Federal Court of Appeal  Cour d'appel fédérale

Date: 20120718

Docket: A-363-11

Citation: 2012 FCA 208

CORAM: **DAWSON J.A.**
GAUTHIER J.A.
STRATAS J.A.

BETWEEN:

SRI HOMES INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Vancouver, British Columbia, on June 18, 2012.

Judgment delivered at Ottawa, Ontario, on July 18, 2012.

REASONS FOR JUDGMENT BY: DAWSON J.A.

CONCURRED IN BY: GAUTHIER J.A.
STRATAS J.A.

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REASONS FOR JUDGMENT

DAWSON J.A.

[1] This is an appeal from a decision of the Tax Court of Canada (2011 TCC 386, 2011 DTC 1283). At issue before the Tax Court was whether the appellant taxpayer was entitled to deduct certain losses in the amount of $411,830.00. In brief reasons, the Tax Court dismissed the appellant's appeal.

[2] On this appeal the issue to be determined is whether the Judge erred in law by failing to provide adequate reasons for his decision.

Factual Background

[3] At all material times, all the shares of the appellant were owned by Norterra Inc. (Norterra). Norterra negotiated an arms' length agreement with R & M Frontier Holdings Corporation (Frontier) in which Frontier agreed to purchase all the shares of the appellant. Prior to the closing of the share purchase transaction, Frontier advised it would only buy the shares if certain assets owned by the appellant were removed and the purchase price reduced. Norterra and Frontier agreed on which assets would be removed and on the reduced purchase price of the shares.

[4] To effect this agreement, the appellant sold the unwanted assets to a related company. Included in the unwanted assets were shares in two companies, Valley Vista Seniors Park Inc. (Valley Vista) and Lakeside Pines Development Inc. (Lakeside), and shareholder loans made by the appellant to Valley Vista and to Lakeside. The proceeds of disposition on the sale of the unwanted assets were $4,430,366.00, of which $1,332,796.00 was allocated to the two shareholder loans. This was $411,830.00 below the face value of the shareholder loans. The deductibility of this amount is the issue in dispute in this proceeding. It is agreed between the parties that the allocation of the proceeds of disposition for the assets other than the shareholder loans was reasonable and equal to their fair market value.

[5] The parties presented competing theories at trial. The appellant taxpayer submitted that the proceeds of disposition allocated to each shareholder loan was equal to the fair market value of the loan at the time it was sold to the related company and that the resulting loss was not on account of capital. The respondent Crown argued that the appellant had "expensed the negative retained

earnings" of its investment in Valley Vista and Lakeside (that is, its portion of those companies' cumulative equity losses in the amount of $411,830.00). The respondent also submitted that the shareholder loans were fully collectible at the time of their disposition and so their fair market value was the face value of each loan. Finally, the respondent submitted that any loss was on account of capital.

[6] The trial took place over three days. Three witnesses were called by the appellant and the Canada Revenue Agency auditor testified on behalf of the Crown.

The Decision of the Tax Court

[7] The reasons for judgment were divided into three sections: a statement of the facts, a statement of the issues, and a portion entitled "Analysis and Decision."

[8] In the statement of the facts, the Court set out certain uncontested facts (reasons, paragraphs 1 to 13) and certain assertions made by the Minister (reasons, paragraphs 14 to 32). Those assertions paraphrased some of the assumptions pleaded in the Crown's reply to the amended notice of appeal.

[9] In the second part of the reasons, at paragraph 33, the Court framed the issues before the Court to be:

> 33. The issues are whether, for its taxation year ending April 30, 2001, SRI:

a) is entitled to expense the negative retained earnings of its investment in Valley Vista and Lakeside Pines (i.e., its portion of those companies' cumulative equity losses) in the amount of $411,830; and

b) had an additional non-capital loss of $411,830 available for carry back to its taxation year ending December 31, 2000.

[10] This statement of the issues was a verbatim quotation of the issues as framed by the Crown in its reply to the amended notice of appeal.

[11] In the final segment of the reasons, under the heading "Analysis and Decision", the Court began by quoting from the opening statements of counsel for the appellant (reasons, paragraph 34) and counsel for the Crown (reasons, paragraphs 35 and 36) where counsel framed their competing theories of the case. The Court then quoted briefly from the closing argument of counsel for the appellant (reasons, paragraph 37) and more extensively from the closing argument of counsel for the Crown (paragraphs 38 to 40). Included in this excerpt was counsel for the respondent's recitation of six different reasons why the amount at issue was not deductible.

[12] Finally, the Court concluded as follows:

> 41. I agree with the reasoning outlined by [counsel for the respondent] in his argument.
>
> 42. The appeals are dismissed, with costs.

The Obligation to Give Reasons

[13] In *R. v. Sheppard*, 2002 SCC 26, [2002] 1 S.C.R. 869, the Supreme Court of Canada confirmed that a trial judge has no general duty to provide reasons for a decision "when the finding

is otherwise supportable on the evidence or where the basis of the finding is apparent from the circumstances" (paragraph 4, citing *R. v. Barrett*, [1995] 1 S.C.R. 752 at page 753).

[14] In *R. v. R.E.M.*, 2008 SCC 51, [2008] 3 S.C.R. 3, the Supreme Court of Canada reiterated that a court of appeal "considering the sufficiency of reasons should read them as a whole, in the context of the evidence, the arguments and the trial, with an appreciation of the purposes or functions for which they are delivered" (paragraph 16). At paragraph 17 the Supreme Court wrote:

> These purposes are fulfilled if the reasons, read in context, show why the judge decided as he or she did. The object is not to show *how* the judge arrived at his or her conclusion, in a "watch me think" fashion. It is rather to show *why* the judge made that decision. The decision of the Ontario Court of Appeal in *Morrissey* predates the decision of this Court establishing a duty to give reasons in *Sheppard*. But the description in *Morrissey* of the object of a trial judge's reasons is apt. Doherty J.A. in *Morrissey*, at p. 525, puts it this way: "In giving reasons for judgment, the trial judge is attempting to tell the parties what he or she has decided and why he or she made that decision" (emphasis added). What is required is a logical connection between the "what" -- the verdict -- and the "why" -- the basis for the verdict. The foundations of the judge's decision must be discernable, when looked at in the context of the evidence, the submissions of counsel and the history of how the trial unfolded. [emphasis in original]

[15] The functional approach described in *Sheppard* and *R.E.M.* requires "reasons sufficient to perform the functions reasons serve -- to inform the parties of the basis of the verdict, to provide public accountability and to permit meaningful appeal. The functional approach does not require more than will accomplish these objectives." (*R.E.M.* at paragraph 25.)

[16] While *Sheppard* and *R.E.M.* arose in the context of criminal prosecutions, these principles apply as well to civil cases. See, for example, *Merck Frosst Canada Ltd. v. Canada (Health)*, 2012

SCC 3, 426 N.R. 200 at paragraph 233; *Brokenhead First Nation v. Canada (Attorney General)*, 2011 FCA 148, 419 N.R. 289.

[17] Moreover, in *Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 S.C.R. 817 at paragraph 43, the Supreme Court stated "it is now appropriate to recognize that, in certain circumstances, the duty of procedural fairness will require the provision of a written explanation for a decision."

Application of these Principles to this Appeal

[18] We are to apply a functional analysis to the reasons of the Tax Court. Under this approach, much will turn on the state of the record before the trial court. Reasons similar to those now before this Court may be adequate, depending on the nature and the number of issues before the trial court, the nature of the evidentiary record and the substance and nature of the submissions made to the trial court.

[19] In the present case, for the reasons which follow, I have concluded that on the state of the record before the Tax Court, the Judge erred in law by failing to give adequate reasons for his decision.

[20] First, as noted above, the parties provided competing theories to the Tax Court. For the taxpayer, the issue was whether the portion of the proceeds of disposition that were allocated to the two shareholder loans represented their fair market value, and if so, whether the resulting loss was

on account of income. However, the Judge gave no explanation as to why he chose to frame the issues as defined by the Crown in its pleading. I am unable to discern from the record why the Judge was not obliged to deal with the case as framed by the appellant and supported by the evidence adduced by the appellant.

[21] Second, as noted above, the Crown advanced six reasons why the appellant's appeal should be dismissed. Some reasons were internally inconsistent. For example, the first reason was that the appellant had written-off as an expense its portion of the equity losses of Valley Vista and Lakeside. The auditor testified that such loss was an equity loss that ought to have been allocated to the shares (transcript, volume 2, pages 285 and 286). Other grounds advanced by the Crown were that the appellant could not take a doubtful account on the non-capital shareholder loan receivables because it no longer owned the loan receivables and the appellants could not take a bad debt expense because the debt was not bad.

[22] It is impossible to meaningfully review the Judge's reasons when this Court is unable to discern how the Judge characterized the transaction. Did the Judge consider the alleged loss to be a capital loss that should have been allocated to share value or was it, in his view, an improperly claimed doubtful account or bad debt?

[23] Third, and related to the second point, the Judge failed to reference any of the *viva voce* evidence adduced through the four witnesses. This was an error when the taxpayer adduced evidence that supported its theory of the case and that evidence was sufficient to require some

apparent adjudication. For example, the appellant's corporate secretary, a chartered accountant by profession, testified that the appellant did not write-off negative retained earnings. Rather, "the actual accounting records on this equity method [of valuation] best represent our market value" of the shareholder loans. During oral argument of the appeal, counsel for the Crown submitted that the Judge did not believe this evidence. If the Judge made credibility findings or gave no weight to certain evidence, meaningful appellate review in this case requires the Court to know what evidence was rejected by the Judge.

[24] Fourth, during oral argument before the Tax Court, counsel for the appellant confirmed the appellant was not arguing that the amount in issue was a doubtful account. Yet the Judge dealt with this argument in his reasons, adopting the Crown's submission on the point. This does not demonstrate that the Judge understood and grappled with the real issues before him.

[25] Similarly, the appellant argued that the loss was not on account of capital for two reasons. First, the appellant argued that it was in the business of lending money and that the loans were made in the ordinary course of that business. Second, the appellant argued that the loans were made for income-producing purposes related to its own business. Specifically, the appellant argued that its primary business was the manufacture of manufactured homes. The loans at issue financed the development of manufactured home parks where only homes manufactured by the appellant could be situated. The Judge adopted the Crown's submission on the first ground but did not deal with the evidence and submissions advanced with respect to the second ground. I am unable to discern from the record any reason why the Judge did not deal with the second argument. Given that he felt

obliged to deal with the issue of whether any loss was on account of income or capital, in light of the evidence and submissions before the Court some explanation was required as to why the second argument failed.

[26] To conclude, in light of the issues, evidence and submissions before the Judge, he was, in my respectful view, required to explain why he embraced the Crown's position so completely.

Conclusion

[27] For these reasons, I would allow the appeal with costs both here and in the Tax Court, and remit the matter to the Tax Court of Canada for redetermination by a different judge in accordance with these reasons.

"Eleanor R. Dawson"
J.A.

"I agree.
Johanne Gauthier J.A."

"I agree.
David Stratas J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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