Docket: 2012-3692(IT)G

BETWEEN:

568864 B.C. LTD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Before: The Honourable Justice Gerald J. Rip

Appearances:

Counsel for the Appellant:	Thomas M. Boddez
Counsel for the Respondent:	Bruce Senkpiel

AMENDMENT TO REASONS FOR JUDGMENT

Upon counsel for the appellant informing the Court in writing that typographical errors were found in certain paragraphs of the reasons;

In paragraph [1], paragraph 1102(1)(*a*) of the *Income Tax Regulations* was inadvertently referenced to, paragraph [1] is therefore amended to read:

> ... According to the Crown the appellant did not acquire the patents in 2005 and if it did, it did not acquire the patents for the purpose of earning income and therefore the patents were not depreciable property [**paragraph 1102(1)(*c*)** of the *Income Tax Regulations* ("*Regulations*")] and the appellant is not entitled to a terminal loss. …

Footnote 24 in paragraph [93] is amended to read:

24 See paras. 56 and 57.

Paragraph [101], near the end of the paragraph, is amended to read:

> … And when **the appellant** acquired the Patents in 2005, it did so in association with income production in pursuit of and part of a profit making exercise to exploit the Patents with another party in some joint venture or partnership where a Woodtone company would be a participant and to which the appellant would licence the Patents to derive income. …

The second sentence in paragraph [104] is amended to read:

> … The **respondent** was also permitted to plead that due to the claim of prior secured creditors the only property the appellant could seize in respect of the defaulted loans were the Patents received under the security agreement with Mr. Cable; that if the Patents were disposed of, the Patents were not depreciable property; and if they were depreciable property, they were not available for use by the appellant and therefore no amount is includable in calculating the adjusted capital cost of a depreciable property.

These amended reasons for judgment are issued in substitution to the reasons for judgement issued on December 29, 2014.

Signed at Ottawa, Canada, this 5th day of January 2015.

"Gerald J. Rip"

Rip J.

Citation: 2014 TCC 373
Date: 20150105
Docket: 2012-3692(IT)G

BETWEEN:

568864 B.C. LTD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

AMENDED REASONS FOR JUDGMENT

Rip C.J.

[1] 568864 B.C. Ltd. ("568"), the appellant, claims that in 2005 it acquired patents, a Class 14 asset, in a bankruptcy proceeding for $3,500,000 and when it sold the patents in 2007, the year in appeal, for $1.00, it incurred a terminal loss in accordance with subsection 20(16) of the *Income Tax Act* ("*Act*").[1] The Crown disagrees. According to the Crown the appellant did not acquire the patents in 2005 and if it did, it did not acquire the patents for the purpose of earning income and therefore the patents were not depreciable property [**paragraph 1102(1)(*c*)** of the *Income Tax Regulations* ("*Regulations*")] and the appellant is not entitled to a terminal loss. The respondent assessed the appellant for 2007 on the basis the appellant disposed of a non-depreciable capital asset which gave rise to a capital loss. An Order of the Court dated, May 16, 2014, permitted the respondent to file an Amended Amended Reply to the Notice of Appeal — three weeks before trial — to withdraw the Minister of National Revenue's assumption that the sale of the patents occurred in 2007; the respondent's new position was that beneficial title and interest in the patents were acquired by the appellant in 2010.[2]

[2] For a taxpayer to deduct an amount as a terminal loss, the taxpayer must have incurred a capital cost in acquiring beneficial ownership of depreciable property of a prescribed class. In the matter at bar the appellant's position is that

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1 The claim of terminal loss is $3,871,057, $3,500,000 plus $371,057 in legal costs.

2 See para. 93-94.

the patents originally were security for a loan of $3,500,000 and on the loan becoming bad, it was assigned beneficial ownership of the patents: subsections 79.1(2) and 79.1(6) of the *Act*.

[3] There are two primary questions I have to answer in this appeal:

1) Did the appellant acquire beneficial ownership of the patents before September 2007, when it claims it sold the patents? If the answer is "no", then the appeal must be dismissed;

2) If the answer to question 1 is "yes", then I must decide if the appellant acquired the patents for the purpose of earning income from a business or property.

[4] To answer these questions, in particular question 2, I believe, unfortunately, requires a rather lengthy review of the facts surrounding the issues.

[5] In assessing the appellant for 2007, the Minister did not assume as a fact that the appellant acquired beneficial ownership of the patents in 2010. The respondent, therefore, is obliged to prove her allegation that the appellant acquired beneficial ownership of the patents only in 2010.

Facts

[6] The appellant is part of a group of corporations known as, and referred to, the Woodtone Group or Woodtone that are controlled by Mr. Jim Young and members of his family.

[7] Mr. Young earned an M.B.A. from the University of Washington after receiving an undergraduate degree from Simon Fraser University. In 1977 he and a partner acquired a cedar shake and a shingle mill and later, in 1989, he purchased Woodtone Industries Inc. in Abbotsford, B.C., a company in the cedar remanufacturing business at the time. As the business succeeded new companies as well as trusts were created in what became known as the Woodtone Group of Companies.

[8] The Woodtone Group's operating company is W.I. Woodtone Industries Inc. ("W.I."). Mr. Young, however, explained that he uses the term "Woodtone" in negotiations with the lumber industry irrespective of the company involved rather than the name of a specific corporation. Thus, although he may be wearing the hat

of President of the appellant, he will use "as common parlance" the term "Woodtone".

[9] W.I.'s main source of income since the 1990s is from the manufacture of a line of exterior trim boards for new residential construction, usually called fascia boards or gutter boards. The board behind a metal gutter around a window or the outside corner of a residence is a gutter board, Mr. Young explained. W.I., according to Mr. Young, is an outside trim board company using real wood only. W.I. also manufactures related products for windows, doors, corners of homes, that is, exterior trim boards and siding products "all custom made, appearance graded, all custom primed and coated ready for use on new construction North America wide."[3]

[10] The role of the appellant itself, according to Mr. Young, includes the provision of management services for a fee to W.I. and to hold assets "that we don't think are appropriate to be held in [W.I.] although they are used by [W.I.] and we rent them [to W.I.] and charge a fee for them".

[11] The reason for separating the functions of the appellant and W.I., explained Mr. Young, is that W.I. pays bonuses to its employees based on the company's earnings that are based only on the profit and loss of the operations of the business. "I don't want previous years' profits invested in something … lost and then everybody has a loss for the year and nobody gets a bonus … [because of] my strategic mistake as the manager." The appellant's role "was to hold assets of value, and to make other investments … on behalf of the Woodtone Group that may be successful, maybe fail, but the operating company doesn't pay the price or take the benefit of that decision."

[12] Mr. Young also described the appellant as "really the general manager" of W.I.

[13] A Management Agreement between the two companies is dated effective July 23, 1998. The second recital to the agreement states that:

> B. At Woodtone's request, 568864 B.C. Ltd. is to provide operation management and financial services to Woodtone to ensure proper management of the Plant, as set out on Schedule A;

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[3] W.I. is in what is often referred to as the softwood lumber market and Canadian softwood industry is frequently in a "lumber fight" with U.S. competitors. From time to time the U.S. imposes tariffs on Canadian softwood lumber.

…

SCHEDULE "A"

SERVICES TO BE PROVIDED

The services to be performed by the Manager shall consist of those services reasonably required to be performed by a manager of a facia siding manufacturing and wholesale facility, consisting of general supervision of marketing, production and personnel, and without limiting the generality of the foregoing, shall include:

1. Determining sales, production, quality control and maintenance priorities;

2. Generally managing production;

3. Procuring and delivering products;

4. Managing customer relations;

5. Recruiting, supervising and managing personnel;

6. Strategic planning and capital budgeting;

7. Supervising sales and marketing teams, maintaining key accounts, and participating in weekly sales meetings;

8. Supervising and managing corporate finances;

9. Determining and supervising sales territories;

10. Overseeing major accounts;

11. Establishing quota and costing formulas;

12. Reviewing completed jobs and analysis of profitability;

13. Establishing sales budgets;

14. Developing marketing strategies.

[14] Mr. Young confirmed that the appellant has been providing these services to W.I.

Products

[15] The type of board that W.I. manufactures for sale led to this appeal. W.I. wants to buy "pretty boards", as Mr. Young described them. The framing lumber that W.I. normally purchases from mills are 2 x 4s, 2 x 6s and 2 x 8s. W.I. does not want holes or splits in the wood; it wants no appearance defects, boards that are appearance graded, not structurally graded. Higher prices are paid for boards of superior appearance.

[16] Builders of homes want the "pretty boards" but they also want long boards. As Mr. Young explained " … if they have to run this fascia board for 30 feet, they have no interest in putting up a 10 and butting it to another 10 and butting it to a third 10 … [T]hey want as few joints as they can get". The less joints there are reduces entry for moisture and mould growth.

[17] Unfortunately, said Mr. Young, the mills do not make long lengths only. They make all lengths. He explained that "Lumber, 2x4 comes in what's commonly known as an 8 to 20 tally.[4] So when you get the sawmill production out, at the end of the day, they sawed 100 logs." There are many 8s and 10s but less 14s, 16s, 18s and 20s. However, W.I.'s customers would prefer 20s and the mills do not want to sell 20s exclusively, that is what Mr. Young referred to as an 8 to 20 tally, wood having lengths from 8 feet to 20 feet. "You have to take a certain amount of shorts in order to get longs. It is always a battle … [to] get as many longs as I can."

Interact technology and relationship with appellant

[18] At the turn of the century Interact Wood Products Ltd. ("Interact") had developed and patented a new technology that would make wide and long boards of almost any length or width. Interact's process enabled the boards to be finger jointed for length and edge laminated for width. The patents and applications for patents were owned by Interact's principal shareholder, Mr. Eric Cable. Mr. Young explained what Interact did:

> … They took some somewhat traditional technology, which is finger jointing, taking little trim ends from the major mills as they trim to the evens, 10 foot, 12 foot, 14 foot. There's these trim ends, which are under 2 feet long, and finger joint them together to make a long one. That's been done before, but what they added to it, there was a couple things, but the simple thing they added to it was

[4] The listed numbers refer to length in feet, the lower numbers, eg. 2 x 4, refer to width and depth in inches.

> take that finger jointed long board and put several of them side by side, gluing them together in a fancy way, so that you could make this big panel of wood. So you'll have finger jointed boards coming through from the finger joiner, short ends being finger jointed, pressed into a long press and you made a 60 foot long board. Now, no sawmill saws 60 foot.
>
> So first off we've got length that's unavailable in solid wood. It's now finger jointed to 60 feet long. You could take that finger jointed piece, in and of itself, and just cut it to 20s, three 20s and you can do that all day long and then you add 100 percent out turn of 20 foot lumber. Just what my customers are asking for.
>
> Second thing that they did was they took that 60 foot long piece and they put another one beside it, another one and another one, another one, and they made this great big wide panel, 20 feet that direction and 60 feet that direction. Then they had a method, I won't get into the detail, they had a method of saws, they're called flying saws, of ripping out of that any width you wanted. So now you could have 60 feet long and any width you want.

[19] The ability to acquire boards of any length and width from Interact, declared Mr. Young, would allow W.I. to have a source of lumber where it could secure all the length and width it wanted. It did not have to acquire sizes it did not need or want. Mr. Young described the process as "game changing".

[20] W.I. had been purchasing lumber from Interact. But, Mr. Young added, Interact was struggling and required financial assistance. Mr. Young personally negotiated the purchase of the boards from Interact on behalf of the appellant. Notwithstanding that the appellant procured the boards, Interact sent the invoices to W.I. as purchaser. Copies of three invoices from Interact to "Woodtone" in October and November 2004 describe the board lengths from 16 feet to 20 feet. There is no evidence that the sales of boards to Interact's other customers were or were not the same lengths or quality sold to Woodtone. Mr. Young said that Woodtone was able to purchase "all the longs we wanted" from Interact. He considered the ability to acquire these longer boards as a competitive advantage notwithstanding that Interact had other customers as well.

Appellant's loan to Interact

[21] In the Fall of 2003, as Mr. Young recalled that Interact "came with their tale of woe regarding money they needed to grow their business, finish the technology,

get into Family 2 and 3 (patents),[5] and build a bigger plant, produce more lumber …". Interact asked for Woodtone's financial help and the appellant eventually advanced $3,500,000 to Interact. Mr. Young recalled:

> We had a look at what they were asking for, or what they thought was required as far as financial help. We actually advanced them far more than [what they wanted]. Because our analysis was that the lesser amount of money was just a band-aid, and that they needed quite a bit more money than that. And since I was so interested in their technology, and so interested in supplying this lumber to the Woodtone Group, and the advantage that it would give to the Woodtone Group, 568 took the risk of investing that three and a half million dollars in the Fall of '03.

[22] Mr. Young explained that the appellant was the appropriate corporation in the Woodtone Group to make the loan since he did not want any operating company to have a "risky investment on its books."

[23] A "Term Sheet" dated October 17, 2003, was prepared by Interact for Mr. Young's review. Mr. Young said this was not the first proposal and not the last but it was the first formal proposal for the loan of $3,500,000.

[24] As part of the loan, Woodtone Group would also provide "general business advice" to Interact in consideration, Mr. Young stated, of "3,500,000 options with an exercise price of $1.00", assuming Interact "has 30,000,000 voting common shares outstanding …". In the event Interact became a public offering corporation at a valuation of less than $30,000,000 or, if Interact "is still private after 3 years" and its value is less than $30,000,000, adjustments would be made to the exercise price.

[25] Mr. Young did not agree to the term in the "Term Sheet" but negotiations continued with Interact who, according to Mr. Young, continued to send him term sheets. He considered Interact's activity to be "an iterative process … looking for more money." However, he cannot recall whether he signed any term sheet, although he has some unsigned copies in his possession.

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[5] Mr. Young described the difference in each Family of patents. Family 1, of most interest to him, was a method to produce an appearance guided product, Family 2 produced a structural rating and Family 3 described how face-laminating supported a "big span." Family 1 were the only patent existing on December 19, 2003. Interact later applied for other patents which are referred to as Family 2 and Family 3, which were held not to be included as security for the subsequent loan to Interact because they were "not sufficiently developed at the time." See paras. 35 and 36 of these reasons.

[26] In midst of negotiations, Mr. Cable and his spouse, Mr. Young recalled, asked for short-term help claiming Interact was "broke". Because he was "very passionate about the [Interact] technology and the potential of the benefit of the out-turned lumber from Interact that would really help the Woodtone Group", he caused W.I. to loan Interact $500,000 on October 17, 2003 and $250,000 on December 2, 2003, the $500,000 being advanced without security at the time.

[27] Mr. Young claimed the reason W.I., and not the appellant, loaned the amounts of $500,000 and $250,000 was because it had the money in its bank account at the time and the appellant did not. Book entries adjusted the two loans from W.I. to the appellant so that the two loans were recorded as loans from the appellant to Interact.

[28] At the time Interact originally approached Mr. Young for a loan it had already borrowed money from "some other bridge financing people" at interest rates of "about 30 per cent" and 51 per cent, according to Mr. Young.

[29] On December 4, Interact executed a Security Agreement in favour of W.I. for $750,000.

[30] Also on December 4, Interact prepared and executed an addendum to the Term Sheet of October 17 (indicating this was the eleventh draft). The signing parties were Interact and the appellant.

[31] On December 19, 2003 a loan agreement for the $3,500,000 was finally executed. The interest rate was 18 per cent per annum. Mr. Young wanted to make sure that Interact paid back the previous bridge loans of 30 per cent and 51 per cent secured loans. He considered the appellant's loan to Interact as "risky" so he required a "first charge on everything". The balance of the loan "would be for expanding the business, finishing the first plant, getting production up and that's what 568 needs" a successful company to get lumber for the Woodtone Group. In cross-examination Mr. Young confirmed that "roughly" $2,000,0000 would be applied to repay the bridge loans, $500,000 to payables, working capital for Interact's plant in Golden, B.C., carrying costs in respect of its plant in Vavenby and the balance for miscellaneous matters. The amount advanced by the appellant

on December 19 was $2,700,000; there was a "holdback" with respect to interest on the earlier loans by Woodtone.[6]

[32] The loan was secured, among other things, by a guarantee of the principal amount and interest by Mr. Cable and Interact Holdings, a corporation he controlled, as well, among other things, by an agreement by Interact to mortgage and charge and grant in favour of 568 specific and fixed security interest in all personal property, assets, rights and undertakings, including accounts receivable, equipment and fixtures and other assets. Mr. Cable would also offer the patents he owned personally as security for the loan.

The Patents

[33] That Mr. Cable owned the patents for the intellectual property came to Mr. Young's knowledge shortly before December 19. As a result it was necessary to obtain Mr. Cable's personal guarantee from the loan including, in particular, security over the patents, the "only valuable asset" according to Mr. Young. As he explained it: "If there was going to be any trouble in this loan … at minimum … we'd like our money back. But if we don't get it … we certainly want to have the patents as security so we can use it to produce the lumber for the Woodtone Group."

[34] Mr. Cable executed an agreement, dated December 19, 2003, ("Security Agreement") securing the appellant's loan of $3,500,000 to Interact and, among other things, charging and granting to the appellant a security interest in the following intangibles described in Schedule "A" of the Security Agreement:

> Inventions or improvements described and claimed in:
>
> 1. United States Patent Application 09/892,142 filed June 26, 2001; and
>
> 2. Patent Corporation Treaty (PCT) Application PCT/CA02/00981 filed June 26, 2002 designating all member states of the Patent Cooperation Treaty, and any and all applications constituting a national or regional phase entry of said PCT Application.
>
> and all right, title and interest in and to the said inventions or improvements and said applications, and all continuations, divisions, renewals of or substitutes for

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[6] The aggregate amounts the appellant actually advanced to Interact was $2,700,000 + $500,000 + $250,000, or $3,450,000.

> said applications, and in, to and under all Letters Patent which may be granted on or as a result thereof, and any reissue or reissues of said Letters Patent, in any and all countries.

[35] The patent or patents ("Patent", "Patents" or "intellectual property") described in Schedule "A" to the Security Agreement were sometimes referred to during the hearing of the appeal as "Family 1" Patents and Patent applications and later were described as patents for a wood-gluing and clamping system. The U.S. patent was pending on December 19 and was for the process Mr. Young described earlier in these reasons. Mr. Young added these Patents, Family 1 Patents, had a secondary part, a layer which, I understand, adds strength to the board. Over the years, until 2007, once the appellant controlled Family 1, it applied for patents in other jurisdiction including Canada, Russia, China, Japan, New Zealand, Mexico, Australia and Europe.

[36] The Security Agreement was prepared by the appellant's solicitors who referred it for review and comment to a patent lawyer, Mr. Hilton Sue.

[37] Mr. Sue confirmed that the U.S. Patent and Investment Office assignment database records that Mr. Cable's security agreement of December 19, 2003 had been recorded against all of Mr. Cable's Patents and patent applications in favour of 568. These include a description of the collateral, U.S. national entry of the PCT application and the "divisional" of the application. Copies of the pertinent patent assignment from the U.S. Patent and Trademark Office confirming the appropriate registrations on January 14, 2004 were produced by Mr. Young. The registered collateral U.S. patent application under the *Personal Property Security Act* of British Columbia was registered on December 24, 2003.

[38] Also, by agreement dated December 19, Interact granted to James Young (RMH) Trust the right to purchase 3,960,000 Class A voting shares for $1.00 per share contemplated earlier.[7] The agreement is signed by both Mr. Cable for Interact and Mr. Young as Trustee. The option was put into trust "as part of strategic planning" according to Mr. Young.

[39] In Mr. Young's view the option to purchase the shares was partly "for … making the loan" in addition to the interest of 18 per cent on the loan. Mr. Young said he hoped to get some benefit in the future if Interact became a publicly traded

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[7] While the agreement of December 15, 2003 provides for 3,960,000 shares, references in subsequent agreements provide for the right to acquire 3,500,0000 shares. A subsequent amendment on June 4, 2004 increases the number of warrants to 4,600,000 shares.

corporation but he considered the option "not very important". I note that earlier he had indicated the share options were consideration for Interact consulting with the appellant.

[40] In cross-examination Mr. Young was referred to a subsequent proposal dated January 10, 2005, made by Woodtone concerning possible refinancing of Interact. Respondent's counsel addressed the comments in the proposal that Woodtone expected the $3,500,000 to earn monthly interest and have the principal repaid "and then watch and wait as the warrants slowly became more and more valuable, until a liquidity event would allow them to be exercised." Mr. Young declared the document was written for Interact "to show them how far off the mark they were." He had "seen too many of these small businesses … to believe that [i.e. the warrants having significant value] would be the case." Mr. Young insisted the warrants were offered to Woodtone as a bonus on the loan and was not a critical consideration in making the loan. The main purpose of the loan was for "Woodtone to acquire the wood and for the appellant to earn management fees from Interact". He repeated that he wanted to make sure Woodtone would get "the wides and longs" once Interact expanded its production using the proceeds of the loan.

Interact's financial problems

[41] Interact did not pay interest on the loan as required. A payment of interest on the $750,000 loan was due in January 2004 and it was not made. Interest on the "main loan" was due on January 31, 2004 but it was not made "so we learned very quickly this Eric Cable … wasn't a man of his word at all. You can't borrow three and a half-million in December and not have $10,000 to make an interest payment on that loan two weeks later … He had the money … he had no intention of paying it."

[42] Mr. Young stated that he kept demanding payment of interest from Mr. Cable and his wife but mostly to no avail. He watched what was happening at Interact's site and saw that the business was expanding "from a capital point of view faster than [Mr. Cable] generated any cash flow to fund it … he overspent dramatically on the capital additions." Mr. Young acknowledged that he received a "little bit of interest in February."

[43] Interact's business was not doing well. Mr. Young had his own ideas how Interact could succeed and was looking to "resurrect" the business. By April 2004, he had discussions with corporations who financed businesses with a view to developing a program that could be "pitched to Interact".

[44] Following a meeting with Mr. Glen Johnson, a friend of Mr. Young and principal of Glace Capital Corporation, Mr. Greg Vezina of Edgemark Capital Inc, who represented Interact in earlier financings, Mr. Young and his son, Chris, a proposal was prepared for discussion purposes. The proposal, a copy of which was sent to Mr. Cable, contemplated restructuring part of the appellant's loan to shares and reduction of the interest rate on the loan, additional investment and a reduction of Mr. Cable's interest in Interact, among other things. The proposal was rejected by Mr. Cable.

[45] By June 2004, Interact was in default of its obligations to 568. Interact required additional funds and negotiated a loan of $800,000 from Nacan Products Ltd. ("Nacan"). Nacan supplied "the polyurethane glues that are critical as part of the patented process to make the finger-jointed edge laminated and for especially structural side" of the Patents, according to Mr. Young, and Nacan wanted to be the exclusive supplier of the glues to Interact in return for the loan. A condition of the loan was that 568 would subordinate certain of its security — not the Patents — to Nacan and Mr. Young agreed to do so since "it was critical for Interact to move forward" or face "CCAA[8] tomorrow."

[46] On June 7, 2004, the appellant, 568, wanted Interact to find a "significant additional equity investor … in excess of two million dollars" and in return 568 would subordinate its security to the new loan and reduce interest on the loan to between 6 per cent and 9 per cent.

[47] Nothing happened except, according to Mr. Young, Interact was "trying to borrow from everywhere" and did in fact again borrow from previous lenders at rates of 30 per cent but 568 did not subordinate any of its security for these loans. In the meantime, Mr. Young believed, Interact continued to lose money.

[48] By the beginning of 2005 Mr. Young realized the appellant's investment in Interact was a "disaster". W.I. was not getting the wood it wanted from Interact and the $3,500,000 loan was at risk. Mr. Young recalled that he and his son spent weeks and weeks preparing a business plan for Interact. The plan reviewed Interact's history, sales, financings, income and recommended $3,000,000 new equity by 568, $1,000,000 payout to Mr. Cable, Mr. Cable transferring 70 per cent of his common shares to 568, 568 reducing interest on its loan to 8 per cent, a new sales manager, removal of a particular employee, etc. Mr. Young had no faith in the management of Interact and believed that if present management continued,

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[8] *Companies Creditor Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*").

568 would have to demand payment of all debt owing to it even if it meant bankruptcy of Interact.

[49] Mr. Young "sat down" to discuss the proposal with Mr. Cable and his wife and "entourage" but Mr. Cable rejected the proposal. Mr. Cable, according to Mr. Young, wanted to retain 100 per cent control. Mr. Young denied Mr. Cable's charge that he wanted to take over the company. In Mr. Young's view, he "wanted to buy a decent share position and use that to change management … to add our talents to Cable and restructure this business for the benefit of both …" Mr. Young "surmized" that Interact was going into bankruptcy and he wanted to keep it alive and "get lumber to Woodtone who needs it, wants it and can make a profit with it [get] the management fees back."

Bankruptcy of Interact and Mr. Cable

[50] In April 2005, Interact filed for creditor protection under the *CCAA* followed by bankruptcy in July 2005. Mr. Cable filed for bankruptcy in August 2005. Price Waterhouse Cooper ("PWC") was Trustee in both bankruptcies.[9]

[51] During this period Mr. Young was discussing with people in the industry possible investment with Woodtone in Interact or, after bankruptcy, to acquire all or some of its assets, in particular the Patents. Mr. Ken McClelland, Vice-president of Luxor Industrial Corporation ("Luxor") an engineered wood producer company in Langley, B.C. at the time, accompanied Mr. Young to Interact's property in Vavenby, B.C. to view the site Interact had purchased for a new plant. In an email of August 2, 2005 to Mr. Young, Mr. McClelland stated he did not see any future for any manufacturing of product at Vavenby. Among his suggestions was for Interact to go into bankruptcy and then they might acquire Interact's mill in Golden, B.C., and the Patent related assets. In effect, Mr. Young stated, Mr. McClelland confirmed what he already thought. A possible joint venture with Luxor after acquiring assets in a bankruptcy auction was a possibility. Discussions and tours to Interact plants continued into 2006. Mr. Young was also taking people

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[9] PWC was initially a monitor in *CCAA* proceedings for Interact Holdings and Interact itself. Shortly after the *CCAA* proceedings were initiated Mr. Cable filed a notice of intention to file for bankruptcy with PWC. The eventual bankruptcy proceedings for the two corporations were staffed by PWC's Calgary office since the main offices of Interact, in Golden, B.C., were closer to Calgary than PWC's Vancouver office. The Vancouver office dealt with Mr. Cable's proposal and bankruptcy. PWC personnel in Calgary and Vancouver kept each other aware of the progress in the respective *CCAA* matters, receivership and bankruptcy.

from other companies to Vavenby who also determined that "the Vavenby plant was never going to be operational in an economic sense".

[52] On September 9, 2005, Canadian Forest Products Ltd. ("CanFor") wrote to PWC in Calgary, Trustee in bankruptcy of Interact's estate, expressing interest in acquiring not only Interact's property but also the intellectual property that "flows with the assets in question". Mr. Young was an Inspector in Mr. Cable's bankruptcy and was being kept abreast of Interact's bankruptcy. Mr. Richard Pallen, a senior vice-president of the insolvency division of PWC and Trustee in bankruptcy, was in charge of Mr. Cable's bankruptcy for PWC, represented PWC and chaired meetings of Inspectors and executed documents for PWC as Trustee of the Estate of Mr. Cable.

[53] Once CanFor realized that the intellectual property, the Patents, was owned by Mr. Cable and that the appellant had a charge on the property, its interest in Interact ended, Mr. Pallen stated. Their interest was also diminished due to Mr. Cable's common law spouse, Patricia Melchior, taking legal action claiming Mr. Cable had no rights to charge the intellectual property as security since there was a resulting trust in her favour relating to the Patents and that Mr. Cable had been unjustly enriched, that she had a constructive trust in the patent. At the time Mr. Pallen considered Ms. Melchior's claim as "dubious" It was only on January 29, 2007 that the British Columbia Supreme Court, Masuhara J.[10] dismissed Ms. Melchior's actions and also limited the appellant's security to a first charge on the Family 1 Patent and Patent applications.

[54] Later, by agreement dated November 2, 2005, PWC, in its capacity as Receiver of Interact's estate, sold to a numbered British Columbia corporation ("BC Corp."), a subsidiary of Matco Capital Ltd. ("Matco"), the debtor in-possession lender to Interact pursuant to the *CCAA*, Interact's assets, including "intellectual property … owned by Interact (and expressly excluding Eric Cable) … " The B.C. Superior Court approved the sale by Order dated November 22, 2005 noting that to the extent the appellant or Ms. Melchior has any interest in Mr. Cable's patent assets, the security of the appellant or any trust interest of Ms. Melchior shall have priority over the interest of the B.C. Corp. and certain

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[10] *Melchior v. Cable (Trustee of)*, [2007] B.C.J. No. 158, 2007 BCSC 136 ("*Melchior*").

other corporations and that the appellant was given leave to enforce its security against any interest Interact may have in the Patents.[11]

[55] On November 18, 2005 Mr. Young had emailed a lawyer representing Matco concerning the acquisition by its subsidiary and delays that might be forced by the Melchior litigation in obtaining the rights to the Patents. He asked for support in obtaining the Patents, offering to partner with Matco to sell "the entire package" of Matco assets and "our IP" to CanFor "for a number we are happy with" or to partner with Matco and "fire up the business". Nothing came of this. Mr. Young repeated that there was "no desire" to sell to CanFor.

Transfer of Patents to appellant

[56] On November 23, 2005 the Inspectors in Mr. Cable's bankrupcty resolved to and did release the intellectual property, the Family 1 Patents, to the appellant (and CVM Holdings Ltd.) "subject to ultimate accounting for the proceeds of disposition". The Inspectors also discussed the Melchior appeal. Mr. Young testified that the purpose of the meeting of Inspectors was to have the appellant "get a hold of the IP, it was the rightful owner". It is on the release of the Patents to the appellant that this appeal turns.

[57] The phrase "subject to an ultimate accounting for the proceeds of disposition" was subject to heated discussion between counsel, the respondent's counsel arguing that these words nullified any claim by the appellant that it became beneficial owner of the Patents on November 23. Mr. Pallen testified he incorporated the phrase as part of the resolution because he was "trying to be pretty conservative", that if Mr. Young could find "somebody in Dubai" willing to cover all Mr. Young's costs, interest "and amounts up the road, I would like to get something to come back to the unsecured creditors" but he doubted this would happen. He had concluded that the "solid wood sector was in a long downturn, with very little capital investment going on in any market", including Europe and Asia. Mr. Pallen explained that the appellant was a secured creditor for $3,500,000. PWC "could not see a situation developing where that [the] intellectual property could result in a greater realization than … [$3,500,000] …". Mr. Pallen also believed that "there was a big well to keep throwing money into on this". In his

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[11] Reference is made in several documents, the Order of November 22, 2005, for example, that the appellant and CVM had a second charge on the Patents in consideration of advancing funds to Interact in 2004. CVM eventually withdrew from protecting its right to security.

view the "[Melchior] trial was out of control", taking 16 days. "Jobs [in the mills] were gone at that point." The appellant had been funding the estate to deal with the Patents, he added. PWC (as Trustee) no longer had an economic interest in the intellectual property and there was no return to the unsecured creditors. The Trustee, he said, was devoting a lot of time and expense.

[58] Mr. Sue's understanding of the Minutes of the Inspectors' meetings of November 23, and specifically the requirements to account for any proceeds of disposition, "was that [568] would take control and beneficial ownership of the IP at the time … "

[59] Subsequently Mr. Pallen wrote to the solicitor who was acting as patent agent for PWC informing him that the Patents had been transferred to the appellant and for him to contact Mr. Young to confirm any instructions. However, PWC was still legal owner of the Patents since, as Trustee of Mr. Cable's estate, title to the Patents were vested in the Trustee. However, once he believed the beneficial title to the Patents was transferred to the appellant in 2005, Mr. Young's position was that the appellant incurred all the risks and costs, including funding all the protection efforts to maintain the rights to the Patents, including protecting its rights in the Melchior litigation, which the appellant did.

[60] This was confirmed by Mr. Sue who stated that he understands that a registered title to the Patents does not change when beneficial title to the Patents changed and that the beneficial interest owner of the intellectual property would have the right to cause legal title to be transferred at a time of its choosing. Also, once 568 became beneficial owner of the Patents, it became responsible for funding future actions necessary to preserve the intellectual property "and to make it progress". The appellant became owner of the intellectual property and, as such, assumed the right for the IP. This, of course, may very well be a legal opinion of Mr. Sue to questions by appellant's counsel but his comments were not subject to any objection by the respondent's counsel.

[61] The Patents were still registered in Mr. Cable's name at the end of 2005. The registered ownership of the Patents had to be transferred in the U.S. Patent Office. Mr. Young recalled that his solicitor, Mr. Dennis Fitzpatrick, obtained the actual U.S. patent and on or about January 13, 2006 put it into his firm's safety deposit box and remained in the safety deposit box to date of this appeal. A copy of the Patent was provided to Mr. Young by his solicitor. It was only in 2010, as described later in these reasons, that legal title was transferred by PWC, as Trustee

of Mr. Cable's estate, to the appellant. The Crown says beneficial title also passed at this time.

Appellant's efforts with Patents

[62] By November 2005 Mr. Young realized the appellant lost $3,500,000, "a lot of money". The challenge at that time, in Mr. Young's view, was to maintain control of the Patents and look for a joint venture partner, regroup, produce the lumber for Woodtone and permit the appellant to earn fees from the joint venture through royalties for use of the Patents or, possibly, through management of the joint venture, depending on the structure of the joint venture. But, to get the tools for the operation of a joint venture and someone to join the joint venture, Mr. Young insisted, required the Patents, which 568 obtained in 2005, the equipment that was able to make use of the patent, which 568 purchased in 2006, and defeat the claim of Ms. Melchior which was achieved in 2007.

[63] In 2006, Mr. Young recalled, Woodtone was discussing a joint venture with several companies, including Synergy Pacific Engineered Timber Ltd. ("SP"), a company that fabricated porch posts from lumber using a process not too different from W.I. in its manufacture of lumber. SP appeared the more promising partner among the various companies Mr. Young spoke to. Woodtone had business relations with SP as early as 2000 when SP started in business and which has continued to date of trial. Woodtone is one of SP's key customers for structured wooden posts.

[64] In June 2006, at a time principals of Woodtone and SP were in serious negotiations, the appellant purchased for $165,000, at auction, Interact's equipment required for the application of Family 1 Patents. In addition the appellant spent $48,000 dismantling the equipment and moving it for safe keeping to SP's facility.

[65] Mr. Young stated that Mr. Morris Douglas, Chief Executive of SP, was "one of the few in the industry that keeps a daily diary" and he asked Mr. Douglas in 2011 to write a description of the various meetings between principals of W.I. and SP and their travels to Interact facilities, among other things. Excerpts from Mr. Douglas' diary are attached to his letter of October 22, 2011 to Mr. Young. Mr. Douglas describes in point form meetings and discussions between principals of Woodtone and SP starting on September 20, 2005 and ending on January 19, 2007. In his letter Mr. Douglas describes SP's interest in Interact. Two former key employees of Interact, Adrian and Steven, working at SP had informed Mr. Douglas of Interact's Patents and Adrian was "pushing" him to have a look at

the Interact process since it could have potential for use in SP's operations. SP was not making any money at the time and Mr. Douglas felt it needed a new product line. He "started to explore the potential of the process" in SP's plant. From February 2006 to January 2007 "we were in constant dialogue with Woodtone's Jim and Chris Young about some sort of joint venture", Mr. Douglas wrote in his letter and repeated in Court.

[66] The major shareholder of SP, Mr. Michael Holzhey, met with Woodtone personnel on several occasions in 2006 to explore the Interact process as it related to SP and Woodtone. Mr. Douglas, indicated Mr. Holzhey, wanted to proceed. In preparation for an August 9 meeting with Mr. Young, SP prepared a block plan proposal for a joint venture that would require an estimated capital cost of $1,500,000 which he was confident the appellant would advance. Meetings between Woodtone and SP personnel continued throughout 2006.

[67] Mr. Douglas noted in his 2011 letter that "the lumber market had been deteriorating through 2006 and by the last quarter, it became more evident that the timing was not right to proceed with this investment … [and] agreed to wait until market conditions improved and we would review the concept at that time." Mr. Douglas noted that as of October 2011 the market had not improved and concluded that "we have gone through the longest lumber market downturn since the 1930's depression."

[68] Mr. Young confirmed the deterioration of the soft lumber market in North America. Business was "great" in 2005 and "okay" during the summer of 2006. It was at the end of 2006 and 2007 that the fall in business was real; it was, Mr. Young said, "the beginning of the most precipitous fall in U.S. housing starts in the history of the United States." About 50 per cent of Woodtone's business is to the U.S. Mr. Young estimated that Woodtone's sales fell by 40 per cent. He produced trade tables describing housing starts in the U.S. for the month of June[12] of the years 2005 to 2010. Below are the numbers for the month of June for each year as well as the number of housing starts for each year:

	JULY	ANNUAL

[12] It was in July 2006 that the appellant purchased equipment from Interact. According to a U.S. Census Bureau table new residential construction starts had its lowest level in 2009, and started to rise in 2012 reaching approximately 1,000,000 starts in 2013 and anticipating 1,200,000 starts this year.

2005	187,600	2,068,100
2006	160,900	1,800,900
2007	127,900	1,355,100
2008	86,700	905,500
2009	56,800	553,900
2010	51,500	586,900

[69] With these numbers of new homes being built it would have been folly to build a new plant, Mr. Young stated. He believes that the "ideal" number of new U.S. residential units for a year for his business is 1,500,000.

[70] Mr. Young stated that the drop in construction of houses in the United States lead to a "dramatic" drop in the price of lumber. Engineered wood, which is what Interact's Patents would produce, is a competitor to solid wood and does not "have the luxury of being able to fall [… since] … it did not have the same input costs". In other words, as I understand it, the price of solid wood, natural wood, has the "luxury", as Mr. Young put it, of being able to fall; engineered wood would be out of sync in price in the market place and be very difficult to sell. That is one reason any planned joint venture was not feasible by the end of summer 2007.

[71] In addition, Mr. Young explained, during a housing start crisis, B.C. sawmills shut down due to lack of business and the trim ends of wood that Woodtone relies on are not available.

[72] From 2005 to 2007 the appellant applied for patents of Family 1 in other jurisdiction including Canada, Russia, Japan, New Zealand, Mexico, Australia and in Europe.

[73] Mr. Young's view was that, notwithstanding the money 568 spent to obtain the Patents, purchase the Interact equipment and defend its interests in the Patents against Ms. Melchior and the time and sundry expenses Woodtone devoted to the project, conditions in 2007 did not warrant further time or money in the project. It was apparent 568 could not build a new plant itself or in a joint venture to manufacture engineered wood applying the Patent acquired from Mr. Cable that would be profitable. Things were not going to improve, Mr. Young concluded.

[74] Therefore, by Agreement "made with effect from September 30, 2007" the appellant 568 sold to Young Financial Ltd., a corporation owned by Christopher Young, Mr. Young's son, the beneficial interest in the intellectual property described in Schedule "A" of the Security Agreement by Mr. Cable

securing the appellant's loan to Interact,[13] that is the Patents in Family 1, for one dollar, "the best estimate of the market value of the Property presently available" according to the Agreement. In filing its income tax return for 2007, 568 claimed a terminal loss calculated as follows:

568 BC Ltd.
Patent – Capitalized cost continuity schedule

Year end	Description	Amount	
30-Sep-06	Defunct loan to Interact Wood Products	3,500,00.00	
30-Sep-06	Legal costs to secure patent/intellectual property	300,596.92	
	Total capitalized cost at September 30, 2006	**3,800,596.92**	
30-Sep-07	Legal costs to secure/defend patent	70,460.38	
	Subtotal	**3,871,057.30**	T2 sch 8 Class 14
30-Sep-07	Sold to Young Financial Ltd. for $1		Proceeds $1 and terminal loss
	Total capitalized cost at September 30, 2007	**(3,871,057.30)**	
30-Sep-08	additional costs paid to lawyer	24,159.00 (24,159.00)	T2 sch 9 Class 14 addition and terminal loss

[75] Three years later, by agreement dated August 24, 2010 ("Legal Transfer Agreement"), PWC, as Trustee of the Estate of Mr. Cable, sold, assigned, and transferred to 568 Mr. Cable's entire "right and title to and the interest in" the Family 1 Patents for a "wood-gluing and clamping system" and applications, the right to apply for patents on the invention in all countries in the name of the assignee or its successors or assignees. The appellant reduced its secured claim by $1,000,000 in consideration of the assignment of legal title.

[13] See para. 36 of these reasons.

[76] When PWC transferred legal title to the Patents to 568 on August 24, Mr. Pallen was not aware that 568 had transferred beneficial title to the Patents to Young Financial in 2007[14].

[77] Mr. Sue drafted the Legal Transfer Agreement. He described the phrase "entire right and title to and interest in" as "a catch-all phrase to capture any interest Mr. Cable would have at that time in respect of this intellectual property up to and including legal title … to make sure nothing is remaining in Mr. Cable's name". He believed that notwithstanding the transfer of the interest in the Patents to the appellant in 2005, Mr. Cable still had legal title. At the time he prepared the assignment of August 24, 2010, Mr. Sue also was not aware that 568 had transferred beneficial interest in the intellectual property to Young Financial Ltd. on September 30, 2007. He received the letter of agreement between the appellant and Young Financial Ltd. a few days before trial.

[78] Mr. Sue registered legal title to the Patents in the Canadian Patent Office in September 2010 and in the U.S. Patent Office in August 2010 in the name of 568. He stated "in patent law it's actually quite common for legal title and beneficial title to be in the names of two separate entities". The fact that 568 had already transferred beneficial title in 2007, he opined, did not affect its legality and "is still effective in transferring legal title from Eric Cable to [568]".

[79] In her Amended Amended Reply the respondent alleged that "even if the Patents met the definition of a depreciable asset, it was not available for use by the appellant and, consequently, no amount is includable with respect thereto in calculating the un-depreciated capital cost of that class of depreciable property". I can only assume that the respondent's conclusion that the Patents were not available for use by the appellant was that the appellant did not have the equipment to apply the Patent or, as suggested in the reasons of Masuhara J. in Mr. Cable's application for an absolute discharge from Bankruptcy.[15] At paragraph six of his reasons, Masuhara J. wrote that the Trustee in bankruptcy "notes that key computer controlled equipment was disabled through the erasure of computer hard drives that rendered the [patent applications] equipment inoperable". Later on, at paragraph 22, the judge stated that the key technical information contained in the computer hard drive had disappeared and the Trustee has not been able to locate it. Crown counsel therefore asked Mr. Young if he was "aware whether or not the hard drive was disabled through the erasure?" This too, among other allegations,

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[14] During the Summer of 2010, 568 acquired the Family 2 and 3 patents which it still owns.

[15] 2007 BCSC 1004 ("*Cable*").

was assumed by the respondent in assessing but respondent's counsel read these portions of the reasons of Masuhara J. in support of the respondent's allegation that without the information on the hard drive, the appellant could not carry on business using the Patents.

[80] Mr. Young declared that he and his associates "did our homework" and the best person to have been asked about any loss of key information in the computer hard drive was Mr. Douglas who had testified the day earlier. As far as Mr. Young was concerned "it was a complete rumor, inuendo by Mr. Cable." He recalled that Adrian, one of the persons interested in the Patents and who had worked at Interact, "informed [him] that no such thing had happened and was of no concern. I [i.e. Adrian] programmed it by the way, not Eric Cable, and I could re-program it even if it did happen."

Analysis

[81] If I find that the appellant was the beneficial owner of the Family 1 Patents on September 30, 2007, when it sold the Patents to Young Financial, I need not consider the respondent's argument that beneficial ownership was transferred only in 2010.

[82] The significance of the transfer of beneficial ownership to the appellant on the facts before me is found in subsection 79.1(2) of the *Act*:

Subject to subsection (2.1) and for the purpose of this section, a property is seized at any time by a person in respect of a debt where	Sous réserve du paragraphe (2.1) et pour l'application du présent article, un bien est saisi par une personne relativement à une dette lorsque les conditions suivantes sont réunies :
(*a*) the beneficial ownership of the property is acquired or reacquired at that time by the person; and	*a*) la propriété effective du bien est acquise ou acquise de nouveau, au moment de la saisie, par la personne;
(*b*) the acquisition or reacquisition of the property is in consequence of another person's failure to pay to the person all or part of the specified amount of the debt.	*b*) l'acquisition ou la nouvelle acquisition fait suite au défaut d'une autre personne de lui payer tout ou partie du montant déterminé de la dette.

[83] A creditor seizes a property where it acquires the beneficial ownership of the property; that is, the beneficial ownership of all of the property. Note that the phrase "beneficial ownership" in English is "propriété effective" in French and vice versa.

[84] Did the appellant seize the Patents so as to acquire beneficial ownership of the Patents in November 2005? What do the courts and dictionaries consider to be the ordinary meaning of "beneficial ownership"? I could find no definition of the term "beneficial ownership", although the two words separately are defined.

[85] *The Shorter Oxford English Dictionary*[16] defines "owner" to include:

> one who has the rightful claim or title to a thing

[86] *The New Shorter Oxford Dictionary*[17] defines "beneficial" as:

> of, pertaining to, or having the use of benefit of property, etc.

[87] *Le Petit Robert I*[18] refers to "effectif, ive" as follows:

> Concret, positif, réel, tangible … réels (et non simplement inscrits sur les rôles.)

[88] *Le Petit Robert I* comments that the word "réel" means real as opposed to imaginary, something that is certain or true.

[89] In *Jodrey Estate*[19] the Supreme Court of Canada approved of the meaning given to the words "beneficial owner" by Hart, J. in *Mackeen v. Nova Scotia* who wrote:

> It seems to me that the plain ordinary meaning of the expression "beneficial owner" is the real or true owner of the property. The property may be registered in another name or held in trust for the real owner, but the "beneficial owner" is the one who can ultimately exercise the rights of ownership in the property.

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16 Clarendon Press, Oxford, 1993, 3rd Ed.

17 Oxford University Press, 1993.

18 *Le Petit Robert* 1983.

19 *Covert v. Nova Scotia (Minister of Finance)*, [1980] S.C.J. No. 101 (QL), [1980] 2 S.C.R. 774, at p. 784, citing *MacKeen Estate v. Nova Scotia*, [1977] C.T.C. 230 (NSSC), para. 46. The reader also may refer to *Prevost Car Inc. v. The Queen*, 2008 TCC 231, [2008] T.C.J. No. 168 (QL), at paras. 72 to 100 for a discussion of beneficial owner in the context of treaty interpretation.

[90] Earlier, in *Wardean Drilling Ltd. v. M.N.R.*[20], Cattanach, J. opined that for the purposes of undepreciated capital cost

> … the proper test as to when property is acquired must relate to the title to the property in question or to the normal incidents of title, either actual or constructive, such as possession, use and risk.
>
> …
>
> As I have indicated above, it is my opinion that a purchaser has acquired assets of a class in Schedule B when title has passed, assuming that the assets exist at that time, or when the purchaser has all the incidents of title, such as possession, use and risk, although legal title may remain in the vendor as security for the purchase price as is the commercial practice under conditional sales agreements. In my view the foregoing is the proper test to determine the acquisition of property described in Schedule B to the *Income Tax Regulations*.

[91] The Federal Court of Appeal confirmed the "incidents of title" test in *Wardean Drilling Co. v. M.N.R.*[21], in *Hewlett Packard (Canada) Ltd. v. R.*[22] and *Morin v. R.*[23]

[92] A beneficial owner of property therefore, is someone who is the real owner of the property, a person who is in possession of the property, a person who could derive income from the property or otherwise use it and who is the person who suffers any loss if the property is damaged or destroyed. The beneficial owner is the only person who can dispose of the property in his or her sole discretion without interference.

[93] The respondent submits that the appellant did not obtain beneficial ownership of the Patents in 2005, that beneficial ownership was assigned to the appellant when legal ownership was transferred to it in 2010. The phrase "subject to an ultimate accounting for the proceeds of disposition" in the resolution of Inspectors transferring the Patents to the appellant restricted the appellant's right to real or beneficial ownership of the Patents[24]. The appellant only obtained a security interest in the Patents in 2005. The appellant had to account to the Trustee for any proceeds of sale in the Patents in excess of $3,500,000. An equity of redemption,

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20 69 DTC 5194 (Exc. Ct.), at pages. 5197, 5198.
21 [1978] F.C.J. No. 50 (QL), 1978 CarswellNat 189.
22 2004 FCA 240, 2004 DTC 6498.
23 2006 FCA 25, 2006 DTC 6057 (Eng.).
24 **See paras. 56 and 57**.

argued respondent's counsel,[25] belonged to the Trustee notwithstanding the purported release of the Patents to the appellant.

[94] Respondent's counsel referred to the assignment of legal title in the Patents to the appellant in 2010, that what was being assigned was the "entire right and title to and interest in" the Patents and that this included both legal and beneficial ownership.

[95] Mr. Pallen, who testified as the Trustee in Bankruptcy representative, said that in November 2005, PWC intended to transfer beneficial title to the Patents to the appellant and the appellant intended to acquire such title. This is absolutely clear from the evidence of Messrs. Pallen and Young and was how they conducted themselves once PWC assigned the rights to the Patents to the appellant. The appellant had absolute use enjoyment and possession of the Patents. The appellant possessed physical patent documents and it had the right to exploit the processes protected by the Patents. Mr. Pallen confirmed to the patent agent that the appellant, through Mr. Young, was the person who henceforth would be instructing him. The appellant assumed all risk associated with the Patents. The appellant assumed the owner's risk, for example, being the costs of ownership and was responsible for defending its Patent ownership rights against the claims of Mr. Cable's wife. The Trustee did not interfere with the appellant's use and enjoyment of the Patents. In short, November 23, 2005 the appellant gained all the incidents of beneficial title: possession, use and risk. It had the rightful claim to the Patents and was the only person who could deal effectively with the Patents as owner. By 2007 the appellant also had purchased the equipment capable of utilizing the Patents and in 2007 had defeated Ms. Melchior's claim to the Patents. The appellant was the beneficial owner of the Patents and, like any other beneficial owner, had the right to sell the Patents to Young Financial in 2007.

The Patents

[96] The Patents were available for use by the appellant on acquisition in 2005. What the appellant did subsequent to acquisition was in the course of confirming and exercising its control and ownership of the Patents.

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[25] This submission came at almost the eleventh hour of the hearing and, at the request of appellant's counsel, I ordered written submissions whether the respondent was entitled to raise the issue of equity of redemption near the end of oral argument when there appeared to be no supporting facts or allegations in the respondent's pleadings. It was not an assumption of fact relied on by the Minister in making the subject assessment.

[97] In *Gartry (W.C.) v. Canada*,[26] Bowman, J. (as he then was) explained when a person becomes owner of depreciable property:

> Where … a taxpayer … has exercised sufficient dominion over a depreciable property that, having committed himself to purchase it, he orders its modification for his specific purposes, and supervises and pays for those modifications, even if passage of title is deferred until full payment … is received, he has acquired a sufficient interest in the property and indicia of title thereto that it becomes depreciable property in his hands …[27]

[98] The appellant exercised the attributes of a true owner, acquired equipment to manufacture the wood using the Patents, moved the equipment for safe keeping at its cost and, among other things, paid to protect its ownership of the Patents. The appellant acquired sufficient interest in the Patents and indicia of title, beneficial title thereto that it became depreciable property in its hands. That it did not own the equipment to exploit the Patents in 2005 is not significant, since the appellant could have licensed the Patents to others who could have acquired the equipment. It, therefore, had use of the Patents as early in 2005 in acquisition or as late as 2007 when it had acquired the equipment and defeated Ms. Melchior's claims.

Acquired for purpose of earning income

[99] Paragraph 1102(1)(*c*) of the *Regulations* requires that for the Patents to be included as a Class 14 property, the Patents be acquired by a taxpayer for the purpose of gaining or procuring income. The respondent's main thrust with respect to paragraph 1102(1)(*c*) is that the appellant did not acquire the Patents to earn income since no business was being carried on or had commenced at the time the Patents were acquired. In fact, W.I. was carrying on a business at the time, of which the appellant was the manager. And it was for business reasons that the appellant became involved in this imbroglio.

[100] In *Hickman Motors v. The Queen*,[28] McLachlin J. (as she then was), described the purpose of paragraph 1102(1)(*k*) of the *Regulations*, at p. 5364:

> … The exclusion [in paragraph 1102(1)(*c*)] is aimed at assuring that the asset for which the deduction is claimed is an asset associated with income production as distinguished from an asset acquired for non-income producing purpose, such as pleasure or personal needs.

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26 94 DTC 1947, [1994] 2 C.T.C. 2021.

27 *Gartry*, supra, at par. 33.

28 97 DTC 5363 (SCC).

[101] It is apparent to me that Mr. Young's, or rather the appellant's, adventure in advancing the loan and subsequent default by Interact weighed quite heavily against him. A period of ten years, from the time the loan to Interact to the time of the hearing of this appeal, does not help one's memory of events in the earlier years, and frequently, witness' testimony includes evidence as to what he or she imagined or thought took place. Nevertheless, while I concluded during trial that some of Mr. Young's evidence may have suffered from hyperbolae and unintentionally favourable recall of facts, I have found him to be a credible witness and a practical businessman. For example, I believe he may have minimized what factor the share warrants of Interact played as part of the loan to Interact. But the appellant's prime motivating reason to lend $3,500,000 to Interact was to give Interact the means to exploit the Patents in such a manner that the appellant would get the wood sizes it wanted when it wanted and earn income as a result. And when **the appellant** acquired the Patents in 2005, it did so in association with income production in pursuit of and part of a profit making exercise to exploit the Patents with another party in some joint venture or partnership where a Woodtone company would be a participant and to which the appellant would licence the Patents to derive income. The appellant acted in accordance with reasonably acceptable principles of commerce and business practice[29].

[102] It was the appellant who advanced funds to Interact for the reasons described by Mr. Young: for Woodtone to secure ideal sized wood and that the appellant was its instrument to accomplish this. Mr. Young stated the reasons for choosing the appellant was that it had a history of acquiring property which it rented or leased for income to Woodtone for the latter's production of product and this was no different. The loan to Interact was secured by the very property that was the reason for the loan. There was no cross-examination proving otherwise.

[103] Once Interact and Mr. Cable became bankrupt the appellant's goal had not changed: it still wanted to exploit the use of the Patents for profit. The lengthy evidence describes efforts made by Mr. Young to try to cause Interact to improve its business so that it could sell product to W.I. When this failed and Interact became a bankrupt, his efforts − and those of the appellant − were in trying to make use of the Patents by the appellant or a Woodtone company through a joint venture or partnership with others, charging a royalty for use of the Patents and a managerial fee to manage the joint partnership. The appellant was searching to use the Patents one way or another, originally on its own and later in a partnership or joint venture, to give Woodtone access to the wood it wanted. The appellant was

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29 *Hickman Motors, op. cit.*, p. 5372.

treating the Patents no different than other property it had acquired and leased or licensed to Woodtone in the past. Even before the appellant became the beneficial owner of the Patents Mr. Young sought others in the industry to join the appellant in exploiting the Patents for profit. That the appellant was looking for potential joint ventures to join it in exploiting the Patents as early as September 2005 was assumed by the Minister in assessing and, for the period after acquiring the Patents in November 2005, corroborated by Mr. Douglas. One way or the other, by licensing the Patents to W.I. alone, in a partnership or joint venture, and, in addition earning management fees, would the appellant gain income from the Patents.

Motions

[104] On May 6, 2014 by motion of the respondent, the Court granted an Order to amend its Amended Reply to the Notice of Appeal to (a) correct the assumption of the Minister (and thus deny) that the appellant sold the Patents to Young Financial Ltd. on September 30, 2007; and (b) to allege that PWC, as Trustee of Mr. Cable's estate, sold Mr. Cable's entire right, title to and interest in the Patents to the appellant on April 24, 2010. The **respondent** was also permitted to plead that due to the claim of prior secured creditors the only property the appellant could seize in respect of the defaulted loans were the Patents received under the security agreement with Mr. Cable; that if the Patents were disposed of, the Patents were not depreciable property; and if they were depreciable property, they were not available for use by the appellant and therefore no amount is includable in calculating the adjusted capital cost of a depreciable property.

[105] Subsequently, at the opening of trial the appellant applied for an order that four documents ought not be admitted in evidence by the respondent since the respondent did not include them in her List of Documents in accordance with Rule 89 of the *Tax Court of Canada Rules* (*General Procedure*) ("*Rules*"). The respondent wished to produce these documents without including them on a required List of Documents as a result of their production on a discovery of the appellant on September 5, 2013. There is no evidence as how the respondent obtained these documents whether through the appellant's witness on discovery or otherwise. The respondent argued that to disallow these documents would render null the Court Order of May 6, 2014. I reserved my decision until after trial of the appeal although the documents in question were submitted.

[106] Rule 89 of the *Rules* provides that:

(1) Unless the Court otherwise directs, except with the consent in writing of the other party or where discovery of documents has been waived by the other party, no document shall be used in evidence by a party unless	(1) Sauf directive contraire de la Cour, ou sauf si les autres parties ont renoncé au droit d'obtenir communication de documents ou ont consenti par écrit à ce que des documents soient utilisés en preuve, aucun document ne doit être utilisé en preuve par une partie à moins, selon le cas :
(*a*) reference to it appears in the pleadings, or in a list or an affidavit filed and served by a party to the proceeding,	*a*) qu'il ne soit mentionné dans les actes de procédure, ou dans une liste ou une déclaration sous serment déposée et signifiée par une partie à l'instance;
(*b*) it has been produced by one of the parties, or some person being examined on behalf of one of the parties, at the examination for discovery, or	*b*) qu'il n'ait été produit par l'une des parties, ou par quelques personnes interrogées pour le compte de l'une des parties, au cours d'un interrogatoire préalable;
(*c*) it has been produced by a witness who is not, in the opinion of the Court, under the control of the party.	*c*) qu'il n'ait été produit par un témoin qui n'est pas, de l'avis de la Cour, sous le contrôle de la partie.
(2) Unless the Court otherwise directs, subsection (1) does not apply to a document that is used solely as a foundation for or as part of a question in cross-examination or re-examination.	(2) Sauf directive contraire de la Cour, le paragraphe (1) ne s'applique pas au document utilisé uniquement comme fondement ou comme partie d'une question dans un contre-interrogatoire ou en réinterrogatoire.

[107] There is no question that the respondent did not adhere to Rule 89. An Order allowing a party to modify a pleading to allege new facts and argument does not and cannot liberate that party from the requirements of Rule 89. The appellant's application is therefore allowed. The documents complained of are struck from the record.

Judgment

[108] The appeal is therefore allowed, with costs, and the assessment is referred back to the Minister National Revenue for reconsideration and reassessment on the basis that the appellant is entitled to a terminal loss of $3,871,057 on the disposition of a Class 14 asset for the taxation year at issue.

[109] These amended reasons for judgment are issued in substitution to the reasons for judgement issued on December 29, 2014.

Signed at Ottawa, Canada, this 5th day of January 2015.

"Gerald J. Rip"

Rip J.

CITATION:	2014 TCC 373
COURT FILE NO.:	2012-3692(IT)G
STYLE OF CAUSE:	568864 B.C. LTD v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Vancouver, British Columbia
DATE OF HEARING:	June 2, 3, 4, 5 and 6, 2014
AMENDED REASONS FOR JUDGMENT BY:	The Honourable Justice Gerald J. Rip
DATE OF AMENDED REASONS FOR JUDGMENT:	January 5, 2015

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