Federal Court of Appeal | Cour d'appel fédérale

CANADA

Date: 20090602

Docket: A-474-08

Citation: 2009 FCA 180

CORAM: **NOËL J.A.**
NADON J.A.
PELLETIER J.A.

BETWEEN:

ROBERT ALLAN SCRAGG

Appellant

and

ATTORNEY GENERAL OF CANADA

Respondent

Heard at Vancouver, British Columbia, on May 14, 2009.

Judgment delivered at Ottawa, Ontario, on June 2, 2009.

REASONS FOR JUDGMENT BY: NOËL J.A.

CONCURRED IN BY: NADON J.A.
PELLETIER J.A.

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REASONS FOR JUDGMENT

NOËL J.A.

[1] This is an appeal from the decision of Justice Bowie (the Tax Court Judge) of the Tax Court of Canada, dated August 8, 2008, wherein he dismissed the appeals from reassessments made under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the *ITA*), for Mr. Scragg's (the appellant's) 1999, 2000, and 2001 taxation years.

[2] The appeal as it pertains to years 1999 and 2000 is from the disallowance by the Minister of National Revenue (the Minister) of interest deductions on loans which, according to the appellant, were used for the purpose of earning income from a business. The appeal as it pertains to 2001 is consequential on the outcome of the appeal with respect to the two prior years.

[3] The appellant is a management consultant. He was engaged in a number of businesses over the years, many of them through corporations owned by him, or possibly in one case by a family trust.

[4] The record shows that in 1996, the appellant borrowed $150,000 from a business associate at the rate of 14% interest per annum, calculated annually. These are the funds which the appellant contends were put to an eligible use in 1999 and 2000.

[5] The interest deductions initially claimed were $33,774 and $70,167 for the 1999 and 2000 taxation year respectively. The appellant later reduced the amounts claimed to $22,401 and $66,190.

[6] In assessing the appellant the Minister did not dispute that the appellant borrowed the $150,000 or that interest was paid as claimed or that the loan was repaid in 2000. The Minister, however, took the position that the loan proceeds were not used for the purpose of earning income from a business or property and disallowed the deductions and the resulting non-capital loss carry-forward.

[7] The ensuing appeal to the Tax Court of Canada was dismissed. Relying on the decision of the Supreme Court in *Bronfman Trust v. The Queen*, [1987] 1.S.C.R. 32 at page 45, the Tax Court Judge held that the appellant had failed to trace the borrowed funds to an eligible use.

[8] The appellant takes issue with this decision. According to him, the evidence establishes that the funds were used to provide working capital for his corporations. In particular, the appellant points to the fact that at the relevant time, two of these corporations (Scragg Development Corporation and 286603 B.C. Ltd.) were in a deficit position and that this deficit remained greater than the amount of the loan to the date of the repayment. Since these were dividend paying corporations, the appellant argues that this is sufficient to show that the funds were put to an eligible use.

[9] This is essentially the same argument as that presented before the Tax Court Judge (Reasons, para. 8):

> … [The appellant] said a number of times in one way or another that his companies required the borrowed funds for their continued existence, and the he had borrowed the money at a very high rate of interest, and on other unfavourable terms, only in order to keep his businesses afloat. He also argued at some length that an examination of the yearend [sic] balances of his loan accounts in the various corporations, and demonstrated that he had injected the loan proceeds into these corporations, and that it remained there throughout the period that the loan was outstanding. His submission was that he needed to say no more than that to be entitled to deduct the interest that he paid out on the loan.

[10] The Tax Court Judge disposed of the argument as follows (Reasons, para. 9):

> All this evidence falls far short of discharging the onus that Chief Justice Dickson spoke of in *Bonfman Trust*. The only information concerning the appellant's shareholder loan

> accounts is the yearend [sic] balances shown on the balance sheets of the corporations. It is impossible to tell from these to what extent, if any, the appellant advanced the loan proceeds to any of these corporations. The increase of about $12,000.00 in the SDC loan account between 1996 and 1997 certainly does not corroborate Mr. Scragg's account of the $73,403.41 deposit as being a credit to his loan account in that company. Nor is there any useful evidence from which I could conclude that the borrowed funds, even if they were initially put to an eligible use, continued in the same use. It was quite apparent from Mr. Scragg's evidence that he simply did not know either how he applied the proceeds initially, or their use in later years, other than in the most general terms.

[11] I can see no error in this disposition. The appellant cannot by simply showing that his corporations had a deficit greater than the loaned amounts during the years when the deductions were claimed assume that his onus has been met. In order to discharge this onus, he had to show that the borrowed funds were actually used for an eligible purpose. The Tax Court Judge's finding that the appellant did not know the use to which the borrowed funds were put is dispositive of the appellant's appeal.

[12] The appellant compared his case to that of *Singleton v. Canada*, 2001 SCC 61, [2001] 2 S.C.R. 1046 in which a taxpayer who used borrowed funds to replace equity taken from his law firm to purchase a house was allowed the interest deduction on the borrowed funds. The comparison is not apt because in *Singleton*, the taxpayer was clearly able to trace the borrowed fund to an eligible use. The appellant's argument is that the only difference between his case and *Singleton* is that he did not bother with the formalities, that is, he did not withdraw his equity from his companies and replace it with borrowed money, but in substance his transaction achieves the same result. With respect, it does not. A taxpayer cannot deduct interest on borrowed money unless the

money is actually used to produce income. It is not enough to say that it could have been, as the appellant says here.

[13] I would dismiss the appeal with costs.

"Marc Noël"
J.A.

"I agree.
M. Nadon J.A."

"I agree.
J.D. Denis Pelletier J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-474-08
(APPEAL FROM A JUDGMENT OF THE HONOURABLE JUSTICE BOWIE OF THE TAX COURT OF CANADA DATED AUGUST 7, 2008, DOCKET NO. 2004-2257(IT)G.)	
STYLE OF CAUSE:	ROBERT SCRAGG and HER MAJESTY THE QUEEN
PLACE OF HEARING:	Vancouver, British Columbia
DATE OF HEARING:	May 14, 2009
REASONS FOR JUDGMENT BY:	Noël J.A.
CONCURRED IN BY:	Nadon J.A. Pelletier J.A.
DATED:	June 2, 2009

APPEARANCES:

Robert Scragg	ON HIS OWN BEHALF
Andrew Majawa Victor Caux	FOR THE RESPONDENT

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