Docket: 2004-3314(IT)G

BETWEEN:

VESNA SMITLENER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 22 and 23, 2007,
at Charlottetown, Prince Edward Island.

Before: The Honourable Justice Gaston Jorré

Appearances:

Counsel for the Appellant:	Christopher S. Montigny
Counsel for the Respondent:	Marcel Prevost

JUDGMENT

The appeal of Vesna Smitlener from the assessment made under the *Income Tax Act* (the "*ITA*"), notice of which is dated June 26, 2003 and bears number 34035, is allowed, with costs to the Respondent, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the following basis in accordance with the attached Reasons for Judgment:

> For the purposes of determining the amounts owed by the transferor, Zlatica Smitlener, within the meaning of subsection 160(1) of the *ITA*, in respect of the taxation year in which the property was transferred or any preceding year, the amounts owed shall be determined as if the transferor had been reassessed

for her 1996 and 1997 taxation years on the basis that the amount of water and tax expenses deductible were increased by $68,350.

Signed at Ottawa, Canada, this 22nd day of May 2009.

"Gaston Jorré"

Jorré J.

Citation: 2009 TCC 268
Date: 20090522
Docket: 2004-3314(IT)G

BETWEEN:

VESNA SMITLENER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Jorré J.

Introduction

[1] This is a trading case. The key issue is whether the sale of 498 units in four buildings in Fort McMurray, Alberta, was on capital account or on income account. I shall refer to the land and buildings as the River Park Glen property or as River Park Glen.

[2] There is a subsidiary issue with respect to expenses for water and taxes in the amount of $197,935 that were disallowed by the Minister.

[3] The Appellant was assessed pursuant to section 160 of the *Income Tax Act* (the "*ITA*") in respect of amounts owed by her mother, Zlatica Smitlener ("Ms. Smitlener"). The mother was reassessed[1] with respect to the gain on the sale of the River Park Glen units and the expenses mentioned above.

[4] The Appellant's appeal was limited to challenging the basis of the underlying assessment of her mother regarding the two issues described.[2]

---

1 With respect to the 1996 and 1997 taxation years.

2 The parties both proceeded on the basis that the River Park Glen property was entirely that of Zlatica Smitlener. I also note that the parties agreed that no issue arose as to my ability to deal with the underlying assessment of Zlatica

Facts

[5] Ms. Smitlener acquired the River Park Glen property by an agreement made on September 9, 1995.[3] The sale closed on September 11, 1995 and the purchase price was $12,450,000 consisting of:

a) $225,000 payable on or before closing;
b) $7,636,000 by assuming mortgages in favour of the Ontario Municipal Employees Retirement Board ("OMERS") and Northward Developments Ltd. ("Northward"); the Northward mortgage was a "dream mortgage" — half of it had no interest rate and half of it had a very low interest rate of 1% or 2%;[4]
c) $4,475,350 by assuming a vendor take-back mortgage with a 10% interest rate;
d) $113,650 by assuming certain liabilities.

[6] The property consisted of four buildings, for a total of 498 suites, as follows:

a) building No. 1: 112 townhouses with three bedrooms in each;
b) building No. 2: 96 suites, two thirds being three-bedroom and one third being two-bedroom apartments;
c) building No. 3: 149 suites, two thirds being two-bedroom and one third being one-bedroom apartments;
d) building No. 4: 141 suites, two thirds being two-bedroom and one third being one-bedroom apartments.

[7] At the time of the sale, the vendor was well advanced in the process of converting the River Park Glen property into four distinct condominiums.

[8] Clause 3.7(a) of the Offer to Purchase and Interim Agreement[5] provides that the vendor will ". . . proceed with all due diligence to complete, on behalf of the PURCHASER, registration . . ." of the condominiums. The registration of each of the

---

Smitlener. While Zlatica Smitlener appealed her assessments and a hearing of the matter began, the said appeal was withdrawn without this Court having made any decision on the merits. See transcript, pages 11 to 16.

3 Exhibit A-4. Ms. Smitlener purchased River Park Glen from the beneficial owners of the lands, the partners of the River Park Glen Joint Venture. She also purchased for $1 the shares of River Park Glen Ltd. who held the property as bare trustee for the Joint Venture. Trizen Equities Ltd. acted as the agent of the beneficial owners. Because none of this is material, I shall simply refer to the vendors or their agent, Trizen, as the vendor.

4 Transcript, page 31.

5 Exhibit A-4.

four buildings was done separately. Three registrations were done over the course of 1996 and one in 1997.[6]

[9] Ms. Smitlener paid over $100,000 in registration and surveying fees for the condominium plans.[7] As well, a further amount of $100,000 in fees for the condominium registration was paid to the City of Wood Buffalo.[8]

[10] The vendor take-back mortgage provided for a rapid schedule of principal repayments over a period of two years. Specifically, it provided for the following repayments:

a) $75,000 on December 1, 1995;
b) $225,000 on December 7, 1995;
c) $300,000 on March 1, 1996;
d) $300,000 on June 1, 1996;
e) the balance on or before September 1, 1997.

It also provided that there could be partial discharge of the mortgage on the sale of condominium units provided that a certain amount of repayment of the principal, calculated by formula, was made for each unit sold. The repayment per unit would have to be at least $10,800 plus outstanding interest not yet paid on the date of the partial discharge.[9] When individual units were sold, payments also had to be made to OMERS and Northward to obtain partial discharges from them.

[11] Clause 3.7(d) of the Agreement also provided that the $75,000 principal repayment on December 1, 1995 would be postponed until a condominium plan had been registered for the building with the townhouses, if that plan had not been registered as of that date.

[12] Similarly, the clause provided for the postponement of $100,000 of the payment due on March 1, 1996 for each of the other three buildings for which a condominium plan had not been registered on March 1. The postponement would be until such time as a plan was registered for the particular building.

[13] Finally, there was a provision that if the vendor failed to obtain registration of all four condominiums by April 1, 1996, then for each unit that had not been divided

---

6 Transcript, page 38.
7 Transcript, pages 68 and 69.
8 Transcript, pages 116 and 117.
9 Exhibit A-4, Schedule C.

into a separate condominium the principal remaining due would be reduced by $5,000 per unit.

[14] I note that the effect of this last provision, had no condominium plans been successfully registered, would have been to reduce the principal payable by $2,490,000. Put another way, the effect would have been to reduce the purchase price from $12,450,001 to $9,960,001, a 20% decrease in the price.

[15] The entire purchase price was financed. The purchaser not only took over the mortgages from OMERS and Northward and obtained the vendor take-back mortgage, but the purchaser obtained the funds for the $225,000 payment at closing from a loan made by Aaron Acceptance Corporation. Ms. Smitlener's mother's house was used as collateral for the Aaron Acceptance loan.

[16] With respect to the River Park Glen property, Ms. Smitlener testified:

> It seemed like an ideal property for our family. At that point, in '95 my daughter went through a divorce so she needed a job. We needed income. I was getting older. I was looking for some retirement security for myself.
>
> And I also at that time had two other children so this seemed like an ideal family business to run, to work at, to live off and have future security.
>
> . . .
>
> So the River Park Glen was purchased with intention of a long-term rental income and a future security for the four of us, three of my children and myself.[10]

[17] Exhibit A-5 reads, in part, as follows:

> TO: Mr. S. BUFTON
> FROM: Z. SMITLENER
>
> February 23, 2000
>
> Re: Ft. McMurray townhouses & apartments
>
> First objection is to you arbitrarily chang[ing] the classification from investment to business. This is objected on following grounds:
> - When I looked at the property it was clear that the owners were losing in ex[c]ess of $60,000 per month, without doing any repairs or renovations. The vacancy rate was 30% and there was no hope to generate more income thru increased rents. But, what I had gambled on was the capital appreciation thru upcoming announcem[en]ts about expansion in tar sands oil fields. I figured that if I can hang on long enough till expected influx of new workers poured into Ft. McMurray, I can realize a capital gain. Since this was a lot of units, it made sense to cut it into

[10] Transcript, pages 22 and 24.

> pieces as it would be easier to sell. The gamble was big, and had it not worked all my friends and family would have lost everything. "The business" portion of your assessment is further shot down by continued losses of operating the project, which you yourself gave a credit of $1,243,272.00, even though it is still higher. Everything I ever did was to pick up run down properties, fix them and hope for capital appreciation. . . .

[18] In direct examination Ms. Smitlener explained that the text of Exhibit A-5 provided the reason why she sold the property and not the reason why she bought it.

[19] At the time of purchase, the previous owners were having financial difficulties. They had some $225,000 in bills which they could not pay and needed to be paid immediately as well as other liabilities which they could not pay and which Ms. Smitlener assumed.[11] The previous owners were also losing in excess of $60,000 per month.[12]

[20] The previous owners had 150 vacant units, a 30% vacancy rate, at the time of the purchase by Ms. Smitlener. At that time the general vacancy rate in Fort McMurray was 10%.

[21] Ms. Smitlener said they planned to get to a positive cash flow by lowering the vacancy rate to 10%. She also said that they cut the staff down from 17 to 12 persons saving some $20,000 a month. The previous owners paid $150,000 a year in management fees while she was only paying the Appellant $30,000, saving $120,000 a year or $10,000 a month.

[22] Ms. Smitlener thought that with hard work they could bring the vacancy rate down to 10% and make a go of it. Her plan was to establish six to 12 months of positive cash flow and refinance.

[23] Although she tried to obtain refinancing and approached the Bank of Nova Scotia, People's Trust and a broker, she was unable to find someone who would do a first mortgage allowing her to pay off everyone.[13] Ms. Smitlener testified that she kept trying to find such financing right up to the final sale.

[24] Things did not work out as Ms. Smitlener expected. The 150 vacant units were not in good shape and, although they reduced vacancies, the improvement came too

---

11 Transcript, page 30.
12 Transcript, pages 81 and 82; Exhibit A-5.
13 Transcript, pages 33 and 34.

late. There were other unexpected expenses. The vendor started putting pressure on them when payments were missed.[14]

[25] As a result Ms. Smitlener retained a real estate agent and began selling townhouse units. However, she hoped to keep much of the property.

[26] The first sale of a unit was in March 1996,[15] six months after the purchase of River Park Glen.

[27] Subsequently, another 65 individual units were sold in 1996.[16]

[28] At the end of 1996, 16 months after the purchase, Property Team Inc. ("Property Team") made one offer for all remaining units in two tranches, the first with 196 units and a closing date of December 31, 1996 and the second with 237 units and a closing date of April 1, 1997.[17]

[29] Property Team would not buy only part of the property. Ms. Smitlener stated that she did not want to take their offer but that the vendor forced her to sell since the vendor insisted on being paid out.[18]

[30] Ms. Smitlener reported no rental income or loss in her 1996 return and reported a gross rental income of $3,891,560.76 and a net loss of $1,243,272.25 in her 1997 return.[19] The figures reported in 1997 appear to include both 1996 and 1997. However, if one takes account of two changes made by the Minister in assessing and not in dispute,[20] the loss for the two years — 19 months of operation — is reduced to $936,829.94.

[31] Prior to the River Park Glen property acquisition, in 1991 or 1992, Ms. Smitlener purchased the shares of Monashee Vineyards ("Monashee") because she wanted to purchase the 200 acres of land owned by the company in British Columbia. Shortly afterwards she sold the parcels of land that Monashee owned.

[32] Ms. Smitlener had the possibility of buying some apartments in Florida. At one point she put down a deposit of US$100,000. No transaction ever came about

---

14 Transcript, pages 34 and 35.
15 Transcript, page 70.
16 Exhibit A-3, page 7.
17 Transcript, first full question and answer, page 71; also generally, pages 70 and 71 and Exhibit A-3, page 7.
18 Transcript, pages 44 to 46.
19 Exhibits A-1 and A-2.
20 The disallowance of a $350,000 management fee and an increase of the interest expense to $43,557.69. See Exhibit A-3.

and she lost the deposit. The loss of the deposit was claimed as a business expense by Monashee.

[33] Subsequently to River Park Glen, Ms. Smitlener bought a 24-unit townhouse property at 100 Mile House. She intended that the units be sold and the transaction was reported on income account.

[34] With respect to the expenses in dispute, Ms. Smitlener's evidence was, in essence, that she kept all the bills and she believes she reported the expenses correctly.

[35] The Appellant testified that she moved to Fort McMurray once River Park Glen was purchased. Ms. Smitlener remained in the Okanagan.

[36] The Appellant looked after the day-to-day management of the building including renting the units, seeing to it that vacant units were fixed up and managing the staff. She had minimal involvement with the registration of the condominium plans or the sale of the units. Ms. Smitlener took care of all financial matters except some day-to-day bill paying. Ms. Smitlener was the one who had the idea of purchasing River Park Glen.

[37] The Appellant's understanding of the reason for the purchase of River Park Glen was that it was done to provide her with a long-term job. She had completed a master's degree in aeronautical science the year before but could not find a job.

[38] Mr. William Bufton, a Canada Revenue Agency employee, the auditor in this matter, testified as to his reasons for the assessment. Among other things he testified as to why he disallowed $197,935 of the claimed water and tax expenses. In the course of his testimony on this point, Exhibit R-1 was produced and it eventually became apparent that due to a computation error the amount disallowed should only have been $129,588 and not $197,935.

Analysis

The water and tax expense issue

[39] The Appellant's evidence on this point does not give me any reason to change the assessment. However, there is the computational error referred to in the preceding paragraph. That correction will be made to the assessment.

The trading issue

[40] The question here is whether Ms. Smitlener's sale of River Park Glen was the disposition of an investment or whether its acquisition and disposition was an adventure in the nature of trade.

[41] There have been numerous cases in this area. The parties referred me to *Happy Valley Farms Ltd. v. M.N.R.*[21] and the summary of the tests therein.

[42] In determining whether the property was acquired as an investment or not, one looks at a variety of factors including the taxpayer's intention, the taxpayer's whole course of conduct, the nature of the property, the property's ability to produce income, the length of ownership of the property, whether the taxpayer engaged in similar transactions and the circumstances surrounding the sale.

[43] There is also what is sometimes referred to as the "secondary intention" test. Someone may purchase a property with a dual intention that includes a secondary intention of selling it at a profit. To have a "secondary intention" it is not sufficient that a person could be induced to sell at a sufficiently high price; the possibility of selling it at a profit must have been an operating motivation at the time of acquisition.

[44] In looking at the taxpayer's intention one must consider not only the stated intention as expressed in testimony at trial, but one must consider the stated intention in the context of all the circumstances and the whole course of conduct.

[45] Ms. Smitlener's testimony was that she intended the purchase of River Glen Park to be a long-term investment.

[46] It is quite hard to see how this could have been the case when one looks at all the surrounding circumstances.

[47] The whole of the purchase was financed. At the time of acquisition the vendor was losing in excess of $60,000 per month. Ms. Smitlener said that they expected to be able to move to a positive cash flow by reducing the vacancy rate, by reducing the number of employees and by making major savings on management fees since the Appellant did the management at a much lower cost. Once they had a positive cash flow they would refinance.

[48] Even if the planned revenue enhancing measures and the cost reduction efforts were entirely successful it is hard to see how the planned measures could have produced a positive cash flow. Renting an extra 100 units to bring the vacancy rate

---

[21] [1986] 2 C.T.C. 259, 86 DTC 6421 (FCTD).

down to the area average of 10% would have brought in about $50,000 per month,[22] the cut in employees saved $20,000 per month and the savings on the management contract saved $10,000 per month.[23]

[49] While this would produce an improvement of $80,000 a month, it is also necessary to take into account the interest on the vendor take-back mortgage which, initially, exceeded $35,000 per month and, once the first two instalments of principal repayment were paid, would be about $35,000 per month.[24]

[50] Taking account the interest on the vendor take-back mortgage, the result is a net improvement of the order of $45,000 a month leaving a negative cash flow in excess of $15,000 a month without taking any account of the need to fund the scheduled payments of the principal of the take-back mortgage. This was entirely foreseeable.

[51] While Ms. Smitlener said that the vendor kept forcing them, it does not appear that the vendor was asking for anything other than payments in accordance with the vendor take-back mortgage. Again, this was quite foreseeable.

[52] It is also not clear how refinancing, had it occurred, would have solved these problems. There was no evidence that it was likely that if the property were refinanced combined monthly interest and principal payments would fall to an extent that would reduce monthly payments by over $15,000 so as to generate a positive cash flow. It is worth recalling that the Northward mortgage was a "dream mortgage" with very low interest rates.[25]

[53] Given that I found Ms. Smitlener to be an intelligent and astute person, I have no doubt that it would have been apparent to her that River Park Glen would have major and continuing negative cash flow problems.

[54] Looking at other factors, it is clear that the property was not held for long. The first sale was in March 1996, six months after the purchase. Given that no condominium plan was registered prior to 1996, the first sale was soon thereafter. The last sale was completed on April 1, 1997, 19 months after purchase, but the agreement for that sale was made no later than the end of 1996, 16 months after the purchase.

---

[22] Assuming an average $500 rent a month given that rents averaged between $300 and $600 per month.

[23] See paragraph 21 above.

[24] $4,475,350 - $75,000 - $225,000 = $4,175,350; $4,175,350 X 10% = $417,535; $417,535 ÷ 12 = $34,794.58 in interest per month.

[25] There might have been other costs as well, given that on the individual units sold, Ms. Smitlener was obliged to pay a penalty of $2,500 per unit. See transcript, page 41.

[55] The Agreement and the vendor take-back mortgage clearly contemplate registration of condominiums and the possibility of the sale of units. Indeed, the effective purchase price would have been $2,490,000 less if the vendor failed to successfully register condominium plans for all the buildings.

[56] Ms. Smitlener had previously bought 200 acres of land in British Columbia by purchasing Monashee's shares and shortly thereafter sold that land. When she looked at buying a property in Florida and lost a US$100,000 deposit, Monashee claimed the deposit as a business expense.[26]

[57] Looking at all these circumstances, I cannot accept the stated intention that River Park Glen was purchased as a long-term investment. Ms. Smitlener would have to have been aware of the difficulties that would arise and could only have expected to benefit from River Park Glen by selling it at a profit. River Park Glen was an adventure in the nature of trade.

[58] This is confined by Exhibit A-5. I am unable to accept Ms. Smitlener's evidence that Exhibit A-5 was an explanation of why she sold rather than an explanation of why she bought; the wording simply does not support such a reading.

[59] Indeed, in Exhibit A-5, Ms. Smitlener summarizes well the situation:

> . . . But, what I had gambled on was the capital appreciation thru upcoming announcem[en]ts about expansion in tar sands oil fields. I figured that if I can hang on long enough till expected influx of new workers poured into Ft. McMurray, I can realize a capital gain. Since this was a lot of units, it made sense to cut it into pieces as it would be easier to sell. The gamble was big, and had it not worked all my friends and family would have lost everything. . . .

Conclusion

[60] For these reasons, the appeal will be allowed only to correct the amount of the water and tax expenses. Accordingly, the assessment, notice of which is dated June 26, 2003 and bears number 34035, will be referred back to the Minister of National Revenue for reconsideration and reassessment on the following basis:

> For the purposes of determining the amounts owed by the transferor, Zlatica Smitlener, within the meaning of subsection 160(1) of the *ITA*, in respect of the taxation year in which the property was transferred or any preceding year,

---

[26] The 100 Mile House transaction is after River Park Glen and is of limited assistance in evaluating the character of the River Park Glen transaction.

the amounts owed shall be determined as if the transferor had been reassessed for her 1996 and 1997 taxation years on the basis that the amount of water and tax expenses deductible were increased by $68,350.

[61] The Respondent has been almost entirely successful and, accordingly, costs will be awarded to the Respondent.

Signed at Ottawa, Canada, this 22nd day of May 2009.

"Gaston Jorré"

Jorré J.

CITATION:	2009 TCC 268
COURT FILE NO.:	2004-3314(IT)G
STYLE OF CAUSE:	VESNA SMITLENER v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Charlottetown, Prince Edward Island
DATE OF HEARING:	November 22 and 23, 2007
REASONS FOR JUDGMENT BY:	The Honourable Justice Gaston Jorré
DATE OF JUDGMENT:	May 22, 2009

APPEARANCES:

Counsel for the Appellant:	Christopher S. Montigny
Counsel for the Respondent:	Marcel Prevost

COUNSEL OF RECORD:

For the Appellant:

Name:	Christopher S. Montigny
Firm:	Stewart McKelvey Stirling Scales Charlottetown, Prince Edward Island

For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada