Federal Court of Appeal | Cour d'appel fédérale

CANADA

Date: 20101217

Docket: A-498-09

Citation: 2010 FCA 353

CORAM: **LÉTOURNEAU J.A.**
NADON J.A.
TRUDEL J.A.

BETWEEN:

GENEX COMMUNICATIONS INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Montréal, Quebec, on December 14, 2010.

Judgment delivered at Ottawa, Ontario, on December 17, 2010.

REASONS FOR JUDGMENT: LÉTOURNEAU J.A.

CONCURRED IN BY: NADON J.A.
TRUDEL J.A.

Federal Court of Appeal | Cour d'appel fédérale

CANADA

Date: 20101217

Docket: A-498-09

Citation: 2010 FCA 353

CORAM: **LÉTOURNEAU J.A.**
NADON J.A.
TRUDEL J.A.

BETWEEN:

GENEX COMMUNICATIONS INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

REASONS FOR JUDGMENT

LÉTOURNEAU J.A.

Issue

[1] The appellant challenges a decision of Justice Favreau (judge) of the Tax Court of Canada dismissing its appeal with costs and confirming the assessment for the year 2003 made by the Minister of National Revenue (Minister) on October 19, 2006, under the *Income Tax Act*, R.S.C. 1985, 5th Supp. (Act).

[2] The issue which was before him, and which is now before us in part, concerned the concept of “commercial debt obligation” as defined in subsection 80(1) of the Act and the effects of a waiver by the shareholders of Corporation Showbizznet (Corporation) of their right to claim repayment of advances they had made to the Corporation.

[3] I say, in part, since the judge’s finding to the effect that this was commercial debt obligation within the meaning of section 80 of the Act is not challenged in this appeal.

[4] Instead, the appellant’s new counsel astutely takes issue with the calculation of the “forgiven amount” as defined in subsection 80(1) of the Act. He argues that the judge erred in determining the quantum of the forgiven amount at the time the principal amount of the obligation was settled. It was this error, he says, that led the judge to dismiss his client’s appeal.

[5] To properly appreciate the parties’ arguments, it is useful to reproduce the relevant legislative provisions and summarize the facts giving rise to the dispute.

Relevant legislative provisions

[6] Section 80 of the Act reads as follows:

80. (1) In this section,	**80.** (1) Les définitions qui suivent s’appliquent au présent article.
“commercial debt obligation” « créance commerciale »	« créance commerciale » “commercial debt obligation”

"commercial debt obligation" issued by a debtor means a debt obligation issued by the debtor (*a*) where interest was paid or payable by the debtor in respect of it pursuant to a legal obligation, or (*b*) if interest had been paid or payable by the debtor in respect of it pursuant to a legal obligation, an amount in respect of the interest was or would have been deductible in computing the debtor's income, taxable income or taxable income earned in Canada, as the case may be, if this Act were read without reference to subsections 15.1(2) and 15.2(2), paragraph 18(1)(g), subsections 18(2), 18(3.1) and 18(4) and section 21;	« créance commerciale » Créance émise par un débiteur et sur laquelle un montant au titre d'intérêts est déductible dans le calcul du revenu, du revenu imposable ou du revenu imposable gagné au Canada du débiteur compte non tenu des paragraphes 15.1(2) et 15.2(2), de l'alinéa 18(1)g), des paragraphes 18(2), (3.1) et (4) et de l'article 21, si ces intérêts : *a*) soit ont été payés ou étaient payables par le débiteur en exécution d'une obligation légale; *b*) soit avaient été payés ou payables par le débiteur en exécution d'une telle obligation. Il est entendu que la créance commerciale constitue une obligation pour l'application de la définition de « principal » au paragraphe 248(1).
"commercial obligation" « dette commerciale »	« dette commerciale » "commercial obligation"
"commercial obligation" issued by a debtor means (*a*) a commercial debt obligation issued by the debtor, or (*b*) a distress preferred share issued by the debtor;	*a*) Créance commerciale émise par un débiteur; *b*) action privilégiée de renflouement émise par un débiteur. Il est entendu que la dette commerciale constitue une obligation pour l'application de la définition de « principal » au paragraphe 248(1).
"forgiven amount" « montant remis »	« montant remis » "forgiven amount"
"forgiven amount" at any time in respect of a commercial obligation issued by a debtor is the amount determined by the formula	« montant remis » S'agissant du montant remis, à un moment donné, sur une dette commerciale émise par un débiteur, le montant déterminé selon la

formule suivante :

A - B

A - B

where
A is the lesser of the amount for which the obligation was issued and the principal amount of the obligation, and
B is the total of
(*a*) the amount, if any, paid at that time in satisfaction of the principal amount of the obligation,

où :
A représente le moins élevé du montant pour lequel la dette a été émise ou du principal de la dette;
B le total des montants suivants :
a) le montant payé à ce moment en règlement du principal de la dette,

. . .

[…]

Reductions of non-capital losses

(3) Where a commercial obligation issued by a debtor is settled at any time, the forgiven amount at that time in respect of the obligation shall be applied to reduce at that time, in the following order,

Réduction des pertes autres qu'en capital

(3) En cas de règlement d'une dette commerciale émise par un débiteur, le montant remis sur la dette au moment du règlement est appliqué en réduction, à ce moment, des pertes suivantes selon l'ordre établi ci-après :

(*a*) the debtor's non-capital loss for each taxation year that ended before that time to the extent that the amount so applied
(i) does not exceed the amount (in subsection 80(4) referred to as the debtor's "ordinary non-capital loss at that time for the year") that would be the relevant loss balance at that time for the obligation and in respect of the debtor's non-capital loss for the year if the description of E in the definition "non-capital loss" in subsection 111(8) were read without reference to the expression "the taxpayer's allowable business investment loss for the year", and

a) la perte autre qu'une perte en capital du débiteur pour chaque année d'imposition qui s'est terminée avant ce moment, dans la mesure où le montant ainsi appliqué :
(i) d'une part, ne dépasse pas le montant (appelé « perte autre qu'en capital ordinaire » au paragraphe (4)) qui constituerait le solde de pertes applicable, à ce moment, quant à la dette et à la perte autre qu'une perte en capital du débiteur pour l'année s'il n'était pas tenu compte du passage « sa perte déductible au titre d'un placement d'entreprise » à l'élément E de la formule figurant à la définition de « perte autre qu'une perte en capital »

(ii) does not, because of this subsection, reduce the debtor's non-capital loss for a preceding taxation year;

au paragraphe 111(8),
(ii) d'autre part, ne réduit pas, par l'effet du présent paragraphe, la perte autre qu'une perte en capital du débiteur pour une année d'imposition antérieure;

(*b*) the debtor's farm loss for each taxation year that ended before that time, to the extent that the amount so applied
(i) does not exceed the amount that is the relevant loss balance at that time for the obligation and in respect of the debtor's farm loss for the year, and
(ii) does not, because of this subsection, reduce the debtor's farm loss for a preceding taxation year; and

b) la perte agricole du débiteur pour chaque année d'imposition qui s'est terminée avant ce moment, dans la mesure où le montant ainsi appliqué :
(i) d'une part, ne dépasse pas le montant qui constitue le solde de pertes applicable, à ce moment, quant à la dette et à la perte agricole du débiteur pour l'année,
(ii) d'autre part, ne réduit pas, par l'effet du présent paragraphe, la perte agricole du débiteur pour une année d'imposition antérieure;

(*c*) the debtor's restricted farm loss for each taxation year that ended before that time, to the extent that the amount so applied
(i) does not exceed the amount that is the relevant loss balance at that time for the obligation and in respect of the debtor's restricted farm loss for the year, and
(ii) does not, because of this subsection, reduce the debtor's restricted farm loss for a preceding taxation year.

c) la perte agricole restreinte du débiteur pour chaque année d'imposition qui s'est terminée avant ce moment, dans la mesure où le montant ainsi appliqué :
(i) d'une part, ne dépasse pas le montant qui constitue le solde de pertes applicable, à ce moment, quant à la dette et à la perte agricole restreinte du débiteur pour l'année,
(ii) d'autre part, ne réduit pas, par l'effet du présent paragraphe, la perte agricole restreinte du débiteur pour une année d'imposition antérieure.

[Emphasis added]

Factual background

[7] Under a sales contract dated August 23, 2002, the appellant acquired all of the shares in the Corporation, which was in serious financial difficulty at the time. The Corporation was undercapitalized and running a deficit. The Corporation's shareholders made advances to it on a regular basis so that it could continue operating. After the appellant acquired all of the shares, the Corporation was liquidated.

[8] The appellant acquired all of the Corporation's shares for $1 and assumed all of its debts, as evidenced by clauses 1 and 2 of the sales contract contained in the Appeal Book, Vol. 1, pages 57 and 58, which read as follows:

> [TRANSLATION]
> 1.00 SALE
>
> 1.01 Class A shares
>
> Subject to the payment of the consideration and to the terms of this Contract, the VENDORS sell to the VENDEE a total of three million two hundred and eighty-nine thousand three hundred and sixty-six (*3,289,366*) Class A shares in the Corporation's capital stock, representing 100% of the share ownership in this class and all of the capital stock, in all classes of shares, on the basis that the allotment of shares before this sale was as follows:

Production Gilles Parent Inc.	762,407 shares
Ghislain Parent	242,943 shares
Groupe financier Réal Parent	2,087,668 shares
Réal Parent	76,48 shares
Martin Parent	83,580 shares
Productions Michel Morin	35,820 shares
TOTAL	3,289,366 shares

1.02 Waiver

The VENDORS waive the repayment of the advances, including accrued interest, that they have made to the Corporation and have not yet been repaid.

2.00 CONSIDERATION

2.01 Base price

This sale is made for and in consideration of the total amount of ONE DOLLAR ($1), which the VENDEE undertakes to pay upon the signing of this Contract.

2.02 Discharge of sureties

The VENDEE undertakes to do everything in his power to obtain the discharge of the suretyships granted in favour of the Corporation by the VENDORS and their affiliates as soon as possible after the signing of this Contract and further undertakes to indemnify them and save them harmless from and against any and all losses or damage that may result from those suretyships.

2.03 Repayment of financial institutions

Within 30 days of the signing of this Contact, the VENDEE will or will have repaid the debts incurred by the Corporation with the Caisse populaire des Chutes Montmorency and the Bank of Montreal.

[9] As can be seen in clause 1.02, with this sale, the Corporation's shareholders waived the repayment of the advances they had made to it. All of these facts are admitted in the Notice of Appeal that the appellant filed in the Tax Court of Canada, under section C), entitled [TRANSLATION] Material Facts. Item 2.4 reads as follows:

> [TRANSLATION]
> 2.4 When Genex purchased all of Showbizz's shares, in consideration of Genex paying $1 and assuming all of Showbizz's debts, it was agreed that Showbizz's shareholders would waive the repayment of their advances;
>
> [Emphasis added]

(See Appeal Book, Vol. 1, at page 26).

[10] I would add that, at the time of the sale, the shareholder's advances were not converted into shares but simply written off, as appears from item 2.6 of the appellant's Notice of Appeal:

> [TRANSLATION]
> 2.6 To simplify the transaction, it was agreed not to convert the advances in to shares, but to simply write them off.

[11] At the hearing before the Tax Court of Canada, counsel representing the appellant at that time confirmed this (see Appeal Book, Vol. 2, at page 61) in the following terms:

> [TRANSLATION]
> RENÉ DION: Your Honour, if you look at our pleadings, at no point do we argue that the advances were converted into capital stock.

[12] This explains how the shareholders were able to claim a capital loss on their respective tax returns and why the Minister accepted these losses.

[13] According to the sales contract, in acquiring the Corporation, the appellant undertook [TRANSLATION] "to do everything in his power to obtain the discharge of the suretyships granted in favour of the Corporation by the VENDORS and their affiliates as soon as possible after the signing of this Contract and . . . indemnify them and save them harmless from and against any and all losses or damage that may result from those suretyships": see clause 2.02 of the sales contract, above.

[14] Furthermore, according to clause 2.03 of the same contract, above, the appellant was to repay or to have repaid, "[w]ithin 30 days of the signing of this Contact, . . . the debts incurred by the Corporation with the Caisse populaire des Chutes Montmorency and the Bank of Montreal".

[15] I will now turn to the analysis of the parties' arguments and the judge's decision.

Analysis of parties' arguments and judge's decision

[16] Counsel for the appellant submits that the quantum of the forgiven amount under subsection 80(1) of the Act is negative, since the amounts of the long-term debt ($251,667) and short-term debt ($110,000) total $361,667 and thus exceed the amount for which the commercial obligation was issued, that is, $329,543.

[17] According to the formula A - B in subsection 80(1), to determine the amount of the forgiven amount, we take A, the principal amount of the commercial obligation ($329,543), and subtract B, the total of the amounts set out in paragraphs (*a*) to (*l*) of the definition of "forgiven amount", in this case $361,667, which according to counsel for the appellant is the amount his client paid in consideration of the shareholder's waiver of their advances.

[18] Counsel for the appellant takes issue with paragraph 11 of the judge's decision, in which the judge finds—incorrectly, in counsel's view—that the amounts under element B do not apply in this case. In that paragraph, the judge wrote as follows:

> For the purposes of application of section 80 of the Act, "forgiven amount" in respect of a commercial obligation is the amount determined by the formula A - B, where A is the lesser of the amount for which the obligation was issued and the principal amount of the obligation (that is, in the present case, $329,543) and B is the total of the amounts listed in paragraphs (*a*) to (*l*) of the definition of "forgiven amount" of subsection 80(1) of the Act. Since the amounts listed under item B are not applicable to the present case, the forgiven amount of the advances is the principal of the advances.
>
> [Emphasis added]

[19] The appellant's arguments run up against two insurmountable problems.

[20] First, apart from the appellant's agreement in principle to repay the amounts owed by the Corporation to the financial institutions, no evidence was adduced in the Tax Court of Canada showing that these payments were made or, if so, what the terms of these payments were.

[21] Réal Parent was a financial planner and one of the Corporation's founders. When questioned about the Corporation's long-term and short-term debt, he attributed it to loans taken out and arrangements made with financial institutions, including the Bank of Montreal, which he mentioned explicitly: see Appeal Book, Vol. 2, his testimony at pages 36 to 38.

[22] Later, while still under examination by counsel for the appellant, he stated that he did not know and could not recall what had become of the long-term debt. [TRANSLATION] "I imagine that the debt was assumed by Genex": *ibidem*, at pages 52 to 54.

[23] At that point, counsel for the appellant interrupted and said that Patrice Demers, the appellant's president, was present and that he was going to examine him to shed light on the long-term debt appearing in the Corporation's financial statements dated August 23, 2002. However, he never did get Mr. Demers to testify, with the result that there is no evidence that the undertaking to assume the Corporation's debt had resulted in any payments that could have been accounted for as consideration for the shareholders' waiver of their advances.

[24] Furthermore, and this is the second problem, counsel for the respondent objects to the appellant's argument that, as was mentioned above, the "forgiven amount" as defined in subsection 80(1) of the Act would be negative after subtracting B from A.

[25] She submits that the appellant's argument is a new one, raised for the first time on appeal, and would cause her client irreparable harm. In her view, this changes the basic thrust of the case, since the quantum of the forgiven amount was never discussed at trial and was not in issue. I agree with her.

[26] The correspondence exchanged with the Canada Revenue Agency (Agency), the pleadings at trial and the judge's decision clearly show that the debate centered on the issue of whether the shareholders' advances were a commercial debt obligation.

[27] In a letter to the Agency dated September 7, 2006, the appellant states that the shareholders' advances to the Corporation cannot be characterized as commercial debts because no interest was

paid, and there is no legal obligation to pay any such interest: see Appeal Book, Vol. 1, at page 24, item 4, under [TRANSLATION] “Judicial History” and at page 29, item 2.5.

[28] The Notice of Appeal filed by the appellant in the Tax Court of Canada repeats the position she submitted to the Agency: *ibidem*, at page 26. The appellant states the issues as follows:

> [TRANSLATION]
> D) ISSUES
>
> 1. Does the $329,543 in shareholder advances to Showbizznet qualify as a “commercial debt obligation” under paragraph 80(1)(b) of the Act?
> 2. Can the shareholders’ waiver of the right to claim repayment of the $329,543 in advances made to the corporation Showbizznet be characterized as a gain resulting from a forgiven amount in respect of the settlement of a commercial obligation?
> 3. Accordingly, was the Agency entitled to reduce the balance of the Genex’s non-capital loss account by $329,543 for the fiscal year ending August 31, 2003, and make a reassessment on this basis?

[29] In his preliminary remarks at trial in the Tax Court of Canada, the judge summed up the debate before him as follows:

> [TRANSLATION]
> The only issue is this: Is this a commercial debt obligation? Are these advances commercial debt obligations or not, for the purposes of section 80?

(See Appeal Book, Vol. 2, at page 8).

[30] The parties agreed that this was the issue. Counsel for the appellant also acknowledged that the debate was [TRANSLATION] "rather circumscribed" and that it would be difficult to fill up the two days requested for the hearing: *ibidem*, at page 9. In fact, the hearing lasted only a morning.

[31] Finally, paragraphs 15 to 17 of the judge's reasons confirm the nature and limited scope of the debate before him:

> Analysis
>
> [15] Counsel for the appellant submits that the advances made by the shareholders to Showbizznet are not a commercial debt obligation owing to the fact that the shareholders had no legal obligation to pay interest on the advances, that no interest was in fact paid on the advances, and, lastly, that the intention of Showbizznet and its shareholders was to convert the advances into Class "A" shares in Showbizznet's capital stock. Accordingly, section 80 of the Act cannot be applied in respect of the amount forgiven on the advances.
>
> [16] For her part, counsel for the Respondent contends that even though there was no interest on the advances, those advances were nevertheless a commercial debt obligation within the meaning of the definition in subsection 80(1) of the Act because Showbizznet could have claimed a deduction for the interest under paragraph 20(1)(*c*) of the Act if interest had been paid or payable by Showbizznet under a legal obligation. Counsel for the respondent refers, moreover, to the English definition of "commercial debt obligation" in interpreting paragraph (*b*) of the French version of that definition ("créance commerciale"), which, according to her, deals with interest-free debt obligations, hence, debt obligations for which there is no legal obligation to pay interest.
> .
> [17] The main issue to be determined is whether the definition of "commercial debt obligation" includes advances entailing no legal obligation to pay interest.

[32] Counsel for the respondent refers to *Naguib v. Canada*, 2004 FCA 40; *Crête v. Canada*, 94 D.T.C. 5122 (FCA); and *SMX Shopping Centre Ltd. v. Canada*, 2003 FCA 479 in support of the principle that a new argument cannot be raised on appeal if the opposing party would be prejudiced by having had no opportunity to adduce evidence that could defeat the new argument.

[33] I do not think that there can be any doubt that the respondent's argument is correct. In a judgement rendered in November 2010, *Keus v. Her Majesty the Queen,* 2010 FCA 303, Justice Dawson, writing on behalf of this Court, adopted the following words of Justice Binnie in *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, [2002] 1 S.C.R. 678, at paragraph 32:

> [32] Unless the parties have fully addressed a factual issue at trial in the evidence, and preferably in argument for the benefit of the trial judge, there is always the very real danger that the appellate record will not contain all of the relevant facts, or the trial judge's view on some critical factual issue, or that an explanation that might have been offered in testimony by a party or one or more of its witnesses was never elicited. As Duff J. put it in *Lamb v. Kincaid* (1907), 38 S.C.R. 516, at p. 539:
>
> A court of appeal, I think, should not give effect to such a point taken for the first time in appeal, unless it be clear that, had the question been raised at the proper time, no further light could have been thrown upon it.

[34] As our colleague so aptly puts it, it is a matter of the fairness of both the trial and the appeal.

[35] However, counsel for the appellant argues that the issue of the quantum of the "forgiven amount" under subsection 80(1) of the Act was implicit in the question submitted to the judge. He relies on this Court's judgment in *The Queen v. Costco Wholesale Canada Ltd.*, 2010 FCA 9, in which this Court ordered a new hearing and left it open to the judge presiding over the new hearing to admit any further evidence that he or she may decide to allow. Should we disagree with his arguments on the merits regarding the quantum of the forgiven amount, counsel for the appellant asks that the matter be remitted back to the Tax Court of Canada for rehearing.

[36] With respect, I am of the opinion that that *Costco* does not apply in this case. In *Costco*, the Crown argued on appeal that the Tax Court of Canada had failed to consider the extended definition of the word “property” in subsection 123(1) of the Act, which includes a right or interest of any kind.

[37] It is true that in the pleadings of the Crown, no reference was made to the definition of “property”, but it was clearly brought to the attention of the judge during the course of argument. However, in the present case, there is no indication at any stage of the proceedings that the quantum of the forgiven amount was ever expressly or implicitly contested, or that the judge’s attention was drawn to this issue. Quite the contrary.

[38] Furthermore, in *Costco*, the judge made a certain number of findings that required that the extended definition of the word “property” be considered, which he had not done. Writing on behalf of the Court, Justice Noël found at paragraph 8 of the reasons that it “would be inappropriate to allow this matter to be decided without consideration being given to this definition”. Since the factual record was incomplete, the Court held that it would be better to remit the matter back to the Tax Court of Canada judge.

[39] In this case, the factual situation is very different. The judge was only asked to rule on the issue of whether the definition of “commercial debt obligation” included advances made without a legal obligation to pay interest and without actual payment of interest. If the advances were not a

commercial debt obligation, the Minister's assessment would have no legal basis and should be set aside. If, on the contrary, they did fit the definition, the assessment would be confirmed and the appeal, dismissed. To decide this issue, the judge did not have to make findings regarding the determination of the quantum of the forgiven amount. This is also why he did not consider it and made no rulings on questions beyond what the parties agreed among themselves to put to him.

[40] I am satisfied that the record does not contain relevant evidence relating to this new argument, evidence which it was up to the appellant to adduce, *inter alia*:

1) evidence of the apportionment of the consideration between the shares and the writing off of the advances;

2) evidence proving that the appellant paid an amount to Corporation shareholder's in consideration of their waiver of the repayment of $329,543 in cash advances;

3) evidence of the appellant's actions, if any, regarding the discharge of the sureties; and

4) as already mentioned, evidence of the repayment of amounts borrowed from financial institutions and their terms of payment.

[41] I am also satisfied that the respondent was prejudiced by being deprived of the opportunity to present evidence refuting this new argument.

Conclusion

[42] For these reasons, I would dismiss the appeal with costs.

"Gilles Létourneau"
J.A.

"I agree.
M. Nadon J.A."

"I agree.
Johanne Trudel J.A."

Certified true translation
Michael Palles

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-498-09
STYLE OF CAUSE:	GENEX COMMUNICATIONS INC. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	December 14, 2010
REASONS FOR JUDGMENT BY:	LÉTOURNEAU J.A.
CONCURRED IN BY:	NADON J.A. TRUDEL J.A.
DATED:	December 17, 2010

APPEARANCES:

Richard Généreux	FOR THE APPELLANT
Nathalie Labbé	FOR THE RESPONDENT

SOLICITORS OF RECORD:

Richard Généreux Drummondville, Quebec	FOR THE APPELLANT
Myles J. Kirvan Deputy Attorney General of Canada	FOR THE RESPONDENT