

Docket: 2006-3332(IT)G

BETWEEN:

DOMINIQUE RICHER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

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Appeals heard on April 4, 2008, at Montreal, Quebec.

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the Appellant:	Jean Groleau and Jacques Plante
Counsel for the Respondent:	Yanick Houle

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**JUDGMENT**

The appeals from the reassessments made under the *Income Tax Act* on December 6, 2004, for the 2001, 2002 and 2003 taxation years, are dismissed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 14th day of November 2008.

"Réal Favreau"

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Favreau J.

Translation certified true  
on this 29th day of January 2009.

Erich Klein, Revisor

Citation: 2008 TCC 547  
Date: 20081114  
Docket: 2006-3332(IT)G

BETWEEN:

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and

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### **REASONS FOR JUDGMENT**

Favreau J.

[1] These are appeals from reassessments made by the Minister of National Revenue ("the Minister") on December 6, 2004, in which the following business income amounts were added to the Appellant's income for the 2001, 2002 and 2003 taxation years:

- (a) \$27,779 for the 2001 taxation year;
- (b) \$10,130 for the 2002 taxation year; and
- (c) \$21,580 for the 2003 taxation year.

[2] The business income that was added to the Appellant's taxable income resulted from profits from flow-through share transactions by the Appellant. The dispute is about the tax treatment of profits made by an investment advisor on flow-through share transactions for himself.

[3] The Respondent submits that the profits from the flow-through share transactions constitute business income in the Appellant's hands, just as profits or losses from transactions involving securities other than flow-through shares would constitute business income or losses for the Appellant.

[4] The Minister made the reassessments for the 2001, 2002 and 2003 taxation years on the basis of the following facts set out in subparagraphs 15(a) through (q) of the Reply to the Notice of Appeal:

[TRANSLATION]

- (a) National Bank Financial Inc. (NBF) operates a securities brokerage business.
- (b) The Appellant is an investment advisor with NBF.
- (c) NBF investment advisors are professionals whose role is to assist NBF's clients with their investment decisions by offering them informed advice based on objective, solidly documented research, with a view to helping them make sound financial decisions.
- (d) All or part of the remuneration that the Appellant receives from NBF is in the form of commissions that are based on the volume of investments made.
- (e) The Appellant received the following employment income amounts from NBF during the 2001, 2002 and 2003 taxation years:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Employment income	\$564,758	\$633,358	\$473,332

- (f) As a sideline to his activities as an NBF investment advisor, the Appellant regularly trades in securities (flow-through shares or other securities) on his own account.
- (g) The Appellant takes advantage of the knowledge and experience relating to the securities (flow-through shares or other securities) markets that he has acquired as an investment advisor.
- (h) The securities (flow-through shares or other securities) transactions are part of the Appellant's ordinary business.
- (i) The Appellant has a history of intensive buying and selling of securities (flow-through shares or other securities).
- (j) The securities (flow-through shares or other securities) are usually held by the Appellant for short periods.
- (k) The securities (flow-through shares or other securities) are mainly either purchased by the Appellant on margin or financed through some other type of debt:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Carrying charges and interest	\$41,000	\$16,553	\$8,729

- (l) A profitable resale of the securities (flow-through shares or other securities) is a deciding factor in the Appellant's purchasing them.
- (m) The Appellant's securities (flow-through shares or other securities) transactions are speculative.

- (n) Indeed, for the 2001, 2002 and 2003 taxation years, the Appellant reported business losses from transactions involving securities other than flow-through shares:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Business losses	(\$288,814) <sup>1</sup>	(\$34,746) <sup>1</sup>	(\$22,656)

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- 1 Part of the business losses for the 2001 and 2002 taxation years results, *inter alia*, from the disposition of shares in Majescor Resources and/or Freewest Resources.

- (o) For the 2001, 2002 and 2003 taxation years, the Appellant reported, however, capital gains from transactions involving flow-through shares:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Capital gain	\$11,863 <sup>1</sup>	\$6,081 <sup>2</sup>	\$10,790 <sup>3</sup>

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- 1 From the disposition of shares in Freewest Resources.  
 2 From the disposition of shares in Majescor Resources.  
 3 From the disposition of shares in National Bank, Majescor Resources and Freewest Resources.

- (p) For tax purposes, the Appellant had no reason to treat his flow-through share transactions any differently from his transactions in other securities.  
 (q) This is especially true because some of those transactions involved the same shares (i.e., shares in Freewest Resources and Majescor Resources) and the Appellant treated them differently for tax purposes depending on whether or not they qualified as flow-through shares.

[5] Subparagraphs 15(a) through (q) of the Reply to the Notice of Appeal correspond to paragraphs 9 to 23 of the Respondent's Request to Admit of June 27, 2007. In his response to the Request to Admit, the Appellant admitted the facts alleged in paragraphs 1 through 15 and paragraphs 19 through 23. The Appellant refused to admit the fact alleged in paragraph 16 (subparagraph (h) of the Reply to the Notice of Appeal) for the following reason: The transactions involving the flow-through shares are not part of the Appellant's ordinary business because he rarely (approximately one to four transactions per year) trades in flow-through shares. The Appellant also refused to admit the fact alleged in paragraph 17 (subparagraph (i) of the Reply to the Notice of Appeal) for the following reason: Given the volume of his flow-through share transactions, the Appellant does not have a history of intensive buying and selling of flow-through shares. Lastly, the Appellant refused to admit the fact alleged in paragraph 18 (subparagraph (j) of the Reply to the Notice of Appeal) for the following reason: The flow-through shares which the Appellant traded were held by him for at least one year during the period covered by the notices of assessment in issue.

[6] The income tax returns filed by the Appellant for the taxation years in issue report the following exploration and development expenses attributable to the flow-through shares:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Exploration and development expenses	\$15,996	\$24,000	\$32,000

[7] In his written answers upon examination for discovery, the Appellant also confirmed the following information:

- (a) His client base was approximately 500 clients, made up essentially of individuals, as well as foundations, trusts and businesses.
- (b) Roughly \$500 million in assets was under management, invested primarily in government bonds, corporate bonds and debentures, Canadian and U.S. stocks, foreign stocks (Europe, Asia and South America) and certain investment funds. Shares of companies operating in the natural resource sector accounted for roughly 8% of the assets under management.
- (c) The companies operating in the natural resource sector whose shares (flow-through or otherwise) were recommended to his clients were Alcan Inc., Inco Limited, Canadian Oil Sands Trust, Canadian Natural Resources Limited, Talisman Energy Inc., Sherritt International Corporation, Falconbridge Limited, Mines d'Or Virginia Inc., Majescor Resources Inc., Murgor Resources Inc., Freewest Resources Canada Inc., Calvaley Petroleum International Inc., Dia Bras Exploration Inc., Ashton Mining Canada Inc., Metco Resources Inc. and Teck Cominco Limited.
- (d) During 2001, his personal portfolio consisted primarily of U.S. technology stocks; natural resource securities (flow-through shares or otherwise) likely accounted for 10-15% of total portfolio value. In 2002 and 2003, natural resource securities probably represented more than 50% of total portfolio value.
- (e) The transactions in his personal portfolio that involved flow-through shares of companies operating in the natural resource sector were as follows:

Date of disposition	Number of shares	Name of corporation	Selling price	Date acquired <sup>1</sup>	Acquisition cost	Tax deduction	Acquisition cost – tax deduction
Dec.21, 2001	30 000	Freewest Resources Canada Inc. (80 000)	\$8,350.00	Dec. 15, 2000	\$20,000.00	\$18,000.00	\$2,000.00

Jan. 3, 2002	50 000	Freewest Resources Canada Inc.	\$13,992.21				
July 12, 2002	8 500	Majescor Resources Canada Inc. (48 265)	\$5,700.00	July 30, 2001	\$25,000.00	\$15,995.60	\$9,004.40
July 22, 2002	6 000	Majescor Resources Inc.	\$3,580.00				
July 26, 2002	10 000	Majescor Resources Inc.	\$5,420.00				
Jan. 30, 2003	10 000	Majescor Resources Inc.	\$3,320.00				
Jan. 31, 2003	13 765	Majescor Resources Inc.	\$4,557.22				
May 12, 2003	300 000	Metco Resources Inc.	\$21,000.00	Dec. 31, 2002	\$30,000.00	\$24,000.00	\$6,000.00
Jan. 6, 2004	133 325	Pershimco Resources Inc.	\$26,665.00	Dec. 15, 2003	\$25,000.00	\$20,000.00	\$5,000.00
April 21, 2004	40 000	Metco Resources Inc. (190 590)	\$6,320.00	Dec. 15, 2003	\$30,000.00	\$12,000.00	\$18,000.00
April 22, 2004	60 000	Metco Resources Inc.	\$8,970.00				
May 20, 2004	90 590	Metco Resources Inc.	\$9,964.90				

<sup>1</sup> Flow-through shares can be purchased only upon their issuance by the company.

(f) The transactions in his personal portfolio that involved other kinds of securities of companies operating in the natural resource sector were as follows:

Date of disposition	Number of shares	Name of corporation	Selling price	Date acquired	Acquisition cost
Jan. 22, 2001	20 000	Freewest Resources	\$5,119.50	July 21, 2000	\$14,400.00

Feb. 1, 2002	10 000	Mines d'Or Virginia	\$7,000.00	Feb. 2, 2002	\$8,083.66
Feb. 23, 2001	25 000	Freewest Resources	\$7,179.00	Feb. 6, 2002	\$7,580.50
Feb. 20, 2001	15 900	Majescor Resources	\$5,317.50	Feb. 1, 2002	\$7,950.00
April 29, 2002	18 500	Majescor Resources	\$1,1825.55	June 27, 2001	\$10,259.60
June 27, 2001	20 000	Freewest Resources	\$7,718.28	July 21, 2000	\$14,400.00
April 29, 2002	13 500	Majescor Resources (15 000)	\$8,629.45	Sept. 4, 2001	\$9,460.00
April 8, 2002	1 500	Majescor Resources	\$1,855.98	Sept. 4, 2001	
Sept. 4, 2001	30 000	Freewest Resources	\$8,020.00	July 21, 2000	\$21,600.00
Jan. 21, 2002	5 000	Ashton Mining Canada	\$19,453.60	Nov. 6, 2001	\$5,830.00
Jan. 24, 2002	5 000	Ashton Mining Canada	\$19,800.20	Dec. 5, 2001	\$8,335.59
Jan. 24, 2002	5 000	Ashton Mining Canada	\$19,156.52	Dec. 24, 2001	\$10,960.86
April 8, 2002	3 500	Majescor Resources (11 500)	\$4,330.61	Dec. 27, 2001	\$8,770.00
Jan. 28, 2002	15 000	Patrician Diamonds	\$7,050.00	Jan. 23, 2002	\$7,555.00



Date of disposition	Number of shares	Name of corporation	Selling price	Acquisition date	Acquisition cost
April 26, 2002	5 000	Ashton Mining Canada	\$13,115.81	Feb. 14, 2002	\$14,555.46
June 14, 2002	3 000	Ashton Mining Canada	\$6,354.90	Feb 14, 2002	\$8,659.54
June 14, 2002	3 000	Ashton Mining Canada	\$6,354.90	Feb. 15, 2002	\$8,305.30
Feb. 14, 2002	10 000	Majescor Resources (15 000)	\$13,660.16	Jan. 3, 2002	\$15,898.39
April 8, 2002	5 000	Majescor Resources	\$6,335.05		
March 25, 2002	4 000	Teck Cominco — WTS May 25, 2004	\$6,610.00	March 18, 2002	\$6,400.00
May 27, 2002	25 000	Freewest Resources	\$9,154.69	May 24, 2002	\$8,750.00
May 28, 2002	1 500	Freewest Resources	\$555.00	May 24, 2002	\$375.00
Nov. 7, 2002	17 129	Majescor Resources (20 000)	\$5,995.15	Nov. 6, 2002	\$7,210.00
Nov. 20, 2002	2 400	Majescor Resources	\$1,056.00		
Sept. 3, 2003	471	Majescor Resources	\$117.75		
Feb. 14, 2003	3 113	PrimeWest Energy	\$79,727.31	Feb. 13, 2003	\$80,159.75

Date of disposition	Number of shares	Name of corporation	Selling price	Acquisition date	Acquisition cost
Sept. 8, 2003	8 200	Ashton Mining Canada (10 000)	\$12,056.00	July 3, 2003	\$22,080.00
Sept. 9, 2003	1 800	Ashton Mining Canada	\$2,566.58		
Sept. 9, 2003	5 000	Ashton Mining Canada	\$7,129.41	July 28, 2003	\$8,530.00
Jan. 30, 2004	10 000	Tri Origin Resources	\$2,700.00	Dec. 3, 2003	\$3,080.00

- (g) With respect to the flow-through shares, there was no research report or financial analysis concerning the various exploration companies. The decisions to invest in these companies were based on reading the prospectuses.
- (h) As for the shares other than flow-through shares, the investment decisions were based, *inter alia*, on financial analyses, offering memoranda, company histories or the various press releases issued by the exploration companies.
- (i) The main motivation for purchasing the flow-through shares of companies operating in the natural resource sector was the tax deduction. The second motivation was the opportunity to have a stake in a mineral discovery that could cause those securities to increase in value.
- (j) The motivation for purchasing the securities other than flow-through shares of companies operating in the natural resource sector was capital appreciation based on stock market speculation regarding "potential" mineral discoveries on their properties.

[8] The Appellant submits that the assessments are wrong in fact and in law for the following reasons set out in sub-subparagraphs 12(a)(i) through (ix) of the Notice of Appeal:

[TRANSLATION]

- (i) The nature of a gain or loss upon the disposition of a security is a question of fact.
- (ii) The fact that the Appellant was a broker does not mean that all his securities transactions give rise to business income or losses.
- (iii) The CRA was required to analyze the specific facts related to the purchase and sale of flow-through shares before determining whether they took place in the course of a business or were transactions of a capital nature.
- (iv) Indeed, whether the purchaser is a securities broker or not, the main purpose of transactions involving flow-through shares is usually not to sell the shares for a price higher than that paid for them.
- (v) The Appellant's objective upon acquiring the flow-through shares was, primarily, to take advantage of the tax benefit available under the ITA, not to resell them at a profit.
- (vi) Absent an intent to resell at a profit, the property acquired will normally be held as a capital asset and its disposition will be a transaction on capital account.
- (vii) In addition, the profit from the disposition of flow-through shares is a fictitious profit, because subsection 66.3(1) of the ITA deems the Appellant to have acquired them at a cost of nil.
- (viii) As Hugessen J.A. held in *Loewen v. The Queen*, 94 DTC 6265 (F.C.A.), fictitious profit cannot be treated as business income.
- (ix) Moreover, in *Petit v. The Queen*, 2005 DTC 932 (T.C.C.), Lamarre J. held that if the motivation for an investment is obtaining a tax benefit, not the possibility of reselling at a profit, the investment is capital in nature and is not inventory.

Analysis

[9] It may be helpful to point out that the deemed cost of a flow-through share is nil by virtue of subsection 66.3(3) of the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1, as amended ("the Act"), which reads as follows:

(3) Any flow-through share (within the meaning assigned by subsection 66(15)) of a corporation acquired by a person who was a party to the agreement pursuant to which it was issued shall be deemed to have been acquired by the person at a cost to the person of nil.

[10] The flow-through shares acquired and/or disposed of by the Appellant in the 2001, 2002 and 2003 taxation years are not subject to the election contemplated in subsection 39(4) of the Act, by virtue of the application of the definition of the term "Canadian security" in subsection 39(6) of the Act, which excludes prescribed securities. Under Part LXII of the *Income Tax Regulations*, which part is titled

"Prescribed Securities, Shares and Debt Obligations", flow-through shares are prescribed securities.

[11] Counsel for the Respondent gleaned from the case law factors which are to be considered in determining whether gains or losses are of an income or a capital nature. Those factors, stated summarily, are as follows:

- (a) The question whether gains or losses are of an income as opposed to a capital nature is one of fact, and the taxpayer's whole course of conduct must be examined.
- (b) One of the most important factors in categorizing property as a capital asset or as inventory is the taxpayer's primary intention at the time that the property was acquired. The taxpayer's secondary intention at that time is also important, and objective evidence concerning the taxpayer's conduct must indicate that the prospect of reselling the property was an "operating motivation" for its purchase.
- (c) The primary or secondary intention to resell the property at a profit is indicative of the property having been acquired as inventory whose resale would result in business income (or a business loss). The possibility of selling at a profit must have been a motivation for purchasing the property. Such motivation is to be inferred from the circumstances surrounding the transaction.

[12] Counsel for the Respondent also referred to Interpretation Bulletin IT-479R, pertaining to securities transactions. It states that, in addition to the intention existing at the time of purchase, other factors may be considered in order to determine whether a loss or gain of principal from the disposition of a security is on income or capital account. The factors that tend to show that the disposition of a security resulted in a business profit (or loss) are the following:

- (a) the frequency of [similar] transactions;
- (b) the period of ownership;
- (c) the taxpayer's knowledge of securities markets;
- (d) the taxpayer's ordinary business;
- (e) the time spent studying the securities markets and investigating potential purchases;
- (f) financing (on margin or some other form of debt);
- (g) advertising; and

- (h) in the case of shares, their nature (speculative, non-dividend or dividend).

Application of the criteria to the facts of this case

[13] The Appellant is an investment advisor who carried out a very large number of transactions on his own account during the period in issue. In the course of the years 2002 and 2003, more than 50% of the Appellant's personal transactions involved securities of companies operating in the natural resource sector. They involved shares in mining companies that were listed on a prescribed stock exchange in Canada. Thus, the investments were very risky and highly speculative. Earning dividends was not one of the Appellant's objectives.

[14] The flow-through shares in which the Appellant invested were shares of Freewest Resources Canada Inc., Majescor Resources Inc., Metco Resources Inc. and Pershimco Resources, while the other securities in which he invested were shares of Freewest Resources, Mines d'Or Virginia, Majescor Resources, Ashton Mining Canada, Patrician Diamonds, Teck Cominco, PrimeWest Energy and Tri Origin Resources. Thus, the Appellant purchased both flow-through and other shares of Freewest Resources Canada Inc. and Majescor Resources Inc.

[15] The Appellant's investments in shares other than flow-through shares were primarily motivated by the possibility of making a significant profit upon resale in the event that a new mineral deposit was discovered. With respect to the flow-through shares, the Appellant's primary intention at the time of purchase was to take advantage of the available tax benefit, and his secondary intention was to make a profit upon resale in the event that a new mineral deposit was discovered (see paragraph 7(i), *supra*).

[16] The Appellant held most of the flow-through shares for more than a year – which was longer, generally, than he held the non-flow-through shares he acquired. The explanation for this is a statutory requirement that flow-through shares acquired as a private investment be held for at least one year before they can be resold in the market. This rule was in effect until December 2002. As of January 2003, this mandatory holding period was reduced to four months. The flow-through shares of Freewest Resources Canada Inc. and Majescor Resources Inc. were acquired by the Appellant as private investments.

[17] The securities (flow-through shares and other shares) were financed mainly on margin or through some other type of debt, as reflected in the carrying charges and interest charges claimed by the Appellant for each of the years under appeal.

[18] As stated in subparagraph (n) in paragraph 4, *supra*, for each of taxation years 2001, 2002 and 2003, the Appellant reported significant business losses resulting from transactions in securities other than flow-through shares, and some of the losses claimed in 2001 and 2002 resulted from the disposition of shares of Majescor Resources Inc. and/or Freewest Resources Canada Inc. During the years in issue, the Appellant carried out five transactions involving flow-through shares, two of which resulted in a commercial profit, that is, the proceeds of disposition of the shares exceeded the initial acquisition cost. In most cases, there was a fictitious profit, that is, the proceeds of disposition exceeded the acquisition cost after the tax benefit was applied.

[19] In view of the circumstances set out above, it is clear that the primary motivation for the Appellant's purchasing the flow-through shares was the tax deduction associated with the ownership of such shares. However, as the Appellant himself admitted, there was a second operating motivation in his purchase the flow-through shares: the opportunity to have a stake in a mineral discovery that could cause those flow-through shares to increase in value.

[20] In the case at bar, contrary to the situation in *Paquet v. The Queen*, [1995] 2 C.T.C. 2941, the resale at a profit of the flow-through shares and of the other shares issued by the same corporations was an operating motivation in their purchase.

[21] If the Appellant had been interested in the flow-through shares only because of the tax deduction entitlements that they conferred, he would never have acquired securities other than flow-through shares of companies operating in the natural resource sector, some of which issued flow-through shares that the Appellant acquired.

[22] The decisions of the Federal Court of Appeal in *Loewen v. The Queen*, [1994] 3 F.C. 83, and *Moloney v. The Queen*, 92 DTC 6570, are not applicable to the instant case, because here the Appellant's sole motivation was not just to obtain a tax advantage, and because there was a real possibility here of the Appellant's realizing a profit in a commercial sense, as opposed to a fictitious profit equal to the tax benefit received. It might be useful to bear in mind that the resale price of the flow-through shares was not predetermined, like that of the debenture in *Loewen*, *supra*. In the instant case, the decision to sell the flow-through shares was entirely the Appellant's,

and the selling price of those shares was necessarily the market value of the issuing company's common shares and was therefore subject to market fluctuations and changes in metal prices.

[23] If Parliament had intended that the tax benefit associated with flow-through shares (the fictitious profit) be subject solely to capital gains treatment, it would have included a clear provision to that effect in the legislation. In this regard, it should be pointed out that, until 1981, the tax benefit associated with flow-through shares was treated as business income (see paragraph 66.3(1)(a) of the Act).

[24] For all these reasons, the appeals are dismissed, with costs.

Signed at Ottawa, Canada, this 14th day of November 2008.

"Réal Favreau"

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Favreau J.

Translation certified true  
on this 29th day of January 2009.

Erich Klein, Revisor

CITATION: 2008 TCC 547

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DATE OF JUDGMENT: November 14, 2008

APPEARANCES:

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    Counsel for the Respondent: Yanick Houle

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