Date: 20080407

Docket: A-19-07

Citation: 2008 FCA 128

CORAM: **LINDEN J.A.**
SEXTON J.A.
RYER J.A.

BETWEEN:

BERT TOLHOEK

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on March 4, 2008.

Judgment delivered at Ottawa, Ontario, on April 7, 2008.

REASONS FOR JUDGMENT BY: RYER J.A.

CONCURRED IN BY: LINDEN J.A.
SEXTON J.A.

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REASONS FOR JUDGMENT

RYER J.A.

[1] This is an appeal from a decision of Justice Diane Campbell of the Tax Court of Canada (2006 TCC 681), dated December 15, 2006, dismissing the appeal of Mr. Bert Tolhoek ("Mr. Tolhoek" or "the appellant") against a reassessment of his 1997 taxation year that was made by the Minister of National Revenue (the "Minister"), pursuant to the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA"). Unless otherwise indicated, all statutory references in these reasons are to the corresponding provisions of the ITA for the taxation year under consideration.

[2] In 1997, the ICON Capital Limited Partnership (the "Limited Partnership") issued limited partnership units to Mr. Tolhoek for consideration that included the assumption by Mr. Tolhoek of a portion of an indebtedness of the Limited Partnership (the "Assumed Indebtedness"). On December 31, 1997, the Limited Partnership allocated a loss in the amount of $47,646 to Mr. Tolhoek.

[3] Subsection 96(2.1) essentially limits the amount of any loss of a limited partnership that can be allocated to a limited partner to an amount equal to the at-risk amount, as defined in subsection 96(2.2), of the limited partner in respect of the limited partnership. The at-risk amount of a limited partner in respect of a limited partnership is basically the adjusted cost base, within the meaning of section 54 (the "adjusted cost base"), of that limited partner's interest in the limited partnership, subject to a number of adjustments.

[4] Pursuant to subsection 143.2(6), the adjusted cost base of an interest in a limited partnership can be reduced by an amount equal to any limited-recourse amount, within the meaning of subsection 143.2(1) (a "limited-recourse amount"), of a limited partner that relates to the limited partnership interest. A limited-recourse amount is generally the amount of any indebtedness in respect of which the recourse against the debtor is, or is deemed to be, limited.

[5] The Minister determined that the Assumed Indebtedness constitutes a limited-recourse amount and that the adjusted cost base of Mr. Tolhoek's interest in the Limited Partnership was required to be reduced, pursuant to subsection 143.2(6), by the amount of $32,646. The

reassessment, in reliance upon subsection 96(2.1), denied a corresponding amount of the loss of the Limited Partnership that was allocated to Mr. Tolhoek.

[6] The reassessment was issued on November 24, 2003, after the end of Mr. Tolhoek's normal reassessment period, within the meaning of paragraph 152(3.1)(*b*), (the "normal reassessment period"), in respect of his 1997 taxation year.

[7] The issues in this appeal are whether the Assumed Indebtedness constitutes a limited-recourse amount and whether the reassessment was impermissible because it was issued outside the normal reassessment period in respect of Mr. Tolhoek's 1997 taxation year or was otherwise issued too long after the end of that taxation year.

BACKGROUND

[8] The actual transactions that were undertaken are detailed and complex and the applicable provisions of the ITA are at least comparable in detail and complexity. Accordingly, a detailed consideration of the facts is warranted.

[9] Mr. Edward K. Furtak controls Trafalgar Research (Bermuda) Ltd. ("Trafalgar Research"), a non-resident of Canada, which, in turn, controls Trafalgar Capital Ltd. ("Trafalgar Capital"), another non-resident of Canada.

[10] The Limited Partnership was formed prior to 1997, with ICLP Management Inc. (the "General Partner") as its general partner, and Mr. Furtak as its initial limited partner. The taxation year of the Limited Partnership ends on December 31st in each calendar year.

[11] On December 31, 1996, the Limited Partnership acquired certain computer software (the "Software") from Trafalgar Capital, pursuant to a "Software Agreement" that was amended several times after its execution. Certain of the relevant provisions of this agreement and of an "Amended Software Agreement" are as follows:

(a) The Software, which originally had been developed by Trafalgar Research, was intended to instruct money managers when to buy and sell certain S&P contracts.

(b) The initial price of the Software was $20,000,000, which was paid by the issuance of a $20,000,000 promissory note (the "Acquisition Note") that bore interest at the rate of 5% per annum and was due December 1, 2006.

(c) The purchase price of the Software and the principal amount of the Acquisition Note were reduced to $14,880,000, effective December 31, 1997, to reflect the lower number of units in the Limited Partnership that had been sold to investors.

(d) Pursuant to clause 4.01(k) of the "Amended Software Agreement", Trafalgar Capital made the following representation" (the "Clause 4.01(k) Warranty"):

> 4.01(k) The Computer Programs are capable of generating at least 500 Trading Reports per year per $250,000 in Trading Funds and, between the date hereof and December 1, 2006, will generate an

> average annual return of no less than 12% on leveraged Trading Funds.

[12] On July 22, 1997, Revenue Canada assigned a tax shelter identification number to the Limited Partnership, and as such, units in the Limited Partnership constituted tax shelter investments, within the meaning of subsection 143.2(1).

[13] The Limited Partnership, Trafalgar Capital and Trafalgar Research, formed a Bermuda limited partnership (the "Bermuda Limited Partnership"), as of October 31, 1997, for the purpose of licensing the Software from the Limited Partnership and using it to buy and sell S&P contracts, effectively as a broker for, and with funds (the "Trading Fund") that were to be provided by, Trafalgar Research.

[14] Pursuant to a "Software Licence Agreement" made as of October 31, 1997, the Limited Partnership granted a non-exclusive right to use the Software (the "Licence") to the Bermuda Limited Partnership. As consideration for the Licence, the Bermuda Limited Partnership agreed to pay US$20 to the Limited Partnership for each futures contract trading instruction (a "Trading Report") generated by the Bermuda Limited Partnership from the use of the Software.

[15] Trafalgar Research and the Bermuda Limited Partnership entered into an Investment Agreement, as of October 31, 1997, pursuant to which Trafalgar Research agreed to provide the Trading Fund, in the amount of $4 million, to the Bermuda Limited Partnership. Under this agreement, the Bermuda Limited Partnership agreed to buy and sell S&P contracts on behalf of

Trafalgar Research, in accordance with the instructions contained in the Trading Reports generated by the Software using the Trading Fund, which remained the property of Trafalgar Research. For each futures contract purchased or sold using the Software and the Trading Fund, Trafalgar Research agreed to pay a Trading Report Fee of US$30 to the Bermuda Limited Partnership. Profits from such trading were to be shared by the Bermuda Limited Partnership (in which the Limited Partnership was a member) and Trafalgar Research.

[16] On October 28, 1997, Mr. Tolhoek subscribed for and was issued 50 units in the Limited Partnership at a price of $1,000 per unit, in accordance with an “Offering Memorandum”. In so doing, he executed a Subscription and Power of Attorney and an Assumption Agreement, which was dated as of June 30, 1997. (This date is curious given that Mr. Tolhoek’s subscription for units was not accepted until December 31, 1997.) Certain of the relevant provisions of the Assumption Agreement are as follows:

(a) Mr. Tolhoek agreed to assume and become liable to pay Trafalgar Capital his *pro rata* share of the Acquisition Note, it being understood that such share was expected to be $35,000, the difference between the total subscription price ($50,000) and the portion thereof that was paid in cash ($15,000). The amount of the Acquisition Note that Mr. Tolhoek agreed to assume has been hereinbefore referred to as the Assumed Indebtedness.

(b) Mr. Tolhoek agreed to a form of irrevocable direction (the "Direction") authorizing the Limited Partnership to pay certain amounts to Trafalgar Capital. Specifically, clause 3 of the Assumption Agreement reads as follows:

> 3. Each Limited Partner hereby irrevocably directs the Partnership to pay to the Vendor 100% of his or her share of Gross Receipts, as defined in the offering memorandum of the Partnership dated May 30, 1997 (the "Offering Memorandum"), on a quarterly basis, until all of the interest owing under the Acquisition Note is paid in full, and to pay to the Vendor 100% of the Class A Interest distribution (as defined in the Offering Memorandum) until all principal owing under the Acquisition Note is paid in full.

(c) In the Offering Memorandum, "Gross Receipts" and "Business" are defined as follows:

> "Business" means the acquisition and exploitation of the Computer Programs by the Partnership for the purpose of earning income and all activities incidental thereto.
>
> "Gross Receipts" means aggregate, without duplication, of all revenues received from the operation of the Partnership's Business during the fiscal period in question, and all investment income earned on the funds of the Partnership.

[17] For the fiscal period ending on December 31, 1997, the Limited Partnership claimed capital cost allowance in respect of the Software in the amount of $14,880,000. During that period, the Limited Partnership was entitled to receive US$20 for every Trading Report that was generated by the Bermuda Limited Partnership using the Software and a share of the trading profits generated by the Bermuda Limited Partnership from its trading activities.

[18] The Bermuda Limited Partnership undertook its business operations in December of 1997 and provided a report to the Limited Partnership in respect of those operations. Similar reports were provided on a monthly basis. In the initial report, the Bermuda Limited Partnership stated that it had a trading loss of $2,915.99 and that it had generated 377 Trading Reports. The Bermuda Limited Partnership also stated that the Trading Fund amounted to $750,420.41.

[19] As a result of these 1997 activities of the Bermuda Limited Partnership, the Limited Partnership generated revenues of US$7,540 (US$20 x 377) from Trading Reports and no revenues from the trading activities of the Bermuda Limited Partnership. During 1997, the Limited Partnership had no material amount of investment income. Notwithstanding these results, the Limited Partnership reported revenues of $704,900 in its financial statements for 1997.

[20] The promoters of the tax shelter arrangements testified before the Tax Court that the difference between the revenues generated from the activities of the Limited Partnership and those that were reported in the 1997 financial statements were the result of the operation of the Clause 4.01(k) Warranty. In their view, this provision was intended to be a mechanism that would ensure that the Limited Partnership derived enough revenues to enable the limited partners to pay the interest on the debt that they had assumed as partial consideration for their partnership interests.

[21] In respect of the 1997 year, the promoters testified that the General Partner and Trafalgar Capital agreed that the amount of the accrued interest on the Acquisition Note in respect of that year was to be paid on behalf of the limited partners by offsetting that amount against a corresponding amount that was considered to be owing by Trafalgar Capital to the Limited Partnership, namely, the total of the actual business revenues for that year plus an amount that was considered to be payable to Trafalgar Capital to the Limited Partnership under the Clause 4.01(k) Warranty.

[22] The Minister's representatives requested information to verify the amount of the 1997 revenue that was reported in the 1997 financial statements of the Limited Partnership and that the full amount of the interest on the Acquisition Note that had accrued in 1997 had, in fact, been paid by Mr. Tolhoek and the other limited partners within the first 60 days of 1998.

[23] In the course of its verification efforts, the Minister dealt mainly with the General Partner. However, significant interaction also occurred with legal counsel ("Legal Counsel") to Mr. Tolhoek. In addition, correspondence was sent by the Minister to the Trafalgar Group in Bermuda. The information garnering efforts of the Minister ultimately lead to the issuance of a requirement, as contemplated by paragraphs 231.2(1)(*a*) and (*b*) (the "Requirement"), to the General Partner, formally requiring the production of information that the Minister believed to be relevant to the verification of the 1997 revenues of the Limited Partnership and the payment by Mr. Tolhoek and the other limited partners of the 1997 accrued interest on the Acquisition Note within the first 60 days of 1998. The Requirement requested documents and information that the Minister believed to be situated in Bermuda. Such documents and information included bank accounts and records with respect to the "Trading Accounts" of the Bermuda Limited Partnership, as well as banking and other records and information that were related to the indebtedness of Mr. Tolhoek and the other limited partners to Trafalgar Capital and to the computation of the business revenues of the Limited Partnership for its 1997 and subsequent periods.

[24] The General Partner responded to the Requirement, indicating that Trafalgar Capital had provided certain information but that it would not provide any banking records that pertained to the

interest received by Trafalgar Capital on the Acquisition Note or any banking records and other source documents that pertained to the business revenues of the Limited Partnership for its 1997 and subsequent periods (the "Unprovided Offshore Information").

[25] The Minister continued to press the General Partner for information verifying the 1997 revenues of the Limited Partnership and the payment of the 1997 accrued interest on the Acquisition Note and was advised by the General Partner, in correspondence dated November 19, 2002, that Trafalgar Capital had been given a copy of the Requirement and that Trafalgar Capital continued to decline to provide the Unprovided Offshore Information.

[26] The Minister had also received correspondence from Legal Counsel, who represented Mr. Tolhoek and other limited partners. In correspondence dated March 21, 2001, Legal Counsel stated:

> Investors generally understood that Trafalgar Capital Ltd. would be directly involved in the marketing and distribution of the *S&P Index* trading method. Many of the investors had met and/or spoken with Ed Furtak, the principal of Trafalgar Capital, and were confident Trafalgar Capital Ltd. was capable of marketing the *S&P Index* trading method to attract third party capital.

In addition, in correspondence dated March 31, 2003, Legal Counsel advised the Minister as follows:

> **The 1997, 1999 and 2000 Taxation Years**
>
> For the 1997, 1999 and 2000 taxation years, you have suggested that the Partnership could not have paid the interest amount because the Partnership did not have sufficient sales in its financial years ended December 31, 1997, 1999 and 2000 to enable it to make the interest payment.
>
> We have been advised by ICLP Management Inc. (general partner of the Partnership) that the parties to the software acquisition transaction intended that the Partnership would earn,

from its business venture with Trafalgar Research, revenues from the sale of trading reports at least sufficient to cover interest on the Acquisition Note in each year. In this respect, Trafalgar Capital (an affiliate of Trafalgar Research) represented and warranted to the Partnership that the software was capable of generating, at a minimum, 500 trading reports per $250,000 of trading capital (see section 4.01 of the Software Agreement, a copy of which was previously provided to you). The Partnership earned US$20 for each trading report generated by the Partnership. Assuming the software produced the minimum number of trading reports warranted by Trafalgar Capital, the revenues from trading report fees would enable the Partnership to pay the interest on the Acquisition Note. It was the understanding between the parties that Trafalgar was effectively guaranteeing minimum revenues equal to those it had warranted in the Software Agreement.

ICLP Management advised us that in 1997 and 1999, the software did not produce the warranted number of trading reports. Nonetheless, Trafalgar Capital paid to the Partnership (pursuant to its warranty under section 4.01 of the Software Agreement) an amount that reflected the trading report fees the Partnership would have earned had the software produced the warranted number of reports. Trafalgar Capital and ICLP Management further advised that at the time these payments were made, the parties contemplated that the software would generate greater than the warranted number of trading report fees owed to the Partnership. In effect, these payments were pre-payments for future trading report fees. Accordingly, in our submission, the amounts paid from Trafalgar Capital and recorded in the financial statements of the Partnership for 1997 and 1999 represent *bona fide* revenues of the Partnership from which the Partnership paid interest on the Acquisition Note on behalf of the limited partners.

It is our submission that, in any case, the source of the funds used to pay the interest is not relevant to this issue. Subsection 143.2(7) requires only that interest be paid on the Acquisition Note within 60 days of the end of the year. It does not require that interest be paid out of current revenues of the debtor (or other payor). As indicated in your letters, for each of 1997 and 1999 the Partnership made the payments to Trafalgar Research, by wire transfer, to satisfy the interest on the Acquisition Note.

…

In the present case, the Partnership paid interest on the Acquisition Note by way of setoff of the amounts owed to it by Trafalgar Research in respect of trading report fees pursuant to section 4.01 of the Software Agreement and pursuant to their existing business arrangement. We submit that under these circumstances it is clear that the Partnership paid the interest on the Acquisition Note as required by subsection 143.2(7) of the Act.

[27] The concerns with respect to the 1998 "interest payment" transaction are highlighted in correspondence from the Minister to Legal Counsel, dated July 4, 2003, as follows:

> You also indicate "the source of funds used to pay the interest is not relevant to the issue." However, Subsection 143.2(7) of the Income Tax Act ("ITA") states the interest must be "paid in respect of the indebtedness by the debtor." In other words, the ITA requires that the debtor be responsible for the indebtedness and the source of funds must then be a source of funds of the limited partners (ie. the "debtors"). As Icon is a Limited Partnership, the limited partners would only get distributions from it based on the business of Icon. Therefore, the revenues that are being attributed to the limited partners must be from Icon's business. As mentioned above, the General Partner has not supplied any calculations that would allow the Agency to come to the conclusion that the limited partners, in fact, were due any distributions from Icon's business activities. It is the debtors that owed the interest payments and the General Partner has not provided any information that would establish a link between the debtors and the revenues that Icon is reporting.
>
> …
>
> **Interest Payments to Trafalgar Capital**
>
> In addition to the positions that were outlined in our proposal letter, it has come to our attention that the interest payments made regarding the 1997 taxation year were made to TRB [Trafalgar Research]. However, the interest payments were owed to the "Holder" of the Acquisition Note. The "Holder," as per the Acquisition Note, is Trafalgar Capital Ltd. Therefore, it is the Agency's contention that the 1997 payment was not made "in respect of the indebtedness" since the limited partners did not owe the interest payments to TRB. Subsection 143.2(7) would then treat the Acquisition Note as a limited recourse note in this situation. It should be noted that the 1999 payment was handled similarly to the 1997 payment.
>
> The 1998 interest payment was allegedly made via journal entries. Your March 31, 2003 letter states, on Page 3, "the Partnership paid interest on the Acquisition Note by way of setoff of the amounts owed to it by Trafalgar Research in respect of the trading report fees pursuant to section 4.01 of the Software Agreement and pursuant to their existing business arrangement." Therefore, the "setoff" took place between Icon and Trafalgar Research (Bermuda). However, the amounts owed were by the limited partners of Icon were to Trafalgar Capital Ltd. Nowhere is Trafalgar Capital Ltd. mentioned in the payment of the 1998 interest. The Agency views the 1998 payment in this manner as falling under subsection 143.2(7) and treating the Acquisition Note as a limited recourse amount.

[28] The record disclosed that the actual business revenues of the Limited Partnership for each year prior to 2001 were never equal to or greater than the accrued interest on the Acquisition Note at the end of each such year. According to the promoters of the tax shelter, the Clause 4.01(k) Warranty was invoked so as to "top up" the business revenues of the Limited Partnership in respect of each of those years to an amount that would be sufficient to enable the Limited Partnership to stipulate that it had paid all of the accrued interest on the Acquisition Note to Trafalgar Capital at the end of each of those years within the time period contemplated by paragraph 143.2(7)(b).

[29] It is undisputed that the Minister did not receive information from Trafalgar Capital and/or Trafalgar Research that was situated outside Canada and that related to the 1997 revenues of the Limited Partnership and the 1998 interest payment transactions.

DECISION OF THE TAX COURT

[30] The Tax Court determined that if either of subsections 143.2(7) or (13) applied to deem the unpaid principal of the Assumed Indebtedness to be a limited-recourse amount, the adjusted cost base of Mr. Tolhoek's interest in the Limited Partnership would be reduced by the amount of the deemed limited-recourse amount, provided that the Minister was entitled to reassess outside the normal limitation period pursuant to subsection 143.2(15).

[31] The Tax Court observed that the unpaid principal of the Assumed Indebtedness could be deemed a limited-recourse amount pursuant to subsection 143.2(7) if there were no *bona fide* arrangements for the repayment of the indebtedness and all interest on the indebtedness as required

by paragraph 143.2(7)(*a*), or if interest was not actually paid on the indebtedness within the 60 day period prescribed in paragraph 143.2(7)(*b*).

[32] In addressing the application of paragraph 143.2(7)(*a*), at paragraph 40 of its reasons, the Tax Court rejected as too low a threshold, the contention of Mr. Tolhoek that *bona fide* arrangements exist if there is a genuine intention to repay:

> Without being over simplistic, the phrase "*bona fide* arrangement" in the context of tax shelters cannot be resolved in favour of a taxpayer simply by having an investor come to Court and asking the Court to accept that there was an honest intention to repay the debt. A *bona fide* arrangement must encompass more than this. Such an arrangement should readily be seen to be binding upon the parties; it should be *prima facie* obvious.

[33] At paragraph 34, the Tax Court described the evidentiary burden under paragraph 143.2(7)(*a*) for establishing the *bona fide* nature of an arrangement:

> Examining various indicia and evidentiary requirements is essential to establishing the total relationship between the parties respecting their obligation to repay a debt. This is the appropriate approach to interpretation of this provision. Although there may be differences between "arrangements" and "contracts", I believe that you either have a meaningful, binding agreement between parties that means something to them or you do not. If the evidence does not support the existence of a legally binding agreement, then ultimately it is going to be on a collision course with the limited-recourse debt rules.

[34] The Tax Court rejected the assertion of Mr. Tolhoek that the most compelling evidence of the *bona fide* nature of the arrangements is found in the Acquisition Note. According to the Tax Court, the terms of the Acquisition Note were confusing leaving unanswered questions concerning the specific terms of the transaction. Moreover, the terms of the Acquisition Note were not reinforced by the surrounding circumstances of the transaction, including the lack of security for the

Acquisition Note, the presence of Mr. Furtak "on both sides of the deal" and the prospect of circular cash flows in relation to interest payments.

[35] On reviewing all of the facts, particularly the circular flow of money and the inconsistencies in the evidence presented, the Tax Court concluded that the arrangements were not *bona fide* within the meaning of paragraph 143.2(7)(*a*).

[36] In determining whether paragraph 143.2(7)(*b*) applied to deem the unpaid principal of the Assumed Indebtedness to be a limited-recourse amount, the Tax Court noted that the heart of the dispute was whether interest was paid within the 60 day period following the end of each particular taxation year in which the Acquisition Note was outstanding. The Tax Court went on to state that to adequately resolve this issue it had to examine “whether interest was actually paid at all and, if interest was paid, whether it was the correct amount”.

[37] The promoters testified that the tax shelter was structured such that business income earned by the Limited Partnership from the Trading Reports was expected to be treated as a distribution to the limited partners and such notional payments would be redirected to pay interest owing by them to Trafalgar Capital. The position of Mr. Tolhoek was that interest was paid in full each year or paid by way of off-setting journal entries in 1998. The Tax Court found that in certain years, funds did flow and "payment-like events occurred", within the time limit prescribed in paragraph 143.2(7)(*b*). In particular, there was evidence of a $700,000 payment in 1997.

[38] The Tax Court stated that "it is critical that interest was paid pursuant to a '*bona fide* arrangement'". While the Tax Court did not find the circular flow of money described by Mr. Tolhoek in itself offensive, additional evidence was required to establish that the payment-like events constituted payments of interest, within the meaning of paragraph 143.2(7)(*b*).

[39] According to the Tax Court, Mr. Tolhoek provided inconsistent evidence documenting the amount of the principal owing under the Acquisition Note, the amount of income earned by the Limited Partnership from the Trading Reports, and the cash amounts paid by the limited partners on the purchase of their units in the Limited Partnership. Moreover, the Tax Court noted that witnesses were unable to offer a precise calculation of the $700,000 payment in 1997 and Mr. Tolhoek was unable to give any evidence respecting his payment obligations including the interest rate, quantum of interest, or the dates that payments were made. The Tax Court found that all of these factors made it impossible to determine with any certainty the precise amount of interest owing in any year. The Tax Court noted that relevant records of Trafalgar Capital and source documents relating to the business revenues of the Limited Partnership may have resolved this uncertainty, but such documentation was not put into evidence. Accordingly, the Tax Court was "unable to conclude that interest was paid pursuant to a *bona fide* arrangement".

[40] The Tax Court went on to consider whether subsection 143.2(13) applied to deem the Assumed Indebtedness to be a limited-recourse amount on the basis that information relevant to that indebtedness was located outside Canada and was not provided to the Minister. Documentation relating to the "Trading Accounts" of the Bermuda Limited Partnership, in which Trafalgar Capital

was the general partner, and the banking records of Trafalgar Capital were requested from the Limited Partnership and not provided to the Minister. For that reason, the Tax Court determined that subsection 143.2(13) applied, notwithstanding that Mr. Tolhoek may not have been in a position to force Trafalgar Capital to comply with the Minister's request for information and that the correspondence from the Minister did not reference subsection 143.2(13).

[41] In determining whether the Minister was entitled to reassess outside the normal limitation period, pursuant to subsection 143.2(15), the heart of the debate was with respect to the meaning of the phrase "as are necessary". Following a textual, contextual and purposive analysis of subsection 143.2(15), the Tax Court concluded that the Minister's power to reassess under subsection 143.2(15) cannot be defined by considerations revolving around the timing and availability of particular facts and information to the Minister. According to the Tax Court, subsection 143.2(15) grants broad discretionary power to the Minister to reassess beyond the normal limitation period in order to identify and combat abuses using tax shelters. As such, the Tax Court found that the reassessment by the Minister for the 1997 taxation year of Mr. Tolhoek was not statute-barred.

ISSUES

[42] The issues in this appeal are whether the Assumed Indebtedness is a limited-recourse amount and whether the Minister was permitted to reassess Mr. Tolhoek for his 1997 taxation year beyond the normal reassessment period for that year.

ANALYSIS

STANDARD OF REVIEW

[43] The standard of review that applies to appeals from decisions of the Tax Court under the informal procedure contained in section 18 of the *Tax Court of Canada Act*, R.S.C. 1985, c. T-2, has been determined by this Court in *McGoldrick v. Canada*, 2004 FCA 189. At paragraph 7, Justice Malone described the standard of review as follows:

> The standard of review set out in *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 applies to appeals from the Tax Court conducted under its informal procedure (see *Jastrebski v. Canada*, 94 DTC 6355 (F.C.A.); *Polygon Southampton Development Ltd. v. Canada* [2003] F.C.J. No. 674, 2003 FCA 193). That is, for questions of law, the standard is correctness while for findings of fact, inferences or conclusions of fact, or conclusions of mixed law and fact, the standard is palpable and overriding error.

IS THE ASSUMED INDEBTEDNESS A LIMITED-RECOURSE AMOUNT?

[44] The Assumed Indebtedness could be a limited-recourse amount if, under its terms, recourse against the debtor is limited. That has not been argued. Rather, the argument is whether the Assumed Indebtedness is deemed to be a limited-recourse amount, pursuant to either subsection 143.2(7) or (13).

Subsection 143.2(7)

[45] Subsection 143.2(7) deems the unpaid principal of an indebtedness to be a limited-recourse amount unless two conditions are met. Those conditions are contained in paragraphs (*a*) and (*b*) of that subsection, which read as follows:

(7) For the purpose of this section, the unpaid principal of an indebtedness is deemed to be a	7) Pour l’application du présent article, le principal impayé d’une dette est réputé être un montant à

limited-recourse amount unless

(*a*) *bona fide* arrangements, evidenced in writing, were made, at the time the indebtedness arose, for repayment by the debtor of the indebtedness and all interest on the indebtedness within a reasonable period not exceeding 10 years; and

(*b*) interest is payable at least annually, at a rate equal to or greater than the lesser of

(i) the prescribed rate of interest in effect at the time the indebtedness arose, and

(ii) the prescribed rate of interest applicable from time to time during the term of the indebtedness,

and is paid in respect of the indebtedness by the debtor no later than 60 days after the end of each taxation year of the debtor that ends in the period.

recours limité sauf si :

a) des arrangements, constatés par écrit, ont été conclus de bonne foi, au moment où la dette est survenue, pour que le débiteur rembourse la dette et les intérêts y afférents dans une période raisonnable ne dépassant pas dix ans;

b) les intérêts sont payables au moins annuellement, à un taux égal ou supérieur au moins élevé des taux suivants, et sont payés sur la dette par le débiteur au plus tard 60 jours suivant la fin de chacune de ses années d'imposition qui se termine dans la période visée à l'alinéa *a*):

(i) le taux d'intérêt prescrit en vigueur au moment où la dette est survenue,

(ii) le taux d'intérêt prescrit applicable pendant la durée de la dette.

[46] The Tax Court concluded that the Assumed Indebtedness is a limited-recourse amount under each of paragraphs 143.2(7)(*a*) and (*b*), as well as subsection 143.2(13). Any one of those three bases will be sufficient to support that conclusion. For my part, I prefer to start with paragraph 143.2(7)(*b*).

[47] In the circumstances, the issue is whether interest on the Assumed Indebtedness was paid within the 60 day period referred to in paragraph 143.2(7)(*b*). It is noteworthy that a failure to pay interest in respect of any year in which the Assumed Indebtedness is outstanding will result in the principal amount of that indebtedness being deemed to be a limited-recourse amount.

[48] The Tax Court correctly determined that it was necessary to establish whether interest was paid at all and if any interest was paid, whether the correct amount was, in fact, paid. In assessing the evidence, the Tax Court concluded that it was impossible to determine, with certainty, the precise amount of interest that was owing in any year, noting that the Unprovided Offshore Information of Trafalgar Capital was not put into evidence. Accordingly, the Tax Court determined, in paragraph 52 of its reasons, that it was "unable to conclude that interest was paid pursuant to a *bona fide* arrangement".

[49] The appellant attacks this conclusion on the basis that there is no obligation in paragraph 143.2(7)(*b*) to pay interest pursuant to a "*bona fide* arrangement". In my view, the critical finding of the Tax Court was that the appellant had not substantiated that the correct amount of interest had been paid and that the reference to the "*bona fide* arrangement" was not essential to that finding. It was open to the Tax Court to make a finding of fact that interest had not been paid having regard to the evidence that was before it and I have not been persuaded that the Tax Court made a palpable and overriding error in this factual determination. Accordingly, this conclusion is sufficient to decide the issue of whether the Assumed Indebtedness is a limited-recourse amount.

[50] While the reference of the Tax Court to a "*bona fide* arrangement" in respect of the finding of non-payment of interest was unnecessary, I am of the view that such reference was not incorrect. In my view, the requirement of a "*bona fide* arrangement" in paragraph 143.2(7)(*a*) extends to both the principal and interest payments. It is incongruous to argue that even though paragraph 143.2(7)(*a*) requires interest to be payable pursuant to a *bona fide* arrangement, interest which is in fact paid in order to satisfy the requirement in paragraph 143.2(7)(*b*) need not have been paid pursuant to a *bona fide* arrangement.

[51] While I am of the view that the conclusion of the Tax Court with respect to the payment of interest on the Assumed Indebtedness should not be interfered with, I am also of the view that such a conclusion can also be supported by virtue of a somewhat different analysis of the evidence that was before the Tax Court.

[52] It is clear that the tax shelter arrangement that was promoted by Mr. Furtak was intended to provide investors with the benefit of "leveraged" tax deductions on a basis that did not come within the anti-avoidance provisions of section 143.2. In particular, the intention was to avoid the Acquisition Note being characterized as a limited-recourse amount. At the heart of this arrangement is the warranty mechanism which was intended to provide a basis upon which the Limited Partnership would receive sufficient business revenue to enable it to notionally make distributions to the limited partners who would, in turn and pursuant to written instructions, direct the Limited Partnership to make interest payments on the notes on behalf of the limited partners on their respective shares of the Acquisition Note.

[53] This intention, in and of itself, may not offend any of the specific provisions of section 143.2 and it is noted that the Minister did not seek to challenge this intended avoidance of the limited-recourse provisions in section 143.2 under the general anti-avoidance rule. However, a mere intention to comply with the provisions of section 143.2 will not, in and of itself, be sufficient to bring about the desired result. The arrangements by which such compliance is to be brought about must be legally effective and must withstand careful scrutiny to determine whether they actually produce the intended compliance, having regard to their specific terms and conditions.

[54] Thus, the question is whether or not the warranty arrangements properly interpreted and construed, were sufficient to bring about the desired result of providing the Limited Partnership with sufficient business revenues to enable it to make notional distributions to the limited partners that would equal or exceed their interest payment obligations on their respective shares of the Acquisition Note.

[55] In my view, the evidence falls short of establishing that interest was paid on the Assumed Indebtedness in respect of the 1997 taxation year. There is no suggestion that Mr. Tolhoek made a direct payment of interest on the Assumed Indebtedness. Accordingly, any such payment of interest must have been made on his behalf pursuant to the Direction.

[56] A careful review of the Direction indicates that it authorizes the Limited Partnership to pay a particular type of amount to Trafalgar Capital on account of interest on the Assumed Indebtedness.

The Direction does not authorize the Limited Partnership to pay Mr. Tolhoek's share out of "any cash-on-hand in the Limited Partnership that is available for distribution" to Trafalgar Capital. Rather, the Direction only authorizes the Limited Partnership to pay his share of Gross Receipts, as defined in the Offering Memorandum, on account of his obligation to pay interest to Trafalgar Capital. Accordingly, if Mr. Tolhoek's share of Gross Receipts for the 1997 fiscal period of the Limited Partnership is less than the amount of the accrued interest on the Assumed Indebtedness, as of December 31, 1997, it cannot be said that Mr. Tolhoek has paid all of that accrued interest pursuant to the Direction. It would necessarily follow, in those circumstances, that the requirement of paragraph 143.2(7)(*b*) could not have been satisfied and as a result, the Assumed Indebtedness would be deemed to be a limited-recourse amount.

[57] The appellant argues that all of the accrued interest on the Acquisition Note on December 31, 1997, and therefore, on the Assumed Indebtedness as of such date, was paid by virtue of certain journal entries that were made in the accounts of the Limited Partnership and Trafalgar Research within the first 60 days of 1998. There are two problems with this assertion. First, the creditor in respect of the Assumed Indebtedness was Trafalgar Capital, not Trafalgar Research. More importantly, the amount credited to the Limited Partnership must be shown to constitute a Gross Receipt, i.e. income from the business of the Limited Partnership.

[58] The appellant argues that the amount credited to the Limited Partnership constitutes a payment required to be made under the Clause 4.01(k) Warranty and therefore, it has the character of a Gross Receipt. The record contains a calculation by the Minister (see Appeal Book page 653)

that shows that the amount credited to the Limited Partnership significantly exceeded the amount determinable by virtue of the application of that contractual provision (even assuming that the issue of the journal entry being made by Trafalgar Research, rather than Trafalgar Capital, could be overcome). In my view, the Minister's interpretation of the Clause 4.01(k) Warranty and his calculation of the maximum amount payable thereunder for 1997 are correct. The Minister contends that the excess amount credited by Trafalgar Research to the Limited Partnership could not be "re-credited" to Trafalgar Capital as an interest payment because the Direction does not contemplate a payment of any amount other than Gross Receipts on account of interest on the Assumed Indebtedness. In my view, this contention should be accepted. However, the appellant then argues that even though the amount credited to the Limited Partnership may have been incorrectly determined, the erroneously determined amount should nonetheless be accepted as constituting a complete payment of all of the 1997 accrued interest because the promoters intended the warranty to produce that result. In other words, because the "heart of the transaction", according to one of the promoters, was that the warranty was expected to provide enough revenues to enable the limited partners to pay interest on the Acquisition Note, the warranty should be regarded as, in fact, bringing about that result even if it did not, in fact, do so, on a proper interpretation of its provisions.

[59] In my view, this assertion cannot be accepted. As previously indicated, the intention on the part of the promoters to structure the tax shelter in such a way as to avoid the provisions of section 143.2 is irrelevant. If the specific and technical aspects of the structure do not, in fact, bring about the intended result, then the scheme must fail. That is what occurred in respect of the 1997 taxation year. The amount that the promoters hoped would be Gross Receipts of the Limited Partnership by

virtue of the interpretation and application of the Clause 4.01(k) Warranty did not materialize. It follows that even assuming that there was a notional flow of funds by virtue of the 1998 journal entries, the amount in excess of the amount determined by virtue of the proper application of that Clause 4.01(k) Warranty was not revenue from the business of the Limited Partnership. Accordingly, whatever that excess amount may have been (in all likelihood some kind of loan or advance), that excess amount could not be said to have been paid by the Limited Partnership on behalf of Mr. Tolhoek as interest on the Assumed Indebtedness because the Direction did not authorize the payment of anything other than Mr. Tolhoek's share of Gross Receipts in that fashion. It follows, in my view, that Mr. Tolhoek has not demonstrated that he paid the full amount of the accrued interest on the Assumed Indebtedness as of December 31, 1997. Accordingly, Mr. Tolhoek has not established that he met the condition in paragraph 143.2(7)(*b*) in respect of the Assumed Indebtedness for his 1997 taxation year and as such, the Assumed Indebtedness is deemed to be a limited-resource amount.

Subsection 143.2(13)

[60] The Tax Court found that the Minister had requested information relating to the Assumed Indebtedness that was available outside Canada and that such information, the Unprovided Offshore Information, had not been provided to the Minister. In addition, the Tax Court concluded that the Minister was not satisfied that the Assumed Indebtedness was not a limited-resource amount. Accordingly, the Tax Court held that subsection 143.2(13) applied to deem the Assumed Indebtedness to be a limited-resource amount. That provision reads as follows:

(13) For the purpose of this section, where it can reasonably	13) Pour l'application du présent article, lorsqu'il est raisonnable

be considered that information relating to indebtedness that relates to a taxpayer's expenditure is available outside Canada and the Minister is not satisfied that the unpaid principal of the indebtedness is not a limited-recourse amount, the unpaid principal of the indebtedness relating to the taxpayer's expenditure is deemed to be a limited-recourse amount relating to the expenditure unless	de considérer que des renseignements concernant une dette se rapportant à une dépense d'un contribuable se trouvent à l'étranger et que le ministre n'est pas convaincu que le principal impayé de la dette n'est pas un montant à recours limité, le principal impayé de la dette est réputé être un montant à recours limité se rapportant à la dépense, sauf si, selon le cas :
(*a*) the information is provided to the Minister; or	*a*) les renseignements sont fournis au ministre;
(*b*) the information is located in a country with which the Government of Canada has entered into a tax convention or agreement that has the force of law in Canada and includes a provision under which the Minister can obtain the information.	*b*) les renseignements se trouvent dans un pays avec lequel le gouvernement du Canada a conclu une convention ou un accord fiscal qui a force de loi au Canada et qui comprend une disposition en vertu de laquelle le ministre peut obtenir les renseignements.

[61] The appellant does not really challenge the finding that the Unprovided Offshore Information had not been provided to the Minister. Instead, the appellant contends that such information was not available to Mr. Tolhoek and that Parliament could not have intended that a taxpayer's indebtedness should be deemed to be a limited-resource amount unless that taxpayer had access to the information and refused to supply it.

[62] In my view, this contention cannot be accepted. The language of subsection 143.2(13) is very broad and does not even require the Minister to request the information in question from the taxpayer. While this provision might, in certain circumstances, work a hardship on a taxpayer who

is unable to obtain the information that the Minister has requested, it must be remembered that section 143.2 is an anti-avoidance provision. A taxpayer who wishes to participate in a tax shelter with an "offshore" flavour must assume the risk that persons outside Canada who are in possession of information that pertains to indebtedness that relates to the taxpayer's expenditure in respect of the tax shelter, may not cooperate in the provision of such information to the Minister.

[63] In the present circumstances, the requested information was in the possession of Trafalgar Capital, a corporation controlled by Mr. Furtak, the promoter of the tax shelter. No reason was provided as to why Mr. Furtak refused to cooperate in the provision of the Unprovided Offshore Information to the Minister. Nonetheless, the failure of Trafalgar Capital to provide the Unprovided Offshore Information is a sufficient basis for the application of subsection 143.2(13) to deem the Assumed Indebtedness to be a limited-recourse amount. In so concluding, the Tax Court made no reviewable error of law or fact.

WAS THE REASSESSMENT TIME-BARRED?

[64] Paragraph 143.2(15) reads as follows:

(15) Notwithstanding subsections 152(4) to (5), such assessments, determinations and redeterminations may be made as are necessary to give effect to this section.	(15) Malgré les paragraphes 152(4) à (5), le ministre peut établir les cotisations voulues et déterminer ou déterminer de nouveau les montants voulus pour l'application du présent article.

The appropriate interpretation to be given to this relatively short provision is not obvious.

[65] In *Markevich v. Canada*, [2003] 1 S.C.R. 94, 2003 SCC 9, the Supreme Court of Canada considered whether the application of section 222, a tax-debt collection provision, was subject to any temporal limitation. At paragraph 13, Justice Major stated:

> The assessment provisions of the *ITA* are clearly stated on prescription. By contrast, the collection provisions of the *ITA* are silent with respect to prescription. There is no reference in s. 222 or its accompanying provisions to either the absence or presence of a limitation period. Nonetheless the appellant submits that the *ITA* has "otherwise provided" for prescription. In the appellant's submission, the *ITA* constitutes a complete statutory scheme for the collection of taxes, and so silence in the legislation indicates Parliament's intent to avoid fettering the Crown's collection powers with limitation periods.

Justice Major rejected the Minister's argument that there was no temporal limitation with respect to the application of section 222 and held that in the absence of any specific reference to prescription in that provision, the prescription provisions in section 32 of the *Crown Liability and Proceedings Act*, R.S.C. 1985, c. C-50 [rep. & sub. 1990, c. 8. s. 31] operated to limit the appellant's collection rights.

[66] *Markevich* provides limited guidance in relation to this appeal. Unlike section 222, which contained no specific reference to prescription, in my view, subsection 143.2(15) specifically negates the application of the prescriptive provisions with respect to reassessments by its opening words "Notwithstanding subsections 152(4) and (5)…". Thus, one is left to wonder whether Parliament intended to totally eliminate prescription insofar as assessments or reassessments under section 143.2 are concerned or to search further in subsection 143.2(15) for guidance with respect to whether there is any prescriptive limitation.

[67] It is clear that subsection 143.2(15) does not contain any express temporal limitation with respect to the power of the Minister to levy assessments or reassessments. At its core, the provision simply instructs that such assessments or reassessments may be made if they are necessary to give effect to section 143.2.

[68] The Tax Court, after a textual, contextual and purposive analysis of subsection 143.2(15), concluded that the reassessment of Mr. Tolhoek's 1997 taxation year that was made on November 24, 2003 – a date that was after his normal reassessment period in respect of that year – was not statute-barred. In so doing, the Tax Court concluded that the words "as are necessary" provided a discretionary power to reassess beyond the normal reassessment period in order to fulfill the purpose of section 143.2, which was, according to the Tax Court, to combat abusive tax shelters.

[69] In my view, the Tax Court was correct in finding that subsection 143.2(15) empowers the Minister to levy assessments or reassessments against Mr. Tolhoek beyond the normal reassessment period in respect of his 1997 taxation year. The Tax Court did not go so far as to conclude that subsection 143.2(15) operates to empower the Minister to levy assessments or reassessment without any limitation. In my view, such a further conclusion would have been unnecessary.

[70] In the circumstances of this case, the terms of the Acquisition Note, a portion of which became an obligation of Mr. Tolhoek, contemplate that interest payments must be made on or before January 31 in each year that such indebtedness is outstanding, up to and including the year of its maturity in 2006. A failure by Mr. Tolhoek to pay such interest in respect of any taxation year,

up to and including the year of the maturity of the Acquisition Note, would permit the Minister to reassess Mr. Tolhoek's 1997 taxation year. Such a reassessment would clearly be necessary in order to give effect to paragraph 143.2(7)(*b*) which is, of course, a part of section 143.2. Accordingly, it follows that in the circumstances of this case, an implied prescriptive limitation on the ability of the Minister to reassess Mr. Tolhoek's 1997 taxation year could not arise before the maturity date of the Acquisition Note, at the earliest. Since the reassessment occurred in 2003, it was well within the boundary of such a prescriptive limitation. For that reason, I am of the view that the Minister's reassessment of Mr. Tolhoek's 1997 taxation year was not time-barred.

DISPOSITION

[71] For the foregoing reasons, I would dismiss the appeal, with costs.

"C. Michael Ryer"
J.A.

"I agree
A.M. Linden J.A."

"I agree
J. Edgar Sexton J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-19-07
(APPEAL FROM A JUDGMENT OF JUSTICE DIANE CAMPBELL OF THE TAX COURT OF CANADA, DATED DECEMBER 15, 2006 (2006 TCC 681))	
STYLE OF CAUSE:	BERT TOLHOEK v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	MARCH 4, 2008
REASONS FOR JUDGMENT BY:	RYER J.A.
CONCURRED IN BY:	LINDEN J.A. SEXTON J.A.
DATED:	APRIL 7, 2008

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