Federal Court of Appeal | Cour d'appel fédérale

Date: 20221110

Dockets: A-151-21
A-152-21

Citation: 2022 FCA 195

CORAM: **STRATAS J.A.**
WEBB J.A.
RENNIE J.A.

Docket: A-151-21

BETWEEN:

JEREMY LEONARD

Appellant/
Respondent on cross-appeal

and

HIS MAJESTY THE KING

Respondent/
Appellant on cross-appeal

Docket: A-152-21

AND BETWEEN:

CAROL TENNEY

Appellant/
Respondent on cross-appeal

and

HIS MAJESTY THE KING

Respondent/
Appellant on cross-appeal

Heard by online video conference hosted by the Registry on October 11, 2022.

Judgment delivered at Ottawa, Ontario, on November 10, 2022.

REASONS FOR JUDGMENT BY:	WEBB J.A.
CONCURRED IN BY:	STRATAS J.A. RENNIE J.A.

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REASONS FOR JUDGMENT

WEBB J.A.

[1] These appeals, and the cross-appeals of the Crown, are from the judgment of the Tax Court of Canada (2021 TCC 33, *per* Sommerfeldt, J.) that allowed Mr. Leonard's claim of a loss in 2011 arising from certain transactions. The amount of the loss that was allowed was, however, less than the amount of the loss Mr. Leonard claimed in his 2011 tax return. Ms. Tenney is Mr. Leonard's spouse and the outcome of her appeal is entirely contingent on the outcome of his appeal, as her appeal only arises as a result of the changes to his income.

[2] In Mr. Leonard's appeal, he submits that the Tax Court Judge erred in determining that the loss was less than the amount he claimed in his tax return. In his submission, the only issue before the Tax Court was the characterization of the loss as either on income account or capital account.

[3] In the cross-appeals, the Crown submits that the Tax Court Judge erred in finding that the mortgage held by Mr. Leonard was a distinct asset from the debt it secured and that Mr. Leonard had disposed of a property that could give rise to the loss in issue.

[4] For the reasons that follow, I would allow the cross-appeals and dismiss the appeals.

I. Background

[5] As noted by the Tax Court Judge, Mr. Leonard has homes in Alberta and Hawaii and through his corporate entities he carries on business in Alberta, Hawaii, and Brazil. In 2004 or 2005, Mr. Leonard became acquainted with Mr. Anderson, who was a real estate developer. Over the next few years, Mr. Leonard loaned money to Mr. Anderson.

[6] Mr. Anderson acquired two adjacent lots (B-2 and B-3) in Kukio, Hawaii. Lot B-2 was vacant and there was a house on Lot B-3. City Bank (which later merged with Central Pacific Bank) held mortgages on these two lots. Only the transactions related to Lot B-2 are relevant in this appeal.

[7] As a result of the economic downturn in 2008, Mr. Anderson was in serious financial trouble. It was Mr. Leonard's understanding that Mr. Anderson had judgments against him in the total amount of approximately $40 million and that he was unable to repay all his debts.

[8] Mr. Anderson was also in default of the mortgage that the bank held in relation to Lot B-2. The bank had commenced foreclosure proceedings in relation to this mortgage.

[9] In 2009, Mr. Leonard acquired the debt owing by Mr. Anderson to the bank together with the mortgage on lot B-2. There is some dispute concerning the amount paid for the debt and the mortgage. However, there is no dispute that the amount paid was at least $1.3 million. For the

purposes of this appeal, is not necessary to determine the amount that was actually paid to the bank for the debt and the related mortgage.

[10] The foreclosure proceedings that had been commenced by the bank had to be completed before Mr. Leonard could sell his interest in Lot B-2. Approximately two years after Mr. Leonard acquired the debt and the mortgage, the judicial sale arising from the foreclosure proceedings occurred. At the auction Mr. Leonard was the only bidder. His bid was $500,000. Following the completion of the foreclosure proceeding, Mr. Leonard obtained a deficiency judgment in the amount of $1,472,006 against Mr. Anderson. No amount has been paid by Mr. Anderson in relation to this deficiency judgment.

[11] In filing his tax return for 2011, Mr. Leonard claimed a bad debt expense in the amount of the deficiency judgment ($1,472,006). By claiming this deduction, he realized a non-capital loss which he carried forward to his 2012, 2013 and 2014 tax returns. He was reassessed to deny the claim for a bad debt expense on the basis that the debt had not previously been included in computing his income. The non-capital loss which reflected this claim for a bad debt was therefore denied. Ms. Tenney was also reassessed solely on the basis of the changes to Mr. Leonard's income arising from the denial of his claim for the non-capital loss.

[12] In his notice of objection, Mr. Leonard stated:

> The taxpayer submits the following position with respect to the re-assessment:
>
> 1. Mr. Leonard is carrying on a business of acquiring mortgages and lending money. When the property was sold, he did not receive his full value of the mortgage he purchased from the

> bank. As a result, the taxpayer submits that he should be entitled to a loss on the mortgage in the adventure in the nature of trade.
>
> The classification of the $1,472,006 does not constitute a bad debt expense as contemplated under 20(1)(p) of the Income Tax Act. …

[13] Mr. Leonard acknowledged that he was not entitled to claim the bad debt expense he claimed in his tax return. Since this claim was not valid, he sought to justify the deduction on the basis he was carrying on a business of acquiring mortgages and lending money as an adventure in the nature of trade. He claimed the loss was incurred because "he did not receive his full value of the mortgage he purchased from the bank…[w]hen the property was sold". In describing the sale of the property, he stated the property was sold for net proceeds of $472,746.74. He did not identify himself as the "purchaser" of the property nor did he disclose the deficiency judgment against Mr. Anderson in the amount of $1,472,006 (the amount he claimed as a bad debt). It is not entirely clear from his notice of objection how carrying on an adventure or concern in the nature of trade would result in the loss as claimed.

[14] The Canada Revenue Agency (CRA) confirmed the reassessment. In the notice of confirmation, the CRA appears to have interpreted Mr. Leonard's argument as being a claim for a bad debt under subparagraph 20(1)(*p*)(ii) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "Act") on the basis that he was carrying on a money lending business. The CRA described Mr. Leonard's grounds for his objection as follows:

The basis of your objections for the above tax years is as follows:

(a) You admitted that "The classification of the $1,472,006 does not constitute a bad debt expense as contemplated under 20(1)(p) of the *Income Tax Act*."

(b) You claimed that you were carrying on a business of acquiring mortgages and lending money. As a result, you should be entitled to a loss ($1,472,006) on the mortgage and the loss should be on account of income as the transaction was an adventure in the nature of trade. You requested to reinstate your 2011 net business loss to $1,278,252.

(c) Even though your claim of bad debt was denied under 20(1)(p)(i) of the *Income Tax Act* (the "Act"), you claimed that the loss of $1,472,006 was deductible against your business income under 20(1)(p)(ii) of the Act because you were in a money lending business for the years in question. Therefore, your request of reinstating your 2011 net business loss should be allowed.

[15] The CRA, in the first sentence quoted above, includes the admission by Mr. Leonard in his notice of objection that he was not entitled to claim a bad debt expense under paragraph 20(1)(*p*) of the Act. However, this reference to paragraph 20(1)(*p*) of the Act in the notice of objection and the notice of confirmation should presumably have been a reference to subparagraph 20(1)(*p*)(i) of the Act, as it appears that Mr. Leonard was submitting to CRA that he was entitled to a deduction under subparagraph 20(1)(*p*)(ii) of the Act, and he also includes a reference to subparagraph 20(1)(*p*)(ii) of the Act in his notice of appeal to the Tax Court.

[16] In making his opening statement at the hearing before the Tax Court, Mr. Leonard abandoned his argument that the loss was realized in the course of a business of acquiring mortgages and lending money (and hence abandoned his argument that he was entitled to claim a

bad debt expense under paragraph 20(1)(*p*)(ii) of the Act) and stated he was restricting his argument to whether he was carrying on an adventure or concern in the nature of trade.

II. Decision of the Tax Court

[17] The Tax Court Judge described the fundamental issues in respect of the appeals as follows in paragraph 5 of his reasons:

> (a) If there was a loss, was it a capital loss or a loss incurred in respect of an adventure in the nature of trade (i.e., a non-capital loss)?
>
> (b) Was there a loss, and, if so, did Mr. Leonard realize the Loss in 2011, and what was the amount of the Loss?

[18] The Tax Court Judge found that Mr. Leonard was carrying on an adventure or concern in the nature of trade and there was a loss as a result of the disposition of the mortgage by Mr. Leonard. According to the Tax Court Judge, 99.9% of the amount paid by Mr. Leonard to acquire the mortgage and the related debt should be allocated to the mortgage. As a result, only 0.1% of the amount paid should be allocated to the Note and the Debt.

III. Issues and Standards of Review

[19] Mr. Leonard's notice of appeal and memorandum focus entirely on the question of whether, based on the pleadings filed with the Tax Court, the Tax Court Judge could reduce the amount Mr. Leonard had claimed as a loss. In Mr. Leonard's submission, the only issue before the Tax Court was the characterization of the loss – was the loss on income or capital account?

[20] In this appeal, the first issue for consideration is: what issues were before the Tax Court? In particular, was the only issue before the Tax Court the characterization of the loss as an income loss or a capital loss or was the issue of whether there was a loss at all one of the issues to be determined by the Tax Court Judge? If the issue of whether there was a loss was properly before the Tax Court, the next issue is whether the Tax Court Judge erred in finding that Mr. Leonard incurred a loss as a result of the disposition of the mortgage.

[21] If no loss was incurred, the question of whether Mr. Leonard was carrying on an adventure or concern in the nature of trade is not relevant. The question of whether a particular loss is on account of income or capital will only arise once that loss is incurred.

[22] Questions of law will be reviewed on the standard of correctness and questions of fact or mixed fact and law will be reviewed on the standard of palpable and overriding error (*Housen v. Nikolaisen*, 2002 SCC 33).

IV. Analysis

A. *What Issues Were Before the Tax Court?*

[23] In his argument that the only issue before the Tax Court was whether the loss was on income or capital account, Mr. Leonard focused on the admission of the Crown, in its reply filed in the Tax Court, that the loss was $1,472,006. In Mr. Leonard's submission, this only left the

characterization of this loss as an income loss or a capital loss for determination by the Tax Court.

[24] However, it is necessary to review the background leading up to the appeal to the Tax Court to understand the context in which the notice of appeal and the reply were drafted. As well, the reply must be read in its entirety.

[25] The starting point is Mr. Leonard's tax return for 2011. In this tax return, he claimed a deduction in the amount of $1,472,006 (which was the amount of the deficiency judgment referred to above) as a bad debt. Paragraph 20(1)(*p*) of the Act provides a deduction for bad debts:

20 (1) Notwithstanding paragraphs 18(1)(*a*), 18(1)(*b*) and 18(1)(*h*), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto:	**20 (1)** Malgré les alinéas 18(1)*a*), *b*) et *h*), sont déductibles dans le calcul du revenu tiré par un contribuable d'une entreprise ou d'un bien pour une année d'imposition celles des sommes suivantes qui se rapportent entièrement à cette source de revenus ou la partie des sommes suivantes qu'il est raisonnable de considérer comme s'y rapportant :
…	[…]
(*p*) the total of	*p*) le total des montants suivants :
(i) all debts owing to the taxpayer that are established by the taxpayer to have become bad debts in the year and that have been included in computing the taxpayer's income for the year or a preceding taxation year, and	(i) les créances du contribuable qu'il a établies comme étant devenues irrécouvrables au cours de l'année et qui sont incluses dans le calcul de son revenu pour l'année ou pour une année d'imposition antérieure,

(ii) all amounts each of which is that part of the amortized cost to the taxpayer at the end of the year of a loan or lending asset (other than a mark-to-market property, as defined in subsection 142.2(1)) that is established in the year by the taxpayer to have become uncollectible and that,	(ii) les montants représentant chacun la partie du coût amorti, pour le contribuable à la fin de l'année, d'un prêt ou d'un titre de crédit (sauf un bien évalué à la valeur du marché, au sens du paragraphe 142.2(1)) que le contribuable a établie, au cours de l'année, comme étant devenue irrécouvrable, lequel prêt ou titre, selon le cas :
(A) where the taxpayer is an insurer or a taxpayer whose ordinary business includes the lending of money, was made or acquired in the ordinary course of the taxpayer's business of insurance or the lending of money, or	(A) si le contribuable est un assureur ou si son activité d'entreprise habituelle consiste en tout ou en partie à prêter de l'argent, a été consenti ou acquis dans le cours normal des activités de son entreprise d'assurance ou de prêt d'argent,
(B) where the taxpayer is a financial institution (as defined in subsection 142.2(1)) in the year, is a specified debt obligation (as defined in that subsection) of the taxpayer;	(B) si le contribuable est une institution financière au sens du paragraphe 142.2(1) au cours de l'année, compte parmi ses titres de créance déterminés au sens de ce paragraphe;

[26] Paragraph 20(1)(*p*) provides a deduction in computing income from a business or property. The deduction is predicated on the debt still being held by the taxpayer but being bad (subparagraph (i)) or uncollectible (subparagraph (ii)).

[27] Mr. Leonard's claim in his tax return that he was entitled to a bad debt expense was based on subparagraph 20(1)(*p*)(i) of the Act. In filing his notice of objection, he changed his argument to one based on subparagraph 20(1)(*p*)(ii) of the Act.

[28] In his brief notice of appeal to the Tax Court, Mr. Leonard defines the "Transaction" as the purchase of the "Promissory Note" for $1,487,551 and defines the "Promissory Note" as the promissory note in the principal amount of $1,500,000 that Mr. Leonard purchased from Central Pacific Bank.

[29] In his notice of appeal, Mr. Leonard states:

> 8. As a result of the Transaction, [Mr. Leonard] incurred a total loss of $1,472,006 (the "Loss").
>
> 9. [Mr. Leonard] reported the Loss as a bad debt expense, along with an associated net business loss. …

[30] The only provisions of the Act cited by Mr. Leonard, in his notice of appeal to the Tax Court, were subparagraph 20(1)(*p*)(ii) (bad debt expense), paragraph 111(1)(*a*) (applying non-capital losses to other taxation years), and subsection 248(1) (definitions). Of these, only subparagraph 20(1)(*p*)(ii) (bad debt expense) could result in a loss.

[31] In his opening statement at the Tax Court hearing, Mr. Leonard abandoned his claim that he was carrying on a money lending business and his claim that he was entitled to a deduction for a bad debt expense. As a result, it is far from clear (based on his notice of appeal) on what basis he was claiming that a loss was incurred. Mr. Leonard defined "Transaction" as the purchase of the Promissory Note. A purchase of a property, in and of itself, does not give rise to a loss. Any loss in relation to the property would only arise when there is a disposition or a deemed disposition of the property.

[32] The only references to carrying on an adventure or concern in the nature of trade appear in the section of Mr. Leonard's notice of appeal related to the reasons upon which he would be relying. In this section, the argument that he was carrying on an adventure or concern in the nature of trade is proposed as an alternate argument with no explanation of how carrying on an adventure or concern in the nature of trade would result in the loss he was claiming:

> **F. REASONS UPON WHICH THE APPELLANT INTENDS TO RELY**
>
> 12. [Mr. Leonard] carries on the business of acquiring mortgages and lending money. In the alternative, [Mr. Leonard's] activities in acquiring mortgages and lending money constitutes an adventure in the nature of trade.
>
> 13. The Transaction was effected in the course of [Mr. Leonard's] business or constituted an adventure in the nature of trade.
>
> 14. The Loss was accordingly on account of income. Additionally, the Loss was deductible against [Mr. Leonard's] business income.

[33] Once Mr. Leonard dropped his argument that the loss in issue arose in the course of a business of lending money and he was entitled to claim a bad debt expense under paragraph 20(1)(*p*)(ii) of the Act, nothing remained in his notice of appeal to support any finding that he had incurred a loss in 2011. Simply stating that he was carrying on an adventure in the nature of trade does not provide any indication of how the loss he was claiming was incurred.

[34] Bowie, J. in the case of *Zelinski v. R.*, 2002 D.T.C. 1204, [2002] 1 C.T.C. 2422 (T.C.C.), affirmed by the Federal Court of Appeal, 2002 D.T.C. 7395, [2003] 1 C.T.C. 53, set out the purpose of pleadings:

> 4 The purpose of pleadings is to define the issues in dispute between the parties for the purposes of production, discovery and trial. What is required of a party pleading is to set forth a concise statement of the material facts upon which she relies. Material facts are those facts which, if established at the trial, will tend to show that the party pleading is entitled to the relief sought. Amendments to pleadings should generally be permitted, so long as that can be done without causing prejudice to the opposing party that cannot be compensated by an award of costs or other terms, as the purpose of the Rules is to ensure, so far as possible, a fair trial of the real issues in dispute between the parties.
>
> 5 The applicable principle is stated in *Holmsted and Watson*:
>
> > This is *the* rule of pleading: all of the other pleading rules are essentially corollaries or qualifications to this basic rule that the pleader must state the material facts relied upon for his or her claim or defence. The rule involves four separate elements: (1) every pleading must state facts, not mere conclusions of law; (2) it must state material facts and not include facts which are immaterial; (3) it must state facts and not the evidence by which they are to be proved; (4) it must state facts concisely in a summary form.
>
> [emphasis in original]

[35] Mr. Leonard failed to plead any facts which would support a claim for a loss that was incurred in the course of carrying on an adventure or concern in the nature of trade.

[36] As noted above, at the commencement of the Tax Court hearing, Mr. Leonard abandoned his argument that he was entitled to claim a bad debt expense. By doing so, he was admitting that the bases on which he had

- claimed a bad debt expense (and resulting loss) in his 2011 tax return,
- filed his notice of objection, and

- filed his notice of appeal to the Tax Court

were not valid. Mr. Leonard cannot now complain that the Tax Court Judge considered whether, in light of Mr. Leonard's abandonment of his bad debt expense argument, there was any basis upon which the loss could be claimed.

[37] Mr. Leonard did not address the shortcomings in his notice of appeal nor did he address his abandonment, at the Tax Court hearing, of his argument that he was entitled to a bad debt expense. Instead, Mr. Leonard chose to argue that, based on the reply filed by the Crown, the only issue before the Tax Court was the characterization of the loss.

[38] In paragraph A1 of the reply filed by the Crown, the Crown admits the facts as stated in various paragraphs of Mr. Leonard's notice of appeal, including paragraph 8 thereof:

> 8. As a result of the Transaction, [Mr. Leonard] incurred a total loss of $1,472,006 (the "Loss").

[39] Mr. Leonard also submitted that the assumptions of fact made by the Minister do not include any assumptions indicating that the Crown was disputing whether the loss had been incurred.

[40] Furthermore, Mr. Leonard submitted that the CRA, in its notice of confirmation, also agreed the loss in question had been incurred and the only issue was whether the loss was on income or capital account.

[41] I do not agree that the notice of confirmation or the reply are restricted to only the issue of whether the loss was on income or capital account.

[42] There are a number of issues addressed in the 16-page notice of confirmation. In particular, one issue addressed at pages 14 and 15 was whether "the possession of the secured real property [was] a separate transaction apart from the acquisition of the Note and Mortgage, or was a part of one overall investment plan or transaction?" In answering this question, the CRA noted at page 15:

> Therefore, it is the opinion of Appeals that the secured real property, and any actions revolved around it, was part of one overall investment plan or transaction.
>
> Since currently you are still holding the title of the real property, the overall investment plan or transaction has not been considered complete, and therefore no gain or loss would be realized until the time when you have sold the real property.

[43] This illustrates that the notice of confirmation is not restricted to the single issue of whether the loss, as claimed, was on account of income or capital, but rather the question of whether any loss had been incurred in 2011 was raised.

[44] In the reply filed with the Tax Court, the first issue identified in paragraph 13 is whether "[t]he Minister properly determined that **if** [Mr. Leonard] incurred a loss from the promissory note, it was on account of capital and not income" (emphasis added).

[45] The Crown also submitted, in the section of its reply entitled "Grounds Relied on and Relief Sought", that Mr. Leonard "has not substantiated that he incurred a loss in respect of the

promissory note and mortgage" (paragraph 17) and "[i]f [Mr. Leonard] incurred a loss, **which the respondent does not admit but denies**, it is on account of capital and not income" (paragraph 18, emphasis added).

[46] As a result, I do not agree with Mr. Leonard that the sole issue raised by the CRA or by the Crown was the characterization of the loss in issue as an income loss or a capital loss. Furthermore, there is no indication that Mr. Leonard objected at the Tax Court hearing to the arguments or submissions with respect to whether a loss was incurred.

[47] Therefore, the Tax Court Judge correctly identified that whether a loss was incurred was an issue for him to decide.

B. *The Tax Court Judge Erred in Finding a Loss on the Mortgage*

[48] Although the Tax Court Judge began his analysis with whether Mr. Leonard was carrying on an adventure or concern in the nature of trade, in my view, the correct approach would have been first to determine whether any loss at all was realized by Mr. Leonard. If no loss was incurred, it would be irrelevant whether Mr. Leonard was carrying on an adventure or concern in the nature of trade.

[49] The loss identified by the Tax Court Judge in this case was a loss arising from the disposition of the mortgage. The Tax Court Judge noted that "disposition", as defined in subsection 248(1) of the Act, includes any transaction or event by which a mortgage is in whole

or in part redeemed, acquired or cancelled. He found that the mortgage was cancelled and, as a result, there was a disposition of the mortgage. He then proceeded to determine the cost of the mortgage. In his view, the purchase price of the mortgage, the note and the debt, was $1.3 million and 99.9% or $1,298,700 should be allocated to the mortgage as a separate property.

[50] In my view, the Tax Court Judge erred in treating the mortgage as a separate property for the purposes of the Act and in allocating to the mortgage 99.9% of the amount paid by Mr. Leonard to the bank.

[51] In his reasons, the Tax Court Judge referred to three properties – the mortgage, the note and the debt. Although he referred to the note and the debt as two different properties, there was nothing to indicate that Mr. Anderson owed $1.5 million to the bank as a debt and a further $1.5 million on the promissory note. The promissory note simply reflected his debt of $1.5 million.

[52] With respect to the separation of the mortgage from the debt, the Supreme Court of Canada in *Royal Trust Co. v. New Brunswick (Secretary Treasurer)*, [1925] S.C.R. 94, at page 96, confirmed that a mortgage cannot effectively be separated from the debt it secures:

> The asset in each case, from the economic or business point of view, is, of course, the security in its entirety; the personal obligation to pay money, plus the charge upon the mortgaged property by which the payment is guaranteed. But from the legal point of view, the personal obligation is for many purposes regarded as distinct from the charge, although the relation between them is such that the mortgagee cannot effectively transfer the personal debt while retaining ownership of the charge, or enforce payment of the debt without releasing the mortgaged property, or, by appropriate proceedings, converting it into money applicable in reduction of the debt. …

[53] I would add that the converse is also true – the mortgagee cannot effectively transfer the charge on the property but retain the debt.

[54] In *Bank of Montreal v. Orr* (1986), 4 B.C.L.R. (2d) 1, the British Columbia Court of Appeal noted that a debt is a vital part of a mortgage:

> 25 A mortgage consists of two things: (a) a contract on the part of the mortgagor for the payment of a debt to the mortgagee; and (b) a disposition (in the case of an equitable mortgage a mere delivery or pledge) of an estate or interest of the mortgagor to the mortgagee as security for the repayment of the debt. Every mortgage implies a debt (quantified or ascertainable) and an obligation on the part of the mortgagor to pay it. A repayable mortgage debt is a vital element of a mortgage.

[55] As a result, the Tax Court Judge erred in finding that, for the purposes of the Act, the mortgage could effectively be separated from the debt it secures and that 99.9% of the amount paid by Mr. Leonard to the bank to acquire the mortgage and the debt should be allocated to the mortgage.

[56] Even if a mortgage could be treated as a different property than the debt it secures, no portion of the amount paid by Mr. Leonard to the bank for the debt and the mortgage could reasonably be allocated to the mortgage. The reasoning of the Tax Court Judge would lead to the conclusion that Mr. Leonard could have purchased the mortgage from the bank for $1.3 million (using the amount as determined by the Tax Court Judge as the purchase price) but the bank could still retain the debt Mr. Anderson owed to the bank. If that were the case, what would Mr. Leonard have acquired? Mr. Anderson would not be required to pay any more than the

amount owed to the bank and therefore no amount would be payable to Mr. Leonard as the "mortgage holder".

[57] Rather, a mortgage would simply increase the value of the debt it secures. Assume, for example, that two creditors of Mr. Anderson are each owed $1.5 million. One creditor's debt is secured by a mortgage and the other creditor's debt is unsecured. Which creditor would be able to receive the higher price for their debt in the open market? Logically, the creditor whose debt is secured by a mortgage will be able to sell their debt for a greater amount. How much more will be based on the circumstances and the value of the property on which the security is taken.

[58] As a result, the basis for the loss as found by the Tax Court Judge is not valid. If there is no other basis for claiming a loss in 2011, Mr. Leonard is not entitled to any claim for a loss in 2011.

C. *Mr. Leonard's Alternate Arguments*

[59] Having abandoned his claim that he was entitled to claim a loss arising as a result of the debt becoming a bad debt, Mr. Leonard's oral arguments before this Court justifying his entitlement to a loss in 2011 included:

- he incurred an outlay and because his outlays exceeded his revenue for the year, he incurred the loss;
- even if he acquired an asset in exchange for the amount he paid to the bank, the asset was not inventory;

- because the debt was bad from the beginning, he was entitled to deduct the full amount paid for the debt; and

- the business carried on as an adventure or concern in the nature of trade was at an end.

[60] None of these arguments have any merit.

[61] With respect to his argument that his outlays exceeded his revenue and, therefore, he incurred a loss, it is necessary to determine what was acquired for the outlay in issue. It is clear that Mr. Leonard paid the amount to the bank to acquire Mr. Anderson's debt (as evidenced by the promissory note and secured by the mortgage) from the bank. In paragraph 5 of his notice of appeal to the Tax Canada, Mr. Leonard stated that he "purchased the Promissory Note for $1,487,551". In its reply, the Crown admitted that Mr. Leonard "purchased the promissory note for $1,487,551". At the commencement of the hearing before the Tax Court, Mr. Leonard's counsel stated "[s]o what happened here was … he bought a loan for 1.5 million". The documents filed with the Tax Court, the testimony of Mr. Leonard and his counsel's opening statement to the Tax Court all confirm that Mr. Leonard paid the amount that he did to the bank to acquire Mr. Anderson's debt and the related mortgage.

[62] Although there appears to be some dispute with respect to the actual amount paid to the bank for the debt (as evidenced by the promissory note and secured by the mortgage), it is clear that the transaction between Mr. Leonard and the bank resulted in Mr. Leonard acquiring an asset – the amount payable by Mr. Anderson to the bank which was secured by mortgage on lot B-2.

[63] Having acquired an asset, the amount paid to acquire that asset, even if he were carrying on an adventure or concern in the nature of trade, is not deductible absent a provision in the Act that would allow the deduction. There is nothing to suggest that the cost of the asset would be deductible in computing profit for the purposes of section 9 of the Act and Mr. Leonard did not point to any provision of the Act that would allow this deduction.

[64] Mr. Leonard argued that the debt he acquired was not inventory as he had not acquired it for the purpose of resale. If the debt was not acquired for the purpose of resale it and it was not inventory, then it was a capital property and any loss arising from the disposition of the debt would give rise to a capital loss not an income loss. As noted by Major J., writing on behalf of the majority of the Supreme Court of Canada in *Friesen v. Canada*, [1995] 3 S.C.R. 103:

> [28] … The Act defines two types of property, one of which applies to each of these sources of revenue. Capital property (as defined in s. 54(b)) creates a capital gain or loss upon disposition. Inventory is property the cost or value of which is relevant to the computation of business income. The Act thus creates a simple system which recognizes only two broad categories of property. The characterization of an item of property as inventory or capital property is based primarily on the type of income that the property will produce.

[65] Assuming the debt was inventory acquired in carrying on an adventure or concern in the nature of trade, no loss will be realized until there was a disposition of the debt. Subsection 10(1.01) of the Act provides that for any person carrying on an adventure or concern in the nature of trade, any property described in inventory is valued at the cost at which the taxpayer acquired the asset. As a result, if Mr. Leonard were carrying on a business that is an adventure or concern in the nature of trade, he would not be entitled to claim any amount as an inventory write-down in relation to the debt. Any loss would only be realized when there is a disposition of

that debt. In this case, Mr. Leonard does not argue that there has been any disposition of the debt and there is nothing in the record to suggest that there has been any disposition of the debt.

[66] Mr. Leonard argued that the debt was bad from the beginning. This argument is based on the premise that the debt had no value when it was acquired. However, if this were the case, it would raise doubts about whether he acquired anything from the bank for the purpose of making a profit. As noted by the Tax Court Judge, the intention to make a profit is an important consideration in determining whether a person is carrying on an adventure or concern in the nature of trade (reasons at paragraph 55). Arguing that the debt was bad from the beginning appears to contradict the Tax Court Judge's finding that Mr. Leonard acquired the debt for the purpose of making a profit.

[67] In any event, even if Mr. Leonard paid too much for the debt, because it was an arm's length transaction between Mr. Leonard and the bank, the cost of the debt would be the amount he paid.

[68] Although Mr. Leonard claimed that the business he had been carrying on as an adventure or concern in the nature of trade was at an end, it is far from clear when this occurred or how this would result in a disposition of the debt as reflected in the deficiency judgment. The year in which the loss was claimed was 2011. The Tax Court Judge found that Mr. Leonard intended to make a profit from the foreclosure sale (assuming that someone would outbid him) or from the sale of Lot B-2 (if he acquired it) (paragraph 55 of the Tax Court Judge's reasons). The Tax Court Judge, after noting that Lots B-2 and B-3 had been combined in 2015, also found:

> [72] … However, as Mr. Leonard, at the time of the hearing, still owned the two Lots (albeit combined into a single lot), no profit or loss had yet been realized from any adventure in the nature of trade in respect of the Lots.

[69] There is nothing in the record to support his argument that, assuming he was carrying on a business as an adventure or concern in the nature of trade, it had ceased in 2011. As well, Mr. Leonard did not point to any provision of the Act in support of his argument that, even if it had ceased, he would be entitled to the loss as claimed.

[70] As a result, there is no merit to any of Mr. Leonard's arguments that he is entitled to claim the loss in issue in computing his income for 2011.

V. Conclusion

[71] I would allow the cross-appeal in relation to Mr. Leonard's appeal with costs and dismiss his appeal without costs. I would allow the cross-appeal in relation to Ms. Tenney's appeal without costs and dismiss her appeal without costs. I would set aside the judgments of the Tax Court in each matter. Granting the judgments that the Tax Court should have made, I would dismiss Mr. Leonard's appeal to the Tax Court with costs and I would dismiss Ms. Tenney's appeal to the Tax Court without costs.

"Wyman W. Webb"
J.A.

"I agree.
David Stratas J.A."

"I agree.
Donald J. Rennie J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-151-21
STYLE OF CAUSE:	JEREMY LEONARD v. HIS MAJESTY THE KING
AND DOCKET:	A-152-21
STYLE OF CAUSE:	CAROL TENNEY v. HIS MAJESTY THE KING
PLACE OF HEARING:	HEARD BY ONLINE VIDEO CONFERENCE HOSTED BY THE REGISTRY
DATE OF HEARING:	OCTOBER 11, 2022
REASONS FOR JUDGMENT BY:	WEBB J.A.
CONCURRED IN BY:	STRATAS J.A. RENNIE J.A.
DATED:	NOVEMBER 10, 2022

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