Docket: 2004-4347(IT)G

BETWEEN:

KLANTEN FARMS LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on September 22, 2006, at Edmonton, Alberta

Before: The Honourable Justice B. Paris

Appearances:

Counsel for the Appellant:	James Yaskowich
Counsel for the Respondent:	Margaret McCabe

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2000 taxation year is dismissed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 15th day of June 2007.

"B. Paris"

Paris J.

Citation: 2007TCC348
Date: 20070615
Docket: 2004-4347(IT)G

BETWEEN:

KLANTEN FARMS LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Paris, J.

[1] This is an appeal from a reassessment of the Appellant's 2000 taxation year whereby the Minister of National Revenue included in the Appellant's income a taxable capital gain of $563,755 on the disposition of certain farmland in Bowden, Alberta.

[2] The Appellant did not report any gain on the disposition because it claims to have acquired certain replacement properties and that it was therefore entitled to defer the gain pursuant to section 44 of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) the ("*Act*").

[3] Under section 44 of the *Act*, a taxpayer is permitted to defer the capital gain realized on the disposition of certain capital property if a "replacement property" is acquired within a specified period. In order to obtain the deferral, the taxpayer must so elect in its return of income for the year in which it acquired the replacement property.

[4] The first issue in this appeal is whether property acquired by the Appellant in 2000 near Smokey River, Alberta, qualifies as a “replacement property” within the meaning of subsection 44(5) of the *Act*. If so, it must then be determined whether the Appellant properly elected under subsection 44(1) of the *Act* to treat the Smokey River property as a replacement property.

Applicable legislative provisions

[5] The relevant portions of section 44 read as follows:

> **44(1) Exchanges of property** — Where at any time in a taxation year (in this subsection referred to as the "initial year") an amount has become receivable by a taxpayer as proceeds of disposition of a capital property that is not a share of the capital stock of a corporation (which capital property is in this section referred to as the taxpayer's "former property") that is either
>
> > a) property the proceeds of disposition of which are described in paragraph (b), (c) or (d) of the definition "proceeds of disposition" in subsection 13(21) or paragraph (b), (c) or (d) of the definition "proceeds of disposition" in section 54, or
> >
> > b) a property that was, immediately before the disposition, a former business property of the taxpayer,
>
> and the taxpayer has
>
> > (c) where the former property is described in paragraph (a), before the end of the second taxation year following the initial year, and
> >
> > (d) in any other case, before the end of the first taxation year following the initial year,
>
> acquired a capital property that is a replacement property for the taxpayer's former property and the replacement property has not been disposed of by the taxpayer before the time the taxpayer disposed of the taxpayer's former property, notwithstanding subsection 40(1), if the taxpayer so elects under this subsection in the taxpayer's return of income for the year in which the taxpayer acquired the replacement property,
>
> > (e) the gain for a particular taxation year from the disposition of the taxpayer's former property shall be deemed to be … .

44(5) Replacement property -- For the purposes of this section, a particular capital property of a taxpayer is a replacement property for a former property of the taxpayer, if

> (a) it is reasonable to conclude that the property was acquired by the taxpayer to replace the former property;
>
> (a.1) it was acquired by the taxpayer and used by the taxpayer or a person related to the taxpayer for a use that is the same as or similar to the use to which the taxpayer or a person related to the taxpayer put the former property;
>
> (b) where the former property was used by the taxpayer or a person related to the taxpayer for the purpose of gaining or producing income from a business, the particular capital property was acquired for the purpose of gaining or producing income from that or a similar business or for use by a person related to the taxpayer for such a purpose;
>
> (c) where the former property was a taxable Canadian property of the taxpayer, the particular capital property is a taxable Canadian property of the taxpayer; and
>
> (d) where the former property was a taxable Canadian property (other than treaty-protected property) of the taxpayer, the particular capital property is a taxable Canadian property (other than treaty-protected property) of the taxpayer.

Facts

[6] The parties filed a Statement of Agreed Facts the relevant parts of which read as follows:

STATEMENT OF AGREED FACTS

1. Prior to April 2000, the Appellant owned and operated a farming business on 11 quarter sections of farmland near Bowden, Alberta (the "Bowden Farmland").

2. The Bowden Farmland was used exclusively for the purpose of farming.

3. In or about May 2000, the Appellant sold almost 6 quarter sections of the Bowden Farmland (the "Former Property").

4. The proceeds of disposition from the sale of the Former Property was $2,124,632.

5. The capital cost of the Former Property was $1,279,000.

6. In or about November 2000, Willie and Lisa Klanten (the "Klantens") entered into an agreement to transfer a 1/4 section of farmland in the Bowden area to the Appellant.

7. The Klantens subsequently transferred the 1/4 section of land it bought from the Klantens.

8. The Appellant paid $330,000 for the 1/4 section of land it bought from the Klantens.

9. The 1/4 section of land the Appellant bought from the Klantens qualified as a replacement property for the Former Property.

10. The proceeds of disposition of the Former Property exceeded the cost of the land bought by the Appellant from the Klantens by $1,794,632.

11. With the purchase of the 1/4 section from the Klantens, the Appellant operated a farming business on 6 quarter sections of land in the Bowden area.

12. In the fall of 2000, the appellant purchased all of the issued and outstanding shares of 859374 Alberta Ltd.

13. 859374 Alberta Ltd. owned 43 quarter sections of land near the town of Falher, Alberta and near the Smokey River in Alberta (the "Smokey River Property").

14. In or about December 2000, 859374 Alberta Ltd. was wound up.

15. The capital cost of the Smokey River Property to the Appellant on wind-up was approximately $1,900,844.11.

16. At all material times, all of the Smokey River Property was under lease to third parties (the "Tenants").

17. The Appellant was made aware of the Tenants' leasehold interests prior to buying the shares of 859374 Alberta Ltd.

18. The Tenants were not related to either of the Appellant or its shareholder, or both.

19. With the exception of one lease, the Tenants' leases expired on December 31, 2002, but the leasehold interests on the Smokey River Property operated through December 31, 2001.

20. The Appellant received cash rent, not a crop share.

21. The primary business of the Appellant is grain farming.

[7] The Statement of Agreed Facts was supplemented by evidence given at the hearing by Mr. Willie Klanten, the sole shareholder of the Appellant. Mr. Klanten stated that the Smokey River property was acquired by the Appellant in order "to maintain the Appellant's land base" after the sale of the Bowden property. The Appellant wished to maintain an amount of land sufficient to permit Mr. Klanten and his spouse as well as their two sons and their prospective families to earn a living from farming. Mr. Klanten felt that the property that the Appellant still owned in Bowden after the sale of the parcels in question was only large enough to provide a livelihood for himself and his spouse. At the time in 2000, Mr. Klanten's sons were aged 18 and 12 years.

First issue : Was the Smokey River property a "Replacement property" ?

Position of the parties

[8] The Respondent contends that the Smokey River property does not meet the requirements set out in paragraph 44(5)(a.1), because the property was not used by the Appellant or a related person for a use that was the same or similar to the use to which the taxpayer or a related person put the former property.

[9] The Respondent says that the Appellant only used the Smokey River property to earn rental income, whereas it had used the Bowden property to grow crops in its farming business.

[10] Counsel also submitted that, although the Appellant intended to farm the Smokey River property in the future, an intended future use is not a use within the meaning of paragraph 44(5)(a.1) of the *Act*. She relied on the decision of this Court in *Glaxo Wellcome Inc. v. H.M.Q.*, 1996 CarswellNat 853, (T.C.C.), affirmed by the Federal Court of Appeal at 1998 CarswellNat 1928, [1999] 4 C.T.C. 371 (F.C.A.).

The issue there was whether certain vacant land disposed of by the taxpayer had been used by the taxpayer in its business so as to qualify as a "former business property" thereby entitling the taxpayer to a section 44 deferral.

[11] In that case, the former property had been acquired and held for future use in the taxpayer's business. The Court held that the property was not used by the taxpayer, saying that "it was intended to be used, it was waiting to be used, but in any meaningful sense of the term it was not being used".

[12] The Respondent's counsel also says that since the requirements set out in paragraphs 44(5)(a) to (d) are conjunctive and since the Smokey River property fails to meet the requirements of paragraph 44(5)(a.1), the property cannot qualify as a replacement property.

[13] The Appellant's counsel submits that paragraph 44(5)(a.1) does not apply in this case because the Appellant voluntarily disposed of the Bowden property. The Appellant argues that paragraph 44(5)(a.1) only applies to property acquired to replace property which was the subject of an involuntary disposition, whereas paragraph 44(5)(b) applies to property acquired to replace former business property which a taxpayer disposes of voluntarily.

[14] The distinction drawn by the Appellant's counsel between voluntary and involuntary dispositions has its source in subsection 44(1) of the *Act*. That provision allows a deferral of a gain that arises from an *involuntary* disposition of any capital property of a taxpayer if a replacement property is acquired within two years.[1] Involuntary dispositions include those caused by expropriation, destruction or loss of the property. In the case of *voluntary* dispositions of a "former business property" a taxpayer must acquire a replacement property within one year.[2] A "former business property is, generally speaking, real property that was a capital property owned and used by the taxpayer to earn income from a business.[3]

[1] Pursuant to paragraph 44(1)(a) and (c).
[2] Pursuant to paragraphs 44(1)(b) and (d).
[3] As defined in subsection 248(1)

[15] Counsel for the Appellant argues that a similar dichotomy between voluntary and involuntary dispositions is also present in subsection 44(5). Counsel says that it is implicit in subsection 44(5) that paragraph (a.1) does not apply where the property being replaced was disposed of involuntarily. He says that paragraph 44(5)(a.1) was originally enacted (as paragraph 44(5)(a)) to correspond to involuntary dispositions of any capital property, whereas paragraph 44(5)(b) was enacted to correspond to voluntary dispositions of former business properties. Counsel argues that this distinction was carried through the subsequent amendments by which paragraph 44(5)(a) was renumbered as paragraph 44(5)(a.1), and that that paragraph should still be read as corresponding only to involuntary dispositions of capital property.

[16] In the alternative, counsel for the Appellant argues that the Appellant meets the conditions set out in paragraph 44(5)(a.1), because the Appellant maintained the Smokey River property as part of its land base upon which its business could operate. Since the Bowden property had also been held as part of the Appellant's land base, the Appellant says that it put both properties to the same use. Counsel referred to this use as "the broader use" to which both properties were put. Counsel said that the *Act* only required that only one of the uses to which the former property and the replacement property were put had to coincide, and that it is not necessary that the principal use of the two properties be the same or similar. Therefore, the fact that the principal use made by the Appellant of the Smokey River property was to earn rental income was not determinative of the application of section 44.

[17] Counsel relied on the decision in *Depaoli v. The Queen*, 96 D.T.C. 1820, [2000] 1 C.T.C. 6, there the taxpayer was seeking a section 44 deferral of a gain on resulting from the expropriation of land he had acquired as a future site for his home and a farming operation. The issue is that case was whether the two new properties acquired by the taxpayer were replacement properties within the meaning of subsection 44(5). The Respondent argued that since the former property had not been put to any use by the taxpayer, the new properties were not acquired for the same or a similar use. The taxpayer argued that he used the former property by maintaining it as farm land by allowing other farmers to cultivate it, and that the same use was made of the two new properties. The Court agreed with the taxpayer and held that the new properties were replacement properties.

[18] The Appellant's counsel submitted that in *Depaoli,* although the precise use of the land was to cultivate and harvest crops, the broader use, and the use which was

accepted by the Court, was to keep the land clean until some future use could take place. Counsel said that this broader use was analogous to the broader use of the Appellant for the Smokey River Property, that of maintaining a land base which would allow the Appellant to continue to successfully farm into the future.

[19] Counsel also relied on the decision of *Newcastle City Council v. Royal Newcastle Hospital*, [1959] A.C. 248 (N.S.W.P.C.), where it was held that land that was acquired by a hospital to provide clean air and quiet for the patients by acting as buffer between the hospital and neighbouring houses and factories, and to give room to expand the hospital was "used" by the hospital for those purposes.

Analysis

[20] With respect to the Appellant's first argument, I am unable to see any basis for the suggestion that Parliament intended paragraph 44(5)(a.1) to apply only to properties acquired to replace ones that were involuntarily disposed of.

[21] The wording of subsection 44(5) is clear and unambiguous and does not impose any limit on the application of paragraph 44(5)(a.1) to involuntary dispositions or on the application of paragraph 44(5)(b) to voluntary dispositions.

[22] Furthermore, the use of the word "and" at the end of paragraph 44(1)(c) indicates that paragraphs 44(5)(a) to (d) operate conjunctively. A property must thereby meet all of the relevant conditions in subsection 44(5) in order to qualify as a replacement property, regardless of whether the acquisition of the replacement property was preceded by an involuntary or voluntary disposition.

[23] I also find no merit in the Appellant's argument that prior to its amendment subsection 44(5) drew a distinction between involuntary and voluntary dispositions.

[24] Subsection 44(5) as it was originally enacted read as follows:

> 44(5) For the purposes of this section, a particular capital property of a taxpayer is a replacement property for a former property of the taxpayer, if

> (a) it was acquired by the taxpayer for the same or a similar use as the use to which the taxpayer put the former property;
>
> (b) where the former property was used by the taxpayer for the purpose of gaining or producing income from a business, the particular capital property was acquired for the purpose of gaining or producing income from that or a similar business; and
>
> (c) where the taxpayer was not resident in Canada at the time the taxpayer acquired the particular capital property, in addition to the requirements in paragraph (a) and (b), the particular capital property was taxable Canadian property.[4]

[25] It can be seen that this version of subsection 44(5), like the current version, contains no wording that would lead one to conclude that paragraph 44(5)(a.1) was only applicable to involuntary dispositions or that paragraph 44(5)(b) was only applicable to voluntary dispositions.

[26] If Parliament had intended to relate former paragraphs 44(5)(a) and (b) (or current paragraphs 44(5)(a.1) and (b), for that matter) to particular types of dispositions it would have used wording to that effect, such as that found in paragraphs 44(1)(c) and (d). In those paragraphs, the time limit for acquiring a replacement property is made expressly dependent on the involuntary/voluntary disposition distinction. No comparable wording appears in subsection 44(5).

[27] The Appellant's second argument, that it used the Smokey River property for a use that was the same as or similar to the use to which it put the Bowden property, cannot succeed either. Paragraph 2 of the Statement of Agreed Facts states that the Appellant used the Bowden property exclusively for the purpose of farming. There is no evidence to show that the Appellant or anyone related to the Appellant used the Smokey River property for farming. Therefore, even if "maintaining a land base" could be considered to be a use of property within the meaning of paragraph 44(5)(a.1), as submitted by the Appellant, this use of the Smokey River property would not have been the same as or similar to any use made by the Appellant of the Bowden property.

[28] In any event, I do not think that "maintaining a land base" is a use of property such as is contemplated by paragraph 44(5)(a.1) of the *Act*. Maintaining a land base in this case amounts to holding the property to farmed in the future by Mr. Klanten and his sons.

[29] "Use" in paragraph 44(5)(a.1) does not, in my view, include the notion of holding for a future use. This was the finding of this Court in *Glaxo* with respect to the word "use" in the definition of "former business property" in subsection 248(1) of the *Act*. I find the analysis of the issue in that case to be equally applicable here. In particular, Bowman J. (as he then was) distinguished the case of *Newcastle City Council v. Royal Newcastle Hospital* on the basis that the use of the vacant land, to assist in keeping the air clean and the atmosphere quiet, was a current use. This was contrasted with the future intended use of the land by the taxpayer in *Glaxo*.

[30] In *Depaoli*, the Court accepted that the activities of the taxpayer amounted to a current use by him of the property and therefore, for the purposes of subsection 44(5), applied the same test as in *Glaxo*. The maintaining of the property as farmland in *Depaoli* required a certain level of activity on the land, which constituted the current use. In contrast, "maintaining a land base" in this case did not involve any current activity or use of the land by the Appellant. It was merely the passive holding of the land.

[31] For all the foregoing reasons, I find that the Smokey River property was not a replacement property within the meaning of subsection 44(5) of the *Act*.

Second issue: Election under subsection 44(1)

[32] In light of my conclusion set out above, the Appellant was not entitled to treat the Smokey River property as a replacement property, and therefore it is not necessary for me to deal with the question of whether the Appellant properly elected under subsection 44(1) to defer the gain of the disposition of the Bowden property.

[33] The appeal is therefore dismissed, with costs.

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[4] Added by 1977-78, c.1, S. 18(1) applicable to dispositions of property after March 31, 1977.

Signed at Ottawa, Canada, this 15th day of June 2007.

"B. Paris"

Paris J.

CITATION:	2007TCC348
COURT FILE NO.:	2004-4347(IT)G
STYLE OF CAUSE:	KLANTEN FARMS LTD. AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Edmonton, Alberta
DATE OF HEARING:	September 22, 2006
REASONS FOR JUDGMENT BY:	The Honourable Justice B. Paris
DATE OF JUDGMENT:	June 15th, 2007

APPEARANCES:

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