Federal Court of Appeal | Cour d'appel fédérale

Date: 20110630

Docket: A-344-10

Citation: 2011 FCA 219

CORAM: **NADON J.A.**
PELLETIER J.A.
MAINVILLE J.A.

BETWEEN:

ESTATE OF THE LATE DONALD MILLS

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Montreal, Quebec, on June 9, 2011.

Judgment delivered at Ottawa, Ontario, on June 30, 2011.

REASONS FOR JUDGMENT BY: NADON J.A.

CONCURRED IN BY: PELLETIER J.A.
MAINVILLE J.A.

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REASONS FOR JUDGMENT

NADON J.A.

[1] This is an appeal by the estate of the late Donald Mills (the appellant) from a judgment of Sheridan J. (the "Judge") of the Tax Court of Canada, 2010TCC443, dated August 26, 2010, wherein she dismissed the appellant's appeals from the Minister of Revenue's (the "Minister") reassessments of Mr. Mills' 1999 to 2002 taxation years.

[2] More particularly, the Judge found that the unpaid portion of a promissory note in the amount of $10,588,133, delivered to Mr. Mills by 100935 Canada Inc. was not a "debt owing" to

Mr. Mills pursuant to subparagraph 20(1)(p)(i) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Suppl.) (the "Act").

[3] The issue before us in this appeal is whether the appellant can claim a deduction pursuant to subparagraph 20(1)(p)(i).

The Facts

[4] Mr. Mills was the sole shareholder, either directly or indirectly, and director of both 3742878 Canada Inc. and 100935 Canada Inc.

[5] On May 1, 2000, he sold 21,500,000 common shares in 3742878 Canada Inc. to 100935 Canada Inc. for the purchase price of $11,653,000. 100935 Canada Inc. paid the purchase price by delivering to the appellant a non-interest bearing promissory note (the "Note") equal to the purchase price.

[6] At the time of the disposition, the appellant was not dealing at arm's length with 100935 Canada Inc. Because the disposition was not at arm's length, paragraph 84.1(1)(b) of the Act deemed 100935 Canada Inc. to have paid, and deemed Mr. Mills to have received, a dividend in the amount of $11,222,515 (the purchase price minus the cost of the shares). Mr. Mills duly reported this dividend in computing his income in tax year 2000 by including this amount under paragraph 12(1)(j) of the Act.

[7] The transactions engaged in by Mr. Mills were part of a series of transactions carried out by him in the context of the takeover of Newbridge Network Corporation by Alcatel, a French corporation. The value of Mr. Mills' shares in Newbridge, at the relevant time, was approximately $43,000,000.

[8] Between 2000 and 2002, after the tech stock bubble burst, the value of 100935 Canada Inc.'s assets fell significantly.

[9] In October 2002, Mr. Mills demanded payment of the Note. 100935 Canada Inc. transferred some assets to Mr. Mills in partial repayment, but, by the end of taxation year 2002, Mr. Mills considered the balance owing on the Note to be $10,588,133.

[10] When filing his 2002 tax return, Mr. Mills claimed a bad debt deduction of $10,588,133 under subparagraph 20(1)(p)(i) of the Act. The Minister disallowed the deduction.

Decision of the Tax Court

[11] The sole issue before the Judge was whether the third requirement of subparagraph 20(1)(p)(i) of the Act was met. In order for a debt to be deductible under the subparagraph, a taxpayer must demonstrate that: (i) there is a debt owing to him; (ii) the debt has become a bad debt during the year; and (iii) the debt has been included in computing his income for the year or a preceding tax year.

[12] Before the Judge, the parties agreed, as they do before us, that the first two requirements were met. In other words, at the end of taxation year 2002, Mr. Mills was owed $10,588,133 and this amount had become uncollectible during the year. Thus, the remaining question was whether the debt was included by Mr. Mills in computing his income for the year at issue or a preceding taxation year.

[13] The Judge dismissed the appellant's appeal. First, she held that this Court's decision in *Terrador Investments et al v. The Queen*, [1999] 3 C.T.C. 520. (F.C.A.), 243 N.R. 176 (F.C.A.) (*Terrador*) was applicable (Judge's Reasons at para. 21). Therein, two taxpayers had sold assets and received promissory notes in return. This Court held that the taxpayers had voluntarily elected, under subsection 93(1) of the Act, to treat part of the proceeds of disposition as a "deemed dividend received" (cited in Judge's Reasons, para. 13). Thus, when the deemed dividend was included in the taxpayers' income under paragraph 12(1)(k), it was included as a "paid dividend". Once the Act deems a dividend to have been paid and received, it cannot also simultaneously be a "doubtful debt" or a "bad debt". It has been deemed to be paid, so it cannot also be due to be paid (*Terrador*, paras. 18, 19 and 20).

[14] Second, the Judge stated that the differences between *Terrador* and the case before her were irrelevant. In *Terrador*, the taxpayers chose to treat the proceeds as deemed dividend under subsection 93(1) of the Act. In contrast, paragraph 84.1(1)(b) is not an elective provision, but a mandatory anti-avoidance provision (Judge's Reasons, para. 22). The Judge opined that the lack of election was irrelevant (Judge's Reasons, para. 24). In her view, Mr. Mills could have avoided triggering paragraph 84.1(1)(b), but chose not to. If he had not chosen to convert his capital gain

into a deemed dividend, he could have claimed a capital loss (Judge's Reasons, para. 25). Instead, Mr. Mills triggered the provision for tax-planning reasons (Judge's Reasons, para. 22). This choice had certain advantages and disadvantages, and the appellant had to accept the consequences of the choice made.

[15] The Judge also noted that, as in *Terrador*, the deemed dividend was not exactly equal to the amount of the promissory note (Judge's Reasons, paras. 26-27). After all, paragraph 24.1(1)(b) contains a formula for calculating the amount of the deemed dividend and the only variable in that formula is the consideration received. In any case, this part of our Court's analysis in *Terrador* was, in the Judge's opinion, merely supplementary to the central finding that an amount cannot be simultaneously "paid" and "due" (Judge's Reasons, para. 27). Once the deeming provision was triggered, the amount included in the taxpayer's income under paragraph 12(1)(j) was deemed to be a paid dividend and so could not also be a "debt" that qualified for a deduction under subparagraph 20.1(p)(i).

The Issue

[16] The only issue in this appeal is whether the Judge was correct to conclude that the bad debt deduction should be disallowed.

Analysis

A. Standard of Review:

[17] This case is an appeal of a trial judgment. As such, the review standards articulated by the Supreme Court of Canada in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (*Housen*),

are applicable. Questions of fact and of mixed fact and law can only be overturned if the Judge made a "palpable and overriding error". Questions of pure law can be overturned if they are incorrect.

B. Was the Judge correct to conclude that the bad debt deduction should not be allowed?

[18] As I have already indicated, the parties agreed before the Judge, as they do before us, that the only question regarding the applicability of subparagraph 20(1)(p)(i) is whether the debt was included in computing Mr. Mills' income for the year or the preceding year (Appellant's Memorandum, paras. 42 and 43; Respondent's Memorandum, paras. 19 and 20).

[19] I agree entirely with the Judge and have little to add to her reasoning on this point. In particular, I agree with her that, based on *Terrador*, the dividend having been included in Mr. Mills' income for 2000 as a paid dividend could not, at the same time, constitute a bad debt within the meaning subparagraph 20(1)(p)(i). At paragraph 28 of her Reasons, the Judge sets out her rationale as follows:

> [28] … From this it follows that what was included in income in 2000 under paragraph 12(1)(j) was a dividend, deemed by paragraph 84.1(1)(b) to have been fully paid, not a "debt" as required by subparagraph 20(1)(p)(i). In the words of Décary, J.A. above, "What is deemed to have been paid cannot also be said to be due".

[20] The appellant makes a number of arguments, which I will now briefly deal with.

[21] First, it argues that paragraph 84.1(1)(b) "creates a legal fiction" whereby the Act treats a dividend as being paid, although the dividend might not have, as here, in fact been paid. This leads

the appellant to say that "even though the income is deemed 'paid' for the purpose of the Act, legally, a debt remains owing to the appellant" (Appellant's Memorandum, para. 50). In *R. v. Verrette*, [1978] 2 S.C.R. 838 at 845, the Supreme Court made the following remarks concerning deeming provisions:

> … A deeming provision is a statutory fiction; as a rule it implicitly admits that a thing is not what it is deemed to be but decrees that for some particular purpose it shall be taken as if it were that thing although it is not or there is doubt as to whether it is. A deeming provision artificially imports into a word or an expression an additional meaning which they would not otherwise convey beside the normal meaning which they retain where they are used; it plays a function of enlargement analogous to the word "includes" in certain definitions; however, "includes" would be logically inappropriate and would sound unreal because of the fictional aspect of the provision.
>
> [Emphasis added]

[22] I cannot but agree with the appellant that paragraph 84.1(1)(b) of the Act creates a legal fiction. That is exactly what the provision is meant to do. A constitutionally valid legal fiction is an applicable legal fiction. Thus, even though Mr. Mills was not in fact paid the dividend, the provision treats him as if the dividend had been paid to him. Arguing that the provision creates a fiction does not advance the appellant's case.

[23] Next, the appellant argues that it would have had a right to make a legal claim against 100935 Canada Inc. in civil or bankruptcy court for the repayment of the balance due on the Note. Although that statement is true, in that the debt is still, in fact, due and can be collected through the regular mechanisms, paragraph 84.1(1)(b) deems that for the purpose of calculating the appellant's income tax, the proceeds resulting from the disposition of the shares are to be treated as a dividend deemed to have been paid by 100935 Canada Inc. and deemed to have been received by Mr. Mills.

The fact that for other purposes, the Note will be treated as if it were due does not detract from the effect of the deeming provision.

[24] The appellant argues that in *Cloverdale Paint Inc. v. R.*, 2006 TCC 628, (2007) 2 D.T.C. 2024, the Tax Court held, in the context of a similar provision of the Act – namely paragraph 20.1(1) – that a debt deemed to be included in the taxpayer's income could be deductible. I do not find this authority persuasive for two reasons. First, to the extent that it is not consistent with *Terrador*, it is not good authority. Second, what paragraph 84.1(1)(b) deems to be included in the appellant's income is a dividend, not a debt.

[25] The appellant then argues that an amount can be both deemed to be paid and received and still be a "debt" for the purposes of subparagraph 20(1)(p)(i). This contention, with respect, is inconsistent with the view held by this Court in *Terrador*.

[26] The appellant also argues that *Terrador* is not applicable to the case at hand. It says that, unlike in *Terrador*, the application of paragraph 84.1(1)(b) was not voluntary, that the Note was the sole consideration given to the shares and that Mr. Mills paid tax on his deemed dividend.

[27] I do not find any of these arguments convincing. I agree with the Judge's analysis on the voluntariness argument that although the application of paragraph 84.1(1)(b) is not voluntary, Mr. Mills could easily have avoided triggering the provision. I also agree with the Judge that the type and amount of consideration given is not relevant.

[28] Finally, the fact that Mr. Mills paid tax on his transaction whereas the taxpayers in *Terrador* did not is irrelevant. The transactions in the two cases were not the same and, thus, they received different treatment under the Act. Different tax treatments in these two circumstances result in different taxes owing.

Disposition

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

"M. Nadon"
J.A.

"I agree.
J.D. Denis Pelletier J.A."

"I agree.
Robert M. Mainville J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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