Docket: 2007-4061(IT)G

BETWEEN:

SRI HOMES INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on September 16 and 17, 2013, and May 15, 2014,
at Kelowna, British Columbia

Before: The Honourable Justice David E. Graham

Appearances:

Counsel for the Appellant:	Kenneth J. Ihas
Counsel for the Respondent:	Bruce Senkpiel

JUDGMENT

The Appeal is allowed, with costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant had an additional $411,830 in non-capital losses in its taxation year ending April 30, 2001.

Signed at Ottawa, Canada, this 5th day of June 2014.

"David E. Graham"

Graham J.

Citation: 2014 TCC 180
Date: 20140605
Docket: 2007-4061(IT)G

BETWEEN:

SRI HOMES INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Graham J.

[1] In the years in question, the Appellant was in the business of manufacturing and selling manufactured homes. In April 2001, in anticipation of the sale of the Appellant's shares to a third party named R&M Frontier Holdings Corporation ("R&M"), the Appellant disposed of a number of its assets to a related company. Two of those assets were shareholder loans in subsidiary companies. The Appellant claimed non-capital losses relating to the disposition of those shareholder loans in its taxation year ending April 30, 2001. The Appellant carried those losses back to its taxation year ending December 31, 2000. The Minister of National Revenue ultimately reassessed to deny the losses and the carrybacks. The Appellant applied for a loss determination. The Minister determined the Appellant's non-capital losses from its taxation year ending April 30, 2001 to be an amount that did not include the losses that the Appellant claimed arose from the disposition of the shareholder loans. The Appellant has appealed both the reassessment and the loss determination.

[2] The Appellant's Appeal was originally heard before a different judge who ruled in favour of the Respondent. On appeal, the Federal Court of Appeal ordered a new trial before a different judge.

Issues

[3] There are two issues in this Appeal. Since the Appellant and the company that purchased the loans were related, the disposition of the loans is deemed to have occurred at fair market value. The first issue in this Appeal is what the fair market value of the shareholder loans was on April 30, 2001. To the extent that the fair market value of the loans was less than their face value, the Appellant would have incurred losses. The second issue in this Appeal is whether any losses incurred were on income account or capital account.

Witnesses

[4] Robert Adria testified for the Appellant. Mr. Adria is a chartered accountant and businessman. He joined the Appellant in 1992 as its Chief Financial Officer. At the time of the transactions in question, he was the Appellant's Chief Operating Officer. Mr. Adria is currently a director of the Appellant[1]. Mr. Adria became an indirect shareholder of the Appellant in 2003 as part of a management buyout. He indirectly owns approximately 25% of the Appellant. Subject to the one point described in paragraph 15 below, I found Mr. Adria to be a credible witness.

[5] Brian Holterhus also testified for the Appellant. Like Mr. Adria, Mr. Holterhus is a chartered accountant and businessman and is currently a director of the Appellant. Mr. Holterhus worked as the Corporate Controller of the Appellant from 1993 to 1997. He was then hired to work for a subsidiary of R&M. At the time of the transactions, he was the president and Chief Executive Officer of that subsidiary and was a director of R&M. During his time at R&M, Mr. Holterhus gained extensive experience in residential and commercial real estate development. Mr. Holterhus was the lead negotiator at R&M for the purchase of the shares of the Appellant. He became a director of the Appellant immediately following the share purchase. He became a shareholder of the Appellant in 2003 following the management buyout. He owns approximately 25% of the Appellant directly or indirectly. Subject to the one point described in paragraph 15 below, I found Mr. Holterhus to be a credible witness.

[6] The Respondent did not call any witnesses.

Facts

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[1] The Appellant has since changed its name to Tessello Financial Corporation.

[7] In 2001, the Appellant was a wholly-owned subsidiary of NorTerra Inc. (“NorTerra”). NorTerra was a holding company for a number of different investments. The Appellant’s core business was building manufactured homes. The Appellant had 3 plants employing 400 to 500 employees. With a few exceptions that are not relevant for the purposes of the Appeal, the Appellant sold its homes exclusively to dealers who, in turn, sold them to consumers. The Appellant had approximately $60M in revenue from manufactured home sales in 2001. The Appellant also operated 5 manufactured home dealerships in various locations in British Columbia and Alberta and was involved in a number of manufactured home parks either as an owner or a part owner (the “Park Business”). Most of the manufactured home parks that made up the Park Business were owned directly by the Appellant but two of the parks were held through companies known as Valley Vista Seniors Park Inc. (“Valley”) and Lakeside Pines Development Inc. (“Lakeside”).

[8] The Appellant owned one-third of the shares of Valley. The company was formed in approximately 1992 by 3 shareholders: a landowner who wanted to develop its land; one of the Appellant’s dealers who wanted to sell manufactured homes; and the Appellant. Each party received one-third of the common shares of Valley for a total purchase price of $700 each. The shareholders agreed that the landowner would contribute the land, the dealer would provide financing and look after sales and the Appellant would provide both financing and overall management. The land was divided into 183 pads. The plan was to rent each of the pads to consumers and to require those consumers to purchase one of the Appellant’s manufactured homes from the dealer. The landowner contributed the land to Valley in exchange for preferred shares. The dealer made an initial shareholders loan of $100,000. The Appellant made an initial shareholders loan of $200,000.

[9] The Appellant owned 50% of the shares of Lakeside. Lakeside was formed in 1992 or 1993 by one of the Appellant’s dealers and the Appellant. Each party received half of the shares of Lakeside for a total purchase price of $1 each. Lakeside developed lots and sold them to people along with one of the Appellant’s manufactured homes. The dealer and the Appellant both made equal shareholder loans to Lakeside.

[10] In late 2000, NorTerra made a decision that it wanted to sell the Appellant. R&M had a manufactured home business that would have been very compatible with the Appellant’s business. NorTerra approached R&M to see if they were interested in buying the Appellant. NorTerra was insistent that any sale be

structured as a share sale. The initial offer price put forward by NorTerra was approximately $15M. Copies of the calculations by which NorTerra reached this initial offer price were entered into evidence[2].

[11] After receiving the initial offer from NorTerra, R&M began a due diligence process. Mr. Holterhus testified that as part of the due diligence process he prepared working papers by which he calculated R&M's view of the value of the assets of the Park Business including the shares and shareholder loans of Valley and Lakeside (collectively, the "Park Business Assets") and the assets of the Appellant's dealership business[3]. His calculations indicated that the value of the Park Business Assets was approximately $2.5M. As a result of that due diligence process, R&M ultimately decided that it was not interested in buying the Park Business Assets.

[12] NorTerra agreed to transfer the Park Business Assets from the Appellant to another subsidiary prior to the sale of the shares of the Appellant to R&M. The parties agreed that the purchase price for the Appellant's shares without the Park Business Assets would be $10M[4]. NorTerra and R&M signed a letter of intent to that effect.

[13] In accordance with the parties' agreement, NorTerra incorporated a wholly-owned subsidiary named 3556514 Canada Ltd. ("514"). On April 30, 2001, 514 purchased all of the Park Business Assets for $4,430,366.

[14] On May 1, 2001, NorTerra sold the shares of the Appellant to R&M. All proceeds of the sale of the Park Business Assets were removed from the Appellant by way of dividend prior to the share sale.

[15] There was evidence from both Mr. Holterhus and Mr. Adria that, sometime between the initial $15M offer and the ultimate $10M deal, there were preliminary negotiations that lowered the purchase price from $15M to approximately $14M. They testified that NorTerra and R&M agreed that the fair market value of the Park

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[2] Exhibit A-3, Tab 16.

[3] Exhibit A-3, Tabs 1 to 4, 6 to 11, 14, 15 and 17.

[4] There was an initial letter of intent whereby the parties agreed on a purchase price of $9.8M. Under the terms of that agreement the Appellant was to transfer to a related company, not just the Park Business Assets but also a manufactured home dealership in Prince George, British Columbia. R&M subsequently decided that it wanted the Prince George dealership so the agreement was amended and the purchase price increased to $10M. Nothing turns on this point.

Business Assets was $4,430,366. The concept that the witnesses were trying to convey was that the parties agreed that the fair market value of SRI with the Park Business Assets was approximately $14M and that once those assets (worth $4,430,366) were removed, the price dropped to $10M. No documentary evidence was entered to support any of these positions. The working papers that were entered into evidence do not support the idea that a valuation of $14M was ever calculated or agreed upon. On cross-examination, Mr. Holterhus was unable to adequately explain where the $14M figure had come from or why NorTerra would agree that the fair market value of the Park Business Assets was $4,430,366 when its internal valuation had placed their value at approximately $2.5M. I do not accept Mr. Adria's and Mr. Holterhus' testimony on these points. I find that the initial purchase price offered by NorTerra was $15M, that there was never any negotiation of a $14M price and that, while the $4,430,366 price for the Park Business Assets may have been agreed upon by NorTerra and R&M, it was not determined by hard bargaining between them.

Valuation of the Shareholder Loans

[16] At the time of the sale of the Park Business Assets, the Appellant's shareholder loan to Valley had grown to $1,316,946 including additional advances, unpaid interest, management fees and expense recoveries and the Appellant's shareholder loan to Lakeside had grown to $427,680 including unpaid interest, management fees and expense recoveries.

[17] Of the $4,430,366 purchase price for the Park Business Assets, $1,332,797 was allocated to the shareholder loans: $356,602 to the Lakeside loan and $976,195 to the Valley loan. The Minister did not challenge the allocation of the balance of the purchase price among the remaining Park Business Assets and did not take issue with how the disposition of those assets was reported.

[18] The $1,332,797 purchase price for the shareholder loans was $411,830 less than the book value of the loans: $71,078 less than the book value in the case of Lakeside and $340,751 less than the book value of the loan in the case of Valley. The $411,830 difference represents the total amount of losses in issue[5].

[19] The Appellant submits that the amounts that 514 paid for the loans represent fair market value. The Respondent presented no evidence regarding the fair market

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5 These figures can be found in Exhibit A-1, Tab 5 on Schedule "A".

values of the shareholder loans, choosing instead to rely on its assumption of fact that their fair market values were equal to their book values.

[20] In the working papers that Mr. Holterhus prepared as part of R&M's negotiations with NorTerra, he valued the shareholder loans to Valley at $960,000 and the shareholder loan to Lakeside at $237,500[6]. Mr. Holterhus was not qualified as an expert witness. However, he is a chartered accountant who, when he prepared his working paper valuation, had a strong familiarity both with SRI's business (having worked for the Appellant previously), real estate valuation techniques, the particulars of the real estate market in some of the areas where the Park Business Assets were located and the manufactured home business in general. He toured each of the sites that made up the Park Business Assets and asked extensive questions about their operations. The Appellant provided him with detailed and open information about the Park Business Assets. Most importantly, at the time Mr. Holterhus prepared his working paper analysis, R&M was in the midst of arm's length negotiations with NorTerra for the possible acquisition of the Park Business Assets meaning that Mr. Holterhus had a strong incentive to prepare an accurate valuation. Based on all of the foregoing, I find that Mr. Holterhus' calculations are good evidence of what an arm's length purchaser (i.e. R & M) would have been willing to pay for the Park Business Assets in April 2001.

[21] The value of the Valley loan that was ultimately used by the Appellant was $16,195 higher than that value determined by Mr. Holterhus'[7]. This difference resulted in fewer losses being available to the Appellant than would have been available had Mr. Holterhus' figure been used. Similarly, the valuation of the Lakeside loan that was ultimately used by the Appellant was $119,102 higher than Mr. Holterhus' value[8]. This difference also resulted in fewer losses being available to the Appellant than would have been available had Mr. Holterhus' figure been used. Since the use of these higher values hurt the Appellant's position, I do not consider these differences to undermine Mr. Holterhus' calculations.

[22] In addition to the above, there was a significant amount of evidence indicating that both Valley and Lakeside were in financial difficulties in April 2001. I find that that evidence supports Mr. Holterhus' conclusions on value.

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6 Exhibit A-3, Tabs 1, 2 (second page) and 4.
7 Compare Exhibit A-3, Tab 1 to Exhibit A-1, Tab 5, Schedule "A".
8 Compare Exhibit A-3, Tab 1 to Exhibit A-1, Tab 5, Schedule "A".

[23] Mr. Adria testified that, at the time of the sale, the Appellant's prospects of receiving full repayment of the Valley shareholder loan were not good. The sales of manufactured homes in the area around the Valley development were low as were the sales of homes in the development. Approximately one-third of the pads remained vacant and the pace with which homes were being sold suggested it would take another 10 years to fill the pads. Valley was not producing enough cashflow from its rental operations to cover the interest on the loans. Valley's total debt, including shareholder loans, preferred shares (which were effectively the same as debt due to an agreement among the shareholders) and bank debt, exceeded the value of its assets. Valley had tried to sell the property but had found it difficult to attract a buyer who was interested in a partially completed development. While Valley had had one offer at a good price in the previous year, the other terms of that offer were unacceptable[9]. In addition, the shareholder who had originally contributed the land to Valley was having health problems and his children, who were looking after his affairs, had begun making all communications through their lawyer.

[24] Valley continued to lose money after the asset sale but, in October 2002, an unsolicited buyer bought Valley's assets. All of the shareholder loans were repaid, the preferred shares were redeemed and there was additional cash remaining to be shared among the parties. 514 agreed to waive approximately $55,000 in accrued interest but received approximately $80,000 to $90,000 of dividends from the additional cash remaining. The net effect was thus that 514 came out ahead by between $25,000 and $35,000. Mr. Adria attributed the change in the value of the company to the presence of a uniquely motivated buyer, a change in provincial government, an improving regional economy and improved airline access to the community where the development was located. I accept that these factors would have affected the purchase price. Based on the foregoing, I am not prepared to take this subsequent sale into account when determining the fair market value of the loans in 2001.

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[9] The only evidence of this other offer was a note in Mr. Holterhus' working papers which stated "An offer of $4.8M was declined for the park this year because of unfavourable terms." (see Exhibit A-3, Tab 4). Mr. Holterhus was not working for the Appellant when the offer was received so he had no personal knowledge of it. Mr. Holterhus' only knowledge of the offer came from discussions with representatives of the Appellant in 2001. He could not recall any details of those discussions beyond the simple statement in his working papers. Mr. Adria testified that no offers had been received for the property. Mr. Adria gave this testimony prior to Mr. Holterhus locating the documents in Exhibit A-3. Based on that fact, I consider Mr. Adria's erroneous testimony to be due to the 14 years that have passed since the offer was made rather than an intention to mislead the Court.

[25] Mr. Adria testified that, at the time of the sale, the Appellant's prospects of receiving full repayment of the Lakeside shareholder loan were also not good. There had been no sales of lots in the previous 4 months and sales in the area in general were not doing well. The other shareholder was very pessimistic about the prospects of the development. The shareholder loans exceeded the value of Lakeside's assets. The other shareholder and the Appellant had agreed to waive the interest on their loans since January 2000[10]. I note, however, that the problems that Mr. Adria described for Lakeside do not appear to be as serious as those he described for Valley. There was no bank debt and the shareholders were getting along. I acknowledge that when Lakeside was ultimately sold to a third party about 3 years later, 514 received less for its loan than it had paid to purchase the loan from the Appellant but, due to the time period that elapsed between the two events, I have not taken this subsequent sale into account when determining the fair market value of the loans in 2001.

[26] The Respondent submitted that the value that Mr. Holterhus calculated for the shareholder loans was neither negotiated with nor agreed to by NorTerra. I acknowledge that fact. However, the value of the Valley loan calculated by Mr. Holterhus was the same as the value first proposed by NorTerra and the value of the Lakeside loan calculated by Mr. Holterhus was only $112,500 lower than the value first proposed by NorTerra. This means that, in the course of arm's length negotiations, the parties were only $112,500 apart on the value of two loans with a total face value of over $1.7M. I do not consider a variation of approximately 6% to be a material difference particularly because the result of that difference was that the Appellant claimed fewer losses than it might otherwise have claimed.

[27] The Respondent also submitted that there was a very significant difference between the $2.5M value that Mr. Holterhus placed on the Park Business Assets and the $4,430,366 purchase price that was ultimately used when 514 acquired those assets. I agree. However, the portion of the difference that can be attributed to the shareholder loans in question is only the $16,195 and $119,102 described at paragraph 21 above. The balance of the difference relates to the remaining assets. The Minister did not dispute the value allocated to those assets so I do not consider any difference in value on those assets to be relevant nor do I consider it to undermine the value otherwise determined by Mr. Holterhus.

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[10] This was acceptable to the Appellant as the shareholder loans had been made equally by the two shareholders. It would not have made sense to waive interest on the Valley loans because those loans were not made pro-rata to the shareholders' ownership interests.

[28] The Respondent highlighted the fact that in the asset sale agreement the Appellant referred to the difference between the face value of the loans and the sale price as an "Allowance for doubtful account"[11]. I acknowledge this fact but I attach no significance to the description. The simple fact is that the Appellant did not actually claim an allowance for doubtful accounts in either its own financial records or its tax return. The Appellant sold the loans and claimed the resulting loss. The issue is whether that sale occurred at fair market value. The manner in which the Appellant described the loss in the asset sale agreement is irrelevant.

[29] The Respondent also focused on the fact that the amount of the losses is very similar to the Appellant's proportionate share of the deficits of Valley and Lakeside[12]. The Respondent referred to this as the Appellant attempting to "expense the negative retained earnings" of Valley and Lakeside. Mr. Adria testified that the Appellant did no such thing. He also walked me through the Appellant's books and records and demonstrated that no such thing occurred. The Respondent did not call any witnesses on this point and offered little more than speculation to counter Mr. Adria's testimony. I have difficulty understanding from an accounting point of view how one could ever expense a deficit. At worst, the similarity of the numbers indicates that the Appellant used the deficits as a rough method of valuing the loans, not that the Appellant somehow expensed those deficits.

[30] In summary, while the evidence entered by the Appellant was by no means ideal, I find that the valuation that Mr. Holterhus prepared during the negotiations is sufficient evidence of value to demolish the assumption of fact made by the Minister. It is not necessary for me to conclude that Mr. Holterhus' figures are the correct fair market values nor that the figures used by the Appellant are. I do not need to reach an exact determination of the fair market value of the loans. It is sufficient for me to find that the fair market value of the loans was no higher than the amounts claimed by the Appellant. Based on all of the evidence, I make that finding and therefore conclude that $411,830 in losses were incurred by the Appellant on the disposition of the shareholder loans.

Capital Loss or Non-Capital Loss

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11 See Exhibit "A-1", Tab 5, Schedule "A".

12 The loss on the Valley loan was $340,751. The Appellant's one-third share of Valley's deficit on April 30, 2001 was $340,344 (see Exhibit R-2, Tab 18). The loss of the Lakeside loan was $71,078. The Appellant's 50% share of Lakeside's deficit on April 30, 2001 was $71,079. (see Exhibit R-2, Tab 18).

[31] Having determined that the Appellant incurred losses on its disposition of the shareholder loans, I must now determine whether those losses were capital losses or non-capital losses.

[32] Both parties referred me to paragraphs 15 to 17 of the Federal Court of Appeal decision in *Easton v. The Queen*, 97 DTC 5464.

> [15] As a general proposition, it is safe to conclude that an advance or outlay made by a shareholder to or on behalf of the corporation will be treated as a loan extended for the purpose of providing that corporation with working capital. In the event the loan is not repaid the loss is deemed to be of a capital nature for one of two reasons. Either the loan was given to generate a stream of income for the taxpayer, as is characteristic of an investment, or it was given to enable the corporation to carry on its business such that the shareholder would secure an enduring benefit in the form of dividends or an increase in share value. As the law presumes that shares are acquired for investment purposes it seems only too reasonable to presume that a loss arising from an advance or outlay made by a shareholder is also on capital account. …
>
> [16] There are two recognized exceptions to the general proposition that losses of the nature described above are on capital account. First, the taxpayer may be able to establish that the loan was made in the ordinary course of the taxpayer's business. The classic example is the taxpayer/shareholder who is in the business of lending money or granting guarantees. The exception, however, also extends to cases where the advance or outlay was made for income-producing purposes related to the taxpayer's own business and not that of the corporation in which he or she holds shares. For example, in *Berman & Co. v. Minister of National Revenue*, [1961] C.T.C. 237 (Can. Ex. Ct.) the corporate taxpayer made voluntary payments to the suppliers of its subsidiary for the purpose of protecting its own goodwill. The subsidiary had defaulted on its obligations and as the taxpayer had been doing business with the suppliers it wished to continue doing so in future. [*Berman* was cited with apparent approval in the Supreme Court decision in *Stewart & Morrison Ltd. v. Minister of National Revenue*, [1974] S.C.R. 477 (S.C.C.) at 479].
>
> [17] The second exception is found in *Freud*. Where a taxpayer holds shares in a corporation as a trading asset and not as an investment then any loss arising from an incidental outlay, including payment on a guarantee, will be on income account. This exception is applicable in the case of those who are held to be traders in shares. ...

[emphasis added]

[33] The Appellant seeks to rely on the first exception set out in *Easton*. The Appellant submits that it is saved by both aspects of this exception, namely that it advanced the shareholder loans in the course of its money lending business and that it advanced funds to Valley and Lakeside not for the purpose of advancing those companies' businesses but rather for the purpose of creating a market for its manufactured homes.

Did the Appellant Have a Money Lending Business?

[34] The Appellant had a finance division. This division provided a number of different types of financing:

(a) Trade Receivables: The Appellant provided financing in the form of trade receivables on individual purchases of manufactured homes by its dealers. The need for trade receivable financing usually arose when a dealer had purchased a home for sale to a specific customer but had not yet been paid by that customer. On any purchase, a dealer would have 10 days to pay before interest would begin accruing. The Appellant carried an average of $3M to $5M in trade receivables but, at certain times of year, the balance could be as high as $12M. The Appellant earned interest of approximately $300,000 per year from its trade receivables.

(b) Inventory Financing: The Appellant provided inventory financing to dealers in situations where the dealers were unable to obtain their own financing. The Appellant would take various forms of security from the dealer including general security agreements and personal guarantees.

(c) Working Capital / Start-up Financing: The Appellant provided working capital or start-up financing to some of its dealers. This financing differed from inventory financing in that it was directed at financing aspects of the dealer's operations other than its inventory.

(d) Consumer Financing: The Appellant did not actively seek to finance consumers. However, on rare occasions the Appellant found itself holding debts directly from consumers in situations where a dealer had defaulted on its obligations to the Appellant under one of the above types of financing and the Appellant was thus forced to seize the dealer's consumer debts.

[35] I accept that the above activities are evidence that the Appellant was carrying on a money lending business. The Appellant submits that the shareholder loans that it made to Valley and Lakeside were part of that business. The Respondent concedes that the Appellant was in the business of lending money but argues that the shareholder loans it made to Valley and Lakeside were not part of that business. I agree with the Respondent.

[36] The factors that make the Appellant's financing business a money lending business are simply not present with the shareholder loans. There was no evidence that the Appellant took any security for the loans and the interest received on the loans did not appear to be an important factor for the Appellant. In fact, in the case of the loan to Valley, the agreement among the shareholders of Valley provided that interest on the shareholder loans and dividends on the preferred shares were to be paid at the discretion of Valley's directors, that any payment of interest or dividends and that any repayment of loans or redemption of preferred shares was to occur pro-rata among the parties. A person in the money lending business would not put themselves in a position where their ability to receive interest or a repayment of capital was subject to the discretion of two other people.

Were the Shareholder Loans Made for a Purpose Relating to the Appellant's Business?

[37] Having concluded that the Appellant did not make the shareholder loans in the course of its money lending business, I must now consider whether the Appellant made those loans for income producing purposes relating to its own business and not for income producing purposes relating to the businesses of Valley or Lakeside. The Respondent submits that the Appellant made the loans in order to allow Valley and Lakeside to make money. The Appellant submits that the entire purpose of the loans was to allow the Appellant to make money from the sale of its manufactured homes. I accept the Appellant's position.

[38] The caselaw in this area was thoroughly canvassed by Justice Campbell in her decisions in *Valiant Cleaning Technology Inc. v. The Queen*, 2008 TCC 637 and *Excell Duct Cleaning Inc. v. The Queen*, 2005 TCC 776. In *Excell* Justice Campbell summarized the caselaw as follows at paragraph 7:

> In *Easton v. R.* (1997), 97 D.T.C. 5464 (Fed. C.A.), the Federal Court of Appeal stated the general proposition that an advance made by a shareholder to or on behalf of a corporation will be treated as a loan for the purpose of providing

> working capital to the corporation. Any resulting loss would therefore be capital in nature as either the loan was given to generate a stream of income or to secure an enduring benefit. However the Court in *Easton* recognized certain exceptions to this general proposition. One of these exceptions exists where the loan was made in the ordinary course of the business. This exception has been recognized as extending to cases where the loan was made for income producing purposes as it related to the taxpayer's own business (*R. v. Lavigueur* (1973), 73 D.T.C. 5538 (Fed. T.D.) and *Paco Corporation v. R.* (1980), 80 D.T.C. 6328 (Eng.) (Fed. T.D.)). Other examples of this exception are where the loan was made for the purpose of increasing the profitability of the taxpayer's own business (*Williams Gold Refining Co. of Canada v. R.*, 2000 D.T.C. 1829 (T.C.C. [General Procedure])) and where the loan was made for the purpose of protecting the existing goodwill of the taxpayer's business (*Berman & Co. v. Minister of National Revenue* (1961), 61 D.T.C. 1150 (Can. Ex. Ct.)).

[39] The parties took me through these cases. I found the facts in *Paco* to be quite similar to the Appellant’s case and found the decision to be very persuasive. In that case the taxpayer manufactured machinery and equipment used to make concrete blocks. The taxpayer had been successful in selling its products in North America and wanted to expand its sales into Europe. The only way to successfully sell the products was through a demonstration. The taxpayer was not interested in entering into the cement block manufacturing business but it needed a manufacturer in order to demonstrate its products. Since the product was not currently in use anywhere in Europe, the taxpayer decided to establish a demonstration plant. The taxpayer incorporated a company in France. The taxpayer took 60% of the shares and the remaining 40% were held by local businesspeople. The taxpayer intended to sell its shares in the company to the other shareholders once the plant was in operation but planned, as a condition of the sale, to maintain the right to bring potential customers to the plant. The taxpayer lent a significant amount of money to the company. The taxpayer was ultimately unsuccessful in selling its products in Europe and suffered a loss on its loans. The taxpayer claimed the loss as a non-capital loss but the Minister treated it as a capital loss. The Federal Court Trial Division held that the loss was a non-capital loss.

[40] In the case at bar, substantially all of the Appellant’s revenue came from selling its manufactured homes. The Appellant was involved in the Park Business for the purpose of selling its homes, not for the purpose of owning and operating a manufactured home park or speculating on the sale of manufactured home lots. The Appellant only entered into deals in respect of parks where the consumers who would be leasing pads or buying lots in the parks were required to purchase one of the Appellant’s manufactured homes as part of their purchase or lease. If the Appellant’s interest had been in leasing or selling land it would not have cared

whose manufactured homes were placed on the lots. The Appellant sold its homes to dealers who then sold them to the consumers who had leased a pad or purchased a lot. Thus, by becoming involved in the parks, the Appellant was able to ensure that its dealers had a market for its products and therefore that the Appellant would be able to sell more products to the dealers. In addition, by supporting dealers through these sales, the Appellant made it more likely that the dealers would be financially viable and thus that the dealers would continue to be available to make other sales of the Appellant's manufactured homes to other consumers. The Appellant's strategy was to sell its interest in a given park once the potential to place new homes in the park ended. It had no interest in earning long term rental income.

[41] The potential for the Appellant to earn revenue as a result of the Valley and Lakeside developments was significant. Mr. Adria testified that the average invoice for one of their manufactured homes is $50,000. There were 183 pads in the Valley development[13]. The Appellant's potential revenues from selling homes to its dealer for the Valley development were therefore approximately $9.15M. There were 134 lots in the Lakeside development[14]. The Appellant's potential revenues from selling homes to its dealer for the Lakeside development were therefore approximately $6.7M. Admittedly there was revenue that Valley and Lakeside would earn from the rental of the pads or sale of the lots, but there were also considerable expenses associated with developing the parks, preparing the pads and lots for lease or sale, actually leasing the pads or selling the lots and then operating the park.

[42] Counsel for the Respondent drew my attention to the fact that the Appellant's audited financial statements for its year ending December 31, 2000 describe the shareholder loans as "equity investments"[15] and that the Appellant had consistently referred to the loans it made to Valley and Lakeside as shareholder loans and had only begun calling them "receivables" in its Notice of Objection and Amended Notice of Appeal. This choice of terminology suggests that the Appellant viewed the loans as capital in nature. That said, I have given little weight to this point as, in my view, the nature and purpose of the loans is more important than what the Appellant called them.

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13 Exhibit A-3, Tab 4.

14 Exhibit A-3, Tab 2, page 2.

15 Exhibit A-1, Tab 2.

[43] Counsel for the Respondent also drew my attention to the decision of Justice Bowie in *Wescast Industries Inc. v. The Queen*, 2010 TCC 538. In my view, Justice Bowie's decision does nothing to alter the state of the law as described by Justice Campbell. *Wescast* can easily be distinguished from the Appellant's case. The taxpayer in *Wescast* established a subsidiary for the purpose of earning income in the subsidiary from the same business that the taxpayer itself carried on and then, on advice from its accountants and lawyers, appears to have engaged in retroactive tax planning designed to recharacterize the purpose of working capital advances that it had made to the subsidiary as being on income account. As set out above, Valley and Lakeside carried on completely different businesses from the Appellant's business and the Appellant's purpose for lending money to those companies never changed.

[44] Based on all of the foregoing, I find that the Appellant advanced the shareholder loans to Valley and Lakeside for the purpose of earning income from its manufactured home business and thus that the losses incurred on the ultimate disposition of those loans were non-capital losses.

Conclusion

[45] The Appeal is therefore allowed with costs and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant had an additional $411,830 in non-capital losses in its taxation year ending April 30, 2001.

Signed at Ottawa, Canada, this 5th day of June 2014.

"David E. Graham"

Graham J.

CITATION:	2014 TCC 180
COURT FILE NO.:	2007-4061(IT)G
STYLE OF CAUSE:	SRI HOMES INC. AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Kelowna, British Columbia
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REASONS FOR JUDGMENT BY:	The Honourable Justice David E. Graham
DATE OF JUDGMENT:	June 5, 2014

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