Docket: 2010-2288(IT)I

BETWEEN:

GERALD HANSEN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on February 28, 2011 at Windsor, Ontario

By: The Honourable Justice Judith Woods

Appearances:

Counsel for the Appellant: John Mill

Counsel for the Respondent: Ryan Gellings

JUDGMENT

The appeal with respect to assessments made under the *Income Tax Act* for the 2006 and 2007 taxation years is allowed, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that automobile benefits should only be $2,000 for each taxation year. Each party shall bear their own costs.

Signed at Ottawa, Canada this 31st day of March 2011.

"J. M. Woods"

Woods J.

Citation: 2011 TCC 194
Date: 20110331
Docket: 2010-2288(IT)I

BETWEEN:

GERALD HANSEN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Woods J.

[1] Gerald Hansen appeals in respect of assessments made under the *Income Tax Act* for the 2006 and 2007 taxation years.

[2] The appeal relates to benefits allegedly conferred by a corporation related to the appellant, Oak Farms Ltd. ("Oak Farms"). There are two types of benefits that were identified in the notice of appeal.

[3] An issue concerning personal use of an automobile was resolved by the parties before the hearing. It is agreed that the benefit should only be $2,000 in each of the 2006 and 2007 taxation years. The formal judgment will reflect this agreement.

[4] The other issue relates to a series of expenditures made by Oak Farms for the benefit of the appellant. These amounts were recorded in a corporate account

identified as “Gerry’s drawings.”

[5] For purposes of the assessments, the Minister considered that the expenditures recorded in this account were interest-free loans from Oak Farms to the appellant. This gave rise to benefits assessed pursuant to section 80.4 of the *Act*. The amount included in income was derived from an interest rate prescribed for purposes of the relevant legislation.

[6] The relevant provision, subsection 80.4(2) of the *Act*, reads:

> **80.4(2)** Where a person (other than a corporation resident in Canada) or a partnership (other than a partnership each member of which is a corporation resident in Canada) was
>
> (*a*) a shareholder of a corporation,
>
> (*b*) connected with a shareholder of a corporation, or
>
> (*c*) a member of a partnership, or a beneficiary of a trust, that was a shareholder of a corporation,
>
> and by virtue of that shareholding that person or partnership received a loan from, or otherwise incurred a debt to, that corporation, any other corporation related thereto or a partnership of which that corporation or any corporation related thereto was a member, the person or partnership shall be deemed to have received a benefit in a taxation year equal to the amount, if any, by which
>
> (*d*) all interest on all such loans and debts computed at the prescribed rate on each such loan and debt for the period in the year during which it was outstanding
>
> exceeds
>
> (*e*) the amount of interest for the year paid on all such loans and debts not later than 30 days after the later of the end of the year and December 31, 1982.
>
> [Emphasis added]

[7] The balance owing in Gerry’s drawings’ account fluctuated from time to time as expenditures were made by Oak Farms or as the appellant made payments to Oak Farms. At the beginning of the assessment period, the opening balance was $146,009 owing by the appellant to Oak Farms.

[8] The amounts that were included in income as a result of s. 80.4 were $5,981

and $7,147, for the 2006 and 2007 taxation years respectively.

[9] The appellant submits that the benefits under subsection 80.4(2) were not properly calculated by the Minister because they failed to take into account an amount loaned by the appellant to Oak Farms in 2004 in the amount of $471,667.

[10] It is submitted that the expenditures recorded in "Gerry's drawings" account do not represent indebtedness from Oak Farms to the appellant because these amounts are more than offset by the loan made in 2004 from the appellant to Oak Farms.

[11] For the reasons below, the benefits assessed under s. 80.4 should be upheld in my view.

Discussion

[12] Oak Farms operates a greenhouse and retail flower shop in Leamington, Ontario. During the relevant period, it was managed by the appellant who took over the operation from his father.

[13] In 1994, the appellant borrowed $975,000 from the Bank of Montreal (the "Bank") in order to finance the purchase of the business from his father.

[14] In March 2004, at a time when $488,333 was the balance outstanding on the loan, it was replaced by new financing with the Bank totalling $960,000 (the "2004 loan").

[15] The 2004 loan involved two parts. The first part replaced the balance owing by the appellant on the 1994 loan ($488,333). The second part ($471,667) consisted of funds used entirely by Oak Farms. It was comprised of a fresh advance in the amount of $240,000 and the balance was used to repay existing debt of Oak Farms.

[16] The essential question is whether the appellant was indebted to Oak Farms in the two taxation years at issue.

[17] The appellant submits that he was not indebted to Oak Farms. He suggests that he advanced more money to Oak Farms than Oak Farms advanced to him, and accordingly that he was not indebted to Oak Farms.

[18] The first question is whether the appellant advanced any money to Oak Farms

at all.

[19] The appellant submits that he did advance money to Oak Farms when he borrowed $960,000 from the Bank in 2004 and re-lent $471,667 of this amount to Oak Farms.

[20] The problem with this submission is an evidentiary one. No loan documentation was introduced into evidence which clearly established that the Bank lent the appellant $960,000.

[21] The respondent submits that the Oak Farms' portion of the loan ($471,667) was lent directly by the Bank to Oak Farms. In other words, the respondent submits that the Bank lent funds to both the appellant and to Oak Farms in 2004. The appellant submits that he was the only borrower.

[22] Both parties introduced evidence in support of their position. None of the evidence is definitive and it is conflicting.

[23] In favour of the respondent's position is a letter from the Bank to the solicitors for Oak Farms that was sent in preparation for the closing of the loan transaction in March 2004. This letter suggests that there was more than one borrower. An excerpt of this letter dated February 24, 2004 (Ex. A-3) is reproduced below:

> Since the funds are to be advanced through your office, we require a Letter of Direction, duly signed, sealed/and appropriately witnessed as applicable, by the borrowers.

[24] This instruction was followed by a document signed by Oak Farms which directed to the Bank that a cheque be made in favour of Oak Farms' solicitors (Ex. R-4).

[25] Other evidence is supportive of the appellant's position. In particular, an accountant at Collins Barrow who was the appellant's tax adviser, Jeff Kelly, testified that someone at the Bank told him that the appellant was the only borrower. This was confirmed in writing to the accountants in a form prepared for this purpose (Ex. A-7).

[26] It was on the basis of this information that Collins Barrow prepared financial statements which reflected that the appellant borrowed $960,000 from the Bank and re-lent $471,667 to Oak Farms. The books and records also reflected that the loan

from the appellant to Oak Farms ($471,667) bore interest at the same rate as that charged by the Bank on the loan to the appellant. Oak Farms paid this interest to the Bank and deducted it for income tax purposes. (Oak Farms actually paid all principal and interest on the $960,000 loan but the appellant's portion was reflected in Gerry's drawings' account.)

[27] Mr. Kelly testified that he later tried to confirm with the Bank who the borrower was but the Bank did not cooperate in providing this information because the appellant no longer had a relationship with the Bank.

[28] Other documents were introduced into evidence, but the documents above illustrate that there is uncertainty as to whether there was one borrower or two.

[29] In light of the conflicting evidence, I have concluded that the appellant has not satisfied the burden of proof. It appears that the appellant has not kept the necessary documentation. In light of the conflicting evidence, steps should have been taken to have someone from the Bank testify to clear up the confusion. This was not done.

[30] Moreover, even if I were to accept that the appellant had lent $471,667 to Oak Farms, this would not be sufficient for the appellant to succeed in this appeal. It does not necessarily follow that the indebtedness represented by the account named "Gerry's drawings" is no longer outstanding. A set off of the two debts would be required in order to avoid the application of section 80.4.

[31] In this case, it is clear from the evidence that no set off was intended. The entire $471,667 remained outstanding as a liability of Oak Farms, subject to ordinary repayments of principal to the Bank. This is clear because Oak Farms paid interest on this indebtedness and deducted it for tax purposes. This leads to the inescapable conclusion that a set off of Gerry's drawings' account against this indebtedness was never intended. This is fatal to the appellant's case.

[32] In conclusion, the assessments will be upheld with respect to the account known as Gerry's drawings. The only relief that will be granted will be with respect to the agreement of the parties concerning automobile benefits.

[33] In light of the mixed success, each party shall bear their own costs.

Signed at Ottawa, Canada this 31st day of March 2011.

"J. M. Woods"

Woods J.

CITATION:	2011 TCC 194
COURT FILE NO.:	2010-2288(IT)I
STYLE OF CAUSE:	GERALD HANSEN and HER MAJESTY THE QUEEN
PLACE OF HEARING:	Windsor, Ontario
DATE OF HEARING:	February 28, 2011
REASONS FOR JUDGMENT BY:	The Honourable Justice J. M. Woods
DATE OF JUDGMENT:	March 31, 2011

APPEARANCES:

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Counsel for the Respondent:	Ryan Gellings

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