Docket: 2003-1829(IT)I

BETWEEN:

ALINE RONDEAU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on January 21, 2004, at Montréal, Quebec

Before: The Honourable Justice Paul Bédard

Appearances:

Counsel for the Appellant: Elio Cerundolo

Counsel for the Respondent: Mounes Ayadi

JUDGMENT

The appeal of the assessment under the *Income Tax Act* for the 2000 taxation year is dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 5th day of May 2004.

"Paul Bédard"

Bédard J.

Translation certified true
on this 22nd day of September 2004.

Shulamit Day, Translator

Citation: 2004TCC321
Date: 20040505
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REASONS FOR JUDGMENT

Bédard J.

[1] In her income tax return for the 2000 taxation year, the Appellant claimed a non-capital loss of $28,381. By a notice of reassessment dated January 28, 2002, the Minister of National Revenue (the "Minister") disallowed the deduction of $28,381 claimed for this loss. It seems that this loss arose from a gross loss of $79,200 during the 1999 taxation year. After an objection, the Minister made a reassessment, granting the Appellant a gross business investment loss of $30,288 for the 1999 taxation year. As a result of this reassessment, no non-capital loss was available to carry forward to subsequent years.[1]

[2] To establish the reassessment of January 28, 2002, the Minister relied on the following assumptions of fact:

[1] Paragraph 7 of the Reply to the Notice of Appeal.

[TRANSLATION]

(a) The gross business investment loss of $79,200 relates to loans made by the Appellant to the "Les Vêtements Rewind Inc." corporation (hereinafter the "Corporation"): the two shareholders were the Appellant's sons;

(b) At all relevant times, the Appellant was not a shareholder of the Corporation nor did she hold any shares of its capital stock;

(c) The Corporation began on April 28, 1994, and went bankrupt on March 5, 1999;

(d) According to the information obtained from the Inspector General of Financial Institutions, the Corporation was written off on May 5, 2000;

(e) The Corporation's financial year ended on February 28 of each year;

(f) According to the Appellant, she had lent her sons money to help their business, and not to receive income or goods from the business;

(g) Between 1995 and 1997, the Appellant wrote several cheques payable to the Corporation for amounts totalling $79,200 (see Appendix);

(h) The Appellant submitted original documentation in support of these loans;

(i) The Appellant submitted contracts for three loans, one for $10,000 (August 28, 1995), one for $20,000 (May 15, 1996) and another for $30,000 (May 30, 1996), bearing interest at an annual rate of 3.5%, with a note that the Corporation would repay the Appellant for these loans as soon as it obtained a loan from a financial institution;

(j) These loans were made by the Appellant to the Corporation without consideration or with inadequate consideration;

(k) On August 28, 1995, the Appellant prepared a cheque for $10,000 payable to the Corporation, but the Corporation's financial statements dated February 28, 1996, do not mention any external loans;

(l) The Appellant prepared a cheque for $20,000 dated May 15, 1996, and another for $30,000 dated May 30, 1996, but the Corporation's

financial statements as at February 28, 1997, mention an amount of $18,200 as an "external advance";

(m) Between the months of November 1997 and February 1998, the Appellant wrote several cheques to the Corporation, totalling $19,200 (no contract, loan on demand, no mention of an interest rate) but the Corporation's financial statements as at February 28, 1998, mention an amount of $25,949 as an "external advance";

(n) On May 7, 1997, the Appellant obtained a loan of $56,250 from the National Bank of Canada but there is no mention of the purpose of the loan recorded on the demand note;

(o) The last cheque issued by the Appellant was dated February 3, 1998, and no cheques were issued after that date;

(p) However, according to the financial statements produced by the Corporation with respect to the financial year ending February 28, 1998, the amounts due to the shareholders were $22,057 and the "external advances" had reached $25,949;

(q) The Appellant's name appears on the list of the Corporation's creditors prepared by the Trustee, and according to this list, the amount due to the Appellant is $30,288.59;

(r) The Appellant disposed of her debt to an individual with whom she did not have an arm's-length relationship;

(s) The Appellant did not establish, for the year at issue, that the said debt was a bad debt under subsection 50(1) of the *Income Tax Act*, and did not make this selection in her previous income tax returns.

[3] Therefore the issue here is whether the Appellant is entitled to claim a non-capital loss of $28,381 on her income tax return for the 2000 taxation year. In order for me to draw this conclusion, the Appellant must convince me that:

(1) "Les Vêtements Rewind Inc." (the "Corporation") owed the Appellant $79,200;

(2) The debt was contracted in order to earn business income under subparagraph 40(2)(*g*)(ii) of the *Income Tax Act* (the *"Act"*);

(3) The Corporation was an eligible corporation operating a small business;

(4) The debt became unrecoverable in 2000.

[4] The Respondent has not questioned the fact that the Corporation was an eligible corporation operating a small business. The Respondent has also admitted that the Appellant made the choice required under subsection 50(1) of the *Act*. On the other hand, the Respondent maintains that the Corporation did not owe $79,200 to the Appellant since the debt was repaid to the Appellant in full or in part and, if this was not the case, the debt was not unrecoverable in 2000.[2] Finally, the Respondent asserted that the amounts loaned by the Appellant were not for the purpose of earning business income.[3]

[5] There is no doubt that, if there is a debt, it became unrecoverable in 2000 since the corporation owing the debt to the Appellant became bankrupt on May 5, 1999. Since bankruptcy extinguished the Corporation's debt to the Appellant, it is appropriate to state that the debt was unrecoverable in 2000.[4] As a result, the questions at issue are: (1) Did the Corporation owe the Appellant a debt of $79,000? (2) Did the Appellant lend the total amount of $79,200 in order to earn business income?

[6] As I will explain below, the Appellant has proven that she loaned the Corporation $79,200. On the other hand, the following analysis of the loan contracts and the Appellant's behaviour with respect to these loans leads me to conclude that these amounts were not loaned for the purpose of earning business income.

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[2] Pages 154 and following in the transcript.

[3] Pages 161 and following in the transcript.

[4] Although the Federal Court of Appeal, in *Rich* v. *Canada*, [2003] 3 F.C. 493, at paragraph 13, established the elements which must be considered in order to determine whether the debt is unrecoverable, in this case it is not necessary to refer to these elements since the bankruptcy extinguished the debt owed to the Appellant. (See subsection 178(2) of the *Bankruptcy and Insolvency Act*, (R.S.C. 1985, c. B-3): "Subject to subsection (1), an order of discharge releases the bankrupt from all claims provable in bankruptcy.") On this fact, the debt owing was unrecoverable in 2000.

[7] The legal provisions relevant to this dispute are subsection 50(1), paragraph 39(1)(*c*) and subparagraph 40(2)(*g*)(ii) of the *Act*. The provisions read as follows:

> 50(1) For the purposes of this subdivision, where
>
> (*a*) a debt owing to a taxpayer at the end of a taxation year (other than a debt owing to the taxpayer in respect of the disposition of personal use property) is established by the taxpayer to have become a bad debt in the year, or
>
> (*b*) a share (other than a share received by a taxpayer as consideration in respect of the disposition of personal-use property) of the capital stock of a corporation is owned by the taxpayer at the end of a taxation year and
>
> (i) the corporation has during the year become a bankrupt (within the meaning of subsection 128(3)),
>
> (ii) the corporation is a corporation referred to in section 6 of the *Winding-up Act* that is insolvent (within the meaning of that Act) and in respect of which a winding-up order under that Act has been made in the year, or
>
> (iii) at the end of the year,
>
> (A) the corporation is insolvent,
> (B) neither the corporation nor a corporation controlled by it carries on business,
> (C) the fair market value of the share is nil, and
> (D) it is reasonable to expect that the corporation will be dissolved or wound up and will not commence to carry on business
>
> and the taxpayer elects in the taxpayer's return of income for the year to have this subsection apply in respect of the debt or the share, as the case may be, the taxpayer shall be deemed to have disposed of the debt or the share, as the case may be, at the end of the year for proceeds equal to nil and to have reacquired it immediately after the end of the year at a cost equal to nil.
>
> 39(1) . . .
>
> (*c*) a taxpayer's business investment loss for a taxation year from the disposition of any property is the amount, if

any, by which the taxpayer's capital loss for the year from a disposition after 1977

(i) to which subsection 50(1) applies, or

(ii) to a person with whom the taxpayer was dealing at arm's length

of any property that is

(iii) a share of the capital stock of a small business corporation, or

(iv) a debt owing to the taxpayer by a Canadian-controlled private corporation (other than, where the taxpayer is a corporation, a debt owing to it by a corporation with which it does not deal at arm's length) that is

(A) a small business corporation,
(B) a bankrupt (within the meaning assigned by subsection 128(3)) that was a small business corporation at the time it last became a bankrupt, or
(C) a corporation referred to in section 6 of the *Winding-up Act* that was insolvent (within the meaning of that Act) and was a small business corporation at the time a winding-up order under that Act was made in respect of the corporation,

exceeds the total of

(v) in the case of a share referred to in subparagraph 39(1)(*c*)(iii), the amount, if any, of the increase after 1977 by virtue of the application of subsection 85(4) in the adjusted cost base to the taxpayer of the share or of any share (in this subparagraph referred to as a "replaced share") for which the share or a replaced share was substituted or exchanged,

(vi) in the case of a share referred to in subparagraph 39(1)(*c*)(iii) that was issued before 1972 or a share (in this subparagraph and subparagraph 39(1)(*c*)(vii) referred to as a "substituted share") that was substituted or exchanged for such a share or for a substituted share, the total of all amounts each of which is an amount received after 1971 and

before or on the disposition of the share or an amount receivable at the time of such a disposition by

(A) the taxpayer,
(B) where the taxpayer is an individual, the taxpayer's spouse, or
(C) a trust of which the taxpayer or the taxpayer's spouse was a beneficiary

(vii) in the case of a share to which subparagraph 39(1)(*c*)(vi) applies and where the taxpayer is a trust referred to in paragraph 104(4)(*a*), the total of all amounts each of which is an amount received after 1971 or receivable at the time of the disposition by the settlor (within the meaning assigned by subsection 108(1)) or by the settlor's spouse as a taxable dividend on the share or on any other share in respect of which it is a substituted share, and

(viii) the amount determined in respect of the taxpayer under subsection 39(9) or 39(10), as the case may be.

40(2) Notwithstanding subsection 40(1),

. . .

(*g*) a taxpayer's loss, if any, from the disposition of a property, to the extent that it is

. . .

(ii) a loss from the disposition of a debt or other right to receive an amount, unless the debt or right, as the case may be, was acquired by the taxpayer for the purpose of gaining or producing income from a business or property (other than exempt income) or as consideration for the disposition of capital property to a person with whom the taxpayer was dealing at arm's length,

. . .

WAS THE APPELLANT OWED A DEBT OF $79,200?

[8] The Appellant lent the Corporation several amounts totalling $79,200. The total amount breaks down as follows:

1. August 28, 1995: $10,000 draft – written loan contract;
2. May 15, 1996: $20,000 draft – written loan contract;
3. May 30, 1996: $30,000 draft – no written contract;
4. November 12, 1997: Cheque for $7,000 – no written contract;
5. December 5, 1997: Cheque for $5,000 – no written contract;
6. December 16, 1997: Cheque for $1,000 – no written contract;
7. December 21, 1997: Cheque for $1,200 – no written contract;
8. December 29, 1997: Cheque for $3,000 – no written contract;
9. February 3, 1998: Cheque for $2,000 – no written contract.

[9] The loan contracts for $10,000 and $20,000 respectively were proven by the submission as evidence of documents attesting to these contracts. These are private writings that make proof of the juridical act that they set forth.[5]

[10] With respect to the other loan contracts, although the value of the dispute exceeds $1,500, proof of these juridical acts can be made through testimony when there is a commencement of proof.[6] In this case, the Appellant had signed a draft of $30,000 to the Corporation as well as six cheques in various amounts. On this draft and on each of the cheques, the note "loan" can be found. This draft and these cheques therefore constitute material evidence that serve as a commencement of proof, thereby opening the way for proof by testimony.[7]

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[5] Article 2829 of the *Civil Code of Québec* ("C.C.Q."):

> A private writing makes proof, in respect of the persons against whom it is proved, of the juridical act which it sets forth and of the statements of the parties directly relating to the act.

[6] Article 2862 C.C.Q.:

> Proof of a juridical act may not be made, between the parties, by testimony where the value in dispute exceeds $1 500.
>
> However, failing proof in writing and regardless of the value in dispute, proof may be made by testimony of any juridical act where there is a commencement of proof; proof may also be made by testimony, against a person, of a juridical act carried out by him in the ordinary course of business of an enterprise.

[7] Article 2865 C.C.Q.:

[11] In her testimony, the Appellant affirmed that the amounts loaned to the Corporation without a written contract were subject to the same conditions as the loans which were recorded in writing.[8] The Appellant explained that the interest and capital were due at the same time[9] and that the loans were conditional upon the Corporation obtaining a loan from a banking institution.[10]

[12] Given the testimony of the Appellant and considering that her credibility is not in question, it is my opinion that the Appellant has proven the existence of unwritten loan contracts.

[13] The written loan contracts are not identical, since their wording differs. As a result, these contracts must be interpreted in order to determine the terms and conditions of the verbal loan contracts that were reached in accordance with the same conditions. Since proof by testimony is admissible when interpreting a written document,[11] the Appellant's testimony is relevant to the interpretation of the written loan contracts and therefore to the interpretation of the verbal loan contracts.

Loan contract dated August 28, 1995

> A commencement of proof may arise where an admission or writing of the adverse party, his testimony or the production of a material thing gives an indication that the alleged fact may have occurred.

[8] Page 15 of the transcription:

[TRANSLATION]

Q. Now, the other payments you made, also by cheque, can you tell the Court what the agreement was between the Rewind company and you regarding this additional amount?

A. For the additional amount, that was under the same conditions as the larger loans I made.

[9] Page 29 of the transcript.

[10] Page 28 of the transcript.

[11] Article 2864 C.C.Q.:

> Proof by testimony is admissible to interpret a writing, to complete a clearly incomplete writing or to impugn the validity of the juridical act which the writing sets forth.

[14] The loan contract dated August 28, 1995 included the following sentence:

> [TRANSLATION]
>
> Les Vêtements Rewind, represented by Marc Améziane, President, agrees that the $10,000 will bear interest at a rate of 3.5% per year, until such time as a loan can be obtained from a banking institution.

[15] This first loan contract set an extinctive term with respect to the interest. The loan bore interest from the moment the money was given (since there is no indication to the contrary) until the time the Corporation obtained a bank loan. Thus the Corporation's obligation to pay interest at a rate of 3.5% per year should have been extinguished by expiry of the term, the granting of a loan by a banking institution.[12]

[16] Despite the Appellant's claim that obtaining a bank loan was a condition of [her] loan, this condition was a certain, future event for the parties to the loan contract.[13] As a result, this cannot be a conditional obligation, which requires that the

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[12] See Article 1517 C.C.Q.:

> An obligation with an extinctive term is an obligation which has a duration fixed by law or by the parties and which is extinguished by expiry of the term.

[13] Pages 29 and 30 of the transcript:

[TRANSLATION]

Q. But it's because, on the document, capital is written. . . O.K., it says interest is three. . .

A. Interest and capital. Of three. . .

Q. . . . of three point five (3.5%). . .

A. . . . and a half (3.5%).

Q. . . . per year.

A. Yes. Because I did not know how many years it would take.

. . .

Q. So, when you gave this $10,000, did you ask your sons when the company was going to get a loan?

obligation depend upon a future and uncertain event;[14] rather, this was an obligation with a term. In this respect, I refer to the words of professors Pineau and Gaudet regarding the characteristics of a conditional obligation:[15]

> [TRANSLATION]
>
> The event must be uncertain: if it is not, if it must necessarily occur one day, we would have a term, not a condition. Sometimes interpretation is difficult when the formulation of the agreement is unclear: " I agree to pay you such-and-such an amount as soon as I can." It could be claimed that this is a conditional obligation: it is not certain that I will one day be able to pay you, but it is more likely that this is an obligation with a term: in the mind of the parties, the day will surely come when the debtor will be able to pay. Obviously the time is indeterminate, but it is certain. This is the solution retained in article 1512, para. 2 C.C.Q.

[17] Professor Pierre-Gabriel Jobin and the Honourable Jean-Louis Baudouin express themselves similarly:[16]

A. Yes, I asked them.

Q. What did they tell you?

A. I always assumed it was on demand.

[14] Article 1497 C.C.Q.:

> An obligation is conditional where it is made to depend upon a future and uncertain event, either by suspending it until the event occurs or is certain not to occur, or by making its extinction dependent on whether or not the event occurs.

[15] J. Pineau and S. Gaudet, *Théorie des obligations,* 4th edition (Montréal: Les Éditions Thémis, 2001), at page 645.

Furthermore, article 1512 of the C.C.Q. provides:

> Where the parties have agreed to delay the determination of the term or to leave it to one of them to make such determination and where, after a reasonable time, no term has been determined, the court may, upon the application of one of the parties, fix the term according to the nature of the obligation, the situation of the parties and any appropriate circumstance.
>
> The court may also fix the term where a term is required by the nature of the obligation and there is no agreement as to how it may be determined.

> [TRANSLATION]
>
> Like a condition, a term is a future event, but unlike a condition, it is an event that is *certain* to occur. The term may or may not be fixed, depending on whether the expiry date is known and determined when the obligation is incurred. Paying in one year is therefore a fixed or definite term, whereas paying on someone's death is not, since, although it is certain that the person will die, the exact date of his or her death remains undetermined. Under the *Civil Code of Lower Canada*, the courts sometimes had trouble distinguishing a term from a condition, since the former is sometimes stipulated in the same way as the latter. A debtor's obligation to pay "when he can" or "when he has the means" is not a conditional obligation dependent on his will, but rather an obligation with a term so the court is sometimes obliged to intervene in order to determine whether, on the facts, the term has in fact expired.

[18] In *Rosenbloom c. Québec (sous-ministre du Revenu)*, [1997] A.Q. n^{o} 197 (C.A.Q.), Justice Biron of the Quebec Court of Appeal made a statement with respect to the difference between a suspensive condition and an obligation with a term. Justice Biron affirmed:[17]

> [TRANSLATION]
>
> In *Venne v. Québec* (Commission de la protection du territoire [1989] 1 S.C.R. 880, the Supreme Court had to distinguish between a conditional, suspensive obligation and an obligation with a term.
>
> The facts in this case may be summarized very briefly as follows:
>
> > On May 14, 1977, respondent bought two subdivided lots from Winzen, a commercial corporation specializing in the purchase and sale of real estate for residential development, and signed a standard sale contract. Under this agreement, respondent undertook to pay the purchase price in 84 monthly instalments. Winzen, for its part, retained ownership of the two lots and only undertook to transfer the right of ownership thereof after the monthly payments had been made in full.

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[16] J.-L. Baudouin and P.-G. Jobin, *Les obligations*, 5th edition (Cowansville, Quebec: Les Éditions Yvon Blais, 1998), at page 452.

[17] At paragraphs 46 to 50.

Justice Beetz, who made the decision on behalf of the Court, gives his approval to the opinion of McCarthy J. of our Court, at page 900, in the following passage:

> [TRANSLATION]
>
> In my view, and with respect for the contrary opinion, there is no question of a conditional obligation here; accordingly, the retroactivity mentioned in art. 1085 C.C. does not apply. The "condition" referred to in arts. 1079 et seq. of the *Civil Code* is "an event future and uncertain" on which the existence of an obligation depends. The payment of the price by Venne does not fall in this category: Venne was obligated to pay the price, just as the Winzen company was obligated to convey the immoveable property, within a certain time. The obligations on either side were obligations with a term (arts. 1089 *et seq.* C.C.), not conditional obligations. They existed once the "Contract for Deed" had been signed, even though their performance was in abeyance. The same is true for the rights corresponding to the obligations.

In support of his opinion, Justice Beetz cites the following passages from an article titled "Réflexions d'un civiliste sur la clause de réserve de propriété", written by Professor Jacques Ghestin in *Recueil Dalloz Sirey*, 1981, Chronique-I, at pp. 4-5:

> However, it was argued that this could not be a term because the payment of the price is an uncertain event, especially in commercial relations. The writer of a recent noteworthy study also stressed the fact that "in credit sales . . . the solvency of buyers, especially business buyers, is precarious and difficult to estimate". However, this is used as a basis for saying that it would be "unprecedented to make the transfer of ownership depend on such an uncertain event". In actual fact, while it is true that the uncertain nature of the event considered is definitely the criterion for distinguishing a condition from a term, its application must still be defined.
>
> For there to be a condition the event must first be objectively uncertain. Accordingly, the death of a given person may never be a condition, as that is certain, though its date is uncertain and it is thus an uncertain term. However, such objective uncertainty is not sufficient, it is also necessary that the parties have not taken the occurrence of the event as certain.
>
> . . .
>
> In a credit sale, the payment of the price is not regarded simply as a possibility but as a certainty. The purchaser's obligation is not conditional, but simply an obligation; and the fact that he may prove to be insolvent on the date of payment in no way affects this classification. If it were otherwise all credit sales would give rise merely to conditional obligations. This would still further aggravate the misuse of the word, which has been quite properly deplored.

I intend to apply these principles to the facts in this case.

[19] In summary, the loan contract of August 28, 1995, provided that the capital loaned would bear interest until expiry of the term, which was the acquisition of a loan from a banking institution.

[20] On the other hand, this same loan contract did not have any provisions with respect to the payability of the interest. Interest payments were therefore a pure and simple obligation subject to immediate payment.[18] The same applies to the payability of the capital loaned, since the loan contract also did not make any provisions in this respect. Therefore it was a demand loan, and the Appellant therefore could have required repayment of the interest and capital at any time. Similarly, the Corporation could have repaid the amounts due at any time.

Loan contract dated May 15, 1996

[21] The loan contract dated May 15, 1996 provided as follows:

> [TRANSLATION]
>
> 2. Repayment.
>
> The Borrower agrees that the said capital of twenty thousand dollars ($20,000) shall bear interest at a rate of three and one-half percent (3.5 %) per year.
>
> 2.1 The interest will accrue from the date the amount mentioned above is paid.
>
> 2.2 The Borrower shall be required to repay the current loan as soon as he obtains a loan from a financial institution.
>
> 3. Limit of term.
>
> If the Borrower fails to meet either obligation under this contract, the Lender may require payment of the debt.

[18] J. Pineau and S. Gaudet, *op. cit.*, at page 633: [TRANSLATION] " In principle, a pure and simple obligation must be discharged immediately. It is different when there are terms or conditions attached to the obligation. In this case, payability is delayed until a certain time period has elapsed, in the case of a term, or if and when a certain event occurs, in the event of a condition."

[22] Under this loan contract, the interest began accruing when the $20,000 was paid[19] and continued until the capital was repaid.[20]

[23] Furthermore, repayment of the amount loaned and consequently the payability of this amount were suspended until expiry of the term, which occurred upon receipt of a bank loan.[21] Thus, the amount of $20,000 bore interest at a rate of 3.5% per year until full repayment of the amount loaned, which sum would be required when the Corporation obtained a bank loan.

Verbal loan contracts

[24] Determining the terms and conditions of the verbal loan contracts is difficult because the Appellant affirmed that they were identical to those of the written loan contracts. However, the two written loan contracts differ in their respective wording. In order to establish the conditions of the loans that were not recorded in writing, I must therefore refer to the Appellant's testimony, to the written contracts, and to the additional rules of the C.C.Q in order to determine the conditions of the loans that were not recorded in writing, since:[22]

> In interpreting a contract, the nature of the contract, the circumstances in which it was formed, the interpretation which has already been given to it by the parties or which it may have received, and usage, are all taken into account.

[25] The Appellant explained that the interest and capital were payable at the same time and that the loan was conditional upon the Corporation obtaining a bank loan. Once again, I repeat my position that the loan was not conditional upon the Corporation obtaining a loan from a financial institution, but rather that repayment of the loan was subject to a suspensive term: the granting of a loan by a banking institution.

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[19] According to the date on the $20,000 draft, this amount was paid on May 15, 1996.

[20] I arrive at this conclusion based on the fact that no term restricted the interest bearing; since the incidental (the interest) follows the principal (the capital), it can be concluded that, failing indications to the contrary, the interest accrued until repayment of the capital.

[21] I repeat that obtaining a bank loan constituted a suspensive term that deferred the payability of the capital repayment. This was not a conditional obligation. See paragraphs 16 to 19 of this text.

[22] Article 1426 C.C.Q.

[26] I therefore conclude that the unwritten loan contracts included the following conditions:

- the capital bore interest at a rate of 3.5% per year beginning with the payment of the amount loaned;
- the interest accrued until the capital was fully reimbursed;
- the interest was payable at the same time as the capital;
- the capital became due and payable once a loan was obtained from a banking institution;
- if a bank loan was not obtained, the capital was due and payable immediately.

[27] Furthermore, I would add that all the evidence, particularly the testimony of the Appellant, whose credibility was not in question, leads me to conclude that the Appellant's loan had never been repaid. The Appellant was therefore owed a debt of $79,200 by the Corporation.

WERE THE LOANS GRANTED FOR THE PURPOSE OF EARNING A BUSINESS INCOME?

The loan contracts

[28] The terms and conditions of these loan contracts lead me to believe that the Appellant did not make these loans in order to earn business income.

[29] On the one hand, the loans were made without any guarantee to the Appellant. On the other hand, the interest rate provided (3.5%) was relatively low, considering that the legal interest rate was 5%.[23] Finally, with respect to the loan contract dated August 28, 1995, the interest accrued only until a bank loan was obtained. Therefore the loan was interest-free from the time the bank loan was obtained until the full amount of the debt was repaid.[24] Although an interest-free loan may be granted in order to earn business income, the loan must therefore generate

[23] *Interest Act*, R.S.C., 1985 (5th suppl.), c. I-15, section 3:

> Whenever any interest is payable by the agreement of parties or by law, and no rate is fixed by the agreement or by law, the rate of interest shall be five per cent per annum.

[24] If the Corporation obtained a bank loan without repaying the Appellant at that same moment, the capital owed by the Corporation would bear no further interest until it was fully repaid. Thus, the loan of August 28, 1995, only bore partial interest.

business income in some other manner, such as through dividends or a salary increase.[25] This was not the case here, since the Appellant was not a shareholder, director, or employee of the Corporation. The only possible business income that could be generated by these loans was the interest on the capital loaned. Without this interest, the Appellant could not earn any business income.

The Appellant's behaviour

[30] If the loan contract terms were indicators of the lack of the Appellant's real intention to earn business income, the Appellant's behaviour with respect to these loan contracts confirms it.

[31] The Appellant was not an employee, director or shareholder of the Corporation. Furthermore, the Corporation was directed by two shareholders: the Appellant's sons. In her testimony, the Appellant affirmed that she had lent these amounts to the Corporation rather than to her sons, in order to realize a small return.[26] On the other hand, the Appellant admitted she made these loans because her sons asked her, and to enable them to obtain a bank loan. The Appellant stated: [TRANSLATION] "Because otherwise I would not have lent it."[27]

[32] The Appellant explained that the loans were conditional[28] upon obtaining a bank loan. However, the Appellant did not conduct any real follow-up to determine whether the Corporation had in fact obtained a bank loan, nor did she even establish whether the Corporation was attempting to obtain a bank loan. The Appellant did not know which institutions the Corporation had approached, and furthermore, she assumed that the Corporation had in fact made a loan application.[29] This lack of

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[25] See *Business Art Inc. v. M.N.R.*, 86 DTC 1842 which is cited by Justice Bowie in *McKissock v. Canada*, [1996] T.C.J. No. 1192.

[26] Page 28 of the transcript:

[TRANSLATION]

A. That company, I knew that it was growing because my sons asked me if I couldn't give them a loan rather than keeping it at home, that at least I would earn a small percentage. So I agreed."

[27] Page 34 of the transcript.

[28] With respect to the "condition," see paragraphs 16 to 19 of this text.

[29] Page 30 of the transcript:

[TRANSLATION]

follow-up by the Appellant was a result of the confidence she had in her sons, and therefore, in the Corporation:[30]

> [TRANSLATION]
> Q. So, could we simply say that you did not check because you trusted your sons?
>
> A. Ah! Yes, certainly I trusted them, because I knew that they were going to return the money to me.

[33] At the hearing, the Appellant still did not know whether the Corporation had or had not obtained a loan from a banking institution. The last time the Appellant inquired about the loan was in 1998, in which she did not ask any questions about obtaining a bank loan:[31]

> [TRANSLATION]
>
> Q. That means they got the bank loan?
>
> A. I do not know, at all.
>
> . . .

Q. So, when you gave this $10,000, did you ask your sons when the company was going to get a loan?

A. Yes, I asked them.

Q. What did they tell you?

A. I always assumed it was on demand.

Q. On demand.

A. Yes.

Q. Did you check, a few months later, or a few weeks ... a few months later, "What's happening with your loan application?"

A. I asked, but I was told that they were asking the banks.

[30] Page 33 of the transcript.

[31] Pages 35, 38 and 39 of the transcript.

> Q. Did you ask the question again, "What is happening with your loan?"
>
> A. No. The last time I asked them about it was in '98.
>
> Q. O.K.
>
> A. At the end of '98.
>
> Q. And what...
>
> A. I said, "You're still going to pay me back?"
>
> Q. Yes.
>
> A. So they told me, "Yes."
>
> Q. No, no, but did you ask them whether the company had obtained a loan?
>
> A. No, that, I did not ask that in '98.
>
> Q. O.K. But in '96 and in '97, when you saw the company operating, and, at a certain point, you ask the question, "Did you get a loan?" Or, at some point, they asked you, "Lend us some money because we're still waiting for the loan." But you see the company operating, did you ask, "How are you operating? Where are you getting the money?"
>
> A. No, I didn't ask them that.

[34] The Appellant stated she had not received any amount of money in repayment of the capital, or of the interest on the capital.[32] Nonetheless, the testimony of Marc Améziane demonstrates that the Corporation had obtained financing between August 28, 1995, (the date of the Appellant's first loan to the

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[32] Page 16 of the transcript:

[TRANSLATION]

A. I never received anything, not a penny."

Corporation) and March 5, 1999, (the date the Corporation declared bankruptcy).[33] Mr. Améziane explained that the Corporation was not able to repay the Appellant because it had only obtained a line of credit. Therefore, the Corporation did not have the funds to reimburse the Appellant:[34]

> [TRANSLATION]
>
> Q. Why didn't you pay her back? Did you obtain a loan from a bank?
>
> A. We didn't get a bank loan. We had credit lines but we didn't have access to new money. They simply allowed us to buy our products up to a certain limit, but we, what we needed was an additional loan.
>
> . . .
>
> Q. A line of credit, ...
>
> A. Yes?
>
> Q. That's not a type of financing?
>
> A. It is a type of financing.
>
> Q. Well, O.K.
>
> A. But it's not... In the agreement I had with my mother, when I have new money to replace it that we will replace it.
>
> Q. Ah!
>
> A. That's what we want... A bank loan, if I'd had a bank loan, it's simple: yes, I can pay her back. It's conditional upon the bank's agreement that I pay her back.
>
> . . .

[33] The Corporation's financial statements showed that the Corporation owed $184,208 and $401,000 in bank loans. These bank loans were obtained on February 28, 1996, and February 28, 1997, respectively. Therefore the suspensive term expired such that the debt due to the Appellant was due and payable. (See Exhibit I-1 and page 84 of the transcript.)

[34] Pages 80, 85 and 103 of the transcript.

> Q. Good. So "bank loans", it was said earlier that '96, they were $184,208; '97, they were $401,000, then in '98, they were $514,234.
>
> A. Yes.
>
> Q. Are you going to tell me all that again, it wasn't bank loans, that $514,000 in bank ... money from the bank?
>
> A. Yes, but it's not necessarily, whether they are loans or whatever, that I can repay my mother, because I have this debt to pay to the banks.
>
> Q. Yes. But you said ...
>
> A. If I ... that amount ...
>
> Q. Yes, but you told your mother, when she loaned you the money the first, then the second, then the third, that we'll pay you back when we get financing from a company ... from a bank ...
>
> A. Yes, but if ...
>
> Q. So, you were up to $514,000 and you didn't pay her back?
>
> A. Because I am unable to pay her back. I have ...

[35] In his testimony, Mr. Améziane added that the Corporation could not have repaid the Appellant because the Caisse de dépôt, which had become a "partner" of the Corporation, was not permitting repayment of creditors:[35]

> Q. Why didn't you pay your mother back if the Company was having problems?
>
> A. In '98, we intended to pay her back. The Caisse de dépôt became our partner – not a shareholder, but a partner – to help us grow, except that one of the Caisse de dépôt conditions was that we pay ... that we did not pay anything to any lenders until our situation had stabilized, and they agreed to give us money to allow the company to grow.

[35] Page 57 of the transcript.

[36] On these facts, the term which suspended payability of the loans had expired, because the Corporation had obtained one, if not several, bank loans. The fact that the Corporation did not have permission to reimburse the Appellant, despite having obtained bank loans, does not affect the fact that the term had expired, and consequently did not affect the Appellant's right to claim the amounts due.[36] Nonetheless, the Appellant simply chose to ask her sons if and when she would be paid, without actually conducting any real follow-up.[37]

[37] In March 1999, the Appellant learned that she would not be reimbursed because the Corporation had gone bankrupt.[38] The Appellant did not make any claims during the Corporation's bankruptcy because it did not have sufficient funds to reimburse the guaranteed creditors. Thus there was no chance the Appellant would be paid since she was not a guaranteed creditor.[39] The list of creditors drawn up by the trustee in bankruptcy mentioned the Appellant as a creditor but, curiously, set the amount owed her at $30,288.59 rather than $79,200. The Appellant explained that despite her efforts, she never learned why the list of creditors indicated the amount owed to her was $30,288.59 rather than $79,200.[40]

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[36] The loan contracts did not specify that the Corporation had to obtain a bank loan and have the financial means to reimburse the Appellant in order for the said term to expire. I therefore conclude that the term was not restricted in this way and the simple fact of obtaining a bank loan caused the term to expire.

[37] Page 35 of the transcript:

[TRANSLATION]

A. Each year I asked, when it was a year that each loan had been ... I asked. There shouldn't have been a delay, but I am still waiting.

[38] Page 22 of the transcript.

[39] Page 25 of the transcript.

[40] Page 40 of the transcript:

[TRANSCRIPT]

Q. When you said that in '99, according to what you said, you learned that the company had gone bankrupt, then... Did you see or were you told that, on the trustee's document, it was written that the company owed you $30,000?

A. I saw it when I reviewed the paper.

Q. O.K.

Case law

[38] In *Lowery v. M.N.R.*, 86 DTC 1649, Sarchuk J. of this court dismissed the Appeal for the reason that the family relationship between the Appellant and his son had motivated the Appellant to give a guarantee. Therefore, the Appellant did not have a genuine intention to earn business income. In these reasons, Sarchuk J. asserted that it is relevant to consider the Appellant's intentions when the loan or guarantee was given, as well as the Appellant's subsequent behaviour (my emphasis):[41]

> On the evidence adduced I am not satisfied that there was any business purpose in the granting of the guarantee. Respondent's counsel submitted, and I agree, that it is not sufficient to make a general allegation that the appellant anticipated some participation in the profits of Threads at some unstated time in the future and on that basis to argue that some consideration for the guarantee existed. There was no arrangement as to interest. There was no arrangement relative to repayment in the event of default by Threads. There was no agreement, oral or written, setting out the terms and conditions of the appellant's participation. No mechanism existed enabling the appellant to control the level of earnings to be reached by Threads before his alleged right to participate in the profits could be invoked. The appellant stated that family matters did not require written agreements. This statement however is in some measure inconsistent with the manner in which his proposed investment in Empire was secured and documented. In my view the appellant's involvement bears none of the hallmarks of a commercial or business transaction.
>
> Furthermore, there are inconsistencies in the evidence of the witnesses on the matter of sharing profits. Glenn stated that no discussions had taken place while Joanne maintained that an

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A. Immediately, I called the trustee.

Q. Yes.

A. I was told that this would be fixed and that it was temporary.

Q. And after that?

A. And I didn't get any answer. So, afterwards, I wrote them a letter asking what was going on. I never received an answer. I sent a letter to the accountant as well. I don't know whether it was the right accountant at that time; I never received an answer, and he didn't even bother to call me back.

[41] At pages 7–8, DTC: at page 1652.

> agreement had been reached. Joanne stated that she and Glenn were to share their interest equally. However, Exhibit A-3, Threads' financial statement as at July 31, 1979, disclosed that the net income of Threads had been distributed 70% to Glenn and 30% to Joanne. Insofar as Betton's evidence is concerned it is a fact that with respect to Threads his involvement was minimal. I am constrained to say that his evidence as to the appellant's right to share in Threads' profits appeared to be based on hearsay.
>
> Although the relevant time with respect to the "purpose of earning income test" is the time at which the guarantee was given, it is proper in this case to consider as well the appellant's conduct after he was called upon to pay the debt by the bank. None of the normal commercial considerations were given to collecting the debt from the partners. Not only does this call into question the basis upon which the appellant established the debt to be a bad debt in that year but it also suggests that the risk in guaranteeing the debt had its justification only in the fact of the father/son relationship and was not made for any business or commercial reasons.

[39] In *O'Blenes v. M.N.R.*, 90 DTC 1068, Justice Garon, as he then was, subscribed to the words of Sarchuk J., referring to, among other things, his decision in *Lowery*. According to Garon J., the Appellant did not intend to earn business income when she guaranteed the credit margin to the debtor corporation. On this fact, her subsequent actions could not change this absence of an initial intention. Justice Garon said (emphasis added):[42]

> On the whole of the evidence it is abundantly clear that when the Appellant agreed to guarantee Glenwood's line of credit and to pledge through her husband the subject term deposits, she was not motivated by any benefit she might herself receive. Her purposes were not business purposes as far as her own situation was concerned. Family considerations played a key role. She wanted to assist Glenwood in which shareholding her husband owned a third interest. As well, that company was also at the time her husband's employer.
>
> Subparagraph 40(1)(*g*)(ii) of the Act when it mentions the purpose of the acquisition of a debt, refers of course, to the creditor's purpose of earning income for her own account. The indirect advantage the Appellant would derive in providing financial assistance to a company which in turn would procure a direct financial benefit to her

[42] At page 1072.

> husband is definitely too remote to meet the requirements of that subparagraph.
>
> It has been suggested by the Appellant that in 1981 as a result of the mortgage agreement dated June 1st, 1981 and of the debenture of June 18, 1981, compensation was provided to the Appellant. There is no question that by these two indentures the Appellant would have received a significant benefit if Glenwood had been able to survive and pay off its indebtedness to the Appellant. However, as pointed out by Judge Sarchuk in the case of Hugh Lowery to which case reference will be made later that the critical time at which the Appellant's purpose must be examined is the time at which she gave the guarantee and pledged her term deposits. Almost two years after undertaking to assist Glenwood she moved to secure her position at the time of the refinancing of Glenwood's operations. This belated action had nothing to do with the reason why she agreed in the first place to give the guarantee and pledge her term deposits. The evidence is clear that in 1981 the Appellant was not released from her guarantee given to the Bank. The mortgage and the debenture given by Glenwood were not in respect of a new guarantee provided to the Bank or a new pledge of the term deposits. There was no new injection of capital into Glenwood's business on the Appellant's part.
>
> On the whole of the evidence, I therefore come to the conclusion that the Appellant has not established that when she undertook to grant the guarantee to the Bank and to pledge her term deposits she was motivated by the prospect of a financial gain or reward for herself. Her motives however commendable they are, are of a personal or private nature.

[40] As a result, a taxpayer cannot deduct an amount as a non-capital loss unless he or she had, when the loan or guarantee was granted, a genuine intention to earn business income: this intention cannot arise at a later date. Furthermore, the taxpayer's behaviour after granting a loan or guarantee may be an indicator of this initial absence of an intention to earn business income.

[41] It is important to emphasize that it is not necessary for this initial intention to earn business income to be the main reason for granting a loan or a guarantee. Secondary intention is sufficient. This was affirmed by the Federal Court of Appeal, under the hand of Rothstein J., in *Rich v. Canada*, [2003] 3 F.C. 493 (emphasis added):[43]

[43] At paragraphs 8 and 10.

> . . . The Minister agrees that, though gaining or producing income need not be the exclusive or even the primary purpose of the loan, as long as it was one of its purposes, that is sufficient to meet the requirements of subparagraph 40(2)(*g*)(ii) (see *Ludco Enterprises Ltd. v. Canada*, [2001] 2 S.C.R. 1082, at paragraph 50). I believe the Tax Court Judge was also of that view, from comments he made during the argument before him, at page 388 of the transcript:
>
> His Honour: Mr. Sood, are you suggesting that the familial relationship was the only purpose for the advance of these funds?
>
> Mr. Sood: Well, Your Honour, if not the only purpose, then the primary purpose indeed.
>
> His Honour: Well, there is [*sic*] a big difference there, whether it's the primary purpose or the only purpose, I mean there can be a number of purposes.
>
> The documentary evidence indicates that the loan was intended to bear interest and there was no finding of sham or "window dressing". In addition, the appellant was a 25% shareholder of DSM.
>
> The Tax Court Judge found that the predominant purpose of the loan was to help the appellant's son and his son's company. At paragraph 31, he stated:
>
> Dad was helping his son and his son's company with an expectation to be repaid. This, I find was the predominant purpose, while the normal purpose of a *bona fide* commercial investor to reap interest and dividends was, in this situation, a faint hope.
>
> The finding of the Tax Court Judge that the "predominant purpose" of the loan was to help his son necessarily implies that there was another subordinate purpose. The evidence was that the loan was to bear interest. In addition, the appellant was a shareholder of DSM entitling him to dividends. The Court is not to second-guess the business acumen of taxpayers (see *Stewart v. Canada*, [2002] 2 S.C.R. 645 (S.C.C.), at paragraph 55). The subordinate purpose is sufficient. The requirement of subparagraph 40(2)(*g*)(ii) is satisfied.

[42] I wish it emphasize that this decision was not unanimous, since Evans J. would have dismissed the appeal for the following reasons:[44]

[44] At paragraphs 35 and 36.

> It is admirable that parents help their children to become established in their careers. However, when parents ask other taxpayers to share the burden of assisting a child's struggling business by deducting from their own income part of a loan as a bad debt, they can expect the tax authorities and the courts to examine the claim with care.
>
> I am unable to agree with my colleague Rothstein J.A. that the Tax Court Judge made a reversible error in concluding that Larry W. Rich had not proved that he made an honest and reasonable determination that, at the end of 1995, the debt owed to him by his son's business, DSM Foods Inc., was not collectible. Accordingly, in my opinion, the Tax Court Judge did not err when he found that Mr. Rich could not rely on the ABIL provisions to partially write off the debt against his income for 1995.

[43] In my opinion, the Appellant's behaviour following her consent to the loans clearly illustrates that the Appellant's main objective was not to earn business income. Based on all the facts, I conclude that these loans were essentially motivated by the mother-son relationship between the Appellant and the Corporation's shareholders. The issue therefore becomes whether the Appellant had a secondary intention to earn business income in lending the total amount of $79,200 to the Corporation.

[44] I am convinced that the Appellant did not have any genuine secondary intention to earn business income. The Appellant did not conduct any concrete follow-up to determine whether the Corporation had obtained a bank loan or if it had applied for one. The Appellant made no attempts to recover the capital loaned or the interest accrued during the entire period from the time of the first loan (August 28, 1995) to the day of the bankruptcy (May 5, 1999). I recall that the Corporation had in fact obtained bank loans in 1996 and 1997. Finally, the Appellant made no claim during the Corporation's bankruptcy and in no way defended, before the trustee in bankruptcy the amount of $79,200 owed to her that was erroneously indicated as being $30,288.59.

[45] On the other hand, the Appellant in *Rich* was the accountant for the debtor Corporation when he arranged the guarantee, aside from the fact that, the Appellant eventually became a shareholder in the Corporation. Moreover, the Appellant had sent a letter to the debtor corporation claiming payment of the overdue amounts. In such a situation, I agree that at the very least a secondary intention to earn business income must be recognized, despite the primary intention of helping a family member. In this case, the only evidence supporting the Appellant's claim that she had

a genuine intention to earn business income from these loans is a short remark made by the Appellant during her testimony:[45]

> [TRANSLATION]
>
> A. That company, I knew that it was growing because my sons asked me if I couldn't give them a loan rather than keeping it at home, that at least I would earn a small percentage. So I agreed.

[46] All the evidence, that is, the loan contracts and the Appellant's behaviour, tends to demonstrate that the Appellant did not have any genuine intention, not even a secondary one, in earning business income though her loans to the Corporation. The only comment the Appellant made to this effect is not sufficient to counteract the balance of probabilities that illustrates the absence of an intention to earn business income. I must conclude that the Appellant did not lend the amount of $79,200 in order to earn business income. Accordingly, the Appellant could not deduct the amount of $28,381 as a non-capital loss in her income tax return for the 2000 taxation year and as a result, the appeal must be dismissed.

Signed at Ottawa, Canada, this 5th day of May 2004.

"Paul Bédard"

Bédard J.

Translation certified true
on this 22nd day of September 2004.

Shulamit Day, Translator

[45] Page 28 of the transcript.