Federal Court of Appeal | Cour d'appel fédérale

CANADA

Date: 20100729

Docket: A-415-09

Citation: 2010 FCA 203

CORAM: **NADON J.A.**
SHARLOW J.A.
LAYDEN-STEVENSON J.A.

BETWEEN:

HERON BAY INVESTMENTS LTD.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Ottawa, Ontario, on June 23, 2010.

Judgment delivered at Ottawa, Ontario, on July 29, 2010.

REASONS FOR JUDGMENT BY: SHARLOW J.A.

CONCURRED IN BY: NADON J.A.
LAYDEN-STEVENSON J.A.

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REASONS FOR JUDGMENT

SHARLOW J.A.

[1] In a judgment dated September 8, 2009, the Tax Court of Canada dismissed the appeal of Heron Bay Investments Ltd. from an assessment for the 1995 taxation year under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (2009 TCC 337). Heron Bay's principal argument in this Court is that the judge conducted the trial in a manner that deprived Heron Bay of procedural fairness such that the judgment cannot stand. In the alternative, Heron Bay argues that the judge erred in his interpretation and application of paragraphs 20(1)(*l*) and (*p*) of the *Income Tax Act*. For the reasons that follow, I would allow this appeal for want of procedural fairness and return this matter to the Tax Court for retrial by a different judge.

Facts

[2] The undisputed facts may be summarized as follows.

[3] The Conservatory Group is a group of corporations in the business of real estate development. The Conservatory Group was founded by the late Ted Libfeld. Since his death it has been run by his four sons, Sheldon, Jay, Mark and Corey. Heron Bay is a member of the Conservatory Group, as are Rosehue Downs Developments Inc., Burlmarie Developments Inc., Marlo Developments Inc., Viewmark Homes Ltd., and Shellfran Investments Ltd.

[4] The business of Heron Bay includes the purchase, development and sale of real property and the making of loans to related entities. The shares of Heron Bay are owned by the four Libfeld brothers. Its president and secretary is Sheldon Libfeld.

[5] In August of 1994, Rosehue and Burlmarie agreed to purchase 289 building lots in Ajax, Ontario, from Runnymede Development Corporation Ltd., a corporation unrelated to the Conservatory Group. Rosehue agreed to purchase 147 lots for $11,764,000, and Burlmarie agreed to purchase 142 lots for $12,202,800.

[6] At approximately the same time, Marlo agreed to purchase all 289 lots from Rosehue and Burlmarie for a total of $24,500,000, of which $12,000,000 was payable to Rosehue for its 147 lots and $12,500,000 was payable to Burlmarie for its 142 lots. In entering into that agreement, Marlo was acting as trustee for a joint venture between Viewmark (with a 95% interest) and Shellfran (with a 5% interest).

[7] In October and November of 1994, Viewmark borrowed $3,770,000 from Heron Bay to finance most of its share of the deposit required for the purchase of the 289 lots. The Viewmark loan was payable on demand, bore interest at the rate of 8% per annum, and was secured by Viewmark's interest in the joint venture without recourse, meaning that if the loan was not repaid, Heron Bay would have recourse to Viewmark's interest in the Viewmark/Shellfran joint venture but not to any other assets of Viewmark.

[8] There is some evidence that Sheldon Libfeld considered the purchase price of the 289 lots to have been inflated as a result of certain litigation between Runnymede and the Conservatory Group relating to property in Ajax that included the 289 lots. In November of 1994, Heron Bay obtained a valuation in which the 289 lots were valued at $17,235,000.

[9] Heron Bay, in computing its income for income tax purposes for the fiscal year ending August 31, 1995, deducted $3,770,000 in respect of the Viewmark loan. That deduction was made on the basis that the Viewmark loan was either doubtful or bad because the value of Viewmark's interest in the Viewmark/Shellfran joint venture was less than Viewmark's share of the unpaid purchase price of the 289 lots (approximately $20 million).

[10] The Minister reassessed to disallow the deduction. Heron Bay objected and then appealed to the Tax Court, without success. Heron Bay now appeals to this Court.

Statutory framework

[11] The *Income Tax Act* contains a complex statutory scheme for the treatment of bad and doubtful loans. For the purposes of this appeal it is not necessary to understand the statutory scheme in detail. The following general summary of some of its key elements will suffice.

[12] Where a taxpayer has made a loan on income account and there is a reasonable doubt that the loan will be repaid, the taxpayer may deduct all or part of the amount of the loan as a "reserve" for a doubtful loan under subparagraph 20(1)(*l*)(ii) of the *Income Tax Act*, if certain statutory conditions are met. (Subparagraph 20(1)(*l*)(ii) is quoted in the judge's reasons and need not be reproduced here.)

[13] Given the factual context of this case, three of the statutory conditions may be summarized as follows: (1) in the year in which the deduction is claimed, the taxpayer's ordinary business must include the lending of money; (2) the loan in respect of which the deduction is claimed must be made in the ordinary course of the taxpayer's money lending business; and (3) the loan must be doubtful at the end of the year in which the deduction is claimed, meaning that there must be a reasonable doubt that it would be collected.

[14] The amount of a deduction taken by a taxpayer under subparagraph 20(1)(*l*)(ii) in a year must be included in the taxpayer's income in the following year. If at the end of that year the loan is still doubtful, a new reserve is established and a new deduction may be taken. That pattern is repeated until the year in which the loan is paid or ceases to be doubtful. In that year, the amount of the prior year's reserve is included in income and no new deduction is taken.

[15] If the loan becomes “bad” (that is, entirely uncollectible), the amount of the loan may be deducted under subparagraph 20(1)(*p*)(ii) of the *Income Tax Act* in the year the loan becomes bad. If all or part of the loan is collected in a subsequent year, the amount collected is included in income in that year.

The Tax Court decision

[16] In the Tax Court, Heron Bay argued that in 1995 the loan to Viewmark was a doubtful loan entitling Heron Bay to a deduction of $3,770,000 on the basis of subparagraph 20(1)(*l*)(ii) of the *Income Tax Act*, or alternatively a bad loan entitling Heron Bay to a deduction of the same amount on the basis of subparagraph 20(1)(*p*)(ii). The same arguments were made in this Court. It is clear that if, as the judge found, the conditions in subparagraph 20(1)(*l*)(ii) are not met, the more stringent test in subparagraph 20(1)(*p*)(ii) cannot be met either.

[17] It is common ground that, by virtue of subparagraph 20(1)(*l*)(ii), Heron Bay is entitled to the $3,770,000 deduction claimed if the following three conditions are met. First, Heron Bay’s ordinary business in its 1995 taxation year must have included the lending of money. Second, Heron Bay must have made the Viewmark loan in the ordinary course of its money lending business. Third, by the end of Heron Bay’s 1995 taxation year, there must have been a reasonable doubt that the Viewmark loan was collectible.

[18] The judge concluded that the first condition was met because, in Heron Bay’s 1995 taxation year, its ordinary business included the lending of money. That conclusion is not challenged.

However, the judge also concluded that the second condition was not met because the Viewmark loan was not made by Heron Bay in the ordinary course of its money lending business. That would have been enough to justify dismissing the appeal, but the judge went on to conclude that the third condition was not met either because there was no reasonable doubt, as of the end of Heron Bay's 1995 taxation year, that the Viewmark loan was collectible.

The appeal

[19] In this appeal, Heron Bay argues that the judge was wrong in law when he concluded that the second and third statutory conditions were not met. However, Heron Bay's principal argument is that the judge deprived Heron Bay of procedural fairness by considering authorities not cited by either party without giving the parties an opportunity to make submissions on those authorities, considering issues not pleaded by either party without giving the parties an opportunity to make submissions on those issues, and intervening excessively in the examination of witnesses, giving rise to a reasonable apprehension of bias.

Discussion

Consideration of authorities not cited by either party without inviting submissions

[20] This ground of appeal is based on the fact that the judge considered or referred to the following 16 authorities that were not cited or referred to by either party:

Item	Authority	Judge's use of authority
1.	*Ainsworth Lumber Co. v. Canada*, [2001] 3 C.T.C. 2001, 2001 DTC 496 (T.C.C.)	Reasons, paragraph 60. The reference to this case appears in a quotation from item 5.
2.	*British Columbia Telephone Co. v .Canada (Minister of National Revenue – M.N.R.)*, [1986] 1 C.T.C. 2410, 86 DTC 1286 (T.C.C.)	Reasons, paragraph 53 (relating to the meaning of "ordinary course of business").
3.	*Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, 2005 SCC 54	Not cited in reasons.
4.	*Canadian Commercial Bank v. Prudential Steel Ltd*. (1986), 49 Alta. L.R. (2d) 58, 75 A.R. 121, 66 C.B.R. (N.S.) 172 (Q.B.).	Reasons, paragraph 56 (relating to the meaning of "ordinary course of trade").
5.	Brian R Carr and Duane R. Milot "Copthorne: Series of Transaction Revisited" in "Corporate Tax Planning" (2008) 56:1 *Canadian Tax Journal*, 243-268.	Reasons, paragraph 60 (relating to the principle of statutory interpretation that requires a word used in a statute to be given the same meaning throughout the statute).
6.	Pierre-André Côté, *The Interpretation of Legislation in Canada*, 2nd ed. (Québec: Les Éditions Yvon Blais Inc., 1991).	Reasons, paragraph 60 (same as item 5).
7.	Guy Fortin and Melanie Beaulieu, "The Meaning of the Expressions 'In the Ordinary Course of Business' and 'Directly or Indirectly'", *Report of Proceedings of the Fifty-fourth Tax Conference*, 2002 Conference Report (Toronto: Canadian Tax Foundation, 2003) 36:1-60.	Reasons, paragraph 52 (relating to the meaning of "ordinary course of business").
8.	*Hogan v. Minister of National Revenue*, 15 Tax A.B.C. 1 (I.T.A.B.).	Reasons, paragraph 84 (relating to the factors to be taken into account in determining whether a debt is bad; the listed factors are from *Rich v. Canada (C.A.)*, [2003] 3 F.C. 493, a case cited by the parties which refers to *Hogan* as a precedent).
9.	*Industrial Investments Ltd. v. Minister of National Revenue*, [1973] C.T.C. 2161, 73 DTC 118 (T.R.B.).	Reasons, paragraph 57 (relating to the meaning of "ordinary course of business").
10.	Elizabeth J. Johnson and James R. Wilson, "Financing Foreign Affiliates: The Term Preferred Share Rules and Tower Structures" in "International Tax Planning," (2006), Vol. 54, No. 3, *Canadian Tax Journal*, 726-761.	Reasons, paragraph 55 (relating to the meaning of "ordinary course of the taxpayer's business").

11.	*Re Pacific Mobile Corp*., (1982) 141 D.L.R. (3d) 696 (Qc. C.A.).	Reasons, paragraph 59 (a passage relating to the "ordinary course of business" is quoted as being approved by item 12).
12.	*Pacific Mobile Corp. (Trustee of) v. American Biltrite (Canada) Ltd.*, [1985] 1 S.C.R. 290.	Reasons, paragraph 59 (same as item 11).
13.	*Royal Bank of Canada v. Tower Aircraft Hardware Inc.* (1991), 78 Alta. L.R. (2d) 271, 118 A.R. 86, 3 C.B.R. (3d) 655 (Q.B).	Reasons, paragraph 56 (relating to the meaning of "ordinary course of business").
14.	*Saltzman v. Minister of National Revenue*, 64 DTC 259 (T.A.B.).	Reasons, paragraph 43 (relating to the determination of when a person is carrying on a money lending business).
15.	*Société d'investissement Desjardins v. Canada (Minister of National Revenue - M.N.R.)*, [1991] 1 C.T.C. 2214, 91 DTC 393 (en.), 91 DTC 373 (fr.) (T.C.C.).	Reasons, paragraph 62 (relating to the meaning of "ordinary course of business").
16.	*Swystun Management Ltd. v. Minister of National Revenue*, [1979] C.T.C. 2476, 79 DTC 417 (T.R.B.)	Not cited in reasons.

[21] The judge cannot be precluded from referring in his deliberations to cases that are not cited by a party and are not referred to in his reasons. That disposes of items 3 and 16.

[22] Nor can the judge, when addressing a legal issue raised by a party, be precluded from referring to a case he considers relevant to that issue merely because the case was not cited by a party. As I understand the judge's reasons, most of the cases listed above are relevant to his interpretation of the phrase "in the ordinary course of the taxpayer's business of … the lending of money" in subparagraph 20(1)(*l*)(ii), and one case relates to the principles to be applied in determining whether a debt is bad. Heron Bay may take the position that the judge misinterpreted the relevant statutory provisions, or that he was led into error by his consideration of inapplicable jurisprudence or statutes. But in my view, the mere fact that the judge referred to cases not cited by

either counsel is not, by itself, an error of law or a breach of procedural fairness. That disposes of items 2, 4, 8, 9, 11, 12, 13, 14 and 15.

[23] As to the judge's reliance on articles by learned authors, it seems to me that he has simply adopted from those articles excerpts (including case references) stating principles that the authors have derived from jurisprudence relevant to the issues raised in the appeal. In my view, the judge's reference to those articles is not an error of law or a breach of procedural fairness. That disposes of the remaining items 1, 5, 6, 7, 10.

[24] A breach of procedural fairness might have been demonstrated if the judge, by his reference to any of the 16 authorities referred to above, had introduced a principle of law that was not raised by either party expressly or by necessary implication, or had taken the case on a substantially new and different analytical path. However, as I understand the judge's reasons, he did not use any of these authorities for that purpose. I conclude that there is no merit to this ground of appeal.

Consideration of an issue not raised by either party without inviting submissions

[25] This ground of appeal relates to the judge's analysis of the third statutory condition for entitlement to a deduction under subparagraph 20(1)(*l*)(ii) of the *Income Tax Act*. The third condition was that the Viewmark loan be doubtful as of August 31, 1995, meaning that there was a reasonable doubt at that time that the Viewmark loan would be collected.

[26] The debate on this issue, as framed by the parties, turned largely on the value of the 289 lots that the Viewmark/Shellfran joint venture agreed to purchase in August of 1994 for $24,500,000.

Heron Bay's security for the Viewmark loan was Viewmark's 95% interest in the Viewmark/Shellfran joint venture. The Viewmark loan was made to finance most of Viewmark's 95% share of the deposit on that purchase price.

[27] Heron Bay presented evidence intended to establish that the directing mind of Heron Bay concluded on reasonable grounds that, as of August 31, 1995, the end of Heron Bay's 1995 fiscal year, the value of Viewmark's 95% interest in the Viewmark/Shellfran joint venture was less than Viewmark's share of the unpaid purchase price and, because the Viewmark loan was non-recourse, it was doubtful that the Viewmark loan was collectible.

[28] The Crown presented evidence intended to establish that the value of the 289 lots, and therefore the value of Viewmark's interest in the Viewmark/Shellfran joint venture, did not decline between November of 1994 when the Viewmark loan was fully advanced and August 31, 1995. The Crown's argument, based on that evidence, was that either the Viewmark loan was not doubtful on August 31, 1995, or the Viewmark loan was made on such unreasonable terms that it fell outside the ordinary course of Heron Bay's money lending business.

[29] In closing argument, the judge engaged in a conversation with Mr. Shipley, counsel for the Crown, as to the possible application of section 69 of the *Income Tax Act*. Paragraph 69(1)(*a*) provides that where a taxpayer acquires anything from a person with whom the taxpayer does not deal at arm's length at an amount in excess of its fair market value at the time of acquisition, the taxpayer is deemed for income tax purposes to have acquired the thing at that fair market value.

Section 69 was not pleaded by the Crown and did not form part of the Crown's theory of the case, as counsel for the Crown made clear in his submissions.

[30] The following excerpt from the transcript indicates the judge's concern, during final argument, about section 69 (Appeal Book, Transcript, pages 442:12 – 443:24):

> THE COURT: There is another possibility, which is perhaps [that] the cost was overstated at the outset.
>
> I asked you that question, and you said this is not part of your case, because normally if the loan was non-market when it was [made] at the outset, that the opening cost of that loan could have exceeded fair market value. And then afterwards, you could argue there would be no write-down, because there has been no change in value between the two dates.
>
> But that is not your case, as I understand it. Your case is that the original cost was good, therefore the only real issue is what is its value in the future.
>
> MR. SHIPLEY: I guess our interpretation of those provisions was different than Your Honour's, and we will have to respect Your Honour's views about that.
>
> But we understood that the cost of the loan was $3.7 million, because that was the amount that was paid by the –
>
> THE COURT: Doesn't [section] 69 of the statute say that if I acquire a property, if I exchange cash for a loan on a property, that the cost can never exceed the [fair market value]?
>
> I think it does. You may be trying to get at it on the back end, as opposed to having to try to deal with the issue at the front end.
>
> The back end is that maybe it is worth zero, and it could have been worth zero at the outset, too.
>
> But that is not your case.
>
> MR. SHIPLEY: Let's assume you are right, and I know you are far more experienced in tax matters than I am, so I am not going to quarrel with anything you have said. . . .

[31] Mr. Shipley then proceeded to argue the Crown's theory of the case without further reference to section 69.

[32] Ultimately, the judge concluded that the Viewmark loan was not doubtful on August 31, 1995. His analysis appears at paragraphs 79 to 113 of his reasons. In paragraphs 79 to 89, the judge sets out his analysis of what he considered to be the relevant jurisprudence: *Rich v. Canada (C.A.)*, [2003] 3 F.C. 493, 2003 FCA 38, *Flexi-Coil Ltd. v. Canada*, [1996] 1 C.T.C. 2941 (T.C.C.), affirmed (1996), 199 N.R. 120, [1996] 3 C.T.C. 57, 96 DTC 6350 (F.C.A.), *Coppley Noyes & Randall Ltd. v. Minister of National Revenue* (1991), 43 F.T.R. 291, [1991] 1 C.T.C. 541, 91 DTC 5291 (F.C.T.D.), varied on consent, 93 DTC 5508 (F.C.A.), and *Highfield Corp. v. Minister of National Revenue*, [1982] C.T.C. 2812, 82 DTC 1835 (T.R.B.).

[33] The judge then proceeded to discuss a number of factors that he considered relevant in determining whether it was reasonable to conclude that the Viewmark loan was doubtful on August 31, 1995. The factors were discussed under the headings “History and Age of the Debt” (paragraphs 90 to 92), “The Financial Position of the Debtor” (paragraph 93), “Valuation Reports on the Value of the Land” (paragraphs 94 to 108), “The General Business Conditions in the Community” (paragraph 109) and “The Past Experience of the Taxpayer with Writing off Doubtful Debts” (paragraphs 110 to 114).

[34] Under the heading “Valuation Reports on the Value of the Land”, the judge discussed the expert valuation evidence of Mr. Atlin (for Heron Bay) and Mr. Davies (for the Crown). The judge says at paragraph 104 of his reasons that he preferred Mr. Davies’ approach to the valuation “because he relies on the actual arm’s length sale in concluding that the value of [Viewmark’s] joint venture assets had not declined by the time Heron Bay claimed its write-off.”

[35] The judge then went on, in paragraphs 105 and 106 of his reasons, to discuss Mr. Atlin's evidence and to refer to section 69. Paragraphs 105 and 106 read as follows:

> [¶105] If I was to accept Mr. Atlin's view, I believe a reasonable conclusion could be drawn that Heron Bay's cost of the loan was overstated at the outset and should be reduced pursuant to paragraph 69(1)(*a*) of the *ITA*.
>
> [¶106] Paragraph 69(1)(*a*) provides that where a taxpayer acquires property from a person with whom that taxpayer was not dealing at arm's [length] at an amount in excess of its fair market value at the time, the taxpayer's cost shall be deemed to be that fair market value. Heron Bay gave cash to Viewmark Homes, a non-arm's length party, in exchange for intangible property in the form of a loan receivable. On the face of it, paragraph 69(1)(*a*) could accordingly apply, resulting in no deduction as the cost of the non-recourse loan would be nil for Heron Bay. As Mr. Atlin testified that nothing had changed in the real estate market over the period in question, presumably the absorption costs that he used to justify a decline in the value of the land likewise existed at the time of purchase. I recognize that the Respondent did not seek to pursue this point when I raised it at trial. However, I simply cannot ignore it if it is otherwise applicable.

[36] Heron Bay argues that the judge breached the rules of procedural fairness when he applied section 69 to the detriment of Heron Bay without affording it an opportunity to make submissions.

[37] Heron Bay argues also that the judge's application of section 69 is wrong in law. According to the formula in subparagraph 20(1)(*l*)(ii), the base amount for the determination of the permissible reserve under subparagraph 20(1)(*l*)(ii) is not the "cost" of the loan, but the "amortized cost" as defined in subsection 248(1). Under that definition, the amortized cost of a loan made by a taxpayer (as opposed to a loan that is "acquired", for example by means of a purchase) is the total of all amounts advanced in respect of the loan. On August 31, 1995, the amortized cost of the Viewmark loan was $3,770,000.

[38] The Crown has taken no position on the judge's interpretation of section 69, but argues that the judge's comments on section 69 did not form part of the basis upon which the judge concluded that the Viewmark loan was not doubtful on August 31, 1995. Therefore, according to the Crown, the judge's comments on section 69 resulted in no detriment to Heron Bay.

[39] I express no opinion on the question of whether the judge's interpretation and proposed application of section 69 is correct. I agree with Heron Bay that the introduction of section 69 without inviting submissions was a breach of the rules of procedural fairness and should not have occurred. However, I also agree with the Crown that this breach did not result in a detriment to Heron Bay. Having carefully reviewed all of the judge's comments on the issue of whether the Viewmark loan was doubtful on August 31, 1995, I conclude that the reference to section 69 was *obiter*. This particular breach, by itself, does not justify a retrial.

Whether the judge intervened excessively in examinations and cross-examinations

[40] Heron Bay argues that the judge intervened excessively in the examination in chief of Sheldon Libfeld, its only lay witness. It is common ground that excessive intervention by a trial judge may warrant a new trial (see *James v. Canada (Minister of National Revenue – M.N.R.)* (2000), 266 N.R. 104, [2001] 1 C.T.C. 227, 2001 D.T.C. 5075 (F.C.A.); *Chippewas of Mnjikaning First Nation v. Ontario (Minister of Native Affairs)*, 2010 ONCA 47).

[41] The relevant principles are stated as follows in *James* (paragraphs 51-53):

> [¶51] The applicable principles are not in dispute. They are well established in such cases as *Yuill* v. *Yuill*, [1945] 1 All E.R. 183 (C.A.), *Jones* v. *National Coal Board*, [1957] 2 All E.R. 155 (C.A.), *Majcenic* v. *Natale*, [1968] 1 O.R. 189 (C.A.); *R.* v. *Brouillard*,

> [1985] 1 S.C.R. 39, *Rajaratnam* v. *Canada (Minister of Employment and Immigration)*, (1991), 135 N.R. 300, [1991] F.C.J. No. 1271 (F.C.A.)(QL); *Sorger* v. *Bank of Nova Scotia* (1998), 39 O.R. (3d) 1, 160 D.L.R. (4th) 66 (C.A.).
>
> [¶52] The general rule is that a judge may ask a witness questions of clarification and amplification, but should not intervene in the questioning of a witness to such an extent as to give the impression of taking on the role of counsel. A judge who does so necessarily will be seen as having adopted a position in opposition to one of the parties. That diminishes the appearance of impartiality that is critical to the goal of ensuring that justice is not only done, but is seen to be done. It may also interfere with the effective presentation of the case by counsel.
>
> [¶53] An allegation of undue intervention in the questioning of a witness must be assessed in the context of the proceedings as a whole. The objective of such a review is not to determine whether the interventions were well motivated or well intentioned. Rather, the objective is to determine whether the intervention would cause a reasonable and well informed observer to apprehend that the mind of the trial judge was closed to a fair and impartial consideration of the case: *Committee for Justice and Liberty v. National Energy Board*, [1978] 1 S.C.R. 369. Where it is determined that there are interventions having that effect, the only possible remedy is to remit the matter for retrial.

[42] I emphasize that it is not alleged the judge was impatient, uncivil or disrespectful at any time. Further, there is no allegation of actual bias on the part of the judge, and no suggestion of actual bias is disclosed by the record. The only question is whether the judge's interventions gave rise to a reasonable apprehension of bias.

[43] To put this issue in context in this case, it is necessary to consider some basic facts about the trial. It was not a long trial. It lasted for a total of 2 ½ days, including opening statements and closing submissions. The evidence of Mr. Libfeld consumed the first day. His examination in chief began after the opening statement of counsel for Heron Bay and continued until the lunch break (approximately 3 hours). His cross-examination began after the lunch break and continued for most of the afternoon (slightly more than 2 hours). There was a short, uninterrupted re-examination.

[44] Of the total questions put to Mr. Libfeld in the examination in chief, the judge asked 56 of them (approximately 22%). In the cross-examination, the judge asked Mr. Libfeld 6 of the 315 questions (approximately 2%).

[45] The number of interventions by the judge during the examination in chief of Mr. Libfeld was extraordinary, but that by itself does not establish that the interventions were improper. Many of the judge's questions were appropriate attempts to clarify the facts and gain a full understanding of the transactions.

[46] However, very early in the course of the examination in chief of Mr. Libfeld, the judge seemed to fall into the habit of taking over the questioning. I refer, for example, to page 22 to page 24 of the transcript. Counsel for Heron Bay had asked some questions intended to elicit the corporate history of Heron Bay and facts about how it conducted its business. The judge intervened by asking properly for a clarification of Heron Bay's practice of providing mortgage financing for house buyers.

[47] But then the judge proceeded to ask more questions: whether that practice was "usual" (meaning usual for real estate developers), whether Heron Bay took first or second mortgages, whether Heron Bay would sell the mortgages, and how Heron Bay would finance the reacquisition of the mortgages from the bank if called upon to do so.

[48] Counsel then turned to questions about the specific transactions in issue. Again, the judge asked numerous questions, all apparently for the purpose of clarification. But soon the judge again

took over the questioning, for five full pages of the transcript (pages 52 to 56), relating to the terms of the purchase from Runnymede, the interest on the unpaid purchase price, and the time required to develop and sell the lots. He does the same in a further 3 pages (pages 64-66), asking questions about the Runnymede dispute and arbitration. All of this occurred before the morning break.

[49] Soon after the morning break, the judge made what appears to me to be the most problematic series of interventions (pages 67-70 of the transcript). It begins immediately after counsel for Heron Bay has elicited from Mr. Libfeld the fact that the only security for the Viewmark loan was Viewmark's interest in the joint venture. The judge then took over the questioning, as follows (Appeal Book, Transcript, pages 67:14 to 70:13):

> THE COURT: I would like to ask the witness a question.
>
> We are dealing with related companies at this point. Without questioning your judgment, why would you make a non-recourse loan? What difference would it make, from a business or commercial standpoint?
>
> THE WITNESS: We wanted to protect corporations within the system.
>
> It would be beneficial to make it non-recourse, so if there was a problem with one of the other corporations, it wouldn't end up affecting it.
>
> THE COURT: I understand that. But if you own both companies, whether you make a loan recourse or non-recourse, you can always change the terms of the agreement, right?
>
> If I own both corporations, I could lend on a recourse basis and say the day after that I forgive the loan, or change the terms and conditions of the loan for whatever reason I see fit.
>
> THE COURT: I guess my question is: Is there an overriding commercial reason that sort of drove you towards asking [that] this loan [be] non-recourse?
>
> THE WITNESS: The commercial reason is to protect. If something happened, we wouldn't want people to be able to go through one company to another, to be able to realize on that loan.
>
> We didn't want to put Viewmark at risk, if something happened to Heron Bay.

THE COURT: Did Viewmark have other assets you were trying to protect?

THE WITNESS: It was determined at the time that it was Heron Bay that had the surplus cash, so that it why it came from Heron Bay.

Viewmark, later on, had a lot of debt to the bank as well; they were on covenants to the bank.

So it was determined that Heron Bay had this excess cash available. Number two, it is structured in a way that we protect the interest of the system, so to speak, in terms of not allowing one corporation to end up triggering a domino effect throughout the rest of the system.

THE COURT: But in essence, you are creating an advantage for the seller and the buyer, because by making the loan non-recourse – obviously, he has title for the land because he has kept title, but you still owe him the money.

Say, for example, you didn't close. He could sue for [sic] you for the whole payment of the cash you owe him. Presumably, he would sue Viewmark or whomever he had contracted with.

Are you not creating equity in Viewmark by making a non-recourse loan indirectly?

MR. INNES: Your Honour, the covenant to Runnymede was from Rosehue and Burlmarie.

THE WITNESS: The structure allowed that if we didn't close on the land, it would be Rosehue and Burlmarie they would have to look for.

Because it was a loan, they wouldn't be able to trace it through, up to the various other corporations we had.

It was all done commercially to protect interests within the system at all times.

THE COURT: Is this something that you do today, or did in later years, this sort of non-recourse loans to entities within the group?

THE WITNESS: Yes.

[50] Counsel for Heron Bay then resumed the examination in chief of Mr. Libfeld. The judge made additional interventions, sometimes for clarification, sometimes to ask questions of questionable relevance that were otherwise unobjectionable.

[51] In the only other lengthy intervention in the examination in chief of Mr. Libfeld (pages 77 to 82 of the transcript), the judge asks a number of questions intended to clarify details on an exhibit containing a corporate chart, which counsel for Heron Bay conceded was somewhat misleading in that it was not clear that Marlo was a nominee for the Viewmark/Shellfran joint venture.

[52] My review of the remainder of the transcript indicates that, during the questioning of the other witnesses, the judge intervened less, and his questions were more often directed to counsel than to the witness.

[53] It must be noted that counsel for Heron Bay did not raise any objections to any of the judge's interventions during the examination in chief of Mr. Libfeld. There is not even a polite rebuke or suggestion from counsel that examination in chief was counsel's job.

[54] However, it seems to me that in the circumstances of this case, the failure of the part of counsel to object to the judge's interventions is significantly outweighed by the judge's use of the passage of the transcript quoted above. Specifically, the judge's negative assessment of Mr. Libfeld's explanation for the non-recourse feature of the Viewmark loan is based on the quoted passage, and that negative assessment is the linchpin of the judge's conclusion that Heron Bay did not make the Viewmark loan in the ordinary course of its money lending business. That is apparent from the following excerpt from the judge's reasons (paragraphs 73 to 78; footnotes omitted):

> [73] … In the present case, the specific terms and features of the non-recourse debt made it extraordinary and put it outside Heron Bay's ordinary course of business. This, in tandem with the non-arm's length relationship between Heron Bay and Viewmark Homes, as well as the fact that both non-recourse loans were written off by Heron Bay as

bad or doubtful debts, all suggests to me that something was going on, something outside the ordinary course of the taxpayer's business.

[74] Mr. Libfeld was given the opportunity during cross-examination to explain the underlying reason for making the loan to Viewmark Homes non-recourse. He stated, commencing at line 12 of page 134 of the trial transcript, that "to protect the interests of all the companies involved, we made it non-recourse… ". To similar effect is the following question-answer sequence from the examination-in-chief of Mr. Libfeld, commencing at line 6 of page 67 of the trial transcript:

> Q. Could you tell us what security, if any, Heron Bay took with respect to this loan?
>
> A. Heron Bay took Viewmark's interest in Marlo as security for this loan.
>
> Q. Was there any other form of recourse?
>
> A. No.
>
> THE COURT: I would like to ask the witness a question.
>
> We are dealing with related companies at this point. Without questioning your judgment, why would you make a non-recourse loan? What difference did it make, from a business or commercial standpoint?
>
> THE WITNESS: We wanted to protect corporations within the system.
>
> It would be beneficial to make it non-recourse, so if there was a problem with one of the other corporations, it wouldn't end up affecting it.
>
> . . .
>
> THE WITNESS: The commercial reason is to protect. If something happened, we wouldn't want people to be able to go through one company to another, to be able to realize on that loan.
>
> We didn't want to put Viewmark at risk, if something happened to Heron Bay.
>
> . . .
>
> THE WITNESS: . . . it is structured in a way that we protect the interest of the system, so to speak, in terms of not allowing one corporation to end up triggering a domino effect throughout the rest of the system.

[75] While a borrower may request that a loan be non-recourse for *bona fide* commercial reasons, I do not find Mr. Libfeld's explanation — namely the protection of Viewmark Homes' assets from Heron Bay — to be credible. Heron Bay often borrowed on a full recourse basis from corporations within the group and loaned on a full recourse basis. This included a loan from Viewmark Homes to Heron Bay in excess of $5 million. The inference could thus be made that, but for the without a recourse restriction on the promissory note, Viewmark Homes would have had the capacity to satisfy the debt. That is, rather than loan the money, Heron Bay could, in my view, have instead repaid the loan it received. Heron Bay could have offset one loan against the other, were it not for the without-recourse element of the loan.

[76] Additionally, it does not appear from the evidence that Runnymede, the entity to which was owed a balance of sale price secured by the land, requested that the loan be made non-recourse. There is also no evidence that the banks lending to the Conservatory

> Group requested this feature. Generally speaking, unrelated creditors may demand subordination of related-party indebtedness to provide better security for their loans.
>
> [77] In the end, I find that the loan was extraordinary and abnormal. It deviated from the types of loans that Heron Bay would generally make in the course of its business. This is particularly true if one bears in mind the interpretation to be given to the concept "ordinary course" pursuant to the decision of this Court in *Société d'investissement Desjardins*, above. The loan fails to fall into place as part of the undistinguished common flow of Heron Bay's business. It is clearly different from Heron Bay's day-to-day business and its practice of making full recourse loans. In the absence of any credible and convincing evidence to the contrary, I draw a negative inference from the circumstances presented to me: that is, the loan was made non-recourse to facilitate its earlier write-off.
>
> [78] Considering the other with-recourse loans made back and forth between the related entities and the almost immediate bad debt claim with respect to the without-recourse loan, the assertion that the without-recourse feature was designed to protect the interests of Heron Bay from third parties is difficult to accept as an accurate and realistic portrayal of what was really occurring. The "ordinary course" requirement in paragraph 20(1)(*l*) serves to prohibit the doubtful debt reserve even in the case of persons that loan money as part of their business, unless the loan is made in the ordinary course of the taxpayer's business.

[55] It is sufficiently clear from the judge's reasons that the evidence of Mr. Libfeld elicited by the judge provided the evidentiary basis upon which the judge relied for a critical conclusion in favour of the Crown. It is also clear that this evidence was elicited by the judge in the course of a lengthy intervention toward the end of a morning of questioning of Mr. Libfeld in which the judge almost routinely took over the questioning from counsel for Heron Bay.

[56] I observe also that the judge, in quoting the relevant portion of the transcript in paragraph 74 of his reasons, omitted some relevant passages. First, he omitted the lines containing many of his own questions, thus obscuring the fact that the quoted comments of Mr. Libfeld were not answers to questions by counsel. Second, the judge failed to mention that in answer to the judge's last question in this intervention, Mr. Libfeld indicated that Heron Bay "today or in later years" made "this sort of non-recourse loan" to entities within the corporate group.

[57] In my view, the record is such as to give a reasonable and well informed observer the impression that the judge, during the examination of Mr. Libfeld and as a result of his own questioning, adopted a position in opposition to Heron Bay on a critical issue in the case, giving rise to a reasonable apprehension that the judge was not a fair and impartial arbiter. This procedural flaw is such that the judgment cannot stand, and the matter must be returned to the Tax Court for a new trial before a different judge.

[58] I emphasize that it is possible for a trial judge to obtain necessary information from a witness that has not been elicited by counsel, without risking a fatally flawed trial. In that regard, some useful advice is provided by the Ontario Court of Appeal in *Chippewas of Mnjikaning* (cited above), at paragraphs 237-239 (citations and footnotes omitted):

> [¶237] For the most part, trial judges can manage the trial process by asking questions of counsel, making comments or giving directions about the course of the trial. Trial judges should be careful about trying to control a trial by examining witnesses. In the normal course, "the trial Judge should confine himself [or herself] as much as possible to his [or her] own responsibilities and leave to counsel ... [his or her] ... function"…
>
> [¶238] On occasion, trial judges may be required to play a more active role in asking witnesses questions. However, when they do, it is important that they use care and not create an impression through the questioning process of having adopted a position on the facts, issues or credibility.
>
> **[**¶239] When a trial judge has questions for a witness being examined by counsel, it is generally best to leave the questions to a point during the evidence where counsel has completed a particular area or to the end of the witness's evidence. In that way, the judge avoids interfering with the organization and flow of the evidence. Excessive judicial intervention in the examination of a witness, whether in-chief or on cross-examination, may hamper counsel from following a well thought-out and organized line of inquiry.

Other issues

[59] Of the remaining grounds of appeal, some relate to the judge's application of the relevant statutory provisions to the facts of this case, while others relate to the judge's understanding of the documentary evidence or his assessment of the credibility of the witnesses. Because I have concluded that this matter should be retried, I prefer to make no comment on any of the other grounds of appeal.

Conclusion

[60] For these reasons, I would allow the appeal with costs, set aside the judgment of the Tax Court, and refer this matter back to the Tax Court for retrial by a different judge. The matter of costs of the first trial is deferred to the judge on the rehearing.

"K. Sharlow"
J.A.

"I agree
M. Nadon J.A."

"I agree
Carolyn Layden-Stevenson J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-415-09
(APPEAL FROM A JUDGMENT OR ORDER OF THE TAX COURT OF CANADA DATED SEPTEMBER 8, 2009), NO. 2009 TCC 337 (DOCKET NO. 2003-4006(IT)G))	
STYLE OF CAUSE:	HERON BAY INVESTMENTS LTD. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Ottawa, Ontario
DATE OF HEARING:	June 23, 2010
REASONS FOR JUDGMENT BY:	Sharlow J.A.
CONCURRED IN BY:	Nadon J.A. Layden-Stevenson J.A.
DATED:	July 29, 2010

APPEARANCES:

William I. Innes David Spiro Douglas Stewart	FOR THE APPELLANT
William Softley Perry Derksen John Shipley	FOR THE RESPONDENT

SOLICITORS OF RECORD:

Fraser Milner Casgrain LLP Toronto, Ontario	FOR THE APPELLANT
Myles J. Kirvin Deputy Attorney General of Canada	FOR THE RESPONDENT