarter Claim Agreement (including the 1983 Amending Agreement) and notice of the provision in the 1983 Amending Agreement that Norex could not transfer or assign the separate lease of the Quarter Claim without the consent of Teck/Corona.[79]

[99] The registrations occurred in 1986. Mr. Baylis testified that they were carried out because of financing that Noranda was "looking at doing" in 1986.[80]

[100] I fail to see how the registrations could create the interest in land contemplated by counsel for the Appellant. I accept that Teck/Corona had some interest in the land, namely the right of access granted in the Quarter Claim Agreement, which was discussed previously, and the right granted in the 1983 Amending Agreement to consent to any transfer of the lease. However, those rights did not equate to an interest in the revenue realized from the sale of the minerals.

[101] The requirement for Teck/Corona to consent to the transfer of the lease did not exist at the time the Quarter Claim Royalty was created under the Quarter Claim Agreement. The parties added the requirement for consent in the 1983 Amending Agreement.

[102] As noted previously, the Quarter Claim Agreement contained a clause whereby Teck/Corona agreed that, once it obtained a surface and mineral lease for the David Bell Mine, it would take all necessary steps to create a separate lease for the Quarter Claim for the benefit of Norex.[81]

[103] The 1983 Amending Agreement amended that clause to provide, in part, for the following:

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78 Hemlo Gold co-operated in a similar manner with the owners of the adjacent Page Williams Mine.

79 Exhibits A6 and A8.

80 Transcript, page 276.

81 Joint Book of Documents, Exhibit A3, page 317, clause g.

- Teck/Corona agreed that Norex could be provided with the lease of the Quarter Claim prior to the point in time at which Norex acquired the beneficial interest in the Quarter Claim.

- Until Norex acquired the beneficial interest in the Quarter Claim, it was to hold any lease of the Quarter Claim that it was granted in trust for the benefit of Teck/Corona.

- Norex agreed not to transfer or assign the separate lease of the Quarter Claim without the consent of Teck/Corona.

- Norex agreed that Teck/Corona was entitled to record on title notice of its interest in the Quarter Claim and notice of the required consent.

[104] From the wording of the 1983 Amending Agreement, it is clear that the purpose of the amendment was to amend the clause relating to a separate lease of the Quarter Claim so as to allow the separate lease for the Quarter Claim to be issued at which to Norex prior to the time at which it acquired the beneficial interest in the property. That lease was to be held in trust by Norex for the benefit of Teck/Corona. In such a situation, one would expect that the amendment would contain a restriction on the ability of Norex to transfer the legal interest in the Quarter Claim that it held in trust for Teck/Corona. Further, one would expect that Teck/Corona, as the beneficial owner, would be provided with the option of registering its interest in the Quarter Claim. It is interesting to note that Teck/Corona did not register that interest. Noranda registered the interest over two and a half years later, in the course of arranging financing.

[105] Regardless, the addition of the requirement for Teck/Corona to give its consent to a transfer or assignment of Norex's interest in the Quarter Claim does not evidence an intention by Teck/Corona to retain a direct interest in the minerals once the beneficial interest in the Quarter Claim was transferred to Norex.

[106] Further, as noted by counsel for the Respondent, the fact that Teck/Corona may have had an interest in the Quarter Claim did not result in a reimbursement of the mining taxes. As a question of fact, there was no reimbursement.

[107] Having found that there was not a reimbursement of an *amount*, it is not necessary for me to consider whether the deduction of an amount was denied under paragraph 18(1)*(m)*.

Issue 2: The Write-down of the Windarra Loan

[108] It is the Appellant's "primary position" that the $7.25 million portion of the Windarra Loan written down by Hemlo Gold in its 1990 financial statements and extinguished pursuant to the 1992 Settlement Agreement was deductible in Hemlo Gold's 1992 taxation year under subsection 9(1) of the *Act*. The Appellant argued that Hemlo Gold "was in the business of mining and the intent and purpose of the Windarra Loan was to undertake an exploration expenditure for the purposes of gaining or producing income."[82]

[109] In the alternative, the Appellant argued that the $7.25 million was deductible under subparagraph 20(1)*(p)*(ii) on the basis that Hemlo Gold's ordinary business included the lending of money and the Windarra Loan was made in the ordinary course of Hemlo Gold's mining business.[83]

[110] The Respondent argued that the Windarra Loan was on account of capital and not deductible under section 9. With respect to the Appellant's alternative argument, the Respondent argued that Hemlo Gold did not make the loan in the course of a money-lending business.[84]

Summary of the Law

1. Appellant's Primary Position

[111] The classification of gains or losses from the disposition of income-producing assets, such as a loan and other debt obligations, is, in the first instance, governed by common law principles. The income-producing character of the property gives rise to a presumption that the property is held as an investment.[85] However, this is a rebuttable presumption. Further, the courts have established an exception to the general legal framework to be applied when assessing the tax treatment of losses incurred by shareholders arising from advances or outlays made to or on behalf of their corporations.[86]

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82 Appellant's Written Submissions, The Windarra Issue, paragraph 2.

83 *Ibid*., paragraph 85.

84 Respondent's Written Submissions, paragraph 41.

85 See Peter W. Hogg, Joanne E. Magee & Jinyan Li, *Principles of Canadian Income Tax Law*, 7th ed., (Toronto: Carswell, 2010), pages 361 to 363.

86 See *Easton v. The Queen et al.*, 97 DTC 5464, [1998] 2 F.C. 44, [1998] 3 C.T.C. 26, leave to appeal to the SCC refused, [1997] S.C.C.A. No. 618 (QL), and *Minister of National Revenue v. Freud*, [1969] S.C.R. 75.

[112] The law with respect to a loan by a shareholder to a corporation was summarized by the Federal Court of Appeal in its decision in *Easton v. Canada*.[87] The Court stated:

> As a general proposition, it is safe to conclude that an advance or outlay made by a shareholder to or on behalf of the corporation will be treated as a loan extended for the purpose of providing that corporation with working capital. In the event the loan is not repaid the loss is deemed to be of a capital nature for one of two reasons. Either the loan was given to generate a stream of income for the taxpayer, as is characteristic of an investment, or it was given to enable the corporation to carry on its business such that the shareholder would secure an enduring benefit in the form of dividends or an increase in share value. As the law presumes that shares are acquired for investment purposes it seems only too reasonable to presume that a loss arising from an advance or outlay made by a shareholder is also on capital account. . . .[88]

[113] Further, the Federal Court of Appeal held that there were two exceptions to this rule. The Court stated:

> There are two recognized exceptions to the general proposition that losses of the nature described above are on capital account. First, the taxpayer may be able to establish that the loan was made in the ordinary course of the taxpayer's business. The classic example is the taxpayer/shareholder who is in the business of lending money or granting guarantees. The exception, however, also extends to cases where the advance or outlay was made for income-producing purposes related to the taxpayer's own business and not that of the corporation in which he or she holds shares. For example, in *L. Berman & Co. Ltd. v. M.N.R.*, [1961] C.T.C. 237 (Ex. Ct.) the corporate taxpayer made voluntary payments to the suppliers of its subsidiary for the purpose of protecting its own goodwill. The subsidiary had defaulted on its obligations and as the taxpayer had been doing business with the suppliers it wished to continue doing so in future. . . .
>
> The second exception is found in *Freud*. Where a taxpayer holds shares in a corporation as a trading asset and not as an investment then any loss arising from an incidental outlay, including payment on a guarantee, will be on income account. This exception is applicable in the case of those who are held to be traders in shares. For those who do not fall within this category, it will be necessary to establish that the shares were acquired as an adventure in the nature of trade. I do not perceive this "exceptional circumstance" as constituting a window of opportunity for taxpayers seeking to deduct losses. I say this because there is a rebuttable presumption that

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87 *Easton*, *supra*, footnote 86.

88 *Ibid*., at page 5468 DTC.

> shares are acquired as capital assets: see *Mandryk v. The Queen*, 92 DTC 6329 (F.C.A.) at 6634.[89]

[114] In summary, when a shareholder makes a loan to a corporation in which the shareholder holds shares, the loan will be considered to be on account of capital, subject to two exceptions. The first exception applies where the shareholder is able to establish that the loan was made in the ordinary course of the shareholder's business. This exception extends to cases where the loan was made for income-producing purposes related to the shareholder's own business and not that of the corporation in which the shareholder owns shares. The second exception, which is not relevant for the purposes of this appeal, arises where the shareholder holds shares in a corporation as a trading asset.

2. Appellant's Alternative Argument

[115] Paragraph 18(1)*(p)*(ii) of the *Act* allows for the deduction of certain loans that become uncollectible. The relevant wording of the section is as follows:

> Notwithstanding paragraphs 18(1)*(a)*, *(b)* and *(h)* in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto:
>
> (*p*) – the total of
>
> . . .
>
> (ii) - all amounts each of which is that part of the amortized cost to the taxpayer at the end of the year of a loan or lending asset (other that a mark-to-market property, as defined in subsection 142.2(1)) that is established in the year by the taxpayer to have become uncollectible and that,
>
> (A) where the taxpayer is . . . a taxpayer whose ordinary business includes the lending of money, was made or acquired in the ordinary course of the taxpayer's business of . . . the lending of money, or . . .

[116] In order for paragraph 20(1)*(p)*(ii) to apply the following four conditions must be satisfied:

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89 *Ibid.*

(i) There must be loan;

(ii) It must be established that the loan became uncollectible in the year;

(iii) The loan must have been made by a taxpayer whose ordinary business included the business of the lending of money; and

(iv) The loan must have been made in the ordinary course of the taxpayer's business of the lending of money.

Summary of Relevant Facts

[117] One of the objectives of Hemlo Gold, at the time it was formed, was to grow its earnings by adding gold production.[90] As a result, Hemlo Gold was constantly searching for new mining properties since the Golden Giant Mine had a finite amount of gold.

[118] Mr. Baylis explained that there were two types of interest that Hemlo Gold could obtain in new mining properties: a direct interest and an indirect interest. A direct interest, the preferred option, involved an ownership interest in the mining property, such as a mining claim, a leasehold interest or an interest in the mining patent. An indirect interest involved an investment in the shares of the entity that held the mining property.[91]

[119] During cross-examination, Mr. Baylis provided the following examples of how a mining company, such as Hemlo Gold, could acquire a direct interest in a mining property:[92]

- In consideration for an option to earn an interest in a mine, the mining company would agree to fund the exploration and development of the mine, including bringing the mine into production. An example would be the Golden Giant Agreement.

- The mining company would advance funds to the owner of a mine in exchange for a percentage interest in the mine. The owner of the mine would then carry out the exploration and development work for the mine.

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90 Joint Book of Documents, Exhibit A2, page 269.

91 Transcript, page 151.

92 *Supra*, pages 216-223.

- The mining company would acquire all of an owner's interest in a mine in consideration of the mining company's agreement to carry out the exploration and development work for the mine, and pay the owner a net profit royalty. An example would be the Quarter Claim Agreement.

- The mining company would simply purchase all or a portion of an owner's or prospector's interest in a mine. Mr. Baylis testified that this only happened occasionally.

- Through a series of step transactions, the mining company would acquire all of the shares of a company and then amalgamate with it.

[120] Mr Baylis noted that there are two ways to acquire an indirect interest in a mine.[93] The first would be to acquire shares of the corporate owner of the mine. The second method would be to lend money to the corporate owner in exchange for a convertible note.

[121] Between 1987 and 1989, Hemlo Gold acquired a number of indirect interests in mining companies. These interests were shown on its balance sheet as "Investments and Advances". Hemlo Gold's annual reports for the years 1987 to 1991 show that its "Investments and Advances" rose from $5.4 million at the end of its first fiscal year (1987) to $60 million at the end of its 1988 fiscal year and then peaked at $82 million at the end of its 1989 fiscal year. The "Investments and Advances" fell to $49 million during 1990 and $12.4 million at the end of its 1991 fiscal year.[94]

[122] The "Investment and Advances" consisted of shares of a number of junior mining companies and two loans: a $10 million advance made in 1988 for a convertible note of United States mining company, Viceroy Resources ("Viceroy")[95], and the $8.25 million Windarra Loan.

[123] In addition to making the Windarra Loan, Hemlo Gold acquired shares in Windarra and acquired a direct interest in a mining property owned by Windarra.

[124] Windarra held interests in two mining properties in an area referred to as the "Mishibishu camp." It held a 25% interest in a property referred to as the Magnacon property. The other owners of the property were Flanagan McAdam Resources

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93 Transcript, pages 223-224.

94 Joint Book of Documents, Exhibit A2, pages 243, 275, 313, 348, 396.

95 Joint Book of Documents, Exhibit A2, page 280.

("FMR") and Muscocho Exploration Ltd. (“Muscocho”). Windarra also owned a 50% interest in a property adjoining the Magnacon property, which was referred to as the Eastern Property.[96]

[125] The three owners of the Magnacon property were developing the property as a joint venture. Hemlo Gold attempted to purchase a direct 25% interest in the Magnacon property from Windarra and FMR. However, it was not successful: one of the joint venture participants invoked a right of first refusal contained in the joint venture agreement; which it appears to have done as a result of an agreement FMR and Muscocho entered into with another mining company, Echo Bay.[97]

[126] Hemlo Gold then entered into a financing arrangement with Windarra that included a loan (the “Windarra loan”), an indirect investment in Windarra (acquisition of shares) and a direct investment (acquisition of an interest in the Eastern property).

[127] An April 21, 1988 letter agreement between Hemlo Gold and Windarra summarizes the terms of the financing[98] (the "Letter Agreement"). Hemlo Gold confirms in the Letter Agreement that it has agreed to provide the financing to Windarra in connection with the exploration and development work in relation to Windarra's 25% interest in the Magnacon Mine and its 50% interest in the Eastern Property.

[128] The Windarra loan was for $7.5 million dollars at the prevailing rate for gold loans. The Letter Agreement provided that the amount of the loan could be increased to "cover a reasonable overrun in the cost of the project.” However, the loan could not exceed $8.25 million.[99]

[129] The Windarra loan was secured by a first charge on Windarra's 25% interest in the Magnacon property. The proceeds from the loan were to be used to pay Windarra's portion of the cost of constructing the mine and mill on the Magnacon property.

[130] The Letter Agreement provided that the Windarra loan was to be repaid out of 80% of Windarra's share of the first available cash flow from the Magnacon property.

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96 See Joint Book of Documents, Exhibit A3, page 209.

97 Transcript page 199-200; Exhibit A3, pages 266-267.

98 Joint Book of Documents, Exhibit A-3, pages 209-212.

99 See the Credit Agreement between Windarra and Hemlo Gold, Exhibit A3, page 222.

The parties agreed that Hemlo Gold could replace the Windarra loan with a gold loan from a Canadian chartered bank, which would be guaranteed by Hemlo Gold.

[131] The Letter Agreement also provided for the acquisition by Hemlo Gold of shares of Windarra (the "Windarra shares") as follows:

- Hemlo Gold would subscribe for 1,500,000 Windarra shares in exchange for 150,000 common shares of Hemlo Gold.

- Hemlo would subscribe for 2,000,000 Windarra shares for $4,000,000. Windarra agreed to use $500,000 for working capital and $3,500,000 to pay exploration and development expenses with respect to the Eastern property.[100]

- Windarra granted Hemlo Gold the option to purchase an additional 2 million Windarra shares.

[132] The Letter Agreement contained a standstill clause whereby Hemlo Gold agreed, for a period of six years, not to increase its holdings in common shares of Windarra above 33 1/3% of the outstanding common shares.

[133] The Letter Agreement also provided that Windarra would transfer a 25% interest as a tenant in common of the Eastern Property to Hemlo Gold. After Windarra had spent the $3.5 million of the amount received on the issue of the 2,000,000 Windarra shares, Hemlo Gold was required to pay 50% of the exploration and development expenses for the Eastern property.

[134] During his testimony, Mr. Baylis discussed the Windarra financing. He referred to the various components of the financing in order as a *package deal*.[101] With respect to the Windarra loan, he stated that Windarra required the financing in order to fund cash calls from the operator under the joint venture for construction on, and development of, the Magnacon property.[102] He noted that if Hemlo Gold had not agreed to provide the loan, then Windarra would have had to raise additional capital from third parties. This would have resulted in Windarra issuing additional shares and thus diluting Hemlo Gold's holdings in the company.[103]

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100 Mr. Baylis testified that Windarra paid the $3.5 million to Noranda Exploration, which actually carried out the exploration work. Transcript, page 220.

101 Transcript, page 220.

102 *Ibid*., page 117.

103 *Ibid*., pages 153-154.

[135] An April 25, 1988 memo from the President and the Vice-president, Finance, of Hemlo Gold to Hemlo Gold's board of directors expanded on Hemlo Gold's intentions at the time it provided the financing to Windarra.[104] The memo to the board of directors states that Hemlo Gold was providing financing to Windarra in order to build a land position in the Mishibishu camp (and thus protect Hemlo Gold's "general position" in the camp) and to obtain a direct investment in the Eastern property. The memo also states that the financing facilitated a deal on another property controlled by the same Vancouver group that controlled Windarra. The memo notes as well that by making the investments, Hemlo Gold would "tie up the company as [its] partner and ultimately . . . will take them over, if new discoveries or expansion of Magnacon reserves warrant."

[136] During 1988 and 1989, Hemlo Gold acquired Windarra shares and advanced monies pursuant to the Windarra Loan agreement. By the end of 1989, Hemlo Gold had acquired 5.65 million Windarra shares and advanced the maximum amount under the Windarra Loan agreement, $8.25 million.[105] According to the notes to Hemlo Gold's 1989 audited financial statements, $17.784 million[106] in respect of the Windarra shares and the Windarra Loan was included in the "Investment and Advances" balance on Hemlo Gold's balance sheet.[107]

[137] During 1990, the joint venture participants in the Magnacon Mine decided to close the Magnacon Mine. This resulted in Hemlo Gold writing down, for accounting purposes, its investment in the Windarra shares and the amount of the Windarra Loan. The carrying value of the shares was written down to their estimated market value of $1.978 million, a write-down of $7.293 million. The Windarra Loan was written down to its estimated realizable value of $1 million, a write-down of $7.513 million.[108] The total amount written down with respect to Windarra was $14.806 million.

[138] During 1991, Hemlo Gold wrote down the Windarra shares to zero. There was no write-down in 1991 of the Windarra Loan.

[139] The $14.806 million write-down in 1990 was part of a total $17.419 million write-down by Windarra of its investments and advances. Hemlo Gold classified the

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104 Joint Book of Documents, Exhibit A3, page 266-269.

105 Joint Book of Documents, Exhibit A2, pages 280-281 and 317-318.

106 Composed of Windarra shares at a book value of $9.271 million, the Windarra Loan of $8.25 million and accrued interest on the Windarra Loan of $263,000.

107 Joint Book of Documents, Exhibit A2, pages 313 and 317.

108 *Ibid*., pages 338 and 352-353.

write-down on its income statement as an exploration expense.[109] Hemlo Gold's senior management believed, at the time, that this was the appropriate accounting treatment, since, in their view, "the expenditures incurred in making these investments more closely resemble exploration expenditures than long-term investments in the traditional sense of the term."[110]

[140] However, Hemlo Gold changed this accounting treatment in 1991. In 1991, Hemlo Gold wrote down its investments and advances by an additional $33.595 million.[111] The $33,595 million write-down was shown on Hemlo Gold's income statement as a "net loss on sale or write-down of investments and advances".[112] Further, the $17.419 million write-down that occurred in 1990 was reclassified in Hemlo Gold's 1991 audited income statement as a "net loss on sale or write-down of investments and advances." As noted previously, the 1990 write-down had previously been included in exploration expenses.

[141] The president and chief executive office of Hemlo Gold made the following comments in Hemlo Gold's 1991 Annual Report with respect to the $33,595 million write-down:

> . . . The decision to make these write-downs was taken following a detailed review of carrying values of the Company's long-term investments and is the result of the impact of the continued weakness in the price of gold on the share prices of junior resource companies.[113]

[142] On November 6, 1992, Windarra and Hemlo Gold entered into the 1992 Settlement Agreement pursuant to which the parties were released from their obligations under the Letter Agreement.[114] Windarra's obligation to repay the Windarra Loan was terminated in consideration of Windarra agreeing to pay $1,000,000.[115]

[143] In preparing its 1992 and 1994 tax returns, Hemlo Gold deducted $7,590,684 and $78,294 respectively in respect of the Windarra loan. In 1992, it reported the dispositions of the Windarra shares as dispositions of capital property.[116]

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109 *Ibid*., pages 350 and 354.

110 *Ibid*., page 338.

111 This included the $1.978 million write-down of the Windarra shares.

112 Joint Book of Documents, Exhibit A2, pages 397 and 403.

113 *Ibid*., page 365.

114 Joint Book of Documents, Exhibit A-3, pages 308-312.

115 $921,706 by December 17, 1992 and $78,294 by December 17, 1993. *Ibid*., page 309.

116 Joint Book of Documents, Exhibit A-1, page 207. The loss reported on the tax return was $8.988 million.

[144] When reassessing Hemlo Gold, the Minister disallowed $7,407,308 of the amount deducted in 1992 in respect of the Windarra Loan and the entire amount deducted in 1994.

Application of Law to Facts

1. Appellant's Primary Position

[145] The Appellant's counsel did not refer to, or rely upon, the legal framework set out in the *Easton* case. Rather, he argued that the principal amount of the loan was deductible under subsection 9(1) of the *Act* as an exploration expense incurred for the purpose of gaining or producing mining income. Counsel noted that the Court should focus on Hemlo Gold's intention at the time the Windarra Loan was made, which, he argued, was to acquire some form of interest in a potentially rich mining property expected to produce gold-mining income for Hemlo Gold. He argued that the Court should take mining practices into consideration, as the Windarra Loan was part of an overall strategy by Hemlo Gold to increase its mining income.

[146] In making his argument, the Appellant's counsel placed significant weight on the fact that, when writing down its investment in the Windarra Loan and the Windarra shares, Hemlo Gold accounted for the loss on its audited income statement for 1990 as an exploration expense. However, as noted previously, Hemlo Gold, on its 1991 audited income statement, reclassified the 1990 loss as a "net loss on sale or write-down of investments and advances." The Appellant's counsel (and the witnesses for the Appellant) tried to downplay this reclassification, claiming it was based on a decision made in 1991 by a new management team.

[147] If I accept the Appellant's argument that the proper accounting treatment was to classify the 1990 write-down as an exploration expense, then I would have to accept that Hemlo Gold made an error in its 1991 audited financial statements when it reclassified the write-down as a loss on the write-down of investments and advances.

[148] I cannot accept such a proposition. Hemlo Gold's final position on its 1991 *audited* financial statements was that the 1990 write-down was a loss realized on its long-term investments. Further, the 1991 audited financial statements were prepared at a time when Mr. Proctor, as Vice-president, Finance, of Hemlo Gold, would have had to accept the financial statements before they were issued. At no time during his testimony did Mr. Proctor imply that an error was made in 1991.

[149] Regardless of how the write-down of the Windarra loan was treated for accounting purposes, the evidence before the Court does not support the Appellant's position that the Windarra Loan was an exploration expense.

[150] The numerous indirect interests Hemlo Gold held in mining companies (shares and the two loans) were shown on Hemlo Gold's balance sheet as investments and advances. The acquisition of the indirect interests (including the Windarra shares and the Windarra loan) were made pursuant to a long-term investment program consisting in investing in promising new gold companies. From 1987 to 1989, the investments made by Hemlo Gold under the program rose from $5.4 million to $82 million.

[151] In each of Hemlo Gold's 1987, 1988 and 1989 annual reports, its president and its chairman of the board clearly refer to the shares and loans included in the investments and advances portfolio as long-term investments. For example, in Hemlo Gold's 1987 annual report the president and the chairman of the board state that Hemlo "has . . . taken the first steps *in a long term program of investing* in promising new gold companies by taking a financing position in Viceroy".[117] The president and the chairman expanded on these comments in the 1988 annual report, as follows:

> Supporting our exploration initiatives is Hemlo's *investment portfolio*. This began with the acquisition of shares of Viceroy Resource Corporation in 1987 and continued in 1988 with similar equity *investments* in Windarra Minerals Ltd., Central Crude Ltd. and Granges Exploration Ltd. Hemlo also made production loans to Windarra and Viceroy and committed to make a loan to Central Crude.[118] These *investments* are in gold mining companies with considerable potential to contribute to Hemlo's future revenues while offering further growth opportunities. Further acquisitions of shares of these and other similar growth oriented companies will be pursued.[119]

[152] Further, in each of those years Hemlo Gold classified the investments in the junior oil companies, including the investments in Windarra, as long-term investments on its balance sheet. In addition, for income tax purposes, Hemlo Gold treated the disposition of shares of the junior oil companies, such as the

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117 Joint Book of Documents, Exhibit A2, page 241.

118 Although Hemlo Gold provided the commitment, it did not make any loans to Central Crude.

119 Joint Book of Documents, Exhibit A2, pages 259-260.

1990 disposition of shares in Continental Gold Corp. and the 1991 disposition of shares in Viceroy, as being on account of capital.[120]

[153] The Windarra Loan was part of a package deal. The other components were the acquisition of the Windarra shares and the 25% interest in the Eastern Property. Although Hemlo Gold would have preferred to make a direct investment in the Magnacon Mine, it was only able to make an indirect investment through the acquisition of shares of Windarra. As Mr. Baylis testified, Hemlo Gold provided the Windarra Loan to help prevent the dilution of Hemlo Gold's holdings in Windarra.

[154] In my view, the acquisition by Hemlo Gold of the Windarra shares and the making of the advances in respect of the Windarra Loan resulted in Hemlo Gold acquiring assets of enduring benefit.

[155] The Windarra Loan provided Windarra with working capital to fund its share of the exploration and development costs in respect of the Magnacon property. The Windarra Loan was given to generate a stream of income (interest) for Hemlo Gold and to enable Windarra to develop the Magnacon property. The successful development of the property would have secured for Hemlo Gold an enduring benefit in the form either of dividends or an increase in the value of the Windarra Shares.

[156] As a result, the losses that arose from the 1992 Settlement Agreement, including the loss incurred in respect of the Windarra Loan, were on account of capital.

[157] The Appellant's counsel referred me to several cases in which the Courts have found that a loan qualified as a current expense.[121] These cases can be distinguished from the current case. In the cases cited by the Appellant's counsel, the loans were made either to protect an existing income stream of the lender (such as rental income)[122] or to protect and increase the lender’s existing business (i.e. goodwill).[123]

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120 Joint Book of Documents, Exhibit A1, pages 86, 134. As noted previously, the disposition of the Windarra shares in 1992 was treated, for income tax purposes, as being on account of capital.

121 *Panda Realty Limited v. The Minister of National Revenue*, 86 DTC 1266, [1986] 1 C.T.C. 2417 (TCC), *R. v. Lavigueur*, 73 DTC 5538, [1973] C.T.C. 773 (FCTD), *R. v. F. H. Jones Tobacco Sales Co.*, [1973] C.T.C. 784, [1973] F.C. 825, 73 DTC 5577 (FCTD), *Excell Duct Cleaning Inc. v. R.*, 2005 TCC 776, [2006] 1 C.T.C. 2432, 2006 DTC 2040 (TCC), *Paco Corp. v. R.*, 80 DTC 6328, [1980] C.T.C. 409 (FCTD).

122 See *Panda Realty Limited v. Minister of National Revenue* and *R. v. Lavigueur, supra,* footnote 121.

123 See *R. v. F. H. Jones Tobacco Sales Co.*, *Paco Corp v. R.*, and *Excell Duct Cleaning Inc. v. R. Supra*, footnote 121.

The primary (and only) purpose of the Windarra loan was to fund the exploration and development work in relation to the Magnacon property, exploration and development that was undertaken by Windarra with respect to an asset it owned. Hemlo Gold had no direct interest in the asset.

[158] I have also considered the Appellant's argument within the context of the first exception in the *Easton* case, that is, I have considered whether Hemlo Gold made the Windarra Loan for income-producing purposes relating to its own business and not that of Windarra. As I have just discussed, the Windarra Loan was provided in order to fund the profit-making activities of Windarra through the development of the Magnacon Mine. It was not made for income-producing purposes relating to Hemlo Gold's own business. Such a loan does not fall within the exceptions noted in *Easton.*

2. **Appellant's Alternative Argument**

[159] The Appellant's alternative argument is that the $7.25 million was deductible under subparagraph 20(1)*(p)*(ii) of the *Act.* As discussed previously, subparagraph 20(1)*(p)*(ii) contains four conditions that must be satisfied before it will apply. Both parties accepted the fact that there was a loan and that the loan became uncollectible. The issue before the Court is whether the remaining two conditions of subparagraph 20(1)*(p)*(ii) were satisfied.

[160] Counsel for the Appellant argued as follows: "The only issue is whether [Hemlo Gold's] ordinary business included the lending of money. The Appellant respectfully submits that its ordinary business includes the lending of money as it had multiple money lending arms that were an integral part of its business."[124]

[161] Counsel for the Appellant appears to be arguing that the test to be applied under subparagraph 20(1)*(p)*(ii) is whether Hemlo Gold's ordinary business included the *lending of money*. However, the Federal Court of Appeal in *Loman Warehousing Ltd. v. Canada*,[125] in affirming the decision of Justice Bowman (as he then was), concluded that subparagraph 20(1)*(p)*(ii) contemplates a taxpayer whose ordinary business includes the *business* of the lending of money.

[162] Justice Bowman (as he then was), in his decision in *Loman Warehousing*, explained the requirement that the taxpayer must be in the *business* of lending money as follows:

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124 Appellant's Written Submissions, The Windarra Issue, paragraphs 85 and 86.

125 [2000] F.C.J. No. 1717 (QL) (FCA).

> The expression "whose ordinary business includes the lending of money" requires a determination of just what the taxpayer's "ordinary business" is. The ordinary business of the appellant is warehousing, not lending money to other companies in the group. Some effect must be given to the word "ordinary". It implies that the business of lending money be one of the ways in which the company as an ordinary part of its business operations earns its income. It also implies that the lending of money be identifiable as a business. I agree that the participation in the MNA, in which a company in the group, depending upon whether on a given day it is in a credit or debit position, may loan or borrow funds is an incident of its business. The appellant's argument equates the words "whose ordinary business includes the lending of money" to the words "in whose business the lending of money is an incident." I do not think the two expressions cover the same territory.[126]

[163] Counsel for the Appellant did not address, in his argument, the issue of whether Hemlo Gold was in the business of lending money. However, counsel for the Respondent addressed the issue. Arguing that Hemlo Gold was not in the business of lending money, she noted: "HGM [Hemlo Gold] did not hold itself out as a money lender. It did not offer loans to all and sundry. While it did on occasion lend money to related corporations or for the purpose of acquiring a direct interest in mineral property, the lending of money was an incident of the actual business of HGM, a gold producer."[127]

[164] The determination whether a money-lending business exists is a question of fact. There must be a certain degree of system and continuity.[128] Further, as noted by the Federal Court of Appeal in *Loman Warehousing*, "the business of lending money under the Act extends not only to one who lends money to all who qualify in the conventional sense . . . but would also include one who lends money on a regular and continuous basis over time to a limited group of borrowers for an arm's length consideration."[129]

[165] During the relevant period, Hemlo Gold's lending activity consisted of the following:

a) Loans to junior mining companies in which it held shares and, in certain instances, in whose property it held direct interests (the Windarra Loan,

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126 [1999] T.C.J. No. 341 (QL) (TCC), at paragraph 25.
127 Respondent's Written Submissions, paragraph 56.
128 *Yunger v. Canada*, [2000] T.C.J. No. 329 (QL) (TCC).
129 *Supra*, footnote 125, at endnote 2.

a $10,000,000 loan to Viceroy Resources Corp.[130] and a commitment to loan $18 million to Central Crude);[131]

b) Housing and/or relocation loans to employees; and

c) Loans provided to executives to fund share purchases.

[166] Counsel for the Appellant argued that Hemlo Gold provided gold loans. While there was evidence before me that certain banks made gold loans to Hemlo Gold, there was no evidence before me that Hemlo Gold made gold loans to third parties.

[167] The evidence before me does not support a factual finding that Hemlo Gold loaned money to junior mining companies with any degree of system or continuity. Hemlo Gold was in the gold-mining business. As part of that business, it acquired indirect interests in junior mining companies.

[168] Hemlo Gold acquired the indirect interests by purchasing shares in the junior mining companies. The two loans made during the relevant period (the Windarra Loan and the loan to Viceroy Resources) were a secondary component of the transactions that resulted in the purchase of shares. The evidence before me does not support a finding that the lending of the money to the junior mining companies constituted a business.

[169] The housing loans and the employee-relocation loans were also loans made in the course of Hemlo Gold's mining business and were clearly incidental to that business.

[170] In summary, Hemlo Gold was not in the business of lending money, rather any loans it made were incidental to its gold-mining business. Carrying on a business of lending money was not one of the ways Hemlo Gold, as an ordinary part of its business, earned its income. As a result, no amount was deductible under subparagraph 20(1)*(p)*(ii) in respect of the Windarra Loan.

Issue 3: Deduction of an amount under subparagraph 20(1)*(p)*(i)

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130 By the end of 1988 Hemlo Gold held a 12.4% equity position in Viceroy Resources. The loan was convertible to common shares of Viceroy Resources; see Joint Book of Documents, Exhibit A2, page 280.

131 By the end of 1989, Hemlo Gold held a 41.2% equity position in Central Crude and a 60% interest in one of that company's properties. (See Joint Book of Documents, Exhibit A2, pages 269, 281 and 318.) No amounts were ever loaned by Hemlo Gold to Central Crude.

[171] Subparagraph 20(1)*(p)*(i) reads as follows:

> the total of
>
> (i) all debts owing to the taxpayer that are established by the taxpayer to have become bad debts in the year and that have been included in computing the taxpayer's income for the year or a preceding taxation year, and . . .

[172] The issue before the Court is what amounts were included in computing Hemlo Gold's income for the 1988, 1989, and 1990 taxation years in respect of the interest accrued on the Windarra Loan.

[173] During the course of the CRA audit, Hemlo Gold provided the CRA auditor, Mr. MacGibbon, with the details of the entries recorded in its general ledger account 2101 between August 1, 1989 and the end of May 1990. Hemlo Gold used this general ledger account to record amounts due from Windarra, including accrued interest on the Windarra Loan.[132]

[174] Mr. MacGibbon testified that Hemlo Gold did not provide him with any books or records for periods prior to August 1, 1989.

[175] Based upon his review of the general ledger for account 2101, Mr. MacGibbon was able to identify entries totalling $183,336 that recorded interest income in respect of the interest accrued on the Windarra Loan. As a result, he allowed a deduction under subparagraph 20(1)*(p)*(i) in respect of the accrued interest.

[176] The Appellant argued that the Minister understated the subparagraph 20(1)*(p)*(i) deduction by $156,888. It arrived at this number by performing the following calculation:

> First, it determined the amount of accrued interest as at December 31, 1989 as follows:
>
> a. The amount shown on the balance sheet at December 31, 1989 in respect of the Windarra Loan: $8.513 million[133]
>
> b. Less: the principal amount of the loan at December 31, 1989: $8.25 million[134]
>
> c. Equals the amount of accrued interest as at December 31, 1989: $263,000.

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132 Transcript, pages 646-654.

133 Joint Book of Documents, Exhibit A2, page 317.

134 *Ibid*., page 318.

The Appellant then compared the $263,000 with the amount of interest income Mr. MacGibbon had calculated for the periods prior to 1989, namely $106,112.[135]

[177] It is the Appellant's position that the difference between $263,000 and $106,112, which is $156,888, represents additional accrued interest income that was included in the income reported in Hemlo Gold's 1988 and 1989 income tax returns.

[178] During his testimony, Mr. Proctor summarized the Appellant's argument as follows: "Because we have it on the balance sheet and, since debits must equal credits, it must have been on the Income Statement and we did not adjust it in arriving at net income for income tax purposes. For financial statement purposes it must be in the net income for income tax purposes."[136]

[179] The Appellant's argument requires me to accept that whenever an amount was recorded in account 2101 as accrued interest the offsetting amount was recorded as interest income.

[180] Obviously the easiest way for the Appellant to prove that this did in fact occur was to produce the relevant journal entries or general ledger accounts. However, the Appellant was not able to locate its books and records for 1988 and the first half of 1989. Apparently, they were lost during a move.[137]

[181] I cannot accept the Appellant's argument. Hemlo Gold could have recorded the offsetting amount as interest income. Alternatively, it could have recorded the offsetting amount on a balance sheet account such as a deferred revenue account or a reserve account. The only way to determine how the offsetting amounts were recorded in 1988 and the first half of 1989 would be to review the relevant books and records. Unfortunately, the relevant books were not provided to either the Minister or the Court.

[182] The only evidence before the Court of accrued interest being included in Hemlo Gold's income was in the working papers of Mr. MacGibbon. I agree with counsel for the Respondent that in order for the Appellant to obtain a deduction in excess of the amount allowed by the Minister “the Court should be presented with something more reliable than a conclusion based on unsubstantiated assumptions."[138]

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135 Exhibit A12, page 1.
136 Transcript, page 358.
137 *Ibid*., page 457.
138 Respondent’s Written Submissions, paragraph 67.

Conclusion

[183] For the foregoing reasons, the appeals are dismissed with costs to the Respondent.

Signed at Ottawa, Canada, this 8th day of March 2011.

"S. D'Arcy"

D'Arcy J.

Appendix A

Section as it read with respect to payments made before February 1990

80.2 Reimbursement by taxpayer

Where

(*a*) a taxpayer, under the terms of a contract, reimburses another person for an amount paid or that became payable by that other person and such amount is included in the income of that other person or denied as a deduction in computing the income of that other person by virtue of paragraph 12(1)(*o*) or paragraph 18(1)(*m*), as the case may be, and

(*b*) the taxpayer was resident in Canada or carrying on business in Canada at the time of the reimbursement,

the following rules apply for the purposes of this Act:

(*c*) the taxpayer shall be deemed not to have made the reimbursement to the other person but to have paid an amount described in paragraph 18(1)(*m*) equal to the amount of the reimbursement, and

(*d*) the other person shall be deemed not to have received the reimbursement from the taxpayer.

Section as it read with respect to payments made after January 1990

80.2 Reimbursement by taxpayer [resource royalties]

Where

(*a*) a taxpayer, under the terms of a contract, pays to another person an amount (in this subsection [*sic*] referred to as the "specified payment") that may reasonably be considered to have been received by the other person as a reimbursement, contribution or allowance in respect of an amount (referred to in paragraph (*b*) as the "particular amount") paid or payable by the other person,

(*b*) the particular amount is included in the income of the other person or is denied as a deduction in computing the income of the other person by reason of paragraph 12(1)(*o*) or 18(1)(*m*), as the case may be, and

(*c*) the taxpayer was resident in Canada or carrying on business in Canada at the time the specified payment was made by the taxpayer,

the following rules apply for the purposes of this Act, other than this section:

(*d*) the taxpayer shall be deemed neither to have made nor to have become obligated to make the specified payment to the other person but to have paid an amount described in paragraph 18(1)(*m*) equal to the amount of the specified payment, and

(*e*) the other person shall be deemed neither to have received nor to have become entitled to receive the specified payment from the taxpayer.

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