BETWEEN:

JOSEPH REBUS ..... APPELLANT;

1953
Sept. 30
Oct. 5

AND

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

Revenue—Income—The Income Tax Act 11-12 Geo. VI, c. 52, s. 13—Income or capital—"Amount received by the taxpayer dependent upon use of or production from property"—Royalty—Character of payment not affected by provincial order in council or provincial statute.

Appellant was entitled to receive in cash a certain percentage of the leased substances produced, saved and marketed from certain lands. This royalty was received from the producer and distributed to appellant and others also entitled to a portion thereof by the National Trust Company. Due to a well drilled on the property going out of control the Petroleum and Natural Gas Conservation Board set up by the Province of Alberta immediately took control of the property, brought the well under control, salvaged and sold the large quantities of oil which were produced while the well was out of control.

Pursuant to an order in council passed by the Government of Alberta and to a statute enacted by the Legislative Assembly of Alberta the National Trust Company received a cheque from the Board for a large sum of money "being payment in full of the Rebus royalty arrears". The appellant's share of this after certain deductions was added by respondent to his declared income for the taxation year 1949. An appeal from such assessment was taken to this Court.

Held: That the amount received by the appellant in the taxation year 1949 was income and taxable in that year.

2. That no property rights of appellant were expropriated and he received full compensation for all royalties to which he was entitled.

3. That the payment to appellant related to his claim for royalty only and was not by way of damages or solatium for not receiving the contractual payments or as payment for a general release of existing and future claims.

4. That no provincial enactment can convert into capital that income which The Income Tax Act has declared to be taxable income.

5. That the Petroleum and Natural Gas Conservation Board was a statutory custodian or trustee of the property of the oil company following the taking of possession and the trust funds representing the proceeds of the sale of the salvaged oil for and on behalf of those who might establish a valid claim against the company, the balance to belong to the company itself and had there been no disaster and had the payments been made in the ordinary course by the company the whole of the amount in dispute would have constituted taxable income: the temporary custodianship of the Board or any provisions of the order in council or the statute or of the release executed by appellant did not affect the true nature and quality of the amount he received.

6. That the money received by appellant was dependent upon the use of or production from property and therefore part of appellant's taxable income.

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APPEAL under the Income Tax Act.

The appeal was heard before the Honourable Mr. Justice Cameron at Edmonton.

W. G. Morrow for appellant.

D. B. MacKenzie, Q.C. and *T. E. Jackson* for respondent.

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

CAMERON J. now (October 5, 1953) delivered the following judgment:

In this matter the appellant appeals from an assessment to income tax dated September 25, 1951, in respect of the taxation year 1949. There is no dispute whatever as to the facts, all of which have been agreed to by the parties and are set out in the Agreement filed as Exhibit 1.

By the terms of a certain Petroleum and Natural Gas Lease dated July, 1947, and which forms part of Exhibit 2, there was reserved to the lessor therein, one John D. Rebus, a gross royalty in cash of twelve and one half per cent of production of the leased substances produced, saved and marketed from the lands mentioned, namely the northwest quarter of Section 23, Township 50, Range 26 west of the 4th Meridian in the Province of Alberta. By the terms of a supplementary agreement dated August 16, 1947, which also forms part of Exhibit 2, the members of the Rebus family settled their differences as to their respective interests in the said property and in the royalty reserved in the said lease. *Inter alia* it was agreed that the said royalty should thereafter be paid to the National Trust Company as trustee, which company was thereupon to divide the same in ten equal shares between the ten individuals named therein, of whom the present appellant was one. The appellant thereupon became beneficially entitled to one-tenth of the twelve and one-half per cent gross royalty reserved in the lease.

Oil was found upon the property and in the years 1947 and 1948 the appellant received certain royalties which were duly accounted for in his income tax returns for those years. In his return for the year 1949, the appellant stated that in that year he had received the sum of $26,109.13 *as royalty receipts*. For the reason which will later be referred

to, he claimed that $21,760.00 of that amount was referrable to royalties in respect to the excess of oil produced beyond the amount which had been fixed by the Petroleum and Natural Gas Conservation Board of the Province of Alberta for that property in that year, an amount generally referred to as the "allowable." In respect to that amount of $21,760 he claimed "exhausted depletion" of 75 per cent, or the sum of $16,320, and stated his taxable royalties at $9,789.13. The respondent, in assessing the appellant, added that sum of $16,320 to the declared income on the ground that that income was taxable in the year in which it was received, and assessed him accordingly. The present appeal followed.

The lease in question was at all relevant times held by the Atlantic Oil Company Limited. By 1948, two wells had been drilled and brought into production. In that year when a third well, Atlantic No. 3, was being drilled, it blew out of control. The Petroleum and Natural Gas Conservation Board (hereinafter to be called the 'Board') under powers conferred on it, immediately took over control of the property, brought the well under control, salvaged and sold the very large quantities of oil which were produced while the well was out of control.

On December 21, 1948, Alberta Order in Council No. 1495/48 was passed. After reciting the powers previously held by the Board under The Oil and Gas Resources Conservation Act and that the Board had taken possession of the property in and about Atlantic No. 3 well for the purpose of bringing it under control and controlling and conserving the gas and the flow of oil, and had marketed the oil and placed the proceeds in a special trust account, and that it was desirable to pay the costs incurred by the Board and to endeavour to settle all claims against the company and to settle claims of persons entitled to a royalty on production from wells 1, 2 and 3, the Order in Council proceeded to confer on the Board power to

(1) Pay out of the fund now held in the name of the Petroleum and Natural Gas Conservation Board in trust and representing the proceeds of the sale of petroleum from Atlantic No. 3 well the costs and expenses of and incidental to the proceedings taken by the Board to control the gas flow in the said well and the flow of petroleum therefrom;

(2) Pay out of the said funds such sums as may be required to give effect to any settlement approved by the Board arrived at between the Atlantic Oil Company Limited and any claimant and claimants that may

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have a claim against the Atlantic Oil Company Limited arising directly or indirectly from the Atlantic No. 3 well blow-out, whether recoverable as a debt or damages or otherwise howsoever, other than a claim arising from an interest in mines and minerals;

(3) Pay out of the said fund to any person entitled to a royalty on production from the Numbers 1, 2 and 3 wells of the Atlantic Oil Company Limited such royalty as in the opinion of the Board would have been received by such person if the Atlantic Number 3 Oil Well had not blown out of control and if the said wells had produced at a rate equivalent to the actual rate of production allowed by the Board to similar wells belonging to other companies in the same field at the same time.

The said additional powers were expressly stated to be subject to ratification by the Legislature at its next regular sittings. At that session there was enacted An Act to Determine All Claims Arising from the Atlantic Number 3 Oil Well Disaster (Chapter 17). The preamble recites that numerous claims had arisen directly and indirectly from the disaster and from the measures taken by the Board to bring it under control, the technical difficulties involved in the determination of liability and the assessment of damages common to many of the claims, the impracticability of dealing with them individually and the desirability in the public interest to determine all such claims. It further recites that the Board had held meetings attended by representatives of the company and other producers in the field affected by the disaster for the purpose of determining all such claims; and that it was desirable and expedient to implement the settlement of claims adopted at such a meeting held on January 26, 1949.

Certain specific powers were conferred upon the Board. It was authorized to make provision out of the trust fund, into which the proceeds of the sale of oil had been placed, for its own past and future expenses, and, out of the same fund, to provide for payment of

3. (*c*) The payment of such sums of money as may be required to give effect to any settlement approved by the Board and arrived at between the company and any claimant who may have a claim against the company, provided that if the parties cannot agree upon a settlement the Board may, in its discretion, pay to the claimant such amount, if any, in settlement of the claim as the Board may consider to be just and equitable;

(*d*) The payment to the company from time to time of such sums of money as the Board in its discretion deems it advisable to advance, having regard to the protection of the interests of claimants under this section of whose claims it has notice in writing prior to such advance.

And then subsection (3):

(3) The money remaining in the trust fund, if any, after payment of all claims, costs and expenses authorized to be paid pursuant to this Act shall belong and be paid to the company.

Then by section 7 the Order in Council to which I have referred was validated and confirmed and attached as a Schedule to the Act.

The Board in April, 1949, proceeded to carry out the powers so conferred upon it. On April 22 it forwarded to the National Trust Company a cheque for $317,213.24, "being payment in full of the Rebus Royalty arrears as per the attached statement." The Board required the Trust Company to hold the monies undisbursed until all those individuals entitled to the royalties, including the present appellant, had completed the releases enclosed. The appellant and all the other royalty holders duly completed such releases, a copy thereof forming part of Exhibit 1. The appellant's share, after allowance for depletion, amounted to $26,109.13, and as I have said above, he received that amount in 1949.

I turn now to the law applicable to the case. Under the provisions of The Income Tax Act 11-12 George VI, Chapter 52, section 3:

3. 'Income' includes income for the year from all businesses, property and offices and employment.

Section 6(*j*) thereof is as follows:

6. Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year

(*j*) amounts received by the taxpayer in the years that were dependent upon use of or production from property whether or not they were instalments of the sale price of the property, but instalments of the sale price of agricultural land shall not be included by virtue of this paragraph.

One of the alternative grounds of appeal was that the sums received by the appellant were receipts from the sale of an interest in agricultural land, but at the trial that ground of appeal was abandoned and obviously could not be supported.

Counsel for the appellant further admitted that had there been no such disaster, and consequently no interference or taking over by the Board, the whole of the said sum of $26,109.13 would have been taxable income under the provisions of section 6(*j*).

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The onus is, of course, upon the appellant to establish the existence of facts or law showing the error in relation to the taxation imposed upon him. (*Johnson* v. *The Minister of National Revenue* (1)).

The first submission is based upon the provisions of sections 2 and 3 of the Order in Council which I have set out above. It is submitted that by the terms of section 3 all that the Board was entitled to pay to royalty holders was such royalty as, in the opinion of the Board, would have been received by such persons if well No. 3 had not blown out of control and if the said wells 1, 2 and 3 had produced at a rate equivalent to the actual rate of production allowed by the Board to similar wells in the same area. It is argued that that amount only (and I am not furnished with any information as to what that amount was) constitutes taxable income and that the remainder is not income but capital. It is said that by the Order in Council the nature and quality of the appellant's right to a royalty has been altered, that only a portion thereof has the quality of taxable income and that the balance is damages or a return of capital or compensation for present and future losses. The nature of this submission is expressed in a variety of ways in the Notice of Appeal, but inasmuch as most of these points are dealt with in considering the next submission and in view of the facts as I consider them to be, I need not further mention them at this point. I may add, however, that in my opinion no provincial enactment could convert into capital that income which the Income Tax Act has declared to be taxable income.

Before dealing with the next submission, I think it is desirable to state my findings as to what the Board actually did. Section 3, subsection (1)(*c*) of the Act gave the Board power to pay such sums as might be required to give effect to any settlement approved by the Board and arrived at between the company and any claimant against the company, and by the Interpretation Section thereof a claim includes a claim of a holder of a gross royalty out of the production of petroleum from Well No. 3, and, therefore, included the appellant. If no such settlement was reached, the Board had a discretion to pay the claimants such amount in settlement as it considered just and equitable.

(1) [1948] S.C.R. 486.

It is quite apparent that a settlement was arrived at between the company and the appellant and approved by the Board, and that that settlement was the entire claim of the appellant for his percentage of the royalty up to the time of the settlement. The settlement with the claimant was made under the terms of the Act and not restricted to the provisions of section 3 of the Order in Council.

The next submission is based upon the provisions of The Atlantic Claims Act. Section 3, as I have indicated, authorized the Board to dispose of the trust fund in the manner stated. Then section 4 provides for restrictions as to production and drilling on the lands in question, and is as follows:

> 4. The Atlantic No. 3 Oil Well shall be deemed to have over-produced to the extent of five hundred and sixty-five thousand one hundred and ninety-five barrels of oil during the period it was flowing out of control and the Board may,—
>
> (*a*) restrict the production of the company's No. 1 and No. 2 wells to an amount which shall not exceed two-thirds of the normal allowable production as set from time to time by the Board; and
>
> (*b*) prevent the drilling of further wells on legal subdivisions 11 and 12 of Section 23, Township 50, Range 26, west of the 4th Meridian;
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> until such time as the Board may consider it necessary in order to compensate, in the opinion of the Board, for the over-production of Atlantic Number 3 Oil Well.

By that section the over-production by Well No. 3 was determined and the Board was empowered to restrict the production and further development of the property until other producers in the area had been compensated for the over-production. In the result, Well No. 3 was capped and has not been allowed to recommence production. Wells 1 and 2 have subsequently recommenced production, which has been and still is limited to two-thirds of normal allowable production. No other wells have been drilled or allowed to be drilled on the lands in question, although I understand that in the normal course of events a fourth well would have been drilled. In a letter of the Board to the appellant's solicitors dated February 18, 1950, it was stated that no change was contemplated in the near future.

In his Notice of Appeal the appellant alleged that the total sums received in 1949 were capital "as being damages for loss of future development of property to its full scope," or "capital as compensation upon giving up right to drill on the remaining two well sites," and as capital "because of

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the act of the Alberta Government in interfering and in effect expropriating what might have been income under other circumstances and converting it into a capital payment or compensation for present and future losses."

In my view, none of these contentions is tenable and I must reject them. No property or rights of the appellant were expropriated and he received full compensation for all royalties he was entitled to. It is possible that by reason of the restrictions on production imposed by the Board, his annual income may be less than if full production and development had been allowed. But such restrictions were imposed by competent statutory authority and no possible right to damages would accrue to the appellant against the Board or the company by reason thereof. The appellant surrendered no rights in respect to these matters and no part of the monies which he received in 1949 were paid to him because of such restrictions. The settlement of his claim had nothing whatever to do with the restrictions imposed by the Board and he was not asked to approve or disapprove of them.

Moreover, the fixation in the Act of the amount of the over-production could not affect the character of the payments which he received. It was done merely for the purpose of fixing with precision the amount of the over-production as a guide for the Board in determining when and to what extent the restrictions should later be altered.

Another submission is that, while the receipt signed by the appellant is for the precise amount of royalty to which he is entitled, it is also a release of all claims and demands. It is contended that the total receipts are capital "as being damages or solatium for not receiving the contractual payments, or as payment for a general release of existing and future claims, or as payments not depending on production from property, or as payments made by statutory authority and by the Board which was not a contracting party."

Now, there is no evidence whatever that the appellant had any valid claim against the company except for his share of the royalty reserved; nor is there any evidence that he ever asserted any other claim. On July 8, 1948, the National Trust Company as trustees for the Rebus family, wrote the Board as to the *gross royalties* that family was entitled to from the company. On April 22, 1949, the Board

forwarded its cheque to the Trust Company for $317,213.34, "being payment in full of the Rebus royalty arrears as per the attached statement." That statement is entitled "Gross Royalties Statement re Rebus et al", and the computation therein relates to royalties only. The document which the appellant signed on April 26, 1949, upon receiving his share of that cheque is called a "release." It recites that he is entitled to a share of the royalty payable by the Atlantic Oil Company and acknowledges receipt of such share in the following words:

> That I have received full payment and satisfaction of all of my share of all arrears of royalty payable by said Atlantic Oil Company Limited in respect of the production of leased substances from the said lands up to and including the 31st day of March, 1949, by virtue of payment by the Petroleum and Natural Gas Conservation Board of the Province of Alberta on behalf of said Atlantic Oil Company Limited to National Trust Company Limited at its office in the City of Edmonton in the Province of Alberta of the sum of $317,213.34 for the account of myself and other persons entitled to share in the said royalty under the terms of a certain agreement dated the 16th day of August, 1947, made between Norman George Lacy, Michael Rebus and others therein named.

Then follows the release clause in these words:

> And I do hereby release and forever discharge the said Atlantic Oil Company Limited and said Petroleum and Natural Gas Conservation Board and their and each of their successive successors and assigns from all manner of actions, causes of actions, claims or demands which I or my executors, administrators or assigns or any of them have had, now have or can or shall or may hereafter have against Atlantic Oil Company Limited and/or said Petroleum and Natural Gas Conservation Board for or in respect of any share of production of leased substances from the said lands or proceeds thereof payable to me or to the said National Trust Company Limited for my account up to and including the said 31st day of March, 1949.

It is most apparent that the payment related solely to the appellant's claim for royalty. Even if the terms of the general release were wide enough to constitute a release of other claims (and I do not think they are), that is *nihil ad rem*. The actual payment was and was clearly stated to be on account of royalty only.

Again it is submitted that the payment was a capital payment inasmuch as it was paid by the Board, a non-tracting party, and not by the company. I do not think that is of any importance whatever. The release itself states that the monies were received by the appellant from the Board *on behalf of the Atlantic Oil Company Limited.* Section 6(*j*) (*supra*) does not require that the amount

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received shall have been paid by a contracting party. All that is required is that it shall be an amount *received* by the taxpayer in the year that was dependent upon use of or production from property.

In my view, the Board was a statutory custodian or trustee of the property of the company following the taking of possession and of the trust funds representing the proceeds of the sale of the salvaged oil, for and on behalf of those who might establish a valid claim against the company, the balance to belong to the company itself. As I have said, there can be no doubt—in fact, it is admitted—that had there been no disaster and had the payments been made in the ordinary course by the company, the whole of the amount in dispute constituted taxable income as falling within the provisions of section 6(*j*). I am quite unable to find that the temporary custodianship of the Board or any provisions in the Order in Council or The Atlantic Claims Act or in the release executed by the appellant in any way affected the true nature and quality of the amount he was entitled to and did receive. It was clearly an amount received by the appellant that was dependent upon the use of or production from property and was, therefore, properly included by the respondent as part of the appellant's taxable income.

The appeal must fail on all grounds and will be dismissed with costs, and the assessment made upon the appellant is affirmed.

Judgment accordingly.