Federal Court of Appeal  Cour d'appel fédérale

Date: 20120727

Docket: A-155-11

Citation: 2012 FCA 214

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

BETWEEN:

NEWMONT CANADA CORPORATION

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on February 28, 2012.

Judgment delivered at Ottawa, Ontario, on July 27, 2012.

REASONS FOR JUDGMENT BY: DAWSON J.A.

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

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REASONS FOR JUDGMENT

DAWSON J.A.

[1] The issues on this appeal from the Tax Court of Canada are whether the appellant, in computing its income for income tax purposes, was entitled to deduct:

i. $7,250,000 of unrecovered principal in 1992 and $78,294 of unrecovered principal in 1994 under section 9 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (Act) in respect of a loan made to Windarra Minerals Ltd. (Windarra) that was not fully repaid (Windarra Loan); and

ii. $156,888 in 1992 under subparagraph 20(1)(*p*)(i) of the Act in respect of interest on the Windarra Loan that the appellant says was previously included in its income but not actually received (Windarra Interest).

[2] The Minister, relying upon paragraph 18(1)(*b*) of the Act, reassessed the appellant to disallow the deductions in respect of the Windarra Loan on the basis that the loan was capital in nature. The Minister did not allow the Windarra Interest deduction on the basis that the amount had not previously been included in computing the appellant's income.

[3] The appellant appealed to the Tax Court. In reasons reported as 2011 TCC 148, 2011 DTC 1117 the appeals were dismissed with costs.

[4] For the reasons which follow, I would dismiss the appeal as it relates to the deduction of unrecovered principal owing under the Windarra Loan, but allow the appeal with respect to the deductibility of the Windarra Interest.

The Facts

[5] The evolution of the appellant's corporate structure is briefly explained below. For ease of reference, like the trial judge, I will refer to the appellant and its predecessors as Hemlo Gold.

[6] The Tax Court Judge (Judge) made the following findings of fact which are not disputed on this appeal:

1. During most of the relevant period, the appellant was a public company, Hemlo Gold Mines Inc. The company's main activities were operating the Golden Giant Mine in Northern Ontario (through its subsidiary HGM Inc.) and exploring for minerals, particularly gold, in Canada and the United States (reasons, paragraphs 6 and 15).

2. In 1995, subsequent to the taxation years in issue, Hemlo Gold Mines Inc., HGM Inc. and a numbered company merged to form a new company called Hemlo Gold Mines Inc. In 1996, Hemlo Gold Mines Inc. merged with an arms length corporation, Battle Mountain Gold Ltd. As a result, the name of the company was changed to Battle Mountain Canada Ltd. In 2001, Newmont Mining Corporation acquired the company and its name was changed to Newmont Canada Ltd. (reasons, paragraph 16). At the time of the trial, the appellant's name had changed again to Newmont Canada Corporation.

3. At the time Hemlo Gold was formed, one of its objectives was to increase its earnings by adding gold production. Since the Golden Giant Mine had a finite amount of gold production, Hemlo Gold sought to acquire new mining properties (reasons, paragraph 117).

4. Between 1987 and 1989, Hemlo Gold acquired a number of indirect interests in mining companies which were shown on its balance sheet as "Investments and Advances". The "Investments and Advances" consisted, in part, of shares of a number of junior mining companies and two loans to mining companies, one of which was the Windarra Loan. Hemlo Gold's annual reports for the years 1987 to

1991 showed that its "Investments and Advances" rose from $5.4 million at the end of its 1987 fiscal year to $60 million at the end of its 1988 fiscal year, and then peaked at $82 million at the end of its 1989 fiscal year. The "Investments and Advances" fell to $49 million during 1990 and $12.4 million at the end of its 1991 fiscal year (reasons, paragraphs 121 and 122).

5. As part of its acquisition of shares in junior mining companies, on April 21, 1988, Hemlo Gold entered into an agreement with Windarra (Windarra Agreement) (reasons, paragraph 18).

6. Windarra held interests in two mining properties in an area referred to as the Mishibishu camp. It held a 25% interest in a property referred to as the Magnacon property. The other owners of the property were Flanagan McAdam Resources (FMR) and Muscocho Exploration Ltd. Windarra also owned a 50% interest in a property adjoining the Magnacon property, which was referred to as the Eastern property (reasons, paragraph 124).

7. The three owners of the Magnacon property were developing the property as a joint venture. Hemlo Gold attempted to purchase a direct 25% interest in the Magnacon property from Windarra and FMR. However, one of the joint venture participants invoked a right of first refusal contained in the joint venture agreement and Hemlo Gold was unable to acquire the direct interest that it sought (reasons, paragraph 125).

8. After it failed to acquire a direct interest in the Magnacon property, on April 21, 1988, Hemlo Gold entered into the Windarra Agreement which allowed it to obtain an indirect interest in the property. The agreement provided that:

- Hemlo Gold would lend Windarra $7.5 million dollars at prevailing gold loan rates, which could be increased to $8.25 million in the event of cost overruns;

- the proceeds from the loan were to be used to pay Windarra's portion of the exploration and development work in relation to its 25% interest in the Magnacon property and its 50% interest in the Eastern property;

- the loan was to be repaid out of 80% of the first available cash flow from the Magnacon property;

- Hemlo Gold would subscribe for 1.5 million shares of Windarra in exchange for 150,000 common shares of Hemlo Gold;

- Hemlo Gold would subscribe for two million Windarra shares at two dollars each. Of the resulting $4,000,000, $3,500,000 was to be used to pay for Windarra's share of the future exploration costs of

the Eastern property while the remaining $500,000 was to be used for Windarra's working capital;

- Hemlo Gold would have the option to purchase an additional two million Windarra shares;

- Hemlo Gold agreed not to increase its holdings in common shares of Windarra above 33 1/3% for a period of six years; and

- Windarra would transfer a 25% direct interest in the Eastern property to Hemlo Gold. After Windarra had spent the $3.5 million received on the issue of the 2,000,000 Windarra shares, Hemlo Gold was required to pay 50% of the exploration and development expenses for the Eastern property (reasons, paragraphs 126 to 133).

9. During his testimony, the former Vice-president, Investor Relations and General Counsel of Hemlo Gold, Mr. Joseph Baylis, discussed the Windarra Agreement. He referred to the various components of the agreement as being a package deal. With respect to the Windarra Loan, he explained that Windarra required the financing in order to fund cash calls under the joint venture agreement for construction on, and development of, the Magnacon property. He testified that if Hemlo Gold had not provided the loan Windarra would have had to raise additional capital from third

parties. This would have required Windarra to issue additional shares, thus diluting Hemlo Gold's holdings in the company (reasons, paragraph 134).

10. A memorandum dated April 25, 1988 from the President and the then Vice-president, Finance of Hemlo Gold to Hemlo Gold's board of directors stated that Hemlo Gold was providing financing to Windarra in order to build a land position in the Mishibishu camp (to thus protect Hemlo Gold's "general position" in the camp) and to obtain a direct investment in the Eastern property. The memorandum went on to note that by making the investment, Hemlo Gold would "tie up the company as [its] partner and ultimately [...] will take them over, if new discoveries or expansion of Magnacon reserves warrant" (reasons, paragraph 135).

11. During 1988 and 1989, Hemlo Gold acquired Windarra shares and advanced monies pursuant to the Windarra Agreement. By the end of 1989, Hemlo Gold had acquired 5.65 million Windarra shares and advanced the maximum amount under the Windarra Loan agreement, $8.25 million. The notes to Hemlo Gold's 1989 audited financial statements recorded that $17.784 million in respect of the Windarra shares and the Windarra Loan was included in the "Investment and Advances" balance on Hemlo Gold's balance sheet (reasons, paragraph 136).

12. During 1990, the joint venture participants in the development of the Magnacon property decided to close the Magnacon Mine. As a result, for accounting purposes, Hemlo Gold wrote down its investment in the Windarra shares and the amount of the

Windarra Loan. The Windarra Loan was written down to its estimated realizable value of $1 million, a write-down of $7.513 million (reasons, paragraph 137).

13. On November 6, 1992, Windarra and Hemlo Gold entered into a settlement agreement pursuant to which the parties were released from their obligations under the Windarra Agreement. Windarra's obligation to repay the Windarra Loan was terminated in consideration of Windarra agreeing to pay $1,000,000 (reasons, paragraph 142). The sum of $921,706 was to be paid by December 17, 1992 and the sum of $78,294 was to be paid by December 17, 1993 (reasons, footnote 115). The latter sum was never paid.

14. In preparing its 1992 and 1994 tax returns, Hemlo Gold deducted $7,590,684 and $78,294 respectively in respect of the Windarra Loan. In 1992, it reported the dispositions of the Windarra shares as dispositions of capital property (reasons, paragraph 143).

15. When reassessing Hemlo Gold, the Minister allowed a deduction in respect of $183,336 of accrued interest income previously included in Hemlo Gold's income but never received from Windarra (reasons, paragraph 175). The Minister disallowed the remaining $7,407,308 of the amount deducted in 1992 in respect of the Windarra Loan and the entire amount deducted in 1994 (reasons, paragraph 144).

The Decision of the Tax Court

[7] With respect to the first issue, the Judge found that the unrecovered principal owing in respect of the Windarra Loan was a loss incurred on account of capital because the Windarra Agreement "resulted in Hemlo Gold acquiring assets of enduring benefit" (reasons, paragraphs 154 to 156). In the Judge's view:

> 155 The Windarra Loan provided Windarra with working capital to fund its share of the exploration and development costs in respect of the Magnacon property. The Windarra Loan was given to generate a stream of income (interest) for Hemlo Gold and to enable Windarra to develop the Magnacon property. The successful development of the property would have secured for Hemlo Gold an enduring benefit in the form either of dividends or an increase in the value of the Windarra Shares.

[8] The Judge also noted that the Windarra Loan and the Windarra shares owned by Hemlo Gold were shown on its balance sheet as investments and advances (reasons, paragraph 150). This was consistent with information contained in Hemlo Gold's 1987, 1988 and 1989 annual reports. The Judge quoted, at paragraph 151 of his reasons, the following extract from Hemlo Gold's 1988 annual report:

> Supporting our exploration initiatives is Hemlo's *investment portfolio*. This began with the acquisition of shares of Viceroy Resource Corporation in 1987 and continued in 1988 with similar equity *investments* in Windarra Minerals Ltd., Central Crude Ltd. and Granges Exploration Ltd. Hemlo also made production loans to Windarra and Viceroy and committed to make a loan to Central Crude. These *investments* are in gold mining companies with considerable potential to contribute to Hemlo's future revenues while offering further growth opportunities. Further acquisitions of shares of these and other similar growth oriented companies will be pursued. [emphasis in reasons of the Tax Court]

[9] The Judge observed that characterizing the Windarra Loan to be on account of capital was also consistent with Hemlo Gold's previous treatment for tax purposes of the disposition of shares it

owned in junior oil companies. Dispositions of such shares in 1990 and 1991 were treated by Hemlo Gold as being on account of capital (reasons, paragraph 152).

[10] The Judge rejected Hemlo Gold's contention that the transaction fell within the first exception set out by this Court in *Easton v. Canada*, [1998] 2 F.C. 44. In the Judge's view, the Windarra Loan did not come within the first exception because it was made "to fund the profit-making activities of Windarra […] not made for income-producing purposes relating to Hemlo Gold's own business" (reasons, paragraph 158).

[11] With respect to the second issue, the Judge noted that the issue to be determined was what amounts were included in computing Hemlo Gold's income for the 1988, 1989, and 1990 taxation years in respect of the interest accrued on the Windarra Loan (reasons, paragraph 172). An auditor employed by the Canada Revenue Agency, Mr. MacGibbon, testified that based on his review of Hemlo Gold's general ledger, he was able to identify entries totalling $183,336 that recorded interest income in respect of the Windarra Loan (reasons, paragraph 175).

[12] With respect to the appellant's position, the Judge wrote:

> 176 The Appellant argued that the Minister understated the subparagraph 20(1)*(p)*(i) deduction by $156,888. It arrived at this number by performing the following calculation:
>
> First, it determined the amount of accrued interest as at December 31, 1989 as follows:
>
> a. The amount shown on the balance sheet at December 31, 1989 in respect of the Windarra Loan: $8.513 million

b. Less: the principal amount of the loan at December 31, 1989: $8.25 million

c. Equals the amount of accrued interest as at December 31, 1989: $263,000.

The Appellant then compared the $263,000 with the amount of interest income Mr. MacGibbon had calculated for the periods prior to 1989, namely $106,112.

177 It is the Appellant's position that the difference between $263,000 and $106,112, which is $156,888, represents additional accrued interest income that was included in the income reported in Hemlo Gold's 1988 and 1989 income tax returns.

178 During his testimony, Mr. Proctor summarized the Appellant's argument as follows: "Because we have it on the balance sheet and, since debits must equal credits, it must have been on the Income Statement and we did not adjust it in arriving at net income for income tax purposes. For financial statement purposes it must be in the net income for income tax purposes." [endnotes omitted]

[13] The Judge then reasoned as follows:

180 Obviously the easiest way for the Appellant to prove that this did in fact occur was to produce the relevant journal entries or general ledger accounts. However, the Appellant was not able to locate its books and records for 1988 and the first half of 1989. Apparently, they were lost during a move.

181 I cannot accept the Appellant's argument. Hemlo Gold could have recorded the offsetting amount as interest income. Alternatively, it could have recorded the offsetting amount on a balance sheet account such as a deferred revenue account or a reserve account. The only way to determine how the offsetting amounts were recorded in 1988 and the first half of 1989 would be to review the relevant books and records. Unfortunately, the relevant books were not provided to either the Minister or the Court.

182 The only evidence before the Court of accrued interest being included in Hemlo Gold's income was in the working papers of Mr. MacGibbon. I agree with counsel for the Respondent that in order for the Appellant to obtain a deduction in excess of the amount allowed by the Minister "the Court should be presented with something more reliable than a conclusion based on unsubstantiated assumptions." [endnotes omitted]

The Asserted Errors

[14] With respect to the Judge's conclusion on the first issue, the conclusion that the Windarra Loan was on account of capital, the appellant asserts that:

1. The Judge erred on a question of mixed fact and law by concluding that the Windarra Loan was on account of capital.
2. The Judge erred in law by:
    (a) Misapplying the first exception set out in *Easton*;
    (b) Failing to apply recognized case law which says the most important factor in determining whether a transaction is on income or capital account is the taxpayer's intention at the time the transaction at issue is entered into; and
    (c) Failing to apply recognized case law which says the determination of whether a transaction is on income or capital account should be based on what the transaction was intended to effect from a practical business point of view and not juristic classifications or any rigid test.

[15] During the oral argument of this appeal, counsel for the appellant advised that Hemlo Gold was not pursuing the argument that the unrecovered principal was deductible under subparagraph 20(1)(*p*)(ii) of the Act.

[16] With respect to the Judge's conclusion on the second issue, the conclusion with respect to the proper quantification of the accrued interest previously included in income in respect of the Windarra Loan, the appellant argues that:

1. The Judge erred in law by applying an inappropriately high standard of proof; and,

2. The Judge erred in fact by finding it had not proved that it had included the sum of $156,888 in income for tax purposes for the period prior to August 1, 1989.

Standard of Review

[17] The first issue puts in question whether the Windarra Loan was made on account of capital or income. This is a question of mixed law and fact (*Canada v. Johns-Manville Corp.*, [1985] 2 S.C.R. 46 at page 62). It follows that this Court may only intervene if the Judge committed a palpable and overriding error or an "extricable error in principle with respect to the characterization of the standard or its application, in which case the error may amount to an error of law" (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 at paragraph 37).

[18] Similarly, this Court may only intervene on the second issue if the Judge committed a palpable or overriding error in his appreciation of the evidence, or erred in law with respect to the application of the standard of proof.

Consideration of the Issues

Issue 1: The Windarra Loan

(i) Applicable law

[19] Paragraph 18(1)(*b*) of the Act prevents a taxpayer from deducting a loss of capital, or payments on account of capital, from revenue when calculating the taxpayer's profit from its business or property. Paragraph 18(1)(*b*) states [emphasis added]:

18. (1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of	18. (1) Dans le calcul du revenu du contribuable tiré d'une entreprise ou d'un bien, les éléments suivants ne sont pas déductibles :
[…]	. . .
(*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part.	*b*) une dépense en capital, une perte en capital ou un remplacement de capital, un paiement à titre de capital ou une provision pour amortissement, désuétude ou épuisement, sauf ce qui est expressément permis par la présente partie.

[20] Because the Act does not define what constitutes a loss of capital, or a payment on account of capital, one must look to the jurisprudence which has considered the distinction between capital and income transactions. The jurisprudence instructs that the determination is in each case fact-driven. Thus, in *Canada (Minister of National Revenue) v. Algoma Central Railway*, [1968] S.C.R. 447 the Supreme Court of Canada wrote, at pages 449-50 [emphasis added]:

> Parliament did not define the expressions "outlay ... of capital" or "payment on account of capital". There being no statutory criterion, the application or non-application of these expressions to any particular expenditures must depend upon the facts of the particular case. We do not think that any single test applies in making that determination and agree with the view expressed, in a

> recent decision of the Privy Council, *B.P. Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia* [[1966] A.C. 224, [1965] 3 All E.R. 209.], by Lord Pearce. In referring to the matter of determining whether an expenditure was of a capital or an income nature, he said, at p. 264:
>
> > The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer.

[21] As this Court noted in *Imperial Tobacco Canada Limited v. Her Majesty the Queen*, 2011 FCA 308, 425 N.R. 88 at paragraph 22, a frequently cited articulation of the distinction between transactions on account of capital and income is found in *British Insulated and Helsby Cables v. Atherton*, [1926] A.C. 205 (H.L.) at pages 213-14:

> [...] when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

[22] In *Johns-Manville*, cited above, the Supreme Court referred, at page 59, to an "almost endless rainbow of expressions used to differentiate between expenditures in the nature of charges against revenue and expenditures which are capital." One expression quoted with approval was the test applied by the Privy Council in *B.P. Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia*, [1966] A.C. 224 at page 271:

> Finally, were these sums expended on the structure within which the profits were to be earned or were they part of the money-earning process?

[23] The Supreme Court cautioned, however, that no single test is controlling (Supreme Court reasons, page 59).

[24] In *Easton*, as cited above, in the context of transactions where a shareholder lends money to a corporation, this Court held that there is a rebuttable presumption that the shareholder loan is on account of capital. At paragraph 16 the Court wrote [emphasis added]:

> 16 As a general proposition, it is safe to conclude that an advance or outlay made by a shareholder to or on behalf of the corporation will be treated as a loan extended for the purpose of providing that corporation with working capital. In the event the loan is not repaid the loss is deemed to be of a capital nature for one of two reasons. Either the loan was given to generate a stream of income for the taxpayer, as is characteristic of an investment, or it was given to enable the corporation to carry on its business such that the shareholder would secure an enduring benefit in the form of dividends or an increase in share value. As the law presumes that shares are acquired for investment purposes it seems only too reasonable to presume that a loss arising from an advance or outlay made by a shareholder is also on capital account.

[25] This Court acknowledged two exceptions which rebut the general presumption that a shareholder loan is advanced on account of capital. Of relevance to this appeal is the first exception, which the Court described at paragraph 17 of its reasons as follows [emphasis added]:

> There are two recognized exceptions to the general proposition that losses of the nature described above are on capital account. First, the taxpayer may be able to establish that the loan was made in the ordinary course of the taxpayer's business. The classic example is the taxpayer/shareholder who is in the business of lending money or granting guarantees. The exception, however, also extends to cases where the advance or outlay was made for income-producing purposes related to the taxpayer's own business and not that of the corporation in which he or she holds shares. For example, in *Berman, L., & Co. Ltd. v. M.N.R.*, [1961] CTC 237 (Ex. Ct.) the corporate taxpayer made voluntary payments to the suppliers of its subsidiary for the purpose of protecting its own goodwill. The subsidiary had defaulted on its obligations and as the taxpayer had been doing business with the suppliers it wished to continue doing so in future. (*Berman* was cited with apparent approval in the

> Supreme Court decision in *Stewart & Morrison Ltd. v. M.N.R.*, [1974] S.C.R. 477, at page 479.)

[26] Having briefly set out the applicable law, I turn to its application to the facts and the errors asserted by the appellant.

(ii) Application of law to the asserted errors

(a) The asserted errors of mixed fact and law

[27] Hemlo Gold asserts that the Judge found that the "Windarra Loan was given to generate a stream of income (interest) for Hemlo Gold" and that, if Windarra's properties were successful, the Windarra shares would have become an asset of enduring benefit as a source of dividends or due to an increase in their value. Hemlo Gold argues that there was no evidence to support either finding, so that the Judge committed a palpable and overriding error in his appreciation of the evidence. I respectfully disagree for the following reasons.

[28] First, the Judge's comment concerning the generation of a stream of interest income cannot be taken out of its context. In full, the Judge wrote that [emphasis added]:

> 155 The Windarra Loan provided Windarra with working capital to fund its share of the exploration and development costs in respect of the Magnacon property. The Windarra Loan was given to generate a stream of income (interest) for Hemlo Gold and to enable Windarra to develop the Magnacon property. <u>The successful development of the property would have secured for Hemlo Gold an enduring benefit in the form either of dividends or an increase in the value of the Windarra Shares</u>.

The enduring benefit contemplated by the Judge was not interest income.

[29] Second, while there was evidence capable of supporting the opposite conclusion, there was sufficient evidence to support the Judge's finding that the Windarra Agreement resulted in Hemlo Gold acquiring assets of enduring benefit. The supporting evidence included that reviewed by the Judge at paragraphs 150 to 153 of his reasons to the effect that:

- Hemlo Gold showed the Windarra shares and the Windarra Loan on its balance sheet as investments and advances.
- The acquisition of indirect interests in junior mining companies, such as Windarra, was made pursuant to Hemlo Gold's long-term investment program.
- Hemlo Gold's annual reports for 1987, 1988 and 1989 referred to the shares and loans as being long-term investments.
- For tax purposes Hemlo Gold treated the disposition of its shares in junior oil companies as being on account of capital.
- The Windarra Loan was part of a package deal. As Mr. Baylis testified, Hemlo Gold provided the Windarra Loan to prevent the dilution of Hemlo Gold's holdings in Windarra. This purpose did not relate to Hemlo Gold's income-producing activities.

[30] Moreover, a memorandum circulated to the directors of Hemlo Gold at the time of the Windarra Loan, and referred to by the Judge at paragraph 135 of his reasons, stated:

> To protect our general position in the camp, to get a position in the "East Block" property (see map) adjoining the Magnacon, and to facilitate a deal on another property controlled by the same Vancouver group, the Caribbean, we have negotiated a financing deal with Windarra. It is subject to board approval and is outlined on the attached summary. Basically we are providing them with a $7.5 m gold loan, getting 1.5 million shares for issue of 150,000 shares of Hemlo, providing

> a $4.0 million underwriting for 2.0 million shares with options for another two million shares and getting a half interest in their 50% of the East Block. We end up with 24% of the company if all options are exercised, and can buy up to 33%.
>
> It is a generous appearing deal for Windarra, but is still good for Hemlo: (i) the money we invest in shares is spent by them on the property we want to explore (ii) we can use Hemlo shares as part of the payment (iii) we tie up the company as our partner and ultimately will take them over, if new discoveries or expansion of Magnacon reserves warrant. We also feel this deal will show Hemlo as a strong competitor and protect our "turf" in the area. Windarra has 12.6 million shares outstanding, trading around $1.40. Fully diluted 15 million shares.

[31] In view of this evidence, the Judge's finding cannot be said to be plainly wrong.

[32] On the basis of the evidence and the Judge's findings of fact, I accept the respondent's submission that the monies advanced pursuant to the Windarra Loan could be characterized as "sums expended on the structure within which the profits were to be earned", one of the expressions descriptive of a capital transaction cited with approval by the Supreme Court in *Johns-Manville*. As the Judge found, the purpose of the Windarra Loan was to provide Windarra with working capital so as to ensure that Hemlo Gold's holdings in it were not diluted.

[33] Hemlo Gold also asserts that the Judge ignored evidence with respect to the purpose of the Windarra Loan and that the Judge determined the purpose of the Windarra Loan either: (i) by reference only to the borrower's use of the borrowed monies, or, (ii) by looking at the loan in isolation from the transaction as a whole and without regard to the evidence of Hemlo Gold's purpose. The evidence said to be ignored is:

- The memorandum to Hemlo Gold's directors dated April 25, 1988.

- The evidence of Mr. Baylis as to the purpose of the Windarra Loan.
- The evidence of Mr. Proctor, Hemlo Gold's former Vice-president, Finance, at pages 1680, 1682 and 1683 of the Appeal Book.
- The extracts from the examination for discovery of Mr. Barbour which were read in at trial.

[34] Again, in my respectful view, the Judge committed no palpable and overriding error by ignoring evidence. The Judge summarized the April 25, 1988 memorandum at paragraph 135 of the reasons, and reviewed the relevant evidence of Mr. Baylis at paragraph 134 of the reasons. While the Judge did not expressly refer to the testimony of Mr. Proctor or the read-ins from Mr. Barbour's discovery, the appellant has not pointed to any evidence contained therein that is dispositive so as to compel a conclusion contrary to that reached by the Judge.

[35] I have read the evidence of Mr. Proctor cited by the appellant, and the read-ins from Mr. Barbour's discovery (found at Tab A-27(b) and R-5 of volume 5 of the Appeal Book) and cannot detect any palpable and overriding error in the Judge's omission to expressly deal with this evidence. Mr. Proctor's evidence dealt with the 1990 write-down of certain investments, including the Windarra investment, as exploration expenses. The Judge dealt with the write-down at paragraphs 137 to 141 of the reasons. Mr. Barbour's evidence was consistent with that of Mr. Baylis and did not materially add to it.

[36] Finally, the appellant has not established that the Judge determined the purpose of the Windarra Loan in isolation or by reference only to Windarra's use of the funds. The Judge's analysis on the whole of the evidence is contained in paragraphs 147 to 156 of the reasons. Much of that evidence, already discussed in these reasons, is relevant to Hemlo Gold's intention. The Judge's impugned finding at paragraph 157 of the reasons, relied upon by Hemlo Gold to assert this error, is responsive to a series of cases relied upon by the appellant, and must be read fairly in that context.

[37] Before leaving this issue, I note one argument advanced by Hemlo Gold that was not argued before the Tax Court. In brief, it argues that its primary objective was to acquire the Magnacon mine. At the time of the Windarra Agreement, the Magnacon mine was not a capital property as defined in paragraph 54(*b*) of the Act. Hemlo Gold then asks how a transaction designed to acquire an income account property can be a transaction in respect of capital?

[38] There are, in my view, two answers to this question.

[39] First, as the respondent argues, while specified mining expenditures are given income-like treatment under the Act, a mine is nonetheless a capital asset.

[40] Second, Hemlo Gold tried and failed to acquire an ownership interest in the Magnacon mine. After this failure it entered into the Windarra Agreement. The reasons of the Judge do not support Hemlo Gold's premise that its primary purpose when it agreed to make the Windarra Loan was to acquire the Magnacon mine.

[41] In summary the purpose for which an expenditure is made is a question of fact, to be determined from all of the circumstances. As evidenced from his reasons, the Judge was alive to the evidence, particularly the evidence relevant to Hemlo Gold's intention when entering into the Windarra Agreement, and the Windarra Loan. His assessment of the purpose of the Windarra Loan is entitled to deference and no basis has been established on which to interfere with his conclusion.

(b) The asserted errors of law

[42] Hemlo Gold asserts that the Judge committed the following errors of law:

a. The Judge took an unduly narrow and formalistic view of the first exception in *Easton*. The appellant argues that the Judge decided that the Windarra Loan could not have been made for income-producing purposes related to Hemlo Gold's own business because the proceeds of the Windarra Loan were used by Windarra for the development of the Magnacon property. The appellant submits that the purpose of the loan should be determined with reference to the purpose of the loan from the lender's perspective, not the borrower's perspective.

b. The Judge failed to apply recognized case law to the effect that the most important factor in determining whether a transaction is on income or capital account is the taxpayer's intention at the time of the transaction.

c. The Judge failed to apply recognized case law to the effect that the determination of whether a transaction is on account of income or capital should be based upon what the transaction was intended to effect from a practical business point of view.

[43] For the following reasons, I reject Hemlo Gold's contention that the Judge erred in law in the above respects.

[44] With respect to the asserted error in the application of the first *Easton* exception, during the oral argument of this appeal counsel for the appellant conceded that the Judge made no error in his exposition of the principles established in *Easton*. The Judge cited the relevant passages from *Easton* at paragraphs 112 and 113 of his reasons. At paragraph 114 the Judge wrote [emphasis added]:

> In summary, when a shareholder makes a loan to a corporation in which the shareholder holds shares, the loan will be considered to be on account of capital, subject to two exceptions. The first exception applies where the shareholder is able to establish that the loan was made in the ordinary course of the shareholder's business. This exception extends to cases where the loan was made for income-producing purposes related to the shareholder's own business and not that of the corporation in which the shareholder owns shares. The second exception, which is not relevant for the purposes of this appeal, arises where the shareholder holds shares in a corporation as a trading asset.

[45] Thus, the Judge articulated the correct legal test. He then found that the acquisition by Hemlo Gold of the Windarra shares and the making of the advances in respect of the Windarra Loan were for the purpose of, and resulted in, Hemlo Gold acquiring assets of enduring benefit. As set out above, that was a finding of fact open to the Judge on the evidence. It follows that as Hemlo Gold did not acquire the Windarra Loan for income-producing benefits related to its own business, the Judge made no error in law in the application of the first *Easton* exception.

[46] Second, with respect to the second and third asserted errors of law, in view of the Judge's findings of fact that the Windarra Loan was not an exploration expense and that the effect of the Windarra Agreement was that Hemlo Gold acquired assets of enduring benefit, Hemlo Gold cannot establish on the facts the asserted errors of law in the application of the case law. The Judge rejected Hemlo Gold's evidence of intention, finding the Windarra Agreement was part of a long-term investment program.

[47] The appellant relies upon the reasons of the majority of this Court, at paragraph 43, in *Canada Safeway Ltd. v. Canada*, 2008 FCA 24, 371 N.R. 337 to argue that "the most determinative factor is the intention of the taxpayer at the time of acquiring the property" and that the Judge gave insufficient weight to the appellant's intent when entering into the Windarra Agreement.

[48] In my view, this argument does not assist Hemlo Gold for the following reasons.

[49] The Judge never rejected Hemlo Gold's contention that the Court should focus on Hemlo Gold's intention at the time the Windarra Loan was made (reasons, paragraph 145).

[50] As evidenced in his reasons, the Judge was attentive to the evidence of Hemlo Gold's intention when it entered into the Windarra Loan (see, for example, the Judge's reasons at paragraphs 134 to 135, and 150 to 153).

[51] The Judge was not persuaded by the evidence addressed by Hemlo Gold as to its intention. Instead, he found that the purpose of the Windarra Loan was to secure assets of an enduring benefit and that Hemlo Gold provided the Windarra Loan with the intent to help prevent the dilution of Hemlo Gold's holdings in Windarra. These findings have not been shown to be palpably and overridingly wrong.

[52] To conclude on the first issue, for the above reasons I have not been satisfied that the Judge erred in finding that the Windarra Loan was capital in nature. I would, therefore, dismiss the aspect of the appeal that relates to this issue.

Issue 2: The Windarra Interest

[53] This issue concerns Hemlo Gold's contention that the Minister understated the amount of the deduction it was entitled to under subparagraph 20(1)(*p*)(i) of the Act by $156,888. The Judge's reasoning on this point is described at paragraphs 11 to 13 above.

[54] Subparagraph 20(1)(*p*)(i) of the Act provides that [emphasis added]:

20. (1) Notwithstanding paragraphs 18(1)(*a*), 18(1)(*b*) and 18(1)(*h*), <u>in computing a taxpayer's income for a taxation year from a business or property, there may be deducted</u> such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably	20. (1) Malgré les alinéas 18(1)*a*), *b*) et *h*), <u>sont déductibles dans le calcul du revenu tiré par un contribuable d'une entreprise ou d'un bien pour une année d'imposition</u> celles des sommes suivantes qui se rapportent entièrement à cette source de revenus ou la partie des sommes suivantes qu'il est raisonnable de considérer

be regarded as applicable thereto	comme s'y rapportant :
(*p*) the total of	*p*) le total des montants suivants :
(i) all debts owing to the taxpayer that are established by the taxpayer to have become bad debts in the year and that have been included in computing the taxpayer's income for the year or a preceding taxation year,	(i) les créances du contribuable qu'il a établies comme étant devenues irrécouvrables au cours de l'année et qui sont incluses dans le calcul de son revenu pour l'année ou pour une année d'imposition antérieure,

[55] Subparagraph 20(1)(*p*)(i) requires a taxpayer to establish that a debt has become bad and that the debt had been included in income for the taxation year in question or a proceeding taxation year.

[56] In the present case there was no dispute that the Windarra Loan became uncollectible. The parties jointly submitted a settlement agreement entered into between Windarra and Hemlo Gold in which Windarra's obligation to repay the Windarra Loan was terminated in consideration of Windarra's agreement to pay $1,000,000 to Hemlo Gold. (Settlement Agreement) (Appeal Book volume 4, pages 1122 to 1126). At issue on this appeal is the Judge's conclusion that Hemlo Gold did not present sufficient evidence to prove that it had included $156,888 of accrued interest in income for the period prior to August 1, 1989. The difficulty in establishing the amount included in income arose because Hemlo Gold's books and records for 1988 and the first half of 1989 were lost during a move.

[57] In the absence of such records, Mr. Proctor testified that the 1989 audited financial statements showed the advances to Windarra totalled $8,513,000 as of December 31, 1989. The maximum principal amount advanced was $8,250,000. The difference between the two amounts, $263,000, represented interest accumulated up to the end of 1989. The Minister had allowed Hemlo Gold to deduct $106,112 in respect of accrued interest. The difference between $263,000 and $106,112 (being $156,888) represented, in Mr. Proctor's view, additional accrued interest (Appeal Book volume 7, pages 1694 and forward).

[58] Mr. Proctor went on to testify that the total sum of $263,000 would have been included in Hemlo Gold's retained earnings, as set out in its income statement as at December 31, 1989. He then reviewed Hemlo Gold's 1988 and 1989 income tax returns and testified that the tax returns did not contain any deductions in relation to this interest income. It followed that Hemlo Gold was entitled to deduct the additional sum of $156,888 under subparagraph 20(1)(*p*)(i) of the Act.

[59] On cross-examination, Mr. Proctor agreed that:

i. He was not involved in the preparation of Hemlo Gold's tax returns.
ii. He did not keep the books, and was not familiar with the general ledger account that recorded the advances made by Hemlo Gold to Windarra.
iii. It was unlikely that the amounts advanced to Windarra included items that were neither principal nor interest.

[60] A Canada Revenue Agency auditor, Mr. MacGibbon, identified his audit documents which summarized the interest income amounts ($183,336) that he had allowed Hemlo Gold with respect to the Windarra Loan (Exhibit A-12). The books and records of Hemlo Gold available to him during the audit commenced as of August 1, 1989. Mr. MacGibbon agreed that it was likely that some interest accrued to Hemlo Gold in 1988 and in the first part of 1989 with respect to the Windarra Loan.

[61] The auditor also testified that during the audit process Hemlo Gold never made representations to him to the effect that his interest calculation was incorrect. Mr. MacGibbon had no understanding as to whether anything other than principal and interest were debited to Windarra's account.

[62] This evidence must be viewed in the context of the Minister's assumptions. The Minister assumed that Hemlo Gold agreed to forgive all but $1,000,000 of the amounts advanced to Windarra and it wrote off the remaining $7,590,684 as a bad debt in 1992 (Amended Reply, paragraph 17(z), Appeal Book volume 1, page 69). The relevant assumption to the Windarra Interest concerns the allocation of the remaining $7,590,684 written off as a bad debt. The Minister assumed that "the amount of $7,590,684 claimed by [Hemlo Gold] as a bad debt in 1992 in respect of the Windarra Loan was comprised of principal of $7,407,348 and interest of $183,336" (Amended Reply, paragraph 17(gg)). Thus, the Minister assumed that Hemlo Gold was only entitled to deduct $183,336 in interest income as a bad debt. This assumption precluded a further deduction of $156,888 in accrued interest income.

[63] In tax cases, the taxpayer has an initial onus to demolish the Minister's assumptions. This onus is met if the taxpayer establishes a *prima facie* case that the Minister's assumptions are wrong. Once the taxpayer establishes a *prima facie* case, then the burden shifts to the Minister to prove its assumptions on a balance of probabilities. If the Minister fails to adduce satisfactory evidence, the taxpayer will succeed: see *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336 at paragraphs 92 to 95; *House v. Canada*, 2011 FCA 234, 422 N.R. 144 at paragraphs 30 and 31.

[64] At trial, Hemlo Gold adduced evidence to demolish the assumption that it could only deduct $183,336 in interest income as a bad debt. In particular, it adduced evidence showing:

(i) it had included the additional sum of $156,888 in interest income in its income tax returns; and

(ii) this interest income became a bad debt.

[65] Notwithstanding the auditor's admission that it was likely that interest accrued in 1988 and the first part of 1989 in the Windarra Loan, the Judge rejected Mr. Proctor's evidence that additional interest was included in Hemlo Gold's income on the basis that Hemlo Gold "could have recorded the offsetting amount on a balance sheet account such as a deferred revenue account or a reserve account." However, for the reasons that follow, there was, in my view, no evidence before the Court to support such a conclusion.

[66] The Judge found Mr. Proctor to be a credible witness. Mr. Proctor testified that Hemlo Gold would have included the sum of $263,000 in its retained earnings. He reviewed the Reconciliation

of Net Income for Tax Purposes form (*i.e.* the T2S(1) form) provided by Hemlo Gold for each of the 1988 and 1989 taxation years as part of its income tax returns (Appeal Book volume 2, pages 81 and 109) and identified no adjustments "in moving from financial statement income to net income for tax purposes relating to Windarra" (Appeal Book volume 7, page 1699).

[67] With respect to the Judge's reference to deferred revenue and reserve accounts, while Hemlo Gold's 1988 and 1989 balance sheets did show a deferred revenue liability (Appeal Book volume 5, pages 1176 and 1181), the notes to its financial statements specified that the deferred revenue liability related solely to Hemlo Gold's gold loan owed to a consortium of Canadian banks (Appeal Book volume 5, pages 1178 and 1188). The 1988 and 1989 balance sheets did not record any reserve accounts.

[68] In this circumstance there was, in my respectful view, no evidence on which to impugn Mr. Proctor's evidence, so that the Judge committed a reviewable error in rejecting the evidence for the reasons that he gave. Mr. Proctor's evidence, together with the auditor's concession established that Hemlo Gold had included the additional sum of $156,888 in interest income in its income tax returns.

[69] It remained for Hemlo Gold to establish that the interest income was or became a bad debt. This required consideration of whether any monies paid to it pursuant to the Settlement Agreement were allocated to monies owing on account of interest. If so, that portion of the interest income would not be a bad debt.

[70] Article 1(3) of the Settlement Agreement evidenced the parties' agreement that the settlement proceeds were to be "applied on account of the principal amount of the [Windarra] Loan." This established on a *prima facie* basis that all of the interest owing to Hemlo Gold pursuant to the Windarra Loans was a bad debt.

[71] To conclude on this point, in my view, this Settlement Agreement combined with the evidence of Mr. Proctor and the auditor's concession was sufficient to demolish the Minister's assumption. Further, counsel for the Minister did not point to any evidence which rebutted Hemlo Gold's *prima facie* case.

[72] It follows that Hemlo Gold established its entitlement to deduct $156,888 under subparagraph 20(1)(*p*)(i) of the Act in 1992.

Conclusion and Costs

[73] For these reasons, I would allow the appeal in part. I would set aside the judgment of the Tax Court. Making the judgment that should have been made, I would allow the income tax appeal and I would refer the reassessments under appeal back to the Minister for reassessment on the basis that the appellant is entitled to deduct $156,888 under subparagraph 20(1)(*p*)(i) of the Act for the 1992 taxation year. In all other respects I would dismiss the appeal.

[74] As success has been divided, I would not award any costs on the appeal.

"Eleanor R. Dawson"

J.A.

"I agree.
Johanne Trudel J.A."

"I agree.
David Stratas J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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