Court File No. 2014-4179(IT)G

TAX COURT OF CANADA

BETWEEN:

SUNCOR ENERGY INC.
(AS SUCCESSOR TO PETRO-CANADA)

Appellant

and

HER MAJESTY THE QUEEN

Respondent

NOTICE OF APPEAL

I. ADDRESS OF THE APPELLANT

1. The address of the Appellant is in care of its counsel as follows:

Osler, Hoskin & Harcourt LLP
Barristers & Solicitors
Suite 2500, TransCanada Tower
450 - 1st St. S.W., Calgary AB T2P 5H1
Attn: Al Meghji and **Edward Rowe**

II. REASSESSMENT UNDER APPEAL

2. Suncor Energy Inc. ("**Suncor**") appeals from a notice of reassessment dated June 17, 2014 issued by the Minister of National Revenue (the "**Minister**") under the *Income Tax Act* (Canada) (the "**Act**") in respect of income of its predecessor, Petro-Canada, for the taxation year ending December 31, 2007 (the "**2007 Taxation Year**") (the "**2007 Reassessment**").

3. Suncor is the successor to Petro-Canada by way of amalgamation in 2009 and for the purposes of this Notice of Appeal, references to "Suncor" include Petro-Canada in respect of the 2007 Taxation Year.

4. Petro-Canada was, at all relevant times prior to its amalgamation with Suncor, a "taxable Canadian corporation" and a "public corporation" for the purposes of the Act.

5. Suncor objected to the 2007 Reassessment by way of a Notice of Objection filed on August 21, 2014 (the "**Notice of Objection**").

6. More than 90 days have elapsed since the Minister was served with the Notice of Objection. The Minister has not notified the Appellant that the 2007 Reassessment has been vacated or confirmed, or that there has been a further reassessment. The Appellant brings this appeal pursuant to paragraph 169(1)(b) of the Act.

III. OVERVIEW

7. The central issue in this Appeal involves the Minister's application of the transfer pricing rules in the Act to increase Petro-Canada's income for the 2007 taxation year by approximately CAD $2 billion. More particularly, in reliance on paragraphs 247(2)(a) and (c) of the Act, the Minister made a transfer pricing adjustment to increase Petro-Canada's income by imputing to Petro-Canada a CAD $2 billion reimbursement by Petro-Canada U.K. Limited ("**PCUK**"), an indirect non-resident subsidiary. The imputed reimbursement relates to the loss sustained by Petro-Canada on the close-out and settlement of certain forward derivative contracts entered into between Petro-Canada and third party counterparties in 2004 in respect of the price of Brent crude.

8. The Minister's reassessment of Petro-Canada on the central issue is founded on the Minister's assumption that:

   (a) Petro-Canada entered into and closed out the forward derivative contracts for Brent crude as part of a transaction, series of transactions, arrangement or event in which PCUK was also a participant; and

   (b) if PCUK and Petro-Canada had been persons dealing at arm's length, the terms and conditions of such transaction, series of transactions, arrangement or event would have included a full reimbursement of Petro-Canada by PCUK of the payments made by Petro-Canada under, and upon the close-out of, the forward derivative contracts.

9. A subsidiary issue is the Minister's application of penalties to Petro-Canada under the transfer pricing regime in the Act on the basis of the Minister's assertion that Petro-Canada failed to maintain adequate contemporaneous documentation in 2007 in respect of the terms and conditions of the forward derivatives contract payments.

10. Other unrelated issues in this Appeal deal with: (i) the inclusion of an asset retirement obligation in the proceeds of disposition of a Canadian resource property, contrary to the decision in *Daishowa-Marubeni International Ltd. v. Canada*, 2013 SCC 29; (ii) the classification of and deductions relating to long lead expenditures; and (iii) the classification of, and deductions relating to, glory hole expenditures.

IV. ISSUE 1: TRANSFER PRICING ADJUSTMENT AND PENALTIES FOR AN IMPUTED REIMBURSEMENT OF LOSSES ON FORWARD CONTRACTS

A. Facts relevant to ISSUE 1

Non-Arm's Length Parties

11. At all relevant times:

(a) Petro-Canada was the parent corporation of an international group of directly and indirectly wholly-owned subsidiary corporations that conducted various petroleum and natural gas and other energy related activities in Canada and in other jurisdictions;

(b) PCUK carried on its energy business in the United Kingdom (the "**UK**") and was a wholly-owned subsidiary of Petro-Canada U.K. Holdings Ltd. ("**Holdings UK**");

(c) PCUK and Holdings UK were each resident, and incorporated, in the UK;

(d) Holdings UK was a wholly-owned subsidiary of 3908968 Canada Inc. ("**3908968**"); and

(e) 3908968 was resident, and incorporated, in Canada, and was a wholly-owned subsidiary of Petro-Canada.

PCUK acquires the Intrepid Group of Companies from arm's length Vendors

12. On or about December 3, 2003, JP Morgan plc issued an information memorandum to PCUK soliciting bids for all of the outstanding shares of each of: (i) Intrepid Energy North Sea Limited; (ii) Intrepid Energy Limited; and (iii) Intrepid Energy (U.K.) LLC (collectively, the "**Intrepid Group of Companies**") (such shares, collectively, the "**Intrepid Shares**").

13. The Intrepid Group of Companies owned, among other things, a 29.9% interest in certain assets in an oilfield located in the U.K. sector of the North Sea known as the Buzzard field (the "**Buzzard Assets**").

14. On or about April 2, 2004 and April 19, 2004, Petro-Canada submitted an offer and amended offer, respectively, for the acquisition by PCUK of the Intrepid Shares, conditional upon the negotiation of a share purchase agreement between PCUK and the holders of the Intrepid Shares (the "**Vendors**").

15. On or about April 22, 2004, the Vendors indicated their intent to accept Petro-Canada's amended offer in the amount of USD $840 million for the acquisition by PCUK of the Intrepid Shares, subject to the good faith negotiation of share purchase agreements between PCUK and the Vendors.

16. On or about May 25, 2004, PCUK entered into three share purchase agreements for the purchase of the Intrepid Shares from the Vendors for aggregate consideration in the amount of USD $840 million.

17. On or about June 18, 2004, PCUK successfully closed the acquisition of the Intrepid Shares from the Vendors.

18. The Vendors and the Intrepid Group of Companies acted at arm's length to Petro-Canada and PCUK in respect of the acquisition of the Intrepid Shares by PCUK.

19. The terms and conditions made or imposed in respect of the acquisition of the Intrepid Shares by PCUK from the Vendors were at arm's length.

Petro-Canada enters into Forward Contracts with arm's length Counterparties

20. On March 30, 2004, Petro-Canada's board of directors authorized Petro-Canada to enter into financial derivative contracts for the forward sale of Brent Crude.

21. At all relevant times, Petro-Canada had a separate ISDA Master Agreement in place with each of Morgan Stanley Capital Group Inc. ("**Morgan Stanley**"), and Deutsche Bank AG ("**Deutsche Bank**") (collectively, the "**Counterparties**"), with

    (a) the Morgan Stanley ISDA Master Agreement being dated February 15, 1995, and

    (b) the Deutsche Bank ISDA Master Agreement being dated March 6, 2002.

22. Petro-Canada entered into trade confirmations

(a) between April 30, 2004 and May 24, 2004 with Morgan Stanley under the Morgan Stanley ISDA Master Agreement, and

(b) between April 26, 2004 and May 24, 2004 with Deutsche Bank under the Deutsche Bank ISDA Master Agreement

for the forward sale of an aggregate volume of 28,000 barrels of Brent Crude per day, for the period commencing July 1, 2007 and ending on December 31, 2010 (collectively, the "**Forward Contracts**").

23. Under the terms of the Forward Contracts:

(a) Petro-Canada was entitled to receive from the Counterparties a fixed price of USD $931,136,000 in the aggregate;

(b) Petro-Canada was obligated to pay the Counterparties the floating market price of Brent Crude in respect of the contracted volumes at the time of the monthly closeout of each trade for the period commencing July 1, 2007 and ending on December 31, 2010; and

(c) the net amount in respect of each monthly settlement was to be paid in cash and no physical delivery of commodity was permitted.

24. The Forward Contracts were entered into and authorized by Petro-Canada for its own account. Only Petro-Canada had the right to receive any amount under the Forward Contracts and the obligation to pay any amount under the Forward Contracts.

25. The Counterparties acted at arm's length to Petro-Canada and the terms and conditions made or imposed in respect of the Forward Contracts were at arm's length.

26. Petro-Canada was not acting as an agent of PCUK in respect of the Forward Contracts.

27. Petro-Canada had no obligation to pay any amount to PCUK in respect of the volume of Brent Crude covered by the Forward Contracts.

28. Petro-Canada had no obligation to pay any amount to PCUK in respect of crude oil produced, or anticipated to be produced, from the Buzzard Assets.

PCUK achieves Production from the Buzzard Assets

29. On or about January 1, 2005, PCUK caused the Buzzard Assets to be transferred directly to PCUK from the Intrepid Group of Companies.

30. Production of crude oil from the Buzzard Assets began in early 2007 and the income therefrom was earned and reported by PCUK.

Petro-Canada Settlement of the Forward Contracts with the Counterparties in 2007

31. The first of the cash settlement payments under the Forward Contracts became due and payable by Petro-Canada in July 2007 and amounts under the Forward Contracts were payable to the Counterparties on a monthly basis thereafter.

32. Due to significant increases in the market price of Brent Crude since 2004, Petro-Canada made payments to close out its obligations to the Counterparties as required under the Forward Contracts, on a monthly basis as such obligations became due ("**Monthly Closeout Payments**").

33. The Monthly Closeout Payments from July 1, 2007 to December 31, 2007 amounted to USD $287,326,000. Petro-Canada used its own funds to pay the Monthly Closeout Payments.

34. On October 24, 2007, the Petro-Canada board authorized and approved that the remaining Forward Contracts be unwound or closed out.

35. In November and December 2007, Petro-Canada effectively closed out all of its post-2007 obligations under the Forward Contracts by entering into a series of commodity swaps with Deutsche Bank pursuant to trade confirmations under the Deutsche Bank ISDA Master Agreement. The commodity swaps provided for the forward repurchase by Petro-Canada, at fixed market prices, of an aggregate volume of 28,000 barrels of Brent Crude per day for the period from January 1, 2008 to December 31, 2010. Pursuant to

the terms of the commodity swaps, Petro-Canada made an aggregate settlement payment to Deutsche Bank of approximately USD $1.72 billion (the "**Settlement Payment**").

36. Petro-Canada used its own funds to pay the Settlement Payment.

37. Deutsche Bank acted at arm's length to Petro-Canada and the terms and conditions made or imposed in respect of the commodity swaps with Deutsche Bank that unwound the Forward Contracts were at arm's length.

38. Petro-Canada deducted the sum of all Monthly Closeout Payments and the Settlement Payment (collectively, the "**Forward Contract Payments**") in the aggregate amount of CAD $2,016,385,409 in computing its income under the Act for the 2007 Taxation Year, resulting in the reporting of a loss of CAD $2,016,385,409 (the "**2007 Loss**") in its return of income for the 2007 Taxation Year.

39. None of Petro-Canada's 2007 Loss was transferred or allocated by Petro-Canada to PCUK.

Petro-Canada's transfer pricing documentation

40. Petro-Canada provided to the Minister documentation and other information relating to the bidding process for the Intrepid Shares, the entering into of the Forward Contracts by Petro-Canada, and the closing of the purchase of the Intrepid Shares by PCUK, as requested by the Minister, during the course of the audit and prior to any request for contemporaneous documentation.

41. On September 28, 2012, the Minister issued a letter requesting contemporaneous documentation in respect of the 2007 Taxation Year in respect of transactions with non-arm's length non-residents.

42. On December 19, 2012, Petro-Canada provided contemporaneous documentation to the CRA in respect of transactions between Petro-Canada and non-residents not at arm's length to it in the 2007 Taxation Year, including transactions between Petro-Canada and PCUK.

Minister's reassessment of Petro-Canada

43. By letters dated January 18, 2013 and December 13, 2013, (the "**Proposal Letters**") the Minister proposed to make an adjustment pursuant to paragraphs 247(2)(a) and (c) of the Act to include an additional amount into the income of Petro-Canada for its 2007 Taxation Year equal to the 2007 Loss, as an imputed reimbursement to Petro-Canada by PCUK of the Monthly Settlement Payments and the Close-Out Payment in respect of the Forward Contracts.

44. The Minister reassessed the Appellant on the basis of the Minister's assertion that:

(a) the transaction or series of transactions, the arrangement or event, for the purposes of applying subsection 247(2) encompasses the bidding process, the entering into of the Forward Contracts and the closing of the purchase of the Buzzard Assets;

(b) both Petro-Canada and PCUK were participants, along with the Vendors, in the series of events and transactions culminating in the purchase of the Buzzard Assets;

(c) the Forward Contracts were entered into in contemplation of the purchase of the Buzzard Assets and the series of transaction or events relating to the purchase of the Buzzard Assets therefore includes the Forward Contracts;

(d) since PCUK acquired the Buzzard Assets and eventually received profits from the production from the Buzzard oil field, PCUK was the beneficiary of the series of transactions;

(e) since the Forward Contracts resulted in monthly obligations linked to the monthly production from the Buzzard oil field, the Monthly Closeout Payments made on the Forward Contracts and the Settlement Payment made to close out the Forward Contracts are an extension of the initial series;

(f) for the purpose of the preamble in subsection 247(2),

- the "taxpayer" would be Petro-Canada,

- the "non-resident person with whom the taxpayer does not deal at arm's length" would by PCUK, and

- the "transaction or series of transactions", would be the entering into of the derivatives transactions for the benefit of PCUK and the closing out of the positions resulting in the $2,016,285,409 payment without reimbursement by PCUK;

(g) Petro-Canada and PCUK have priced the Forward Contract transaction at zero dollars by PCUK not reimbursing Petro-Canada for the position Petro-Canada undertook for PCUK's benefit;

(h) the terms and conditions made or imposed, in respect of the transaction or series of transactions, between Petro-Canada and PCUK differ from those that would have been made between persons dealing at arm's length;

(i) the terms and conditions made or imposed, in respect of the transaction or series of transactions, that would have been made between Petro-Canada and PCUK had they been persons dealing at arm's length would have been a reimbursement by PCUK to Petro-Canada for the Forward Contract Payments made by Petro-Canada; and

(j) pursuant to paragraphs 247(2)(a) and (c) of the Act, the amount of the reimbursement by PCUK to Petro-Canada will be adjusted to the amount of the 2007 Loss deducted by Petro-Canada (being $2,016,385,409), resulting in a net deduction of nil for Petro-Canada in the 2007 taxation year in respect of the Forward Contract Payments.

45. The Proposal Letters also proposed to assess a penalty against Petro-Canada, purportedly pursuant to subsection 247(3) of the Act, in respect of Petro-Canada's alleged failure to adequately prepare contemporaneous documentation (as described in subparagraphs 247(4)(a)(i) through (vi) and within the time prescribed in subsection 247(4)) in connection with the imputed reimbursement to Petro-Canada by PCUK.

46. The Minister reassessed the Appellant on the basis of the Minister's assertion that Petro-Canada failed to make reasonable efforts before the documentation due date for 2007, as required by paragraph 247(4)(a) of Act, to appropriately document the terms and

conditions made or imposed between Petro-Canada and PCUK in respect of the Forward Contracts.

47. There was no material change in 2007 to any of the matters referred to in any of subparagraphs 247(4)(a)(i) to (vi) in respect of the Forward Contracts.

48. By Notice of Reassessment dated June 17, 2014, the Minister reassessed Petro-Canada's 2007 Taxation Year to include an additional CAD $2,016,385,409 into its income and to impose a transfer pricing penalty of CAD $201,638,540.90.

B. Issue 1

49. The issues in this Appeal in respect of Issue 1 are:

(a) whether the Minister erred by applying paragraphs 247(2)(a) and (c) of the Act to impute a reimbursement in the amount of CAD $2,016,385,409 by PCUK to Petro-Canada in its 2007 Taxation Year in respect of 2007 Loss;

(b) whether, even if paragraphs 247(2)(a) and (c) of the Act apply, the Minister erred in assessing Petro-Canada on the basis that the transfer price between Petro-Canada and PCUK was inconsistent with the arm's length standard under subsection 247(2) of the Act; and

(c) whether the Minister erred by applying subsections 247(3) and (4) of the Act to impose a penalty on Petro-Canada in its 2007 Taxation Year in respect of its alleged failure to adequately prepare contemporaneous documentation with respect of an imputed reimbursement.

C. Statutory Provisions Relied Upon

50. The Appellant relies, *inter alia*, on subsections 9(1) and 152(4), and sections 247 and 248 and all such other provisions of the Act, the *Income Tax Application Rules* or the *Income Tax Regulations* as may be relevant to this Issue 1.

D. Reasons that the Appellant Intends to Advance

Minister's incorrect transfer pricing adjustment based on an imputed reimbursement

51. Petro-Canada participated in the following transactions: (i) entering into the Forward Contracts, on its own behalf, between April 26 and May 24, 2004 with arm's length Counterparties; and (ii) performing or settling of Petro-Canada's legal obligations under those Forward Contracts in 2007 with the Counterparties (together, the "**Petro-Canada Transactions**").

52. PCUK participated in the following transactions: (i) acquiring the Intrepid Shares on June 18, 2004 from an arm's length vendor; and (ii) earning revenue from the production and sale of crude oil from the Buzzard Assets, which production commenced in 2007, with other arm's length owners (together, the "**PCUK Transactions**").

53. The terms and conditions made or imposed in respect of the Petro-Canada Transactions and the PCUK Transactions were made, and were those that would have been made, between persons dealing at arm's length.

54. A textual, contextual and purposive interpretation of paragraphs 247(2)(a) and (c) requires that a taxpayer (Petro-Canada) and a non-resident person with whom the taxpayer does not deal at arm's length (PCUK) are participants in a transaction or series of transactions and that the terms and conditions made or imposed, in respect of the transaction or series, between any of the participants in the transaction or series differ from those that would have been made between persons dealing at arm's length.

55. Petro-Canada and PCUK were not participants in any transaction or series of transactions between them in which the terms and conditions made or imposed between any of the participants in the transaction or series differ from those that would have been made between persons dealing at arm's length.

56. The Minister's interpretation and application of paragraphs 247(2)(a) and (c) results in arbitrary application of those provisions and lacks consistency, predictability and fairness, requiring taxpayers to self-report on imputed transactions that do not actually occur.

57. The Minister's adjustment in respect of an imputed transaction between Petro-Canada and PCUK for the reimbursement of the 2007 Loss misapplies the transfer pricing rules in paragraphs 247(2)(a) and (c) to make PCUK liable for the obligations of Petro-Canada, which is inconsistent with the legal obligations of the parties.

58. In any event, an arm's length party would not make a voluntary payment of over two billion dollars without it having any legal obligation to do so and without the arm's length party having a legally enforceable entitlement in return. The Minister's imputed reimbursement by PCUK to Petro-Canada in the amount of $2,016,385,409 results in a price that would not have been made between persons dealing at arm's length and is commercially absurd.

59. The only quantum that would have been paid in relation to the Forward Contracts by PCUK to Petro-Canada, had they been arm's length parties, considering the functions performed, assets used and risks borne, would be nil -- as PCUK had neither legal entitlements nor legal obligations under the Forward Contracts.

Minister's incorrect application of transfer pricing penalties

60. There was no transaction within the meaning of section 247 to be documented by Petro-Canada and Petro-Canada had no obligation under subsections 247(3) and (4) to document a transaction that did not occur.

61. The Minister's assertion that a taxpayer must document each notional transaction which the Minister may impute is inconsistent with textual, contextual and purposive interpretation of paragraphs 247(3) and (4).

62. Paragraphs 247(3) and (4) require reasonable efforts and necessarily involve a determination of whether the taxpayer exercised reasonable diligence in the circumstances in documenting the actual transactions undertaken. Petro-Canada exercised reasonable diligence in the circumstances in documenting the actual transactions undertaken.

63. Petro-Canada provided contemporaneous documentation in respect of each of the transactions in the alleged series, being the bidding process, the entering into of the

Forward Contracts, the closing of the Intrepid Shares and the close out of the Forward Contracts.

64. Further and in any event, the application of subsection 247(4) to the 2007 Taxation Year is governed by paragraph 247(4)(b), which only requires Petro-Canada to document "material changes" to the matters referred to in any of subparagraphs 247(4)(a)(i) to (vi) in respect of the Forward Contracts in the 2007 Taxation Year. There were no "material changes" to any such matter in the 2007 Taxation Year.

E. Relief Sought

65. The Appellant respectfully requests that this appeal be allowed with costs and specifically that the 2007 Reassessment be referred back to the Minister for redetermination to remove the inclusion of the transfer pricing adjustment in the amount of CAD $2,016,385,409 and remove the application of the transfer pricing penalties in the amount of CAD $201,638,540.90.

66. The Appellant respectfully requests that: (i) any and all taxes, penalties, instalment interest, arrears interest and clawbacks of refund interest imposed by the 2007 Reassessment be reversed, (ii) refund interest be provided to the Appellant in accordance with the provisions of the Act, and (iii) this Honourable Court grant such further and other relief as the Appellant may request and the Court may deem just.

V. ISSUE 2: ASSET RETIREMENT OBLIGATIONS

F. Facts Relevant to Issue 2

67. On or about January 15, 2007, Petro-Canada Oil and Gas ("**PCOG**"), a general partnership of which Petro-Canada was a member, sold "Canadian resource property" as defined in the Act, being the working interest in certain gas reserves, together with the gas facilities associated therewith (being the Brazeau gas plant and the West Pembina gas facility) to Blaze Energy Ltd., an arm's length party, for a price of $84,419,000.

68. The price of $84,419,000 reflected the fact that there was an asset retirement obligation of approximately $9,039,935 embedded in the net value of the Canadian resource property.

69. No separate amount was paid for the assumption of the asset retirement obligation which was intrinsic to the Canadian resource property.

G. Minister's Reassessment

70. The Minister, in the 2007 Reassessment, included $9,039,935 in the proceeds of the Canadian resource property, allegedly as a result of the separate disposition of the asset retirement obligation. Consequently, the Minister reduced the cumulative Canadian Oil and Gas Property Expense ("**COGPE**") of Petro-Canada. This reduction in the Petro-Canada's cumulative COGPE balance resulted in a decrease in the COGPE that Petro-Canada could claim in the 2007 Taxation Year, pursuant to subsection 66.4(2).

H. Issue 2

71. The issue in this Appeal is whether the Minister properly included $9,039,935 in the proceeds of disposition from PCOG's sale Canadian resource property to Blaze Energy in respect of the asset retirement obligation.

I. Statutory Provisions Relied Upon

72. The Appellant relies, *inter alia*, on subsection 13(21) and subsection 66.4(2) and all such other provisions of the Act, the *Income Tax Application Rules* or the *Income Tax Regulations* as may be relevant to this Issue 2.

J. Reasons that the Appellant Intends to Advance

Minister's incorrect inclusion into proceeds of disposition of asset retirement obligation

73. A vendor of a Canadian resource property is not required to include an amount in respect of an asset retirement obligation in the vendor's proceeds of disposition.

74. The inclusion in proceeds of disposition is inconsistent with the commercial reality of the manner in which negotiations involving the purchase and sale of Canadian resource properties are conducted between arm's length parties.

75. The asset retirement obligation was not a distinct existing liability but an embedded future cost tied to the assets already reflected in the price paid to PCOG by Blaze Energy.

76. No amount was specified in the purchase and sale agreement relating to the assumption of the asset retirement obligation since the obligation was embedded in the net value and price of the assets.

77. Consistent with the Supreme Court of Canada decision in *Daishowa-Marubeni International Ltd. v. Canada*, 2013 SCC 29 no amount in respect of the asset retirement obligations should be added to PCOG's proceeds of disposition.

K. Relief Sought

78. The Appellant respectfully requests that this appeal be allowed with costs and specifically that the 2007 Reassessment be referred back to the Minister for redetermination to remove the inclusion of $9,039,935 in respect of the asset retirement obligation from proceeds of disposition and correspondingly increase Petro-Canada's cumulative COGPE balance by $9,039,935 and allow for the maximum COGPE deduction thereof.

79. The Appellant respectfully requests that: (i) any and all taxes, penalties, instalment interest, arrears interest and clawbacks of refund interest imposed by the 2007 Reassessment be reversed, (ii) refund interest be provided to the Appellant in accordance with the provisions of the Act, and (iii) this Honourable Court grant such further and other relief as the Appellant may request and the Court may deem just.

VI. ISSUE 3: LONG LEAD ITEM EXPENDITURES

L. Facts Relevant to Issue 3

80. Petro-Canada holds a 27.5% interest in the White Rose oil development project, offshore Newfoundland (the "**White Rose project**").

81. The White Rose project is a joint venture operated by an arm's length third party.

82. In the 2007 Taxation Year, the White Rose project procured items such as well heads, well casing and production tubing as "long lead items" to be used in drilling operations.

83. The long lead item process is a method of accounting for drilling and production items that, by their nature, require a long time to procure.

84. Costs associated with these items are initially recorded against authorizations for expenditure set up for this purpose and then moved to specific well authorizations for expenditure as the equipment is moved to the offshore drilling sites.

85. The long lead items were capital in nature and not inventory and were fully available for use, and were used or capable of being used then they were acquired.

86. In its tax return for the 2007 Taxation Year, Petro-Canada classified these expenditures as Canadian Development Expense ("**CDE**").

M. Minister's Reassessment

87. The Minister, in the 2007 Reassessment:

(a) reclassified $9,164,828 relating to long lead items from CDE to inventory; and

(b) denied a credit of $634,840 to Petro-Canada's Class 41 pool in relation to long lead items on the basis that such items were not available for use.

N. Issue 3

88. The issue in this Appeal is whether the Minister properly classified certain White Rose project long lead item expenditures from CDE to inventory, and whether the Minister was correct to deny the inclusion of expenditures in Class 41 as not available for use.

O. Statutory Provisions Relied Upon

89. The Appellant relies, *inter alia*, on subsection 66.2(5) and all such other provisions of the Act, the *Income Tax Application Rules* or the *Income Tax Regulations* as may be relevant to this Issue 3.

P. Reasons that the Appellant Intends to Advance

Minister's incorrect reclassification of long lead item expenditures from CDE to inventory and certain amounts from Class 41 as being not available for use

90. The long lead item expenditures are properly classified as CDE in the year they are acquired and were fully available for use and were used or capable of being used when they were acquired.

91. The long lead item expenditures were not inventory.

92. The long lead items included in the Class 41 property of Petro-Canada were fully available for use and were used or capable of being used when they were acquired.

Q. Relief Sought

93. The Appellant respectfully requests that this appeal be allowed with costs and specifically that the 2007 Reassessment be referred back to the Minister for redetermination to remove $9,164,828 from inventory and adding such amount to CDE and restoring $634,840 to Class 41, and permit the maximum deductions thereon.

94. The Appellant respectfully requests that: (i) any and all taxes, penalties, instalment interest, arrears interest and clawbacks of refund interest imposed by the 2007 Reassessment be reversed, (ii) refund interest be provided to the Appellant in accordance with the provisions of the Act, and (iii) this Honourable Court grant such further and other relief as the Appellant may request and the Court may deem just.

ISSUE 4: GLORY HOLE EXPENDITURES

R. Facts Relevant to Issue 4

95. Petro-Canada holds a 27.5% interest in the White Rose project, an oil development project offshore Newfoundland.

96. The White Rose project is a joint venture operated by an arm's length third party.

97. In the 2007 Taxation Year, the White Rose project incurred certain expenditures for the drilling of a "glory hole".

98. A glory hole is an excavation into the sea floor designed to protect the wellhead equipment installed at the surface of a petroleum well from icebergs or pack ice.

99. The keel of an iceberg or pack ice can extend far below the surface of the water. If this keel extends deep enough to make contact with the sea floor, it will scour the sea floor as the ice moves with the current.

100. To protect the wellhead equipment from possible scouring, a glory hole is excavated into the sea floor. This excavation must be deep enough to allow adequate clearance between the top of the wellhead equipment and the surrounding sea floor.

101. Petro-Canada, in its tax return for the 2007 Taxation Year, classified these expenditures as CDE.

S. Minister's Reassessment

102. The Minister, in the 2007 Reassessment, reclassified $8,624,764 of the expenditures from CDE to Class 41 on the basis that these expenditures should have the same classification as the wellhead equipment protected by the glory hole and that paragraph 66.2(5)(i.1) precludes the cost of depreciable property from being classified as CDE.

103. The Minister did not, however, include the reclassified amount in "qualified property" for the purposes of an ITC under paragraph 127(9)(m) of the Act.

T. Issue 4

104. The issue in this Appeal is whether the Minister properly reclassified certain expenditures for glory hole excavation from CDE to Class 41, and, in the alternative, if such expenditures were properly included in Class 41, whether the Minister erred by failing to include the amount thereof in qualified property for the purposes of Petro-Canada's entitlement to an ITC under subsection 127(9) in respect of such expenditures.

U. Statutory Provisions Relied Upon

105. The Appellant relies, *inter alia*, on subsection 13(21), 66.2(5), subsection 127(9) and all such other provisions of the Act, the *Income Tax Application Rules* or the *Income Tax Regulations* as may be relevant to this Issue 4.

V. Reasons that the Appellant Intends to Advance

Minister's incorrect reclassification of glory hole expenditures from CDE to Class 41 and, in the alternative, Minister's incorrect denial of ITCs

106. The glory hole expenditures are costs of preparing a site in respect of a well and are therefore properly included in the definition of CDE under subparagraph 66.5(2)(a)(ii) of the Act.

107. Paragraph (a)(ii) of the definition of CDE in subsection 66.2(5) provides that CDE of a taxpayer means any cost or expense incurred after May 6, 1974 that is (a) any expense incurred by the taxpayer in ... (ii) ... preparing a site in respect of the well, to the extent the expense was not a Canadian exploration expense.

108. The glory hole expenditures were not a Canadian exploration expense and were not depreciable property at that term is defined in subsection 13(21).

109. In the alternative, if the glory hole costs are properly classified as Class 41, the property is a qualified property for the purposes of Petro-Canada's entitlement to an ITC under subsection 127(9) in respect of such expenditures, and Petro-Canada should be entitled to an ITC under subsection 127(9).

W. Relief Sought

110. The Appellant respectfully requests that this appeal be allowed with costs and specifically that the 2007 Reassessment be referred back to the Minister for redetermination to remove $8,624,764 from Class 41 and adding such amount to CDE and, in the alternative if such amount is properly classified as Class 41, permitting an additional ITC of $862,476.

111. The Appellant respectfully requests that: (i) any and all taxes, penalties, instalment interest, arrears interest and clawbacks of refund interest imposed by the 2007 Reassessment be reversed, (ii) refund interest be provided to the Appellant in accordance with the provisions of the Act, and (iii) this Honourable Court grant such further and other relief as the Appellant may request and the Court may deem just.

I. DATE

112. This Notice of Appeal is dated at the City of Calgary, in the Province of Alberta, this 21st day of November, 2014.

OSLER, HOSKIN & HARCOURT LLP
(Counsel for the Appellant)

Al Meghji / Edward Rowe

Osler, Hoskin & Harcourt LLP
Barristers and Solicitors
Suite 2500
TransCanada Tower
450 - 1st St. S.W.
Calgary AB T2P 5H1

Telephone: 416-862-5677 / 403-260-7033
Facsimile: 416-862-6666 / 403-260-7024

2014-4179(IT)G

TAX COURT OF CANADA

BETWEEN:

SUNCOR ENERGY INC.
(AS SUCCESSOR TO PETRO-CANADA)

Appellant

- and -

HER MAJESTY THE QUEEN

Respondent

REPLY

In reply to the Appellant's Notice of Appeal with respect to the 2007 taxation year, the Deputy Attorney General of Canada says:

1. Unless otherwise stated, all statutory references are to the *Income Tax Act*, R.S.C., c.1 (5th Supp.), as amended (the "Act")

2. He admits the allegations of fact in paragraphs 2, 3, 4, 5 and 6 of the Notice of Appeal.

3. With respect to paragraphs 7, 8, 9 and 10 of the Notice of Appeal, he states that these paragraphs contain a summary of the Appellant's statement of issues and contain no statements of fact to admit, deny or to plead no knowledge.

ISSUE 1: Transfer Pricing Adjustment and Penalty

A. STATEMENT OF FACTS

4. He admits the allegations of fact stated in paragraphs 18, 21, 22, 30, 31, 38, 39, and 41 of the Notice of Appeal.

5. He denies the allegations of fact stated in paragraphs 42 and 47 of the Notice of Appeal.

6. He has no knowledge of and puts in issue the allegations of fact stated in paragraphs 27, 28 and 36 of the Notice of Appeal.

7. With respect to paragraph 11 of the Notice of Appeal, he has no knowledge of and puts in issue whether Petro-Canada U.K. Limited ("PCUK") carried on its energy business at all relevant times, and he admits the remaining allegations of fact in that paragraph.

8. With respect to paragraph 12 of the Notice of Appeal, he admits that JP Morgan plc issued a memorandum on or about December 3, 2003 but he has no knowledge of and puts in issue the remaining allegations of fact, and for greater certainty he states that the memorandum solicited bids for all of the equity or share capital of each of the operating subsidiaries of Intrepid Energy North Sea (Holdings) Limited and Intrepid Energy Developments Limited, and the partners of the Intrepid management company.

9. With respect to paragraph 13 of the Notice of Appeal, he admits that Intrepid Energy North Sea Limited owned all, or part, of a 29.9% interest in certain assets in an oilfield located in the U.K. Sector of the North Sea known as the Buzzard oilfield, and he has no knowledge of the remaining allegations of fact in that paragraph.

10. With respect to paragraph 14 of the Notice of Appeal, he admits that Petro-Canada ("PC") submitted an offer and an amended offer on the stated dates for an

acquisition by PCUK and he denies the remaining allegations of fact in that paragraph, but for greater certainty states that:

a. the acquisition was of Intrepid Energy North Sea (Holdings) Limited's interest in the entire share capital of Intrepid Energy North Sea Limited ("Intrepid") and for the entire share capital in Intrepid Energy Limited and in Intrepid Energy (U.K.) LLC (the "Intrepid Shares"); and

b. the share purchase agreement between PCUK and the vendors of the Intrepid Shares would be negotiated by PC.

11. With respect to paragraph 15 of the Notice of Appeal, he admits that on or about April 22, 2004, the vendors of the Intrepid Shares accepted PC's offer for the acquisition by PCUK of the Intrepid Shares, and he denies the remaining allegations of fact in that paragraph.

12. With respect to paragraph 16 of the Notice of Appeal, he admits only that, on or about May 25, 2004, PCUK executed a share purchase agreement for the purchase of the Intrepid Shares for consideration in the amount of USD $840 million, and he has no knowledge of the remaining allegations of fact in that paragraph.

13. With respect to paragraph 17 of the Notice of Appeal, he admits that the acquisition of the Intrepid Shares by PCUK from the vendors of the Intrepid Shares closed on or about June 18, 2004, and he denies the remaining allegations of fact in that paragraph.

14. With respect to paragraph 19 of the Notice of Appeal, he:

a. admits that the terms and conditions of the Share Sale and Purchase Agreement dated May 25, 2004 between PCUK and the vendors of the Intrepid Shares were at arm's length; and

b. has no knowledge of the remaining allegations of fact in that paragraph.

15. With respect to paragraph 20 of the Notice of Appeal, he admits that PC's board of directors (the "PC Board") authorized certain activity on March 30, 2004, including:

    a. the PC Board approved RBA No. 391 (corporate acquisition, Intrepid North Sea, Buzzard package) and delegated authority to the President and CEO to submit a bid, with authorization to negotiate a bid in the range of US $750 million to US $850 million;

    b. the PC Board authorized the delegation of signing authority to execute all documents to complete the bid to the Executive Vice-President International; and

    c. the PC Board also authorized the implementation of a fixed price swap on dated Brent crude, for the forward sale of Brent crude, to support a successful bid; and

    he denies the remaining allegations of fact in that paragraph.

16. With respect to paragraph 23 of the Notice of Appeal, he has no knowledge of the allegations of fact at subparagraph(c), and he admits the remaining allegations of fact in that paragraph.

17. With respect to paragraph 24 of the Notice of Appeal, the statements are argumentative in nature and call for a legal conclusion and do not contain any allegations of fact to admit, deny, or to plead no knowledge.

18. With respect to paragraph 25 of the Notice of Appeal, he admits only that the terms and conditions made or imposed in the Forward Contracts, as defined in paragraph 35(aa) below, were at arm's length as between the Counterparties and PC, and he has no knowledge of the remaining allegations of fact in that paragraph.

19. With respect to paragraph 26 of the Notice of Appeal, the statements are argumentative in nature and call for a legal conclusion and do not contain any allegations of fact to admit, deny or to plead no knowledge.

20. With respect to paragraph 29 of the Notice of Appeal, he admits only that on January 1, 2005, the Buzzard assets previously owned by Intrepid were transferred from PENSL to PCUK, and he has no knowledge of the remaining allegations of fact in that paragraph.

21. With respect to paragraph 32 of the Notice of Appeal, he:

    a. admits that the market price of Brent crude increased between 2004 and 2007;

    b. admits that PC paid the Counterparties under the Forward Contracts; and

    c. has no knowledge of the remaining allegations of fact in that paragraph.

22. With respect to paragraph 33 of the Notice of Appeal, he:

    a. admits that PC paid the Counterparties the sum of $287,326,000 under the Forward Contracts for the period July 1, 2007 to December 31, 2007; and

    b. has no knowledge of the remaining allegations of fact in that paragraph.

23. With respect to paragraph 34 of the Notice of Appeal, he admits the allegations of fact in that paragraph but, for greater certainty, states that the PC Board resolved that it accepted the recommendation of the Audit, Finance and Risk Committee to approve the delegation of authority to the President and Chief Financial Officer to unwind all or any portion of the Buzzard hedge on such terms as they determined appropriate.

24. With respect to paragraph 35 of the Notice of Appeal, he admits that:

    a. in November and December 2007, PC closed out the Forward Contracts;

b. PC entered into a series of commodity swaps with Deutsche Bank pursuant to trade confirmations under the Deutsche Bank ISDA Master Agreement;

c. the commodity swaps provided for the forward repurchase by PC, at fixed market prices, an aggregate volume of 28,000 barrels of Brent Crude per day for the period from January 1, 2008 to December 31, 2010; and

d. pursuant to the terms of the commodity swaps, PC made an aggregate settlement payment to Deutsche Bank of approximately USD $1.72 billion; and

he has no knowledge of and puts in issue the remaining allegations of fact in that paragraph.

25. With respect to paragraph 37 of the Notice of Appeal, he:

a. admits that the terms and conditions made or imposed in respect of the commodity swaps with Deutsche Bank that unwound the Forward Contracts were at arm's length;

b. has no knowledge of the remaining allegations of fact in that paragraph; and

c. for greater certainty, states that the Forward Contracts were entered into in order to facilitate the acquisition of the Intrepid Shares by PCUK, to mitigate the price risk associated with PCUK's sale of oil from the Buzzard oilfield, and to protect PCUK's internal rate of return on the acquisition of the Intrepid Shares.

26. With respect to paragraph 40 of the Notice of Appeal, he admits that PC provided to the Minister of National Revenue (the "Minister") certain documentation and information relating to the bidding process for the Intrepid Shares, the entering into of the Forward Contracts by PC and the closing of the purchase of the Intrepid Shares by PCUK, as requested by the Minister, during the course of the

audit and prior to any request for contemporaneous documentation, but he denies that that documentation and information was complete and accurate.

27. With respect to paragraph 43 of the Notice of Appeal, he:

a. admits that the Minister issued an initial proposal letter dated January 18, 2013 and a further proposal letter dated December 13, 2013;

b. states that the proposal letters speak for themselves and, as such, he denies the Appellant's purported summary of the contents of the proposal letters; and, for greater certainty, he states that:

i. the January 18, 2013 proposal letter stated that the Minister proposed "to include a reimbursement of [PC's] hedging loss of $2,016,384,409 claimed in the 2007 taxation year";

ii. the December 13, 2013 proposal letter stated that the Minister "proposed to disallow [PC's] hedging loss of $2,015,384,409 claimed in the 2007 taxation year" and "[p]ursuant to paragraphs 247(2)(a) and (c) of the Income Tax Act, then, the amount (the reimbursement by [PCUK] to [PC]) will be adjusted to the amount of the $2,016,385,409 loss, resulting in a net deduction of nil for [PC] in the 2007 taxation year in respect of those derivative contracts."

28. With respect to paragraph 44 of the Notice of Appeal, he states that the allegations are the Appellant's argument as to the basis of the Minister's reassessment and does not contain any material facts to admit, deny or plead no knowledge. To the extent there are any material facts, he denies the Appellant's purported summary of the reassessment and he states that the complete basis for the Minister's reassessment is as set out in paragraph 35 below.

29. With respect to paragraph 45 of the Notice of Appeal,

a. he states that the January 18, 2013 proposal letter speaks for itself and, as such, he denies the Appellant's purported summary of the contents of that proposal letter; and

b. he states that basis for the Minister's reassessment with respect to the penalty pursuant to paragraph 247(3) of the Act is as set out in paragraph 36 below.

30. With respect to paragraph 46 of the Notice of Appeal, he denies the allegations of fact in that paragraph and he states the basis for the Minister's reassessment with respect to the penalty pursuant to paragraph 247(3) of the Act is as set out in paragraph 36 below.

31. With respect to paragraph 48 of the Notice of Appeal, he admits that by notice of reassessment dated June 17, 2014, the Minister reassessed PC's 2007 Taxation Year, pursuant to paragraphs 247(2)(a) and (c) of the Act, to adjust the amount, being the reimbursement by PCUK to PC, to the amount of the $2,016,385,409 loss, resulting in a net deduction of nil for PC in the 2007 taxation year and to impose a transfer pricing penalty of $201,638,540.90, and he denies the remaining allegations of fact in that paragraph.

32. In its 2007 tax return, PC claimed a loss of $2,016,385,409 in respect of hedging losses in the 2007 taxation year (the "Loss").

33. In 2009, PC and Suncor Energy Inc. merged and carried on operations under the name of the Appellant.

34. By notice dated June 17, 2014, the Minister reassessed the Appellant, pursuant to paragraphs 247(2)(a) and (c) of the Act, to adjust the amount, being the reimbursement by PCUK to PC, to the amount of $2,016,385,409 loss, resulting in a net deduction of nil for PC in the 2007 taxation year and to impose a transfer pricing penalty of $201,638,540.90 pursuant to paragraph 247(3) of the Act.

35. In determining PC's tax liability for the 2007 taxation year, the Minister made the following assumptions of fact:

Corporate Structure

a. In 2009, PC and Suncor Energy Inc. merged and carried on operations under the name of the Appellant;

b. At all relevant times, PC was a taxable Canadian corporation and public corporation;

c. PCUK was a UK-based subsidiary of Petro-Canada UK Holdings Ltd;

d. Petro-Canada UK Holdings Ltd was a UK-based subsidiary of 3908968 Canada Inc;

e. 3908968 Canada Inc. was a Canadian direct subsidiary of PC;

PCUK's Bid for Intrepid

f. On December 1, 2003, Intrepid Energy North Sea (Holdings) Limited announced its intention to sell all of the outstanding shares of Intrepid Energy North Sea Limited, Intrepid Energy Limited and Intrepid Energy (U.K.) LLC (the "Intrepid Group of Companies");

g. The Intrepid Group of Companies owned, among other things, a 29.9% interest in the Buzzard oilfield located in the UK North Sea

h. JP Morgan plc issued an Intrepid Energy Information Memorandum, dated December 3, 2003, to PCUK wherein:

    i. Non-indicative bids for the Intrepid Shares offered for sale were to be made on the basis of the information in the Memorandum; and

ii. JP Morgan plc was acting for the vendors of the Intrepid Shares;

i. In preparation for the bidding process, the valuation of the Intrepid Shares was primarily prepared by PC's International Business Development Group which group was led by Peter Kallos, Executive Vice President, International of PC;

j. Other key individuals involved in the valuation were Graham Lyons, Senior Director of Business Development and Communications, PCUK, and Roger Burrows, Manager, Economics;

k. On January 8, 2004, PCUK submitted a non-binding indicative bid for the Intrepid Shares for the amount of US $650,000,000 (the "Bid");

l. Oil from the Buzzard oilfield was expected to be produced by the end of 2006;

m. Intrepid's share of peak production was expected to average 60,000 barrels of oil per day;

The Hedging Strategy

n. On March 4, 2004 an internal analysis was presented to the PC Board which proposed the securing of forward sales of Brent crude oil at US $25.50 per barrel for approximately half of the expected production from the Buzzard oilfield for the years 2007 to 2010 (the "Internal Analysis");

o. The Internal Analysis was based on a review of the potential profitability of PCUK's share of the oil production from the Buzzard oilfield if PCUK was successful in acquiring the Intrepid Shares;

p. The Internal Analysis included the following hedging strategy:

i. PCUK's bid for the Intrepid Shares had to be competitive, but also had to result in a decent rate of return on the investment;

ii. If PCUK's bid for the Intrepid Shares was too high, then PCUK would not make a profit on the acquisition of the shares; and,

iii. If PCUK's bid for the Intrepid Shares was too high and the price of oil fell, then PCUK would lose money;

q. The Internal Analysis contained a detailed review of the projected revenue and profitability of the Buzzard oilfield under different hedging scenarios and was based on information compiled by individuals from both PC and PCUK;

r. The increase in the internal rate of return on the acquisition of the Intrepid Shares, assuming the forward derivative contracts were entered into, would support a second round bid for the Intrepid Shares that could be increased by US $100 million;

s. Prior to March 30, 2004, PC's *Mandate, Policy & Guidelines for Derivatives Trading Activities* (the "MPG") provided that PC was not authorized to enter into derivative instruments for speculative purposes, nor with terms exceeding 18 months unless specifically authorized by the PC Board;

t. The MPG provided further that, for the purposes of derivatives that are subject to accounting disclosure as required by Canadian GAAP, qualification for hedge accounting treatment would be considered a requirement for the use of derivatives to hedge an exposure;

u. On March 30, 2004, the PC Board discussed the fact that the hedging strategy set out in the Internal Analysis would not meet the restrictions contained in the MPG on two counts: the term of the forward derivative

contracts would exceed 18 months; and, the hedging strategy would likely not qualify for hedge accounting treatment;

v. On March 30, 2004, in light of the restrictions, the PC Board passed three resolutions (the "March Resolutions") that:

i. allowed management to elect to continue hedge programs that meet internal effectiveness standards but, due to the nature of the item being hedged or the type of hedge instrument, the transaction may not qualify for hedge accounting treatment;

ii. approved an exception to the MPG derivative instrument term limit in order to accommodate the proposed forward derivative contracts; and,

iii. approved the implementation of a fixed price hedge on dated Brent as an effective means of reducing the downside price risk on the contemplated bid for the Intrepid Shares;

w. In its 2004 Annual Report, PC stated that its Market Risk and Derivative policy prohibits the use of derivative instruments for speculative purposes and that it uses derivatives primarily to hedge physical transactions for operational needs and to facilitate sales to customers, the gains and losses on the derivative instruments would essentially offset the gains and losses on the physical transaction;

The Offer

x. On April 2, 2004, PC offered to purchase, through its wholly owned subsidiary, PCUK, the Intrepid Shares for the amount of US $785,000,000;

y. On April 19, 2004, PC amended its offer to increase the purchase for the Intrepid Shares to US $840,000,000 (the "Offer");

z. On April 22, 2004, the Offer was accepted with some modifications and PC accepted those modifications;

The Forward Contracts

aa. Between April 26, 2004 and May 24, 2004, PC entered into a series of forward sales contracts with Deutsche Bank and with Morgan Stanley to hedge approximately one half of PCUK's anticipated share of oil production from the Buzzard oilfield between July 2007 and December 2010 (the "Forward Contracts");

bb. The Forward Contracts collectively covered 28,000 barrels of oil per day;

cc. PC would receive a fixed price, averaging approximately US $25.98 per barrel, on a total of 35,840,000 barrels of oil between July 2007 and December 2010 under the terms of the Forward Contracts;

dd. The total amount to be received under the Forward Contracts between 2007 and 2010 would be US $931,136,000;

ee. The total amount to be paid under the Forward Contracts would be the market price of the oil at the time of the expiry of each Forward Contract which would be recovered by PCUK upon the physical sale of an equivalent amount of crude oil from the Buzzard oilfield;

ff. The reference price for the Forward Contracts was that of Brent crude oil;

gg. PC was the only member of the corporate group authorized to undertake financial transactions such as the Forward Contracts;

hh. PC was likely the only member of the corporate group that could provide the required credit support for the Forward Contracts;

ii. PC was providing a service for the benefit of PCUK by entering into the Forward Contracts;

The Purchase of the Intrepid Shares

jj. On May 25, 2004, PC stated that it had hedged a significant portion of its share of the Buzzard oilfield's early production at the market's projected future oil price;

kk. On May 25, 2004, PCUK formally agreed to purchase the entire issued share capital of Intrepid and related entities for US $840,000,000;

ll. On June 18, 2004, PCUK acquired the Intrepid Shares for the amount of US $840,000,000 or GBP538,100,000 (the "purchase price") ;

mm. The purchase price was financed by a shareholder contribution from Petro-Canada UK Holdings Ltd of GBP450,000,000, an acquisition loan of GBP38,000,000 from a sister company in Germany and GBP50,000,000 from existing cash;

nn. PC conducted negotiations and discussions with the seller of the Intrepid Shares surrounding details of the share purchase;

oo. Intrepid was subsequently renamed Petro-Canada Energy North Sea Limited ("PENSL");

pp. On January 1, 2005, the Buzzard assets previously owned by Intrepid were transferred from PENSL to PCUK;

qq. Production of oil from the Buzzard oilfield began in 2007;

rr. PCUK reported the revenue from the production and sale of oil from the Buzzard oilfield;

Close-out of the Forward Contracts

ss. The Forward Contracts that matured between July 1 and December 31, 2007 were closed out as they matured at then-current per-barrel prices ranging from US $70.73 to US $92.61;

tt. The total loss on the Forward Contracts that matured between July 1 and December 31, 2007 was US $287,326,000;

uu. On October 24, 2007, the PC Board agreed to unwind all or any portion of the remaining Forward Contracts;

vv. The following strategic considerations were noted in giving the rationale for unwinding the Forward Contracts:

i. protecting project economics was no longer necessary,

ii. the company had the ability and cash to pay out the obligations,

iii. the markets (including a strong Canadian Dollar) in late 2007 were well positioned,

iv. the decision to unwind was not to be, or to be seen by the market, as a price call or bet, and,

v. the company would return to its long-term strategy of not hedging production as a rule;

ww. Between November 5, 2007 and December 11, 2007, PC entered into contracts with Deutsche Bank to close out the remaining Forward Contracts that were to run from January 1, 2008 to December 31, 2010 (the "Close-Out Contracts");

xx. The Close-Out Contracts required PC to repurchase 30,688,000 barrels of Dated Brent crude oil at an average price of approximately US $85.79 per barrel;

yy. The Close-Out Contracts resulted in PC paying US $1.72 billion;

zz. PC deducted the Loss (being $2,016,385,409) in computing its income for tax purposes in 2007 when it closed out its obligations under the Forward Contracts and the Close-Out Contracts;

aaa. PC did not allocate the Loss to PCUK;

bbb. The Forward Contracts would have resulted in a loss in excess of CA $2 billion based on a Bank of Canada average annual exchange rate of 1.59177 to 2.14865 for one Great Britain Pound in the event PC had not entered into the Close-Out Contracts;

Transaction or Series of Transactions

ccc. The following occurred to allow PCUK to acquire the Intrepid Shares and earn revenue from the production of oil from the Buzzard oilfield:

i. PC decided to engage in, and engaged in, the Forward Contracts which were designed to hedge the price risk its indirect subsidiary, PCUK, was exposed to associated with the future anticipated production of oil from the Buzzard oilfield in order to guarantee a certain level of return from the sale of oil from the Buzzard oilfield to enable an increased bid price for the Intrepid Shares;

ii. PC purchased the Intrepid Shares through an indirect subsidiary, PCUK;

iii. PCUK acquired the interest in the Buzzard oilfield from Intrepid, thereby acquiring the crude oil price risk associated with the anticipated production from the Buzzard oilfield; and

iv. PC decided to close out, and did close out, the Forward Contracts linked to PCUK's Buzzard oilfield production with no amount of reimbursement by PCUK;

Financial Reporting

ddd. The PC corporate group presents itself as one consolidated financial entity and the consolidated financial statements in the Annual Report are not segregated between subsidiaries;

eee. PC reported in its Consolidated Financial Statements for 2004, 2005, 2006 and 2007 unrealized before-tax market-to-market losses on the outstanding Forward Contracts and applied these losses against income from PC's international operations;

fff. In 2007, the PC group of companies reported the following based on a Bank of Canada average annual exchange rate of 2.14865 for one Great Britain Pound:

i. PCUK reported revenues of CA $1,750,699,465;

ii. PCUK reported profit after tax of CA $529,340,197;

iii. PCUK reported dividends paid of CA $411,467,199;

iv. Petro-Canada UK Holdings Ltd reported dividends received of CA $411,467,199;

v. Petro-Canada UK Holdings Ltd reported dividends paid of CA $411,467,199;

vi. 3908968 Canada Inc. reported dividends received of CA $402,608,543; and,

vii. 3908968 Canada Inc. reported dividends paid to PC of CA $434,691,493;

ggg. In 2008, the PC group of companies reported the following based on a Bank of Canada average annual exchange rate of 1.96167 for one Great Britain Pound:

i. PCUK reported revenues of CA $2,755,136,717;

ii. PCUK reported profit after tax of CA $1,006,661,860;

iii. PCUK reported dividends paid of CA $1,177,001,430;

iv. Petro-Canada UK Holdings Ltd reported dividends received of CA $1,177,001,430;

v. Petro-Canada UK Holdings Ltd reported dividends paid of CA $1,177,001,430;

vi. 3908968 Canada Inc. reported dividends received of CA $1,201,580,788; and,

vii. 3908968 Canada Inc. reported dividends paid to PC of CA $1,201,704,377;

hhh. In 2009, the PC group of companies reported the following based on a Bank of Canada average annual exchange rate of 1.78036 for one Great Britain Pound:

i. PCUK reported revenues of CA $1,752,259,985;

ii. PCUK reported profit after tax of CA $514,862,868;

iii. PCUK reported dividends paid of CA $676,001,090;

iv. Petro-Canada UK Holdings Ltd reported dividends received of CA $676,001,090;

v. Petro-Canada UK Holdings Ltd reported dividends paid of CA $674,754,841;

vi. 3908968 Canada Inc. reported dividends received of CA $675,526,060; and,

vii. 3908968 Canada Inc. reported dividends paid to PC of CA $318,220,989;

iii. In 2010, the PC group of companies reported the following based on a Bank of Canada average annual exchange rate of 1.59177 for one Great Britain Pound:

i. PCUK reported revenues of CA $2,007,101,147;

ii. PCUK reported profit after tax of CA $790,848,699;

iii. PCUK reported dividends paid of CA $432,483,942;

iv. Petro-Canada UK Holdings Ltd reported dividends received of CA $432,483,942;

v. Petro-Canada UK Holdings Ltd reported dividends paid of CA $432,961,473; and,

vi. 3908968 Canada Inc. reported dividends received of CA $623,917,184.

Terms and Conditions not arm's length

jjj. The terms and conditions made or imposed between PC and PCUK with respect to the purchase of the Intrepid Shares, the hedging strategy and the Forward Contracts differed from the terms and conditions which would have been made or imposed had those parties been dealing at arm's length; and

kkk. At arm's length, PC would have allocated the hedging gains to PCUK and PCUK would have reimbursed PC for the hedging losses.

36. In determining that the Appellant was liable to a transfer pricing penalty pursuant to subsection 247(3) of the *Income Tax Act*, the Minister relied on the following facts:

a. The assumptions of fact listed in paragraph 35 above;

b. PC did not make reasonable efforts to determine arm's length transfer prices between itself and PCUK in respect of the closing out of the Forward Contracts by PC;

c. For the purposes of subsection 247(4) of the Act, the "documentation-due" date in respect of PC's 2007 taxation year was June 30, 2008;

d. PC did not make or obtain, by June 30, 2008, records or documents that provide a description that is complete and accurate in all material respects of:

i. the property or service to which the transaction relates in that it did not describe or address the Forward Contracts' linkage to the purchase of the Intrepid Shares and PCUK's anticipated production from the Buzzard oilfield;

ii. the terms and conditions of the transaction in that it did not address the involvement of PCUK;

iii. the identity of the participants in the transaction and their relationship to each other in that in that it did not recognize PCUK as a participant;

iv. the functions performed, the property used and the risks assumed by the participants in that it did not recognize PCUK as a participant and did not describe any functions, assets or risks of PCUK;

v. the data and methods considered in that it did not provide any analysis to determine an allocation of the results of the Forward Contracts to PCUK; and

vi. the assumptions, strategies and policies considered in the determination of the transfer price in that it did not indicate that it considered allocating the hedging loss to PCUK;

e. On September 28, 2012, the Minister served PC, by hand, with a written request for production of contemporaneous documentation to support the transfer prices between itself and its related non-residents in its 2007 taxation year;

f. PC did not provide records or documents, within 3 months of service of the Minister's request that was complete and accurate in all material respects of:

i. the property or service to which the transaction relates in that it did not describe or address the Forward Contracts' linkage to the purchase of the Intrepid Shares and PCUK's anticipated production from the Buzzard oilfield;

ii. the terms and conditions of the transaction in that it did not describe the Forward Contracts and their relationship to PCUK;

iii. the identity of the participants in the transaction and their relationship to each other in that PCUK was not identified as a participant;

iv. the functions performed, the property used and the risks assumed by the participants in that it did not describe the price risk assumed in PCUK's oil production and PCUK's relationship with the Forward Contracts;

v. the data and methods considered in that no analysis was performed to determine an allocation of the results of the Forward Contracts to PCUK, and

vi. the assumptions, strategies and policies considered in the determination of the transfer price in that it provided no assumptions, strategies or policies that influenced the non-allocation of the results of the Forward Contracts to PCUK;

g. The closing out of the Forward Contracts in 2007 was a material change;

h. For purposes of subsection 247(3) of the Act, PC's "transfer pricing income adjustment" in the 2007 taxation year was $2,016,385,409; and

i. PC's gross revenue in the 2007 taxation year was $16,492,741,000.

B. ISSUES TO BE DECIDED

37. The issues in Issue 1 of the Notice of Appeal are whether:

a. The Minister correctly applied paragraphs 247(2)(a) and (c) of the Act to adjust PC's income by the amount of $2,016,385,409; and,

b. PC is liable to a penalty pursuant to subsection 247(3) of the Act in respect of the transfer pricing adjustment in its 2007 taxation year.

C. STATUTORY PROVISIONS RELIED ON

38. He relies on sections 9, 247 and 248 and subsection 169(2.1) of the Act.

D. GROUNDS RELIED ON AND RELIEF SOUGHT

39. He respectfully submits that, where the terms and conditions in respect of the transactions or series of transactions undertaken by PC and a non-arm's length non-resident person differ from those that would have been made or imposed between persons dealing at arm's length, paragraphs 247(2) (a) and (c) of the Act requires any amounts determined for the purposes of the Act in respect of PC to be adjusted to the quantum or nature of the amounts that would have been determined if those terms and conditions had been those that would have been made between persons dealing at arm's length.

40. The Minister properly determined that PC and PCUK, a non-arm's length non-resident person, were participants in a transaction or series of transactions and applied subsection 247(2) of the Act.

41. A transaction for purposes of section 247 includes an arrangement or event. The transaction or series of transactions in which PC and PCUK participated included:

    a. PC decided to engage in, and did engage in, the Forward Contracts which were designed to hedge the price risk its indirect subsidiary, PCUK, was exposed to associated with the future anticipated production of oil from the Buzzard oilfield in order to guarantee a certain level of return from the sale of oil from the Buzzard oilfield to enable an increased bid price for the Intrepid Shares;

    b. PC purchased the Intrepid Shares through an indirect subsidiary, PCUK;

    c. PCUK acquired the interest in the Buzzard oilfield from Intrepid, thereby acquiring the crude oil price risk associated with the anticipated production from the Buzzard oilfield; and,

d. PC decided to close out, and did close out, the Forward Contracts linked to PCUK's Buzzard oilfield production with no amount of reimbursement by PCUK;

42. The terms and conditions made or imposed between PC and PCUK with respect to the purchase of the Intrepid Shares, the hedging strategy and the Forward Contracts differed from the terms and conditions which would have been made or imposed had those parties been dealing at arm's length.

43. At arm's length, PC would have allocated the hedging gains to PCUK and PCUK would have reimbursed PC for the hedging losses in the amount of $2,016,385,409.

44. He also submits that PC is liable to a penalty pursuant to subsection 247(3) of the Act because PC's transfer pricing adjustment for the 2007 taxation year exceeds the lesser of 10% of its gross revenues and $5,000,000 and PC did not make reasonable efforts to determine arm's length transfer prices between itself and PCUK in respect of the closing out of the Forward Contracts. Further, subsection 247(4) of the Act deems PC not to have made reasonable efforts to do so as:

a. PC did not make reasonable efforts to make or obtain the records and documentation required to be made or obtained by subsection 247(4)(a) of the Act;

b. PC failed to make or obtain on or before the time period described in paragraph 247(4)(b) records or documents that completely or accurately described the material change in 2007; and

c. PC failed to provide the Minister with the requested records and documentation within the time limited by paragraph 247(4)(c) for doing so.

He requests that the appeal, in respect of Issue 1, be dismissed with costs.

ISSUE 2: ASSET RETIREMENT OBLIGATION

45. He accepts that the reassessment of the Appellant's 2007 taxation year, in respect of the asset retirement obligation, be referred back to the Minister for redetermination to remove the inclusion of $9,039,935 in respect of the asset retirement obligation from the proceeds of disposition and correspondingly increase PC's cumulative Canadian oil and gas property expense ("COGPE") balance by $9,039,935.

ISSUE 3: THE LONG LEAD ITEM EXPENDITURES

E. STATEMENT OF FACTS

46. He admits the allegations of fact stated in paragraphs 80 and 81 of the Notice of Appeal.

47. He has no knowledge and puts in issue the allegations of fact in paragraph 83 of the Notice of Appeal.

48. With respect to paragraph 82 of the Notice of Appeal,

    a. he denies that the White Rose project procured items and, for greater certainty, he states that if any items were procured, it is the operator of the White Rose project ("the White Rose Project Operator") that would procure such items;

    b. he denies that certain items such as well casing, if procured, were used in drilling or completing an oil and gas well in the 2007 taxation year;

    c. he denies that certain other items such as well head and production tubing, if procured, were used in production of oil and gas from a well in the 2007 taxation year; and

d. he has no knowledge of and puts in issue the remaining allegations of fact in that paragraph.

49. With respect to paragraph 84 of the Notice of Appeal, he admits the allegations of fact in that paragraph but, for greater certainty, he also states that the costs are moved to specific well authorizations for expenditure as the equipment is moved to the offshore drilling sites in drilling or equipping the well.

50. With respect to paragraph 85 of the Notice of Appeal, he admits only that the items were capital in nature and he denies the remaining allegations of fact in that paragraph and, for greater certainty, he states that inventory is items that, if procured in 2007, were for future drilling, completion or equipping operations.

51. With respect to paragraph 86 of the Notice of Appeal, he admits the allegations of fact in that paragraph but for greater certainty he denies that PC's classification was correct.

52. With respect to paragraph 87 of the Notice of Appeal,

a. he admits that the Minister removed expenditures of $9,164,830 that PC classified as Canadian development expense ("CDE"), as these alleged expenditures were not CDE;

b. he admits that the Minister removed a credit amount of $634,840 from the calculation of undepreciated capital cost allowance of Class 41 on the basis that the property to which this cost related was not available for use in the 2007 taxation year; and

c. he denies the remaining allegations of fact in that paragraph.

53. In filing its tax return for the 2007 taxation year, PC

a. classified expenditures of $9,164,828 as CDE; and

b. included a credit amount of $634,840 in its calculation of undepreciated capital cost allowance of Class 41.

54. In reassessing the Appellant's 2007 taxation year, the Minister:

a. removed alleged expenditures of $9,164,828 that PC classified as CDE, on the basis that the expenditures were not CDE; and

b. determined the credit of $634,840 was in respect of the cost of property that was not available for use and removed it, pursuant to subsection 13(26) of the Act, from the Class 41 calculation of undepreciated capital cost defined in subsection 13(21) of the Act.

55. In determining the Appellant's tax liability for the 2007 taxation year, in respect of Issue 3, the Minister made the following assumptions of fact:

a. the White Rose Oil Project is a joint venture to develop the White Rose Oil Field located in the Jeanne d'Arc Basin, approximately 350 kilometres east of St. John's Newfoundland;

b. the ownership of the White Rose Oil Project, as of December 31, 2007, consisted of:

Husky Oil Operations Limited (White Rose Project Operator) - 72.5%
PC - 27.5%

c. during its fiscal period ending December 31, 2007, the White Rose Oil Project Operator claimed it incurred certain expenditures, of which PC's share was $9,164,828;

d. the expenditures were for items including well heads, well casing and production tubing and other items;

e. part of the expenditures were for certain items that were not used or put in use as of December 31, 2007 and part of the expenditures were for certain

items that were not incurred in drilling a well during the 2007 taxation year;

f. the expenditures were for certain items being stored to be used at a later time;

g. the expenditures that would otherwise be included in Class 41 as gas or oil well equipment were not used or available for use as of December 31, 2007 as they were not connected to or installed in a producing well as of December 31, 2007;

h. the expenditures that would otherwise be included in Class 41 as gas or oil well equipment were not included by PC on a prescribed form within 12 months of the filing date for its tax return, when those items were available for use; and

i. in 2009, PC and the Appellant merged and carried on under the name of the Appellant.

F. ISSUES TO BE DECIDED

56. The issues are:

a. whether the Minister correctly determined that the expenditures of $9,164,828 classified by PC in its 2007 taxation year were not CDE;

b. further, what amount of the expenditures of $9,164,828 were, in fact, incurred in the 2007 taxation year; and

c. whether the Minister correctly determined that the credit of $634,840 was in respect of the cost of property that was not available for use.

G. STATUTORY PROVISIONS RELIED ON

57. He relies on subsections 13(21), 13(26), 13(27), 66.2(5) and 152(9) of the Act and section 1104(2) and Class 41 of Schedule II of the *Income Tax Regulations*, C.R.C., c. 945.

H. GROUNDS RELIED ON AND RELIEF SOUGHT

58. He respectfully submits that the expenditures, to the extent that they were incurred in 2007, do not qualify as CDE in the 2007 taxation year pursuant to the definition of CDE in subsection 66.2(5) of the Act.

59. To the extent that any of the incurred expenditures are "gas and oil well equipment" to be Class 41 additions, they were not available for use at the end of the 2007 taxation year pursuant to subsection 13(26) of the Act.

60. He requests that the appeal with respect to Issue 3 be dismissed with costs.

ISSUE 4: GLORY HOLE EXPENDITURES

G. STATEMENT OF FACTS

61. He admits the allegations of fact stated in paragraphs 95, 96, 99 and 103 of the Notice of Appeal.

62. With respect to paragraph 97 of the Notice of Appeal, he admits that in the 2007 taxation year, the White Rose Oil Project Operator incurred certain expenditures in respect of a glory hole, but he denies the remaining allegations of fact.

63. With respect to paragraphs 98 and 100 of the Notice of Appeal, he admits that the allegations in those paragraphs provide a general description of a glory hole, but he denies that the allegations in those paragraphs fully describe a glory hole, and he further states that the purpose of a glory hole is to protect the wellheads of

producing wells from the potential damage from iceberg scouring thereby preventing oil spill and to protect the environment.

64. With respect to paragraph 101 of the Notice of Appeal, he admits the allegations of fact in that paragraph, but for greater certainty he denies that PC's classification is correct.

65. With respect of paragraph 102 of the Notice of Appeal,

a. he admits that the allegations of fact in that paragraph describe part of the basis for the Minister's reassessment but he states that the complete basis for the Minister's reassessment is set out in paragraph 68 below; and

b. for greater certainty, he also states that the Minister reclassified the expenditures from CDE because the expenditures were not CDE.

66. In it tax return for the 2007 taxation year, PC claimed an amount of $8,624,764 as CDE relating to the glory hole of the White Rose Project (the "Glory Hole Outlays or Expenses").

67. In reassessing the Appellant's 2007 taxation year, the Minister determined that the Glory Hole Outlays or Expenses claimed by PC were not CDE but were Class 41 additions respecting wellheads which were not available for use.

68. In determining the Appellant's tax liability for the 2007 taxation year, in respect of Issue 4, the Minister made the following assumptions of fact:

a. the White Rose Oil Project is a joint venture to develop the White Rose Oil Field located in the Jeanne d'Arc Basin, approximately 350 kilometres east of St. John's Newfoundland;

b. the ownership of the White Rose Oil Project, as of December 31, 2007, consisted of:

Husky Oil Operations Limited (White Rose Project Operator) - 72.5%
PC - 27.5%

c. during its fiscal period ending December 31, 2007, the White Rose Oil Project Operator made or incurred outlays or expenses for excavating a glory hole;

d. the Glory Hole Outlays or Expenses attributed to PC, based on its 27.5% interest in the White Rose Oil Project, were $8,624,764;

e. the purpose of excavating a glory hole is to protect wellhead equipment on the ocean floor from damage from iceberg scouring;

f. the Glory Hole Outlays or Expenses were not costs of preparing a site in respect of a well;

g. the Glory Hole Outlays or Expenses were a Class 41 addition but not available for use;

h. the wellhead equipment was not installed during the 2007 taxation year and the Glory Hole Outlays or Expenses were not available for use as of December 31, 2007;

i. the Glory Hole Outlays or Expenses were not included by PC on a prescribed form within 12 months of the filing date for its tax return, when those items were available for use; and

j. in 2009, PC and the Appellant merged and carried on under the name of the Appellant.

69. He also relies on the additional following facts:

a. The outlays and expenses of excavating glory holes are for the purpose of protecting the wellheads of producing wells from the potential damage

from iceberg scouring thereby preventing spill and protecting the environment;

b. The White Rose Project Operator was required to excavate glory holes as part of an environmental protection strategy which was required in order to obtain regulatory approval for the White Rose Project; and

c. No site preparation is required in drilling an offshore well.

H. ISSUES TO BE DECIDED

70. The issue is whether or not, in the 2007 taxation year, all or any part of the Glory Hole Outlays or Expenses classified by PC as CDE meet the definition of CDE, or whether they are Eligible Capital Expenditures ("ECE") or, in the alternative, Class 41 additions but not available for use.

71. To the extent that the Glory Hole Outlays or Expenses are part of Class 41 property and available for use, the issue also arises as to whether the Appellant is entitled to investment tax credit ("ITCs") in respect of those outlays or expenses.

I. STATUTORY PROVISIONS RELIED ON

72. He relies on subsections 13(21), 13(26), 13(27), 14(5), 66.2(5), 152(9) and 220(2.2) and paragraph 20(1)(b) and the definition of "investment tax credit" in subsection 127(9) of the Act and section 1104(2) and Class 41 of Schedule II of the *Income Tax Regulations*, C.R.C., c. 945.

J. GROUNDS RELIED ON AND RELIEF SOUGHT

73. The Glory Hole Outlays or Expenses are not incurred in preparing a site in respect of a well.

74. Outlays and expenses of excavating glory holes are for the purpose of protecting the wellheads of producing wells from the potential damage from iceberg scouring thereby preventing spill and protecting the environment.

75. The Glory Hole Outlays or Expenses are ECE pursuant to the definition of subsection 14(5) of the Act.

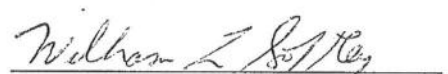
76. In the alternative, the Glory Hole Outlays or Expenses are Class 41 additions. However, the Glory Hole Outlays or Expenses were not available for use during the 2007 taxation year, since the well head equipment was not installed in 2007 and do not meet the available for use rules in subsection 13(26).

77. Also, if any of the Glory Hole Outlays or Expenses are Class 41 additions, those outlays or expenses do not qualify for investment tax credits. In order to claim investment tax credits, the definition of "investment tax credit" in paragraph (m) of subsection 127(9) of the Act requires that a "prescribed form" be filed with the Minister "on or before the day that is one year after the taxpayer's filing due date for the past year". PC did not, at any time, file the prescribed form in respect of any of the Glory Hole Outlays or Expenses. As a result, the Appellant is not entitled to claim investment tax credits in respect of the Glory Hole Outlays or Expenses.

He requests that the appeal, in respect of Issue 4, be dismissed with costs.

DATED at the City of Edmonton, in the Province of Alberta, this 13th day of April, 2015.

William F. Pentney, Q.C.
Deputy Attorney General of Canada
Solicitor for the Respondent

Per: 
William L. Softley/Carla Lamash/Wendy Bridges
Counsel for the Respondent

Department of Justice Canada
Prairie Region
EPCOR Tower
300, 10423 – 101 Street
Edmonton, Alberta
T5H 0E7

Telephone: (780) 495-8351
Facsimile: (780) 495-3319

TO: Tax Court of Canada
200 Kent Street
4th Floor
Ottawa, Ontario
K1A 0M1

TO: Al Meghji / Edward Rowe
Osler, Hoskin & Harcourt LLP
Barristers & Solicitors
Suite 2500
TransCanada Tower
450 - 1st Street SW
Calgary, Alberta
T2P 5H1

FM3280284

Court File No. 2014-4179(IT)G

TAX COURT OF CANADA

BETWEEN:

SUNCOR ENERGY INC.
(AS SUCCESSOR TO PETRO-CANADA)

Appellant

and

HER MAJESTY THE QUEEN

Respondent

ANSWER

---

1. In Answer to the Reply of the Respondent dated April 13, 2015 (the "**Reply**"), the Appellant denies the allegations of fact set out therein, except as specifically admitted hereinafter for the purposes of this Appeal. References herein are to the paragraphs of the Reply, headings used in the Reply are used herein for convenience only, and capitalized terms have the meaning ascribed to them in the Reply.

Issue 1: Transfer Pricing Adjustment and Penalties

2. The Appellant admits the facts stated in paragraph 8 of the Reply, but states for greater certainty that it is common ground between the Appellant and the Respondent that the portion of the equity or share capital referenced in the December 3, 2003 information memorandum that is relevant to this Appeal is the Intrepid Shares, as set out in the Minister's assumption in paragraph 35(h) of the Reply, and pleaded by the Respondent in paragraph 10(a) of the Reply.

3. The Appellant admits paragraph 10(a) of the Reply and accepts the definition of "Intrepid Shares" therein and states for greater certainty that immediately before the acquisition, Intrepid Energy North Sea (Holding) Limited owned the entire share capital of Intrepid Energy North Sea Limited.

4. The Appellant admits the details of the Petro-Canada board authorization on March 30, 2004 set out in subparagraphs 15(a), (b) and (c) of the Reply but states for greater certainty that the fixed price swap on dated Brent crude referred to in subparagraph 15(c) was at all times contemplated to be undertaken by Petro-Canada on its own account.

5. The Appellant admits the further details set out for greater certainty in paragraph 23 of the Reply about the Petro-Canada board authorization on October 24, 2007.

6. With respect to paragraph 24 of the Reply, the Appellant states that the allegations of fact which the Respondent claims no knowledge of, and puts in issue, therein were accepted as accurate and were facts assumed by the Minister as set out in paragraphs 35(ww)-(yy) of the Reply.

7. With respect to paragraph 32 of the Reply, the Appellant admits that PC claimed a loss of $2,016,385,409, but says that the characterization of the loss as hedging losses calls for a legal conclusion and is not a proper allegation of fact. The Appellant states that the Appellant's reporting of the 2007 Loss is more specifically pleaded in paragraph 38 of the Notice of Appeal and admitted in paragraph 4 of the Reply.

8. The Appellant admits paragraph 33 of the Reply and for clarity, states that the Appellant carries on business under the name of Suncor Energy Inc. and states that the particulars of the amalgamation involving the Appellant in 2009 is more specifically pleaded in paragraph 3 of the Notice of Appeal and admitted in paragraph 2 of the Reply.

9. With respect to paragraph 34, the Appellant admits that by notice dated June 17, 2014, the Minister reassessed the Appellant and that the basis of the Minister's

reassessment, and the provisions of the Act relied upon by the Minister in making such reassessment, are accurately described therein. However, the Appellant denies that such provisions are applicable or give rise to the tax consequences asserted by the Minister and described therein.

10. The Appellant states the following with respect to the allegations of fact contained in paragraph 35 of the Reply:

Corporate Structure

(a) The Appellant admits that the Minister made the assumptions described in subparagraphs 35(a), (b), (c), (d), (e) of the Reply but for greater certainty states that for the purposes of this appeal the facts relevant to these assumptions are more precisely described in paragraphs 3, 4, 11(b), (d) and (e) of the Notice of Appeal, which are admitted in paragraphs 2 and 7 of the Reply and are not at issue.

PCUK's Bid for Intrepid

(b) The Appellant admits that the Minister made the assumption described in subparagraph 35(f) but states for greater certainty that in announcing the intended sale Intrepid Energy North Sea (Holdings) Limited was speaking for itself and the other holders of the Intrepid Shares.

(c) The Appellant admits that the Minister made the assumption described in, and admits the accuracy of the allegations of fact described in, subparagraph 35(g) of the Reply.

(d) The Appellant admits that the Minister made the assumptions described in subparagraph 35(h) of the Reply and admits the accuracy of clause 35(h)(ii), and with respect to clause 35(h)(i), admits that bids for the Intrepid Shares offered for sale were to be made on the basis of the information in the Memorandum but states that such bids were to be indicative but non-binding.

(e) The Appellant admits that the Minister made the assumption described in, and admits the accuracy of the allegations of fact described in, subparagraph 35(i), (j), (k), (l) and (m) of the Reply.

The Hedging Strategy

(f) With respect to subparagraph 35(n) of the Reply, the Appellant admits that a presentation was made to the PC Board on March 4, 2004, but states that such presentation was only a part of the "internal analysis" described by the Minister in the Proposal Letters, and relied upon by the Minister in determining PC's tax liability for the 2007 year.

(g) With respect to subparagraphs 35(n), (o), (p), (q), (r) of the Reply, the Appellant denies:

i. that the internal analysis presented to the PC Board on March 4, 2004 contained the statements alleged therein;

ii. that the Minister made the assumptions alleged therein; and

iii. the accuracy of the allegations of fact described therein.

(h) The Appellant admits that the Minister made the assumption described in, and admits the accuracy of the allegations of fact described in, subparagraphs 35(s) and (t) of the Reply.

(i) The Appellant denies that the Minister made the assumptions described in, and denies the accuracy of the allegations of fact described in, subparagraphs 35(u) and (v) of the Reply.

(j) The Appellant admits that the Minister made the assumptions described in subparagraph 35(w) of the Reply but states that the 2004 Annual Report speaks for itself.

The Offer

(k) The Appellant admits that the Minister made the assumptions described in subparagraphs 35(x) and (y) of the Reply, but states that the particulars of

the offers described therein are accurately described in paragraph 14 of the Notice of Appeal.

(l) The Appellant admits that the Minister made the assumptions described in subparagraph 35(z) of the Reply and admits that PC's offer was accepted in principle with some modifications on April 22, 2004 but states that such acceptance was subject to the negotiation of Share Purchase Agreements with the vendors of the Intrepid Shares.

The Forward Contracts

(m) The Appellant admits that the Minister made the assumptions described in subparagraphs 35(aa), (bb), (cc) and (dd) of the Reply but for greater certainty states that for the purposes of this appeal the facts relevant to these assumptions are more precisely described in paragraphs 22 and 23(a) and (b) of the Notice of Appeal, which are admitted in paragraphs 4 and 16 of the Reply and are not at issue.

(n) The Appellant admits that the Minister made the assumptions described in subparagraph 35(ee) of the Reply but denies the accuracy thereof.

(o) The Appellant admits that the Minister made the assumptions described in, and admits the accuracy of the allegations of fact described in, subparagraphs 35(ff) and (gg) of the Reply.

(p) The Appellant denies that the Minister made the assumptions described in, and denies the accuracy of the allegations of fact described in, subparagraphs 35(hh) and (ii) of the Reply.

The Purchase of the Intrepid Shares

(q) The Appellant admits that the Minister made the assumptions described in subparagraph 35(jj) of the Reply but denies the allegations of fact set out in that subparagraph and states that Petro-Canada issued a news release on

May 25, 2004 with respect to the acquisition of the Intrepid Shares which speaks for itself.

(r) The Appellant admits that the Minister made the assumptions described in subparagraph 35(kk) of the Reply but denies the allegations of fact contained in that subparagraph and states that on May 25, 2004, PCUK entered into the following agreements:

i. Share Sale and Purchase Agreement for the sale and purchase of the entire issued share capital of Intrepid Energy North Sea Limited (the "**IENSL Agreement**")

ii. Share Sale and Purchase Agreement for the sale and purchase of the entire issued share capital of Intrepid Energy Limited (the "**IEL Agreement**"); and

iii. Membership Interest Sale and Purchase Agreement for the sale and purchase of all of the membership interests of Intrepid Energy (UK) L.L.C. (the "**LLC Agreement**").

(s) The Appellant admits that the Minister made the assumptions described in, and admits the accuracy of the allegations of fact described in, subparagraph 35(ll) of the Reply.

(t) The Appellant admits that the Minister made the assumptions described in, and admits the accuracy of the allegations of fact described in, subparagraph 35(mm) of the Reply.

(u) The Appellant denies that the Minister made the assumptions described in, and denies the accuracy of the allegations of fact described in, subparagraph 35(nn) of the Reply. The Appellant admits that the Minister made the assumptions described in, and admits the accuracy of, the allegations of fact described in subparagraph 35(oo) of the Reply.

(v) The Appellant admits that the Minister made the assumptions described in subparagraph 35(pp) of the Reply and, with respect to the allegations of fact therein, admits only that on January 1, 2005, the Buzzard assets previously owned by IENSL (renamed PENSL) were transferred to PCUK.

(w) The Appellant admits that the Minister made the assumptions described in, and admits the accuracy of the allegations of fact described in, subparagraphs 35(qq) and (rr) of the Reply, and for greater certainty, states that production income from crude oil from the Buzzard Assets was earned by PCUK, as described in paragraph 30 of the Notice of Appeal, which was admitted by the Respondent in paragraph 4 of the Reply and is not at issue.

Close-out of the Forward Contracts

(x) The Appellant admits that the Minister made the assumptions described in, and admits the accuracy of the allegations of fact described in, subparagraphs 35(ss), (tt), (uu), (ww), (yy), (xx), (zz) and (aaa) of the Reply.

(y) The Appellant admits that the Minister made the assumptions described in subparagraph 35(vv) of the Reply, but states that the Minister's description of the rationale for unwinding the Forward Contracts outlined therein is not complete, precise and accurate.

Transaction or Series of Transactions

(z) The Appellant denies that the Minister made the assumptions described in, and the accuracy of the allegations of fact described in, subparagraph 35(ccc).

Financial Reporting

(aa) The Appellant admits that the Minister made the assumptions described in, and admits the accuracy of the allegations of fact described in, subparagraphs 35(ddd) and (eee) of the Reply.

(bb) The Appellant admits that the Minister made the assumptions described in subparagraph 35(fff), (ggg), (hhh) and (iii) of the Reply and with respect to the accuracy of the facts alleged:

i. the Appellant admits the facts alleged in clauses 35(fff)(i), (ii), (iii), (iv), (v) and (vii);

ii. with respect to clause 35(fff)(vi), the Appellant states that 3908968 Canada Inc. reported dividends received of CAD $434,738,593;

iii. the Appellant admits the facts alleged in clauses 35(ggg)(i), (ii), (iii), (iv), (v) and (vii);

iv. with respect to clause 35(ggg)(vi), the Appellant states that 3908968 Canada Inc. reported dividends received of CAD $1,201,704,704;

v. the Appellant admits the facts alleged in clauses 35(hhh)(i), (ii), (iv), (v) and (vii);

vi. with respect to clause 35(hhh)(iii), the Appellant states that PCUK reported dividends paid of CAD $674,756,400;

vii. with respect to clause 35(hhh)(vi), the Appellant states that 3908968 Canada Inc. reported dividends received of CAD $767,758,104

viii. the Appellant admits the facts alleged in clauses 35(iii)(i), (ii), (iii), (iv) and (v);

ix. with respect to clause 35(iii)(vi), the Appellant states that 3908968 Canada Inc. reported dividends received of CAD $430,914,142;

and for clarification purposes, the Appellant states that the conversion from GB Pounds to Canadian dollars was undertaken by the Minister, where applicable, and not by the Appellant.

Terms and Conditions

(cc) With respect to paragraphs 35(jjj) and (kkk) of the Reply, the statements are not proper assumptions of fact, are argumentative in nature, call for a legal conclusion and to the extent of any allegations of fact therein, the Appellant denies such allegations.

11. The Appellant denies that the allegations contained at paragraphs 35 and 36 of the Reply are a complete pleading of the factual findings and assumptions of fact made by the Minister in determining the Appellant's tax liability for the 2007 taxation year.

12. The Minister made the following findings and assumptions of fact, among others, that are not pleaded in the Reply:

(a) The Appellant has no direct ownership, either legal or beneficial, in the Buzzard assets previously owned by IENSL which were transferred to PCUK on January 1, 2005 (the "**Buzzard Assets**");

(b) PCUK had no direct ownership, either legal or beneficial, in the Buzzard assets owned by IENSL at the time that PC entered into the Forward Contracts;

(c) At all material times, the Appellant had no right to income, profits or gains, if any, arising from the Buzzard Assets;

(d) PCUK was not a party to the Forward Contracts and had no interest in, or obligations in respect of, the Forward Contracts and the payments made thereunder;

(e) PCUK and PC did not enter into any other agreement or arrangement in respect of the Forward Contracts or the payments made thereunder; and

(f) There was no agency relationship between PCUK and PC.

13. The Appellant admits subparagraphs 36(e) and (i) of the Reply.

14. This Answer is dated at the City of Calgary, in the Province of Alberta, this 10th day of July, 2015.

OSLER, HOSKIN & HARCOURT LLP
Counsel for the Appellant

for:

Al Meghji / Edward Rowe

Osler, Hoskin & Harcourt LLP
Barristers and Solicitors
Suite 2500
TransCanada Tower
450 - 1st St. S.W.
Calgary AB T2P 5H1

Telephone: 416-862-5677 / 403-260-7033
Facsimile: 416-862-6666 / 403-260-7024

Court File No.: 2014-4179(IT)G

TAX COURT OF CANADA

BETWEEN:

SUNCOR ENERGY INC.
(AS SUCCESSOR TO PETRO-CANADA)

Appellant

TAX COURT OF CANADA
COUR CANADIENNE DE L'IMPÔT
FILED / DÉPOSÉ
JUL 10 2015
Hazel Buchanan
REGISTRY OFFICER / AGENT DES GREFFES
CALGARY

– and –

HER MAJESTY THE QUEEN

Respondent

AFFIDAVIT OF SERVICE

I, JO-ANNE DE LA RONDE, of the City of Calgary, in the Province of Alberta, Legal Assistant at Osler, Hoskin and Harcourt LLP, SWEAR THAT:

1. I did serve the Respondent with the Appellant's Answer to the Respondent's Reply by sending a copy by fax on July 10, 2015 to William Softley, Solicitor for the Respondent at 1.780.495.3319.

SWORN BEFORE ME at the City of Calgary in the Province of Alberta, this 10th day of July 2015.

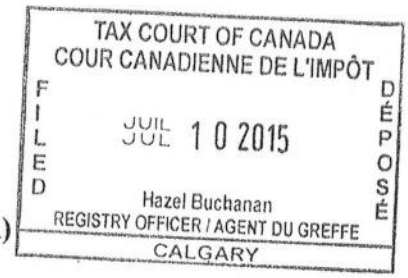
David A. Bach
Student-at-Law

A Commissioner for Oaths in and for the Province of Alberta.

Jo-Anne de la Ronde

Court File No.: 2014-4179(IT)G

TAX COURT OF CANADA



BETWEEN:

SUNCOR ENERGY INC.
(AS SUCCESSOR TO PETRO-CANADA)

Appellant

– and –

HER MAJESTY THE QUEEN

Respondent

CONSENT

The Respondent consents pursuant to Rule 12(3) of the *Tax Court of Canada Rules (General Procedure)* to an extension of time to serve and file the Answer until July 10, 2015.

DATED at the City of Edmonton, in the Province of Alberta this 8 day of July, 2015

William L. Softley
Counsel for the Respondent