Federal Court of Appeal  Cour d'appel fédérale

Date: 20190502

Docket: A-148-18

Citation: 2019 FCA 107

CORAM: **STRATAS J.A.**
RENNIE J.A.
LASKIN J.A.

BETWEEN:

ERIC VAN STEENIS

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Vancouver, British Columbia, on May 2, 2019.
Judgment delivered from the Bench at Vancouver, British Columbia, on May 2, 2019.

REASONS FOR JUDGMENT OF THE COURT BY: LASKIN J.A.

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REASONS FOR JUDGMENT OF THE COURT
(Delivered from the Bench at Vancouver, British Columbia, on May 2, 2019).

LASKIN J.A.

[1] In 2007, the appellant, Eric Van Steenis, borrowed $300,000 to buy units of a mutual fund trust. From 2007 through 2015, he received distributions from the mutual fund totalling nearly $200,000 that were characterized by the fund, in the T3 Statements of Trust Income Allocations and Designations issued to him, as "represent[ing] distribution[s] or return[s] of

capital." Mr. Van Steenis used some of this money to reduce the outstanding principal of the loan, but used the majority of it for personal purposes.

[2] In the years in question in this appeal, 2013, 2014 and 2015, Mr. Van Steenis deducted from his taxable income all of the interest paid on the loan. He did so in reliance on subparagraph 20(1)(*c*)(i) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), by which a taxpayer may deduct interest paid on borrowed money used for the purpose of earning income from a business or property.

[3] The Minister of National Revenue reassessed Mr. Van Steenis's 2013, 2014 and 2015 taxation years, and denied a portion of the interest deducted. She concluded that the money distributed in those years as returns of capital and used for personal purposes was no longer being used for the purpose of earning income.

[4] Mr. Van Steenis appealed the reassessments to the Tax Court of Canada: *Van Steenis v. The Queen*, 2018 TCC 78 (Graham J.). In his notice of appeal, he stated that he had "received return of capital distributions" totalling nearly $200,000 from the mutual fund. However, he argued before the Tax Court judge that his use of the borrowed money did not change with the distributions, since he continued to own all of the units originally purchased. He also argued that it was the mutual fund's choice to characterize the distributions as returns of capital, and that there was no relationship between those distributions and the money he invested.

[5] The Tax Court judge disagreed with Mr. Van Steenis's characterization of what had occurred. He found (at paras. 11-12) that "a distribution of capital to a unitholder is, in essence, a return of that unitholder's capital," that Mr. Van Steenis invested money in the mutual fund and the fund "gave him some of his money back," and that the distributions had "changed" his investment, since a portion of Mr. Van Steenis's money was "no longer invested" in the mutual fund. The Tax Court judge further concluded (at para. 10) that the fact that Mr. Van Steenis continued to own the units did not change the analysis: the borrowed money was used to buy mutual fund units, almost two-thirds of that money was returned to him, and more than half of that amount had then been used for purposes other than earning income.

[6] The Tax Court judge also considered (at para. 11) the scheme of the Act, which he saw as supporting his findings. He observed that, under the scheme, distributions of capital – unlike distributions of income – are not taxed in the hands of the unitholder until they exceed the amount invested. He concluded that this "clearly indicate[d] that Parliament viewed distributions of capital as being returns of the unitholder's own investment." He dismissed Mr. Van Steenis's appeal.

[7] Mr. Van Steenis now appeals to this Court. He accepts that, for the requirements of subparagraph 20(1)(*c*)(i) to be met, the borrowed money must be traceable to a current eligible use: *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622 at para. 31, 178 D.L.R. (4th) 26; *Bronfman Trust v. The Queen*, [1987] 1 S.C.R. 32 at 46, 53, 36 D.L.R. (4th) 197. However, he submits that the Tax Court judge made two reversible errors.

[8] First, he argues that the Tax Court judge erred in law in requiring that Mr. Van Steenis meet the test set out in *Shell* and *Bronfman Trust* when there has been no disposition, in whole or in part, of the mutual fund units purchased with borrowed money. Second, he submits that, in applying the test, the Tax Court judge committed a palpable and overriding error of fact in finding that the distributions in issue represented the return of a portion of the borrowed money that Mr. Van Steenis invested. We do not accept either submission.

[9] Counsel for Mr. Van Steenis candidly acknowledged that there was no authority directly supporting his first submission. He relied, however, on the fact that discussions of the tracing requirement in the case law refer to circumstances in which a disposition of the original investment has occurred.

[10] We are not persuaded that the requirement to trace the borrowed money to a current eligible use applies only where there has been a disposition, in whole or in part, of the original investment. In our view, neither the text nor the purpose of subparagraph 20(1)(*c*)(i) supports the imposition of this prerequisite. The focus of the provision is on the current use of the borrowed money, not on the current ownership status of the property initially acquired with it. As the Crown submits, there are many possible situations in which borrowed funds could be used to purchase an eligible property, but some of the funds could be returned to the taxpayer and then used for a different purpose. Mr. Van Steenis has not suggested any principled reason why tracing of the current use of the borrowed funds should not be required in those circumstances.

[11] Mr. Van Steenis acknowledges that the palpable and overriding error test that he must meet to succeed on his second submission – that the Tax Court judge erred in finding that the distributions returned to Mr. Van Steenis some of the money he invested – is one that is stringent and highly deferential, concerned with obvious errors going to the core of the outcome of a case: *Canada v. South Yukon Forest Corporation*, 2012 FCA 165 at para. 46, 431 N.R. 286, leave to appeal to S.C.C. refused, 2012 CanLII 76981.

[12] In our view, Mr. Van Steenis has not met this standard. He submits that there was no evidence before the Tax Court judge that the distributions were actually a "return" of his invested funds. He stresses that a mutual fund trust's T3s are issued for tax purposes, and that distributions ultimately characterized as "returns of capital" may, in fact, have included the mutual fund's income at the time of distribution: see Catherine Brown, "Allocating Distributions from Mutual Fund Investments to the Income and Capital Beneficiaries of a Personal Trust: The Perplexing World of Who Gets What and Who Gets Taxed" (2008) 27 E.T.P.J. 158 at 176-77.

[13] However, the onus was on Mr. Van Steenis to trace the borrowed funds to an identifiable use that triggered the deduction: *Bronfman Trust* at 45. It was also his onus to disprove the Minister's assumption that he had received "a return of capital each year" (Appeal Book at 15) to the extent this assumption was in dispute: *Canada (National Revenue) v. Cameco Corporation*, 2019 FCA 67 at para. 28, citing *Sarmadi v. Canada*, 2017 FCA 131 at para. 31, [2017] D.T.C. 5081.

[14] As the Crown points out, Mr. Van Steenis tendered no evidence that the distributions were anything other than a return of capital. Indeed, despite his assertion that the record did not support the Tax Court judge's factual findings, in his written submissions to this Court Mr. Van Steenis concedes that, "following the stock market crash in 2008, the [mutual fund] earned little to no taxable income, meaning the distributions were comprised exclusively of what the [Tax Court Judge], the Minister and the witnesses generally referred to as 'returns of capital'": Appellant's memorandum at para. 8. This reflects Mr. Van Steenis's testimony before the Tax Court judge that once the stock market crashed, "[t]hen it became all return of capital": Appeal Book at 128.

[15] For these reasons, the appeal will be dismissed, with costs fixed at $1,900 all-inclusive.

"J.B. Laskin"

J.A.

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-148-18
(APPEAL FROM A JUDGMENT OF THE HONOURABLE JUSTICE GRAHAM OF THE TAX COURT OF CANADA, DATED APRIL 20, 2018, DOCKET NO. 2017-3305(IT)I)	
STYLE OF CAUSE:	ERIC VAN STEENIS v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	VANCOUVER, BRITISH COLUMBIA
DATE OF HEARING:	MAY 2, 2019
REASONS FOR JUDGMENT OF THE COURT BY:	STRATAS J.A. RENNIE J.A. LASKIN J.A.
DELIVERED FROM THE BENCH BY:	LASKIN J.A.

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