AMALGAMATIONS REVISITED: THE APPLICATION OF PARAGRAPH 87(2)(a)

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Recent jurisprudence has considered some of the amalgamation provisions in the Income Tax Act, in particular paragraph 87(2)(a). This article first analyzes, by way of background, previous jurisprudence relevant to those provisions. It then examines the more recent cases, to determine whether they follow or modify the previous jurisprudence, and whether they properly state the law with respect to paragraph 87(2)(a).

KEYWORDS: AMALGAMATIONS n CORPORATE REORGANIZATIONS n INVESTMENT COMPANIES n NON-RESIDENT

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INTRODUCTION

There is very little jurisprudence on the corporate reorganization provisions of the Income Tax Act.¹ This is probably because, in most circumstances, those persons who plan and implement corporate reorganizations carefully review the provisions and ensure that the transactions comply with them. However, tax practitioners, especially those in the legal community, generally prefer to have the benefit of the courts’ interpretation of particular provisions of the Act. This desire for judicial commentary is based on the knowledge that no interpretation of a provision can ever be truly correct until a court approves it. A review of the jurisprudence discussed in this article may well convince practitioners that they should be careful what they wish for, because they may get it.²

This article examines the recent decisions of the Federal Court of Appeal in Dow Chemical Canada Inc. v. The Queen³ and CGU Holdings Canada Ltd. v. The Queen.⁴ By way of background, it also discusses the older Federal Court of Appeal decisions in The Queen v. Guaranty Properties Limited et al.⁵ and The Queen v. Pan Ocean Oil Ltd.⁶ (which Dow Chemical and CGU Holdings consider and apply), and the earlier decision of the Supreme Court of Canada in The Queen v. Black & Decker Manu. Co.⁷

The discussion focuses primarily on the interpretation of paragraph 87(2)(a), although it also refers to other relevant provisions of the Act.

Section 87 provides detailed rules governing amalgamations.⁸ Although the issue of whether these rules provide a complete code has been the subject of some

1 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.
2 The wisdom of this warning was famously illustrated in “The Tale of the Monkey’s Paw,” by W.W. Jacobs, originally published in Harper’s Monthly in 1902.
3 2008 DTC 6544 (FCA); rev’g. 2007 DTC 1701 (TCC); leave to appeal to the Supreme Court of Canada denied, December 18, 2008.
4 2009 DTC 5044 (FCA); aff’g. 2008 DTC 3347 (TCC).
5 90 DTC 6363 (FCA); rev’g. 87 DTC 5124 (FCTD).
6 94 DTC 6412 (FCA); rev’g. 93 DTC 5330 (FCTD); leave to appeal to the Supreme Court of Canada denied, November 17, 1994.
7 [1975] 1 SCR 411.
debate, the recent jurisprudence discussed below supports the proposition that they do.10

Paragraph 87(2)(a) provides that where there has been an amalgamation of two or more corporations after 1971,

for the purposes of this Act, the corporate entity formed as a result of the amalgamation shall be deemed to be a new corporation the first taxation year of which shall be deemed to have commenced at the time of the amalgamation, and a taxation year of a predecessor corporation that would otherwise have ended after the amalgamation shall be deemed to have ended immediately before the amalgamation [emphasis added].

Solely on the basis of the wording of paragraph 87(2)(a), one might assume that a corporation formed as a result of an amalgamation of two or more predecessor corporations would be deemed to be a new corporation for all purposes of the Act. As discussed below, only the CGU Holdings case has applied a strict textual reading of the provision. In the other cases discussed in this article, the courts have adopted a different interpretation. In some instances, they have treated the amalgamated corporation as a new corporation for limited purposes; in others, they have treated it as a continuation of the predecessor corporations. The courts’ inconsistency with respect to the interpretation of paragraph 87(2)(a) has led to uncertainty as to which attributes of the predecessor corporations become attributes of the amalgamated corporation.

But for the decisions in Guaranty Properties and Pan Ocean, the rulings in Dow Chemical and CGU Holdings would be far more understandable and of less significance. The decisions of the Federal Court of Appeal in the two older cases created confusion about the application of paragraph 87(2)(a). They were not only inconsistent; they also lacked clarity. Nevertheless, there were no subsequent decisions of the court that considered paragraph 87(2)(a), until Dow Chemical and CGU Holdings were decided some 15 to 20 years later.

As the discussion in this article will demonstrate, over the last 20 years, the courts have been mercurial in their interpretation of paragraph 87(2)(a). Although, in my view, CGU Holdings, the latest statement of the law, properly interprets the relevant provisions of the Act, the concern is that in the future, a court faced with a unique factual situation will again put a gloss on the provisions of paragraph 87(2)(a) in particular, and the other amalgamation provisions in general.

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9 See, for example, Turner, supra note 8, at 1489ff.; Schwartz, supra note 8, at 9:57ff.; and Heine and Legge, supra note 8, at 37:6-7.

10 See in particular the decision of the Federal Court of Appeal in CGU Holdings, discussed infra at notes 54 to 59 and the accompanying text.
HISTORICAL JURISPRUDENCE

Black & Decker\textsuperscript{11}

Our starting point is a consideration of a non-tax case, the decision of the Supreme Court of Canada in Black & Decker. This case dealt with the issue of whether a new corporation was formed as a result of an amalgamation carried out pursuant to the provisions of the Canada Corporations Act\textsuperscript{12} (“the CCA”). Black & Decker provides a foundation for the reasoning in later tax decisions.

In Black & Decker, the amalgamated company was charged with a number of offences under the Combines Investigation Act, which took place prior to the amalgamation. The issue before the court was whether the amalgamated company could be charged with offences of a predecessor company.

The relevant wording of the CCA provided that any two or more companies might amalgamate and continue as one company, and that the amalgamated company possessed all the property, rights, and liabilities of each of the amalgamating companies. Accordingly, the attributes of the predecessor companies flowed through to the amalgamated company under the CCA. Dickson J, in rendering the decision of the Supreme Court and reversing the finding of the Ontario Court of Appeal, explained the relevant section of the CCA in the following manner:

[I]t would seem that the Court [of Appeal] accepted, as a first step, the proposition that the “new” company, i.e. the amalgamated company, is a different, separate and distinct company from the “old” companies, i.e. the amalgamating companies. Whether an amalgamation creates or extinguishes a corporate entity will, of course, depend upon the terms of the applicable statute, but as I read the Act [the CCA], in particular s. 137, and consider the purposes which an amalgamation is intended to serve, it would appear to me that upon an amalgamation under the Canada Corporations Act no “new” company is created and no “old” company is extinguished. . . . [I]f Parliament had intended that a company by the simple expedient of amalgamating with another company could free itself of accountability for acts in contravention of the Criminal Code or the Combines Investigation Act or the Income Tax Act, I cannot but think that other and clearer language than that now found in the Canada Corporations Act would be necessary.\textsuperscript{13}

The Supreme Court therefore allowed the appeal, on the basis that the offences of a predecessor company could flow through to an amalgamated company, and ordered the case returned to the Ontario Provincial Court for judgment following the decision.

Although there are comments in the tax cases discussed below that suggest that it is a matter of some fundamental principle of law that a new corporation is not

\textsuperscript{11} Supra note 7.

\textsuperscript{12} RSC 1970, c. C-32, section 137.

\textsuperscript{13} Supra note 7, at 416-18 (emphasis added).
formed on an amalgamation, the Supreme Court of Canada’s decision in *Black & Decker* rested on the interpretation of the CCA. It did not purport to espouse some fundamental common-law principle. In the decision, Dickson J referred to comments made by Kelly J of the Ontario Court of Appeal in *Stanward Corporation v. Denison Mines Ltd.* and stated:

Kelly J.A. compared the language of s. 96 of Ontario Statutes 1953, c. 19 upon which the *Stanward* case was decided, and that of its predecessor, s. 11 of *The Companies Act*, R.S.O. 1950, c. 59, upon which Regina v. Howard Smith Paper Mills, Ltd. [(1954) 4 DLR (2d) 161], a judgment of my brother Spence, was decided. The earlier legislation referred to the amalgamated corporation as the “new corporation” and spoke of “the corporation so incorporated.” The language expressed a clear intention to substitute a new corporation in the place and stead of the amalgamating corporations. By the time the *Stanward* case fell to be decided, however, the Legislature had re-enacted the section in words which, in the opinion of Kelly J.A., with which I agree, indicated an intention to change the effect of amalgamation.

**Guaranty Properties**

In *Guaranty Properties*, the issue was the validity of a reassessment of tax issued after an amalgamation in the name of a predecessor corporation. In *Guaranty Properties*, a Canadian company (“Dixie”) was reassessed by the minister in a particular year. In a subsequent taxation year, Dixie amalgamated with a number of other Canadian companies to form a new Canadian company (“Forest Glenn”). Some years later, Forest Glenn amalgamated with three other Canadian corporations to form Guaranty Properties. The minister, unaware of the last amalgamation, sent two notices of reassessment in respect of Dixie to Forest Glenn; however, Forest Glenn had already amalgamated into Guaranty Properties and therefore no longer existed.

The taxpayer brought application before the Federal Court Trial Division to determine the validity of the reassessments issued to Forest Glenn. Rouleau J noted that the taxpayer relied on paragraph 87(2)(a) in support of its position on the basis of the following reasoning:

> By deeming the resulting corporation formed on amalgamation as a new corporation, the *Income Tax Act* also deems that the predecessor corporations which amalgamated to form the new corporation have ceased to exist. A reading of section 87 of the Act as a whole makes it clear that paragraph 2(a) establishes as a general rule for all purposes under the Act, that the resulting corporation is a new corporation and all predecessor corporations have ceased to exist.

14 See the discussion of the *Pan Ocean* case below following note 21.
15 [1966] 2 OR 585 (CA).
16 Supra note 7, at 419.
17 Supra note 5 (FCTD).
The plaintiffs maintain that section 87 contains a number of other deeming provisions which are expressed to revive the predecessor corporations for specific purposes only as set out in those provisions. Therefore, unless the contrary is specifically provided for in section 87, the predecessor corporation, for tax purposes, ceases to exist.¹⁸

The taxpayer further argued that the only corporate entity that the minister could have reassessed after the amalgamation into Guaranty Properties was Guaranty Properties. However, the taxation year at issue was statute-barred; it was not open to the minister to reassess Forest Glenn instead of Guaranty Properties.

The Crown argued that the reassessment was valid on the basis that Forest Glenn did not cease to exist on the amalgamation into Guaranty Properties. Alternatively, if Forest Glenn had ceased to exist, sending a notice of assessment to Forest Glenn should be permitted on the basis of curative provisions of subsections 152(3) and (8) and section 166. The Crown relied on the Black & Decker decision in support of its position, arguing that the corporate law is clear that a predecessor company does not cease to exist on amalgamation. Moreover, the Crown submitted that while the Income Tax Act deems a new corporation to be formed on an amalgamation, it does not include a corresponding rule that deems a predecessor corporation to cease to exist. Therefore, in the absence of a specific provision that deems a predecessor to cease to exist, the applicable corporate law should apply.

Rouleau J found in favour of the plaintiff, holding that the reassessments were invalid on the basis that they were issued to the wrong taxpayer. The court did not expressly conclude as to whether Forest Glenn ceased to exist but held that, notwithstanding, the Act provides a mechanism whereby all assets and liabilities are transferred from predecessor corporations to the amalgamated company. Therefore, since the notice of assessment was issued to Forest Glenn and not to Guaranty Properties, the assessment was not valid.

At the Federal Court of Appeal, MacGuigan J reversed the trial court’s decision. He held that paragraph 87(2)(a) did not result in the extinguishment of the predecessor corporations (Dixie and Forest Glenn); instead, they continued in the form of the amalgamated corporation, unless the specific corporate law provided otherwise. The deeming rule in paragraph 87(2)(a) applied only for the purpose of determining the predecessor’s taxation year-end. MacGuigan J stated:

[I]t seems to me that the purpose Parliament had in mind was not to bring amalgamating corporations to an end but merely to give them a deemed year-end and the new corporation a deemed year-beginning. The words “shall be deemed to be a new corporation” are immediately followed by the clause “the first taxation year of which shall be deemed to have commenced at the time of the amalgamation.” This subsequent clause I find to be a defining or restrictive relative clause, which limits the scope of the antecedent principal clause to the combined concept expressed by the two clauses. . . . The principal effect of paragraph 87(2)(a) is that, for income tax purposes, the amalgamated corporation is

¹⁸ Ibid., at 5128 (emphasis in original).
deemed to be a new taxpayer with a fresh taxation year as of the date of amalgamation. In sum, nothing in the paragraph evinces an intention on the part of Parliament to deem that the amalgamating taxpayer ceased to exist, much less that it should be relieved of liability of its own income taxes prior to the date of amalgamation.\textsuperscript{19}

The conclusion that paragraph 87(2)(a) applies only for the purpose of determining the taxation year-end of an amalgamating corporation does not flow easily from the wording of the provision. As we shall see, this proposition has now been implicitly rejected by the Federal Court of Appeal in the \textit{CGU Holdings} case.

There is probably little value in criticizing a case that is now almost 20 years old.\textsuperscript{20} However, the \textit{Guaranty Properties} decision appears to be results-oriented. The court appeared less than enamoured with the possibility that the taxpayer could escape liability for tax on such a narrow technicality. It is unfortunate that the court had to do such violence to the plain meaning of paragraph 87(2)(a) to arrive at its conclusion. I do not wish to try to reargue the case, but there would have been greater respect for the scheme of the Act had the court held that a notice of reassessment issued to a predecessor corporation was valid on the basis of the argument advanced by the Crown—that the defect did not render the reassessment invalid, by virtue of the curative provisions of subsections 152(3) and (8) and section 166. If the court could not convince itself of the correctness of that argument, it would have been far better for the court to have found for the taxpayer and left it to Parliament to fix up the reassessment provisions of the Act.

\textbf{Pan Ocean}\textsuperscript{21}

The \textit{Pan Ocean} decision saw the Federal Court of Appeal resile from its position in \textit{Guaranty Properties} but still leave the law uncertain. \textit{Pan Ocean} involved the application of the amalgamation provisions to what are known as the successor corporation rules.\textsuperscript{22} The successor corporation rules apply where a taxpayer (referred to in the current provision of the Act as “the original owner”) that has incurred resource expenses (exploration, development, and property acquisition costs) transfers all or substantially all of its resource properties to a corporation (“the successor”). In such circumstances, where all the conditions precedent to the application of the rules are satisfied, the successor can deduct any resource expenses of the original owner that have not previously been deducted. Under the current provisions of the Act, there can be an unlimited number of transfers from the original owner to the successor.\textsuperscript{23}

\textsuperscript{19} Supra note 5 (FCA), at 6368 (emphasis added).
\textsuperscript{21} Supra note 6.
\textsuperscript{22} The successor corporation rules are currently set out in section 66.7.
\textsuperscript{23} See Brian R. Carr and C. Anne Calverley, \textit{Canadian Resource Taxation} (Toronto: Carswell) (looseleaf), chapter 7, for a full discussion of the successor corporation rules.
The transactions in *Pan Ocean* were governed by the Income Tax Application Rules (ITARs), which contemplated in the relevant taxation years (1974 and 1975) that there could be only two successor corporations in respect of any particular expense incurred by a person (referred to as “the predecessor corporation”). Where a corporation was the third transferee with respect to any expenses, it could not deduct the expenses.\(^{24}\)

In 1971, Pan Ocean Oil Limited (“POOL”) purchased a group of companies (“the Dynamic Companies”) that were engaged in oil and gas activities and mining exploration and development in Canada. There was an indirect transfer of resource properties from the Dynamic Companies to POOL, as a result of which POOL became a second successor corporation. In computing its income for 1971 and 1972, POOL deducted some exploration and drilling expenses that had been incurred by the Dynamic Companies but had not been previously deducted, on the basis that POOL was considered a second successor corporation. In 1974, pursuant to the Alberta Companies Act,\(^{25}\) POOL and Pan Ocean (Alberta) Ltd. amalgamated, with the amalgamated corporation retaining the name Pan Ocean Oil Limited (“Pan Ocean”). Following the amalgamation, Pan Ocean continued to deduct undeducted exploration expenses in respect of which POOL had been a second successor corporation. The minister disallowed the deduction for the 1974 and 1975 taxation years on the basis that Pan Ocean was a third successor corporation and the expenses in question were deductible only by a first or second successor corporation.

The taxpayer appealed to the Federal Court Trial Division. Pan Ocean argued that the amalgamation of POOL and Pan Ocean (Alberta) Ltd. was carried out pursuant to the Alberta Act, which provided that an amalgamation does not result in a new corporation or an extinguishment of the amalgamating corporations. Instead, the result is that the amalgamated corporation is a continuation of the predecessor corporations, and all the assets, rights, and liabilities of the predecessor corporations continue in the amalgamated corporation.\(^{26}\) Accordingly, the deductions to

\(^{24}\) The issue was whether Pan Ocean was a second successor for the purposes of ITAR 29(29) as it read in the relevant taxation years. To illustrate the application of the rule in the relevant taxation years, consider the following series of transfers and amalgamations involving four corporations (A, B, C, and D). Corporation A incurs resource expenses and transfers all its resource properties to corporation B. For the purposes of ITAR 29(25) as it then read, corporation A is the predecessor corporation, and corporation B is the successor corporation with respect to corporation A’s resource expenses. Corporation B then transfers all its resource properties to corporation C. Corporation A is the predecessor corporation, corporation B is the first successor corporation with respect to corporation A’s resource expenses, and corporation C is the second successor corporation with respect to those expenses. Corporation C then transfers all its resource properties to corporation D. Corporation D is the third successor corporation with respect to corporation A’s resource expenses. Under ITARs 29(25) and (29) as they then read, corporations B and C can deduct corporation A’s expenses in respect of the transferred resource properties, but corporation D cannot.

\(^{25}\) RSA 1970, c. 60 (now RSA 2000, c. C-21) (herein referred to as “the Alberta Act”).

\(^{26}\) Section 156 of the Alberta Act.
which Pan Ocean was entitled included unused deductions that POOL had acquired as a second successor corporation. Since the predecessor corporation was entitled to utilize the deductions as a second successor corporation, and, on the basis of the corporate statute, the predecessor corporation continued in Pan Ocean, Pan Ocean should similarly be entitled to the deductions. Pan Ocean further argued that once the corporate law had established that the deduction was permitted, there was no provision in the Income Tax Act that specifically denied the deduction. In this respect, Pan Ocean submitted, in accordance with Guaranty Properties, that paragraph 87(2)(a) was not intended to result in a new corporation for all purposes of the Act, but only with respect to the commencement of the company’s taxation year at the time of amalgamation.

The Crown argued that, notwithstanding that the Alberta Act provides that all the property, rights, privileges, liabilities, contracts, and debts of each of the amalgamating corporations become those of the amalgamated corporation, the amalgamated corporation (the “new” corporation in paragraph 87(2)(a)), is deemed pursuant to paragraph 87(2)(c) to have acquired the property of the amalgamating corporations. The amalgamation therefore resulted in an acquisition of property by Pan Ocean, and Pan Ocean became a third successor corporation on the acquisition. Since the Act does not permit deductions of expenditures by third successor corporations, Pan Ocean was not entitled to the deductions.

Jerome J allowed Pan Ocean’s appeal. He held that the amalgamation did not result in an acquisition of property and that, on the basis of the Alberta Act, the rights of the amalgamating corporations should continue in the amalgamated corporation, unless the Income Tax Act specifically denied the deduction. He further held that since there was no acquisition of property on the amalgamation, the successor rules had no application and Pan Ocean was entitled to deduct the expenses.

This decision was consistent with the Guaranty Properties decision, which held that on an amalgamation a new corporation is formed only for the purpose of determining the amalgamated corporation’s taxation year-end. Since the corporation’s taxation year-end was not at issue in Pan Ocean, the predecessor corporations continued as the amalgamated corporation and were not considered a new corporation for the purposes of deducting expenses incurred by predecessor corporations.

The Federal Court of Appeal reversed this decision. The court held that following an amalgamation, the amalgamated corporation was a “new” corporation and did not “acquire” the property of the predecessor corporations; rather, the property “simply became” the property of the new amalgamated corporation. The amalgamated corporation was considered a new corporation for tax purposes notwithstanding the result under the applicable corporate statute.27

Hugessen J noted:

27 This finding is consistent with my earlier comment that the Black & Decker decision does not rest on any fundamental common-law principle but on an interpretation of the provisions of the applicable statute.
[T]here is no doubt that in corporate law, both in Alberta and in most other Canadian jurisdictions, an amalgamation does not put an end to the amalgamating companies and the latter continue to exist in the new entity. . . . That is not the end of the matter, however, for the tax consequences of an amalgamation must be dealt with in the light of the applicable provisions of the *Income Tax Act* and in particular of section 87.28

Applying section 87 to the facts in *Pan Ocean*, the court found that paragraph 87(2)(a) was not intended to apply only to the determination of the timing of the taxation year-end of a corporation, but it was also not intended as a general rule to apply to the Act as a whole. Instead, the “intention was to indicate that the presumption [of the deeming rule in paragraph 87(2)(a)] was one that is limited in scope.”29 The amalgamated corporation was not to be treated as a new corporation for purposes other than the computation of income and the determination of deductions relating to the computation of income. Accordingly, since the successor rules relate to the computation of income, for those purposes *Pan Ocean* was considered a new corporation and not a continuation of the predecessor, or second successor, corporation. Therefore, *Pan Ocean* was not entitled to claim any exploration and development expenses.

The *Pan Ocean* decision attempted to distinguish the *Guaranty Properties* decision on the particular facts. Hugessen J stated:

In *Guaranty Properties*, the Court was concerned with the validity of a notice of assessment which had been sent to an amalgamating company after it had amalgamated with other companies. The question, in effect, came down to deciding whether the presumption (or “deeming”) enacted by paragraph 87(2)(a) was applicable to either Division A of the Act relating to “Liability for Tax,” or to Division I, “Returns, Assessments, Payment and Appeals.” That question was fully answered by the last sentence of the quoted paragraph. *I do not think that the Court intended in the earlier parts of that passage to establish a general rule that the presumption of paragraph 87(2)(a) was limited solely to the timing of the new corporation’s first taxation year; rather, the intention was to indicate that the presumption was one that is limited in scope and not applicable generally to the whole of the Income Tax Act.*30

In reaching his decision, Hugessen J referred to the earlier case of *Palmer-McLellan (United) Ltd. v. MNR*,31 which considered paragraph 85(2)(a), the predecessor to paragraph 87(2)(a).32

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28 Supra note 6 (FCA), at 6414-45.
29 Ibid., at 6415.
30 Ibid. (emphasis added).
31 68 DTC 5304 (Ex. Ct.).
32 Paragraph 85(2)(a) (RSC 1952, c. 148, as amended) read as follows:

(2) Where there has been an amalgamation of two or more corporations the following rules apply:

(a) for the purposes of this Act, the corporate entity formed as a result of the amalgamation shall be deemed to be a new corporation the first taxation year of which
In *Palmer-McLellan*, a corporation ("Old United") borrowed money to purchase the shares of another corporation ("Shoe Company"), and the two corporations were subsequently amalgamated (as "United"). At the time of the decision, the Act did not permit interest to be deducted in respect of money borrowed to acquire shares; therefore, prior to the amalgamation, interest on the indebtedness was not deductible. However, following the amalgamation, the provision that disallowed the deduction no longer applied since the investment in shares had disappeared and the borrowed money could be considered an investment in the business. The taxpayer argued that subsection 85(2) provided for an amalgamated corporation to be deemed to be a new corporation, and that in this case, prior to the amalgamation, there was a fictitious acquisition of assets of Shoe Company by Old United that resulted in a new corporation.

Hugessen J quoted the following statement made by Thurlow J, as he then was, in *Palmer-McLellan*:

> Accepting that the statute requires that the appellant be treated as a new corporation for the purposes of the *Income Tax Act* such purposes, so far as relevant, are, as I see it, the measuring of its income for prescribed periods of time, including the determination of deductions to which it may be entitled, and the computation of its liability for tax. These purposes do not seem to me to require any inference to be made as to how the new corporation came into possession of whatever assets it had at the commencement of its fictitious existence. It is to be treated as a new corporation for the purposes I have mentioned but, as I see it, it is not to be treated as a new corporation for any other purposes and I see in section 851 [now section 87] no basis for treating the assets of such a corporation as having been acquired in any other manner than that in which they were in fact acquired, that is to say, the manner in which they were acquired by the amalgamating corporations.\(^{33}\)

Hugessen J continued:

> The [emphasized] passages make it clear, in my view, that the provisions of paragraph 87(2)(a) are applicable to the amalgamated company’s computation of income under Division B (including the “deductions to which it may be entitled”) and, where necessary as a consequence thereof, to its computations of taxable income (Division C) and of tax (Division E). That is what this Court held in *Guaranty Properties* and the decision in that case should be limited to that holding. In particular, it should not be read as denying that the amalgamated corporation is to be deemed to be a new corporation for all purposes relating to the computation of its income.\(^{34}\)

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33 *Palmer-McLellan*, supra note 31, at 5308, quoted in *Pan Ocean*, supra note 6 (FCA), at 6415 (emphasis added by Hugessen J).

34 Supra note 6 (FCA), at 6416 (emphasis added).
At least two authors have noted that the outcome in Pan Ocean is surprising, since it seems clear that the Federal Court of Appeal had expressly considered the same issues in Guaranty Properties and had dismissed in Guaranty Properties the position taken by the Crown in Pan Ocean. Curiously, Pan Ocean ignored the explicit position taken in Guaranty Properties “that the purpose Parliament had in mind was not to bring amalgamating corporations to an end but merely to give them a deemed year-end and the new corporation a deemed year-beginning.” The basis for the court’s expansion in Pan Ocean of the decision reached in Guaranty Properties is difficult to understand. The court seemed to suggest that while Guaranty Properties did not establish a general rule, limiting the application to the timing of a taxation year-end merely implies that the provision cannot apply for the purposes of the entire Act. However, the specific provisions that were held to be applicable for the purposes of paragraph 87(2)(a) in Pan Ocean seem to be self-serving and purposefully determined on the basis of the desired outcome. There is no rationale for limiting the application of paragraph 87(2)(a) to the particular divisions. It would have been more logical for the court to have decided that the provision should be read as applying to the whole Act on the basis of the wording “for the purposes of this Act” in paragraph 87(2)(a). Indeed, in Canadian Roxy Petroleum Limited v. The Queen, the Alberta Court of Queen’s Bench, discussing the implication of Pan Ocean, stated:

[I]t is notable that the Court [in Pan Ocean] limited the application of s. 87(2) to the computation of income for tax purposes even though that section begins with the words “for the purposes of this Act.”

As discussed below, the decision of the Federal Court of Appeal in CGU Holdings adopted the same position.

CURRENT JURISPRUDENCE

Subsequent to the decisions in Guaranty Properties and Pan Ocean, there were no Federal Court of Appeal cases that considered the application of paragraph 87(2)(a) until the recent decisions of Dow Chemical and CGU Holdings. In CGU Holdings, the court implicitly rejected the decision in Guaranty Properties. While the decision in CGU Holdings has brought some clarity to the proper interpretation of paragraph 87(2)(a), it does raise certain issues with respect to the application of the law in circumstances such as those that existed in Guaranty Properties.

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36 Supra note 5 (FCA), at 6368 (emphasis added).

37 98 DTC 6313, at paragraph 28 (Alta. QB). The court in Roxy accepted the Pan Ocean decision and limited the application of subsection 87(2) to the computation of income for tax purposes.
Dow Chemical

Dow Chemical primarily considered subsections 87(7) and 78(1) of the Act, although some reference was made to paragraph 87(2)(a), particularly in the judgment of the Tax Court of Canada. In this case, the taxpayer, Dow Chemical Canada Inc. (“Amalgamated DCCI”) appealed a determination by the minister that, pursuant to subsection 78(1), the taxpayer must include in income for its December 2001 taxation year the amount of $30,990,628, which was related to accrued but unpaid interest that a predecessor corporation had deducted in a previous taxation year.

In 1998, Union Carbide Corporation (“UCC”), a US corporation, loaned money to a related party, Union Carbide Canada Inc. (“UCCI”). In 1999, UCC assigned its receivable to Union Carbide Canada Finance Inc. (“UCCFI”), a corporation related to each of UCC and UCCI. In computing its income for the taxation year ending December 31, 2000, UCCI deducted the amount of $30,990,627 as accrued interest for the 2000 calendar year in respect of the amount owing to UCCFI.

On February 6, 2001, Dow Chemical Company (“Dow”), a US corporation, acquired control of UCC. On October 1, 2001, UCCI amalgamated with Dow’s wholly owned subsidiary, Dow Chemical Canada Inc., pursuant to the relevant provisions of the Canada Business Corporations Act, to form Amalgamated DCCI.

UCCI had two taxation years in 2001—one beginning January 1, 2001 and ending February 6, 2001, as a result of the acquisition of control by Dow, and the second beginning February 7, 2001 and ending September 30, 2001, as a result of the amalgamation. Amalgamated DCCI’s first taxation year began on October 1, 2001 and ended on December 31, 2001.

As UCCI had done in 2000, in its 2001 income tax return, Amalgamated DCCI reported a net loss of $35,066,100 (related to the unpaid interest) and a current-year non-capital loss of $61,604,100. The minister subsequently issued a reassessment.

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38 Supra note 3.
39 Subsection 87(7) states that where a debt of a predecessor corporation becomes an obligation of the amalgamated corporation, the Act shall apply as if the amalgamated corporation had incurred the debt at the time the predecessor corporation incurred the debt.
40 Subsection 78(1) provides that where an amount in respect of a deductible outlay or expense is owed by a taxpayer to a person who was non-arm’s-length at the time the outlay or expense was incurred and the amount is unpaid at the end of the second taxation year following the taxation year in which it was incurred, the unpaid amount is to be included in computing the taxpayer’s income for the third taxation year following the taxation year in which the outlay or expense was incurred.
41 RSC 1985, c. C-44.
42 In accordance with subsection 249(4) of the Act.
43 This fact is taken directly from the case. Since the first taxation year would have ended immediately prior to the acquisition of control on February 6 by virtue of subsection 249(4), technically the second taxation year must have commenced prior to February 7. The decision does not depend upon the time at which the second taxation year started.
reducing these losses and adjusting Amalgamated DCCI’s income to include the disputed amount in the appeal. Amalgamated DCCI requested that the minister determine the amount of losses for its 2001 taxation year. The minister issued a notice of loss determination for Amalgamated DCCI’s 2001 taxation year, reducing its non-capital loss to $9,381,511 on the basis that the interest of $30,990,628 previously accrued and deducted by UCCI had to be included in Amalgamated DCCI’s income for its 2001 taxation year. This notice of determination was based on the minister’s interpretation of paragraph 87(2)(a), that DCCI was considered a continuation of UCCI. Therefore, the amount deducted by UCCI pursuant to subsection 78(1) in its taxation year ended December 31, 2000 should be included in Amalgamated DCCI’s income for its 2001 taxation year.

The Tax Court found in favour of Amalgamated DCCI on the basis that section 87 deemed Amalgamated DCCI to be a new corporation. The Tax Court judge also considered the non-arm’s-length condition outlined in subsection 78(1), which provides that, for the provision to apply, a non-arm’s-length relationship must exist at the time the outlay or expense is made and at the end of the second taxation year following the taxation year in which the outlay or expense was incurred. In the case of an amalgamation, this condition must exist at the time the debtor-creditor relationship is established and immediately prior to the amalgamation. The Tax Court concluded that Amalgamated DCCI and UCCFI were related immediately prior to the amalgamation. Specifically, prior to the amalgamation, UCCI and UCCFI were related because they were both controlled by Dow; and UCCI was deemed to have been related to Amalgamated DCCI under subsection 251(3.1). Under subsection 251(3), any two corporations related to the same corporation are deemed to be related to each other. Therefore, Amalgamated DCCI was related to UCCFI immediately before the amalgamation.

However, the Tax Court also concluded that prior to the acquisition of control by Dow, there was no provision in the Act that would result in Amalgamated DCCI and UCCFI being related. Therefore, since the interest expense was incurred in 2000, the initial non-arm’s-length condition would not be met under subsection 78(1). The Tax Court further held that subsection 87(7), which provides that the Act is to be applied “as if” the debt had been incurred by Amalgamated DCCI, did not establish that Amalgamated DCCI and UCCFI were non-arm’s-length when the debt was incurred, even though it did support the position that the debt incurred by UCCI was to be considered as entered into by Amalgamated DCCI.

The Tax Court held that Amalgamated DCCI and UCCI were distinct corporations. Accordingly, while UCCI had two taxation year-ends that occurred in 2001, Amalgamated DCCI’s first taxation year could not be considered to be UCCI’s third taxation year for the purposes of subsection 78(1). Therefore, UCCI did not have a third taxation year in which the amount could be included in income. Accordingly, no amount of interest should have been included in Amalgamated DCCI’s income for its 2001 taxation year. The Tax Court also added that while subsection 78(2) specifically provides for the treatment of outstanding debts on a winding up, there is no equivalent provision that deals with amalgamations. Further, while paragraph 87(2)(d)
would deem Amalgamated DCCI to have incurred the debt obligation that UCCI incurred, there is no related provision that would operate to deem Amalgamated DCCI to be dealing not at arm’s length with UCCFI, as is required by subsection 78(1). Therefore, there was no provision of the Act that included the amount previously deducted by UCCI in Amalgamated DCCI’s income for its 2001 taxation year.

The Crown appealed the decision. At the Federal Court of Appeal, the minister maintained that the inclusion of the amount in the computation of the respondent’s income was governed by subsections 78(1) and 87(7) and that the Tax Court had failed to correctly interpret these provisions. Noël J concluded that the Tax Court had misconstrued paragraph 87(7)(d) and subsection 78(1). Section 87 provides generally that the rights and obligations of predecessor corporations continue to the “new corporation.” Paragraph 87(7)(d) specifically provides that a debt or obligation of a predecessor corporation that was outstanding immediately before the amalgamation applies as if the new corporation had incurred or issued the debt or other obligation at the time it was incurred by the predecessor corporation. Noël J, stated that

Based on both a plain and a contextual reading of paragraph 87(7)(d), an amalgamated corporation stands in the shoes of its predecessor insofar as previously incurred debts are concerned as of the time when they were incurred.

I can see no basis for the respondent’s submission that Amalco [Amalgamated DCCI] should be viewed as having incurred the obligation back in 2000, but without regard to the non-arm’s length relationship that prevailed at that time. . . . The words “as if” are not so limited, and such a reading would frustrate Parliament’s clearly expressed intent that deductible expenses that are owing to a related party be included in income unless they are paid within the subsequent two taxation years.44

The Court of Appeal held that UCCI and UCCFI were not dealing at arm’s length when the debt obligation was incurred since UCCI and UCCFI were both controlled by UCC. Therefore, once Amalgamated DCCI was placed “in the shoes” of UCCI, it must follow that UCCFI and Amalgamated DCCI were not dealing at arm’s length when the obligation to pay interest was incurred (that is, in 2000). In addition, at the end of the second taxation year after the year in which the interest accrued (2001, prior to the amalgamation), a non-arm’s-length relationship existed between Amalgamated DCCI and UCCFI. Therefore, the Federal Court of Appeal held that the conditions precedent to the application of subsection 78(1) were met and the interest amount was properly included in Amalgamated DCCI’s income for its first taxation year.

_Dow Chemical_ may not be helpful in providing additional guidance on the reasoning established in _Pan Ocean_ for determining whether a “new corporation” is formed for the purposes of paragraph 87(2)(a), since the decision did not directly consider paragraph 87(2)(a). The Federal Court of Appeal even noted that the _Pan Ocean_ decision was of “no assistance to the respondent on this point since nothing

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44 Supra note 3 (FCA), at paragraphs 30 and 31.
turns on the fact that Amalco [Amalgamated DCCI] and UCCI are otherwise distinct corporations.” 45 The only reason for requiring Amalgamated DCCI to include the interest in income was the application of paragraph 87(2)(d), which specifically provides that debts incurred by predecessor corporations continue to be owed by amalgamated corporations. Therefore, although the Federal Court of Appeal followed the Pan Ocean decision, the court did not provide any clarification as to the circumstances in which a new corporation will be considered to be formed where an amalgamation occurs.

**CGU Holdings** 46

_CGU Holdings_ extends the general principles set out in _Pan Ocean_ and gives paragraph 87(2)(a) a meaning that is more consistent with the plain meaning of the provision.

In _CGU Holdings_, the taxpayer, CGU Ltd. (“CGU”), was a corporation formed by the amalgamation of three companies, one of which (“GA Ltd.”) was a non-resident-owned investment corporation 47 (NRO) under the Act. Immediately before the amalgamation, GA Ltd. had a substantial refundable tax on hand 48 (RTOH) balance. During its first taxation year, CGU paid a taxable dividend to an NRO shareholder and made an election to be deemed an NRO pursuant to subsection 134.1(1).

In 2000, the Act was amended to phase out the special treatment afforded to NROs. In order to accommodate certain timing issues that would result in some NROs being unable to claim refundable tax on dividends paid prior to the phase-out of the NRO provisions, section 134.1 was added as a transitional rule. Section 134.1 allows a corporation that was an NRO in a particular year but is not considered an NRO in the following taxation year to elect to continue to be treated as an NRO in that subsequent taxation year.

Where a corporation meets the conditions set out in subsection 134.1(1), subsection 134.1(2) deems the corporation to be an NRO in its first non-NRO year for the purposes of applying, in respect of dividends paid on shares of its capital stock in its first non-NRO year to a non-resident person or a non-resident-owned investment corporation, subsections 133(6) to (9) (other than the definition of “non-resident-owned investment corporation” in subsection 133(8)) and section 212 and any tax treaty.

Subparagraph 87(2)(cc)(i) provides that where there is an amalgamation and the new corporation is considered to be an NRO, the RTOH of the predecessor corporation becomes the RTOH of the amalgamated corporation.

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45 Ibid., at paragraph 36.
46 Supra note 4.
47 As defined in subsection 133(8).
48 See subsections 133(8), the definition of “allowable refund,” and 133(9), the definition of “allowable tax on hand.”
CGU made an election pursuant to subsection 134.1(1) and applied for an allowable refund from the RTOH account on the payment of the taxable dividend pursuant to subsection 133(6). The RTOH refund requested included the balance of GA Ltd.’s RTOH account, based on subparagraph 87(2)(cc)(i). The minister assessed CGU and denied the refund on the basis that CGU did not satisfy the criteria set out in the Act for making the election to be an NRO, since it could not be considered to be an NRO when it was formed. In addition, the minister held that the RTOH account of CGU was nil. According to the minister, the RTOH account of GA Ltd. did not form part of the RTOH account of CGU since the deeming provision in section 134.1 did not extend to the definition of an NRO under subsection 133(8), which deems a corporation to not be an NRO under certain circumstances.

At the Tax Court level, Hershfield J held that CGU did have the standing to make the deemed NRO election because, while CGU was not considered to be the same corporation as its predecessors, the predecessor corporations continued to exist in the amalgamated corporation.49 According to the Tax Court, paragraph 87(2)(a) applies only for certain purposes, such as the computation of income, taxable income, or tax (as held in Pan Ocean), but does not apply for the purposes of making an election to be treated as an NRO. Therefore, CGU was not deemed to be a new corporation pursuant to paragraph 87(2)(a), but was a continuation of the predecessor corporations. As a result, because GA Ltd. was considered to be continued in the amalgamated corporation, and since GA Ltd. was an NRO prior to the amalgamation, CGU was entitled to make an election pursuant to subsection 134.1(1). The Tax Court held that CGU was considered an NRO under subsection 134.1(1), notwithstanding that the definition in subsection 133(8) specifically provides that a new corporation formed as a result of an amalgamation is not an NRO unless each of the predecessor corporations was an NRO prior to the amalgamation.50 As a result of that exception, absent subsection 134.1(1), CGU would not be considered an NRO for the purposes of the Act.

However, the Tax Court held that GA Ltd.’s RTOH balance did not form part of the RTOH account of CGU and therefore CGU’s RTOH account balance was nil. This decision was based on the fact that the election to be treated as an NRO did not apply for the purposes of paragraph 87(2)(cc) but applied only for the purposes of the provisions specifically referred to in subsection 134.1(2), as described above.

Hershfield J acknowledged the narrow scope of paragraph 87(2)(a) generally, but pointed out that he was bound by such narrow interpretation when he said:

The cases relied on by the Appellant [the taxpayer] are reflective of the state of the law. Parliament has watched how the Courts have limited the application of paragraph 87(2)(a) and done nothing to give it a fuller life. To say now that reading the Act

49 As per Black & Decker, supra note 7.
50 Paragraph (g) of the definition of “non-resident-owned investment corporation” in subsection 133(8).
as a whole should support the Respondent’s argument that this Court on its own initiative breathe fresh life into that section is not something I am prepared to do even though I am of the view that the law as it has evolved has put limitations on its application that I likely would not have imposed. I say this as it seems to me, looking at the Act and Regulations as a whole, that the drafters of the amalgamation provisions of the Act have assumed that an amalgamation gives rise to a new corporation that has none of the tax impacting attributes of a predecessor unless they are continued by an express provision of the Act. This gives Parliament control over the circumstances that afford an amalgamated corporation the tax treatment afforded a predecessor. Parliament, or so it seems, wanted to have that control in order to say “no” to the very situation before me unless it chose to expressly provide otherwise. However, even though Parliament saw such control slipping away, it did nothing to restore it. Perhaps that casts doubt on that theory in the first place.51

Since he was bound by the Pan Ocean decision, Hershfield J held that since section 134.1 does not deal with the calculation of income or taxable income, which would result in a finding that for those purposes CGU was a new corporation pursuant to paragraph 87(2)(a), the election must stand.

With respect to whether a predecessor’s RTOH account flows up to an amalgamated corporation, CGU argued that if the election under section 134.1 did not permit the automatic flowthrough provided under paragraph 87(2)(cc), the election to be treated as an NRO would be rendered meaningless. That is, it is impossible to apply subsections 133(6) through (9) (the NRO provisions for which section 134.1 applies) without applying subparagraph 87(2)(cc)(i). In addition, CGU argued that the deeming provisions in section 134.1 are broad enough to allow for the transfer of the RTOH account, and nothing in the NRO deeming provisions precludes the application of subparagraph 87(2)(cc)(i).

The Tax Court determined that CGU’s RTOH account balance was nil on the basis that Parliament did not intend for amalgamated companies to make an election to be treated as an NRO in the first place. The court noted that there is no mention of subparagraph 87(2)(cc)(i) in subsection 134.1(2) because it was never contemplated that section 134.1 would operate as it has where the requirements for NRO status have not been met generally. Hershfield J noted:

Accordingly, an amalgamated corporation that has lost its NRO status as a result of the amalgamation is simply not deemed by section 134.1 to be an NRO for the purposes of section 87. . . . There is no basis to expand the scope of the deeming provision, where to do so goes well beyond its phasing out purpose and opens a door that Parliament clearly had intentionally shut.52

On this basis, the court held that the RTOH account did not flow up to CGU on amalgamation. The court also stressed that while CGU tried to argue that it is

51 Supra note 4 (TCC), at paragraph 32.
52 Ibid., at paragraph 40.
merely a continuance of GA Ltd. and therefore an NRO, there is no basis to suggest that a continued corporation is the same as the predecessor, or that the RTOH account is automatically transferred on an amalgamation. If such a transfer is to be permitted, it must be expressly provided for in the Act. Hershfield J noted:

The refundable tax account is not like land, inventory, contractual rights or goodwill that are property transferred under corporate law and by the Act under paragraph 87(1)(a) from a predecessor to the amalgamated corporation. That transfer must be provided for expressly by the legislation that notionally brought it into being. That has not been done. The legislative scheme here is clearly not to permit such transfer. Indeed, to the contrary, the transfer is expressly prohibited in the circumstances of the case at bar.53

The taxpayer appealed the decision. At the Federal Court of Appeal, Noël J rejected the Tax Court’s position that paragraph 87(2)(a) “only applies for certain purposes.”54 The court held, contrary to the Tax Court, that GA Ltd.’s status as an NRO was not preserved for the purposes of making an election under section 134.1. Noël J, quoting the position of the respondent, noted:

In reaching the conclusion that CGU had the status to make the election, the Tax Court Judge gave the decision of this Court in Pan Ocean Oil Ltd., supra, too wide a reach. In particular, there is no reason to restrict the application of the new corporation rule set out in paragraph 87(2)(a) to the computation of income and taxable income.55

Noël J further pointed out:

The observation that an amalgamated corporation is “only” a new corporation for the purpose of the [sic] computing income under Division B and where necessary as a consequence thereof, to Divisions C and E is obiter. The Court [in Pan Ocean] did not decide, let alone consider whether paragraph 87(2)(a) deems an amalgamated corporation to be a new corporation for the purpose of the NRO provisions in Division F.

Considering this question, it is apparent that the new corporation rule in paragraph 87(2)(a) which is said to apply “for the purposes of this Act,” would be rendered meaningless in the context of Division F, if its application was restricted, as the appellant suggests, to the computation of income (Division B), and where necessary to the calculation of taxation income (Division C) and tax (Division E).56

On the basis of this reasoning, the court held that CGU was considered a new corporation for the purposes of paragraph 87(2)(a), since the provision should apply for the purposes of the entire Act and specifically for the purposes of division F.

53 Ibid., at paragraph 42.
54 Supra note 4 (FCA), at paragraph 16.
55 Ibid., at paragraph 25.
56 Ibid., at paragraphs 40 and 41.
Therefore, CGU was never considered an NRO in a taxation year pursuant to paragraph 134.1(1)(a) (since only the predecessor was considered an NRO) and was not entitled to make an election to be treated as an NRO.

The court of Appeal in CGU Holdings gave a plain meaning to the provisions of paragraph 87(2)(a) and provides the clarity that has been sought for many years. In reaching its decision, the court expressly broadened the application of paragraph 87(2)(a) and the Pan Ocean decision. While the court specifically considered the application of paragraph 87(2)(a) only to division F, the decision in CGU Holdings implicitly suggests that there is no basis for limiting its application to certain divisions; to the contrary, paragraph 87(2)(a) should apply for the purposes of the entire Act, as the provision reads.

The wording of the decision is clear enough. However, historically, in cases where the Federal Court of Appeal has considered paragraph 87(2)(a), the court’s decisions have distinguished what appeared to be clear holdings of previous panels of the same court. Practitioners would have welcomed a bold statement to the effect that, as the Supreme Court of Canada stated in Shell, “Where the provision at issue is clear and unambiguous, its terms must simply be applied,” and therefore the comments in the jurisprudence that limited the application of paragraph 87(2)(a) were no longer good law. Unfortunately, the court in CGU Holdings was not that bold.

One does wonder where the decision in CGU Holdings leaves the decisions of Pan Ocean and Guaranty Properties. CGU Holdings would have no effect on the decision in Pan Ocean since the court in Pan Ocean treated the amalgamated corporation as a new corporation for the purposes of the relevant provisions. However, if a court were to give the decision in CGU Holdings its full scope, a litigant in the same position as the taxpayer in Guaranty Properties should be successful on the basis of the reasoning in CGU Holdings. The court in CGU Holdings appeared to anticipate this result when it commented that the court in Pan Ocean held that the decision in Guaranty Properties was limited to its own facts. Unfortunately, this was a backhanded endorsement of the holding in Guaranty Properties. Such holding is illogical if a court properly applies the interpretation of paragraph 87(2)(a) to the facts in Guaranty Properties. However, without a firm statement from the court in CGU Holdings that Guaranty Properties is no longer good law, a court faced with a similar situation may say that the issue has been previously considered by the Federal Court of Appeal and that the court hearing the case is bound by that decision.

CONCLUSION

The jurisprudence dealing specifically with paragraph 87(2)(a) has not been consistent over the years, and reconciling earlier cases with the more recent ones is difficult. In reading the provision, one would simply have surmised that the provision should

57 Shell Canada Limited v. The Queen et al., 99 DTC 5669, at paragraph 40 (SCC).
58 The relevant assessment provisions have not changed since the Guaranty Properties decision.
59 Supra note 4 (FCA), at paragraph 39.
apply generally for all purposes of the Act. However, for many years, the provision applied only for the purpose of determining the taxation year-end of predecessor corporations on an amalgamation and for the computation of taxable income. Only recently has the appropriate interpretation been presented, in the CGU Holdings decision. CGU Holdings has established a more general principle for the application of paragraph 87(2)(a). Despite this clarification, it is still unclear how this decision will be applied in the future when different facts are presented to the courts, especially where the facts are similar to those in Guaranty Properties, since the interpretation in CGU Holdings may be inconsistent with the reassessment provisions. Further, since courts render decisions only on the basis of the facts presented, it remains to be seen whether situations that involve divisions of the Act that have not been considered by the jurisprudence to date will be analyzed according to the interpretation set out in CGU Holdings.