Date: 20080923

Docket: T-107-07

Citation: 2008 FC 1074

Ottawa, Ontario, September 23, 2008

PRESENT: The Honourable Madam Justice Simpson

BETWEEN:

DR. DONALD G. MACKAY

Applicant

and

FEDERAL MINISTER OF REVENUE

Respondent

REASONS FOR JUDGMENT AND JUDGMENT

[1] The self-represented applicant, Dr. Donald G. MacKay (the Applicant) seeks Judicial Review pursuant to section 18.1 of the *Federal Courts Act*, R.S.C. 1985, c. F-7 of a decision by the Minister of National Revenue (the Minister) made December 13, 2006 (the Decision) denying his request for fairness relief under subsection 220(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act).

[2] In his application for judicial review, the Applicant sought:

1. An Order cancelling interest and penalties on his tax account from 1997 to the current date;

2. An Order reducing his taxes owing for 1998 by 50%; and

3. Costs.

[3] However, at the hearing it became clear that the relief Dr. MacKay actually seeks is more limited. He would be satisfied with relief from the interest which has accumulated on his income tax arrears in respect of his 1997 and 1998 taxation years.

BACKGROUND

[4] The background is comprehensibly described in a decision by Justice Mogan of the Tax Court of Canada of October 30, 2002. In *Donald G. MacKay (Appellant) v. Her Majesty the Queen (Respondent)*, 2003 DTC 748. There Justice Mogan said:

> [1] At all relevant times, the Appellant was a shareholder in 426783 Ontario Limited ('the Company'). The three taxation years under appeal are 1994, 1995 and 1996. In those years, the Appellant loaned to the Company the amounts of $121,138, $120,839 and $127,614, respectively. When reporting his income for those years, the Appellant reported the loans as business investment losses, and he deducted an allowable business investment loss in each year with respect to those amounts. In the reassessments under appeal, the Minister of National Revenue disallowed the deduction of the allowable business investment losses. The Appellant has appealed from those reassessments. The primary issue before the Court is whether the above amounts may be regarded as business investment losses.
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> [2] The Appellant was born and raised in Port Elgin, Ontario, a small town near Southampton on Lake Huron. He graduated from dentistry in 1976 and went back to Port Elgin to practice dentistry. He and his wife became involved in the affairs of the town. His wife was on the town council and, in 1981 he (either alone or with others) purchased a medical building. Around 1983, he and a

friend, Donald McCulloch, assembled a group of people to build a sports facility which would have primarily squash courts and racquetball courts. They assembled 21 investors who became shareholders of the Company. The Appellant and Donald McCulloch were each 25% shareholders and the 19 other individuals collectively owned the remaining 50% of the shares.

[3] In 1983, the shareholders paid $400,000 for preference shares of the Company. The Company used this subscribed capital and some borrowed money to build the sports facility. It was completed in 1983 or 1984 at a cost of approximately $900,000. The facility consisted of two squash courts, three racquetball courts, a large weight room, a daycare centre for the members, a restaurant of 90 seats and a banquet hall of 300 seats. The sports facility was owned by the Company but operated under the name Lakeshore Racquet and Recreation Centre (referred to hereafter as 'LR&R').

[4] When LR&R was running at peak, it would require a staff of 40 people, but many of them would have been part-time employees. According to the Appellant's evidence, there were about 15 full-time employees. The LR&R had an advantage in the sense that there were no other racquetball facilities in the Town of Port Elgin. The Company was in some financial difficulty from the time it opened in 1983 or 1984 until 1990 because there were operating losses each year in the range of $20,000. The Appellant regarded those losses as manageable.

[5] In order to put the Company on a better financial footing, the original shareholders agreed in 1989 to put another $400,000 into the Company for fresh shares and to use the fresh capital to pay off the bank and get rid of a very onerous loan. At that point in time, they had collectively invested about $800,000 in the Company. As stated, the two significant shareholders were the Appellant and Mr. McCulloch each with 25% of the shares.

[6] In 1990, the Company hired a new manager with the expectation that the losses could be turned around. There was a significant external event which happened in 1990 having a direct effect on the economy of Port Elgin and also on the Company. A new government was elected in Ontario which had promised to close down all nuclear power plants. Soon after the new government took office, there were moves to close down the Bruce Nuclear Power Station which is very close to the Town of Port

Elgin. There were significant layoffs of employees. The Appellant stated that in the preceding 20 years, the Bruce Nuclear Station had been a significant employer in and around the Town of Port Elgin; and the economy of the town was very much tied to the Bruce Nuclear Station. Once the Ontario government announced that it would close down and mothball all or a substantial part of the Bruce Nuclear Station, people in the town tended to stop spending money; they became more careful; they used LR&R less, and the Company got into significant financial difficulties.

[7] The new manager hired in 1990 was not effective, and some of the staff were less than honest. The shareholders did not realize this at the time and so, over the next three or four years from 1990 to 1994, the Company was in real difficulty losing approximately $100,000 a year. By 1991, with the slowdown of the economy in Port Elgin, most of the other shareholders had lost confidence in putting more money into the Company. They wanted to keep it running in the hope that they would get their initial investment back, but they could not afford to keep financing annual losses in the range of $100,000.

[8] The Appellant made a business decision that he would attempt to finance the LR&R operations because he thought that the economy of the town would eventually turn around and that the Company could be made profitable. In 1990 or 1991, the Appellant started making substantial advances to the Company in the range of $100,000 each year. He claimed those advances as business investment losses and the corresponding deductions were permitted by Revenue Canada. He described the manner in which he computed the amount of the loss. The fiscal period of the Company ended on September30. The Appellant would determine the amount of money he advanced to the Company in its 12-month fiscal period ending in a particular year, for example 1992, and when he filed his income tax return for 1992 in the spring of 1993, he would claim 75% of that amount as an allowable business investment loss. That is the pattern he followed each year from 1991 to 1996. As stated, Revenue Canada accepted 75% of those amounts loaned to the Company as allowable business investment losses for each year until sometime in the calendar year 1997 when the character of the amounts loaned to the Company was challenged by Revenue Canada. Later in 1997, reassessments were issued to the Appellant disallowing the deduction of allowable business investment losses for 1996 and the two preceding years, 1995 and 1994.

…

[5] The 1997 reassessment with respect to business investment losses (BILs) claimed in his 1994, 1995 and 1996 taxations years (the First Reassessment) and the reassessment for the 1999 taxation year (the Second Reassessment), (together the Reassessments), meant that the Applicant could no longer assume that BILs for the LR&R would be accepted. Nevertheless, in addition to the years described in the Reassessments, he claimed BILs in 1997, 2000 and 2001.

[6] Mr. Justice Mogan continued:

> [10] The Appellant's position is that the amounts he loaned to the Company had in fact become bad debts at the end of each of its fiscal years. Because there was no possibility of recovering the amounts loaned as at September30 in any particular fiscal year, those amounts should be regarded as business investment losses. Revenue Canada takes the position that, as long as the Company was operating, those amounts could not be regarded as bad debts and the Appellant should have made an attempt to collect on them either by putting the Company out of business or into bankruptcy.
>
> [11] After 1991, the Appellant was the only shareholder financing the operation of the Company. He made it clear, however, that the other shareholders had not given up on their investment; they had only given up on their ability or willingness to put more money into the Company. There were shareholders' meetings each year which he said were well-attended. Each year, they heard a report on how the Company was doing; they elected a board of directors with different individuals except for the Appellant and Mr. McCulloch, the other substantial shareholder, who were always re-elected to the board. And so at all relevant times, the Appellant was a director of the Company but the other directors rotated on and off as elected by the shareholders. The other directors took an active role in the operation of the Company from its inception until around 1997.

[12] The Appellant said that the board of directors took an active role to the point that, in 1994, they fired the person who was the manager of the club and they determined at that time that they could not afford to hire a new manager. They formed an 'operating committee' composed of the bookkeeper, the head of maintenance, the receptionist, and the banquet manager, and they caused that committee to operate the club, reporting directly to the board. The Appellant's evidence is, however, that because he was the sole director who was financing the operation of the Company, the operating committee would usually come to him on a day-to-day basis if there were problems, but they would report to the board of directors from time to time as the directors met.

[13] The Company continued on that basis from the time the new committee was put in place in 1994 until early 1997 when a truly significant event happened. There had been a period of cold and snow in the early part of February 1997 followed by several days of excessive rain and flooding in the Town of Port Elgin. The flooding was disastrous. It flooded the building in which the Company operated LR&R and it did significant damage to the hardwood floors of the squash courts and racquetball courts. They were under water.

[14] The Company was not able to operate its sports facilities but it was able to operate the banquet hall on the upper floor which had not been damaged by the flood. The Company was effectively out of business from February21, 1997 until the end of the year…

[15] After the flood in February 1997, a significant number of the other shareholders simply gave up on their investment and concluded that they would never get their money back from the Company. The LR&R building was totally shut down from February until November 1997 and no one was willing to put any more money into the Company. At that point in time, the Appellant had invested several hundred thousand dollars on loans to the Company; and he was clearly the individual among all shareholders who had the most to lose if the facility was to be sold as a damaged building, using the proceeds of disposition to pay municipal taxes which had gone into arrears of about $150,000 and to pay a loan from the Business Development Bank which the Appellant described as a 'bank of last resort'.

[16] The Appellant and his wife felt that their investment in the Company was too significant to walk away from. They decided

that they would put their own money into the building to rehabilitate it and get the facility running again. The Appellant's wife agreed to give up her employment elsewhere in the Town of Port Elgin to manage the racquet club for no consideration but they would not open the banquet facility. Also, the Appellant would work two or three evenings a week in the bar at the club for no consideration to reduce the operating costs.

[17] With his own capital, the Appellant caused the building to be repaired in the last two months of 1997 and the early months of 1998, and the facility was reopened for business. The building, however, was still owned by the Company and there were still minority shareholders, even though they had given up on ever getting back any money for their shares. The Appellant decided that if he was going to put in fresh capital following the flood damage, and if no one else was going to make a contribution, he should own the building. In the latter months of 1999, there was an agreement entered into between the Company and a new company incorporated by the Appellant alone (or with his wife and children) identified as 1117636 Ontario Limited which I shall simply refer to as the 'New Corporation'.

[18] An agreement of purchase and sale was signed in December 1999 under which the Company sold the real estate, the land and building, to the New Corporation for $400,000. The transaction could not be closed or effected in December 1999 because of the ongoing litigation against the Town of Port Elgin. That litigation was settled in the spring of 2000. Following the settlement, the transfer of the property took place in June 2000 when the Company transferred the land and building to the New Corporation. According to the Appellant's evidence, the New Corporation continues to manage that facility to this day.

[19] The Company used the proceeds of sale in the amount of $400,000 to pay the Business Development Bank about $178,000, the Town of Port Elgin municipal tax arrears of about $110,000, and to pay the balance of about $111,000 to the Appellant with respect to the many loans he had made to the Company…

…

[33] I am impressed by the extent to which the Appellant attempted to recover his investment. He stated that from 1990 to 1995, he had remortgaged his house, refinanced his line of credit,

> run up his credit-card debts, borrowed money from friends, and cashed in his RRSPs, all as a means of obtaining funds to inject into the Company in the hope that it would be revived and that he could recover his investments. He said that he was virtually bankrupt apart from the fact that he did have a successful dental practice which is what sustained him throughout, but that his debts were equal to his assets except for the dental practice.
>
> …

[7] Justice Mogan concluded that the amounts loaned by the Applicant to the LR&R in 1994, 1995 and 1996 were bad debts which could be reported as BILs and that allowable deductions could be taken therefrom.

[8] As a result of this decision, all charges relating to the Reassessments were reversed.

[9] Although his allowable deductions for BILs in all taxation years in which they were claimed have been accepted and although he has been credited with all charges associated with the Reassessments, the Applicant says that he is entitled to further interest relief for the reasons discussed below.

[10] In 1997, his tax account had a 0 balance and he had no history of significant arrears.

[11] In 1997 and 1998, he worked much harder than in previous years because he needed money to rebuild the LR&R after the flood and was told that the BILs he was claiming would not be allowed. In 1997, he increased his professional income by approximately $150,000. and, in 1998, the increase was approximately $200,000. (together these amounts will be described as the

Increased Income). During the hearing, the Applicant acknowledged that income tax was owed on the Increased Income and that he had been unable to pay it because he chose to try to save his investment in the LR&R. The unpaid income taxes on the Increased Income will be described as the Arrears. He is not asking for relief from the Arrears. He only seeks relief from the interest charges which have accrued on the Arrears. That sum will be described as the Interest. He says that, even though he is now making substantial payments ($12,000. quarterly and $6,000. per month), he cannot make reasonable progress in reducing his tax bill because of the Interest.

[12] By letter dated April 15, 2005, the Applicant requested relief on the basis of financial hardship. This was denied.

[13] On August 19, 2005, the Applicant made a subsequent request for fairness on the basis of extraordinary circumstances. This was also denied.

[14] On March 6, 2006, the Applicant requested an administrative review of the decisions denying his requests for fairness and on December 13, 2006, the Minister issued his negative Decision. That is the Decision presently under review.

[15] The applicable guidelines (which have since been replaced) are found in Information Circular 92-2 and are entitled Guidelines for the Cancellation and Waiver of Interest and Penalties and are dated March 18, 1992 (the Guidelines).

[16] The legislation referred to in Section 3 of the Guidelines is subsection 220(3.1) of the Act.

220 (3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest. [my emphasis]	220 (3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation. [je souligne]

STANDARD OF REVIEW

[17] Based on two decisions in the Federal Court of Appeal, I am satisfied that the Standard of Review applicable to the Decision is reasonableness. See *Lanno v. Canada (Customs and Revenue Agency)*, 2005 FCA 153, 2005 D.T.C. 5245 and *Hillier v. Attorney General of Canada*, 2001 D.T.C. 5399 (F.C.A.).

THE DECISION

[18] The Decision reached the following conclusions:

(a) since all interest, penalties and additional taxes attributable to the Reassessments had been reversed, the fact that proceedings before the Tax Court were protracted or that the Reassessments were incorrect did not ultimately cause prejudice;

(b) since the Applicant declined to provide evidence of financial hardship, that aspect of the fairness provisions was not engaged;

(c) since the Applicant did not demonstrate that extraordinary circumstances existed which prevented him from paying his income taxes, that aspect of the fairness provisions did not apply;

(d) since the Applicant chose to work harder and increase his professional income in 1997 and 1998, he is responsible to pay the income tax associated with increasing his income together with interest on any arrears.

DISCUSSION

[19] Since the Applicant was self-represented, his concerns were not clearly expressed and the Respondent did not inteview him to be sure that it understood his position.

[20] I offer no criticism with respect to either fact but, in the result, as counsel for the Respondent indicated in the hearing, the Respondent was not aware that the request for relief related only to the interest on the Arrears (see transcript of February 28, 2008 at page 28)) and was apparently unaware that before 1997, the Applicant had a good payment history. Counsel incorrectly advised the Court

that, in 1997, Dr. MacKay had an outstanding tax liability of $120,290. when, in fact, as counsel later agreed, nothing was owed.

[21] It appears that the Decision did not always deal with the Applicant's arguments. For example, he was not suggesting that he was in a position of financial hardship when he made the request for fairness consideration. His request was actually based on the fact that he had been on the verge of bankruptcy in 1997 and 1998. Similarly, the request for relief based on extraordinary circumstances was not properly understood. It was the flood of the LR&R building in 1997 that was the extraordinary circumstance. In order to save his investment, he could not pay his income taxes on time and, therefore, the interest accrued.

[22] The Applicant also sought relief on the basis that the interest constitutes a disproportionate part of his current payments and that he is therefore unable to conclude reasonable payment arrangements. However, this submission was not addressed in the Decision.

[23] This is not a situation in which a taxpayer disregarded his income tax obligations. He acknowledges his tax liability and only seeks interest relief so that he can eliminate his Arrears.

[24] The implementation of his decision to save his "family fortune" to quote Judge Mogan involved an impressive effort. He extended his professional commitments to the point where he risked his health and, both he and his wife worked at the LR&R without remuneration.

CONCLUSION

[25] In the unusual circumstances of this case, in which it is acknowledged the Respondent did not appreciate that the Applicant only sought relief with respect to Interest on Arrears and in which the Respondent did not appreciate that the Applicant had a responsible payment history and in which the Applicants' submissions were misunderstood or overlooked. I have concluded that the Decision is not reasonable and that the matter should be reconsidered by a different Minister's delegate following a review of the transcript in the hearing before me and an interview with the Applicant.

JUDGMENT

THIS COURT ORDERS AND ADJUDGES that, for the reasons described above, the Decision is hereby set aside.

The Applicant's request for relief from interest in respect of income tax arrears arising from his 1997 and 1998 taxations years is to be reconsidered in accordance with paragraph 25 of the reasons.

There is no order as to costs.

"Sandra J. Simpson"
Judge

FEDERAL COURT

SOLICITORS OF RECORD

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APPEARANCES:

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