Docket: 2012-3125(IT)G

BETWEEN:

THE TDL GROUP CO.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on February 24, 25 and 26, 2015, at Toronto, Ontario

Before: The Honourable Justice F.J. Pizzitelli

Appearances:

Counsel for the Appellant:	Chia-yi Chua John Yuan Brandon Siegal
Counsel for the Respondent:	Elizabeth Chasson Rishma Bhimji

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2002 taxation year is dismissed with costs to the Respondent.

Signed at Ottawa, Canada, this 6th day of March 2015.

"F.J. Pizzitelli"

Pizzitelli J.

Citation: 2015 TCC 60
Date: 20150306
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REASONS FOR JUDGMENT

Pizzitelli J.

[1] The Appellant, a Nova Scotia unlimited liability Company, appeals a reassessment denying interest deductions in respect of its 2002 taxation year totalling $10,094,856 on loans from a parent corporation used to acquire additional common shares in a U.S. wholly-owned subsidiary. The interest claimed and denied was in respect of interest paid for the period from March 28, 2002 to November 3, 2002 (the "Period"). The Minister of National Revenue (the "Minister") disallowed the interest deduction pursuant to subparagraph 20(1)(c)(i) of the *Income Tax Act* (the "*Act*") on the basis that the funds borrowed were not used for the purposes of earning income from a business or property; namely from a U.S. subsidiary's shares acquired with the borrowed funds.

[2] Most of the relevant facts are not in dispute. A chronology of transactions started with Wendy's International Inc. ("Wendy's"), the ultimate parent of the group loaning $234,000,000 Cdn. ($147,654,000 US) to its U.S. subsidiary, Delcan Inc. ("Delcan") before March 18, 2002 at an interest rate not to exceed 7 percent. Delcan in turn loaned the full amount to the Appellant on March 18, 2002 at a rate of 7.125 percent pursuant to a loan agreement and subsequently assigned this loan receivable to another affiliate in the group. The Appellant in turn used the full amount of the loan from Delcan to purchase 1,840 additional common shares in its already wholly-owned U.S. subsidiary, Tim Donut U.S. Limited, Inc. ("Tim's U.S.") on March 26, 2002 which in turn made an interest-free loan to Wendy's the next day, on March 27, 2002 evidenced by a Promissory Note dated as of that date

(the "Note"). A schematic drawing of these transactions was entered as Exhibit R-1. In short, monies that started from Wendy's was loaned out at interest and found its way back to Wendy's interest free through these series of transactions. The evidence is that the Note was originally intended to be on an interest bearing basis according to planning memorandums entered into evidence, although no rate was specified, but that due to concerns an interest bearing note would have on state taxes in the U.S. and concerns with the Thin Capitalization and Foreign Accrual Property Income Rules in Canada under the *Act*, it was decided the loan would proceed on a non-interest basis until the matter was sorted out.

[3] Sometime in June of 2012, following a revised plan evidenced in May of 2012, Tim's U.S. incorporated a new U.S. subsidiary, Buzz Co., which later changed its name to TD US Finance Co. ("Tim's Finance"). Tim's U.S. assigned the Note to Buzz Co. as payment for its shares in Buzz Co. and Buzz Co. then issued a Demand for Payment on the Note to Wendy's which repaid the Note in full by issuing a new promissory note to Buzz Co. on November 4, 2002 (the "New Note") for the same full amount bearing an interest rate of 4.75 percent, thus effectively replacing the non-interest bearing loan with a new interest bearing one. The delay in effecting these plan changes was explained by the preoccupation of the parties of the group in purchasing the interests of one of the group's founders.

[4] It should be noted that the Canada Revenue Agency ("CRA") has in effect denied the Appellant the deduction of interest paid on its loan from Delcan during the Period, which coincides with the time the Appellant's US subsidiary loaned the money back to Wendy's on an interest free basis pursuant to the Note. Once the loan back to Wendy's was effectively repaid and replaced with an interest bearing loan evidenced by the New Note, the Minister allowed interest deductibility from that date onwards.

[5] Before proceeding on a further discussion of facts not agreed to or whose affects are disputed, I will briefly discuss the position of the parties and the provisions of the *Act* in play here as well as to give needed context to this dispute.

<u>The Appellant's Position</u>

[6] The Appellant takes the position that the purchase of common shares by the Appellant in Tim's U.S., the property it acquired from the proceeds of its borrowings from Delcan, is a garden variety transaction that satisfies the test in subparagraph 20(1)(c)(i) and that the "use" of the Appellant as "borrower" is what

must be looked at, not the use that Tim's U.S., the subsidiary, made of the funds invested in it which it accuses the Crown of wrongfully considering. In essence says the Appellant, the act of purchasing shares that capitalizes its subsidiary to allow it to acquire capital assets and operate its business for the Appellant's ultimate benefit and payment of future dividends is sufficient, regardless of whether Tim's U.S. actually earned income from the new capital injection. The Appellant argues there is evidence that Tim's U.S had a 10 year plan to significantly expand its U.S. operations for income earning reasons and in fact ultimately did resulting in substantial future dividends paid to the Appellant starting in 2007, thus demonstrating an income earning purpose to the purchase of the shares.

[7] Notwithstanding this, the Appellant says that even if the Minister is correct in looking at what use the Appellant's subsidiary made of the funds, there is ample evidence that the monies lent by Tim's U.S. to Wendy's were indirectly available for Tim's U.S. use when needed through the groups internal funding mechanisms in place, thus satisfying such indirect purpose test in any event through what the Appellant termed to be "exceptional circumstances".

[8] Finally argues the Appellant, even if the Minister succeeds in its position that the purposes of the loan was to facilitate the making of an interest free loan to Wendy's, it argues such purpose was not the sole purpose as alleged by the Respondent and that the additional purpose of earning ultimate dividend income is sufficient to meet the purpose test.

<u>The Respondent's Position</u>

[9] The Respondent's takes the position that the transactions undertaken by the Appellant are nothing more than a series of predetermined steps to lend money to Wendy's interest free while at the same time giving it an interest expense and that the Appellant had no purpose of earning income from investing in Tim's U.S. shares at the time of the initial loan evidenced by the Note. In any event says the Respondent, the interest deducted by the Appellant would not be a reasonable expense under paragraph 20(1)(c) of the *Act* in the circumstances.

<u>The Law</u>

[10] Subsection 20(1) reads as follows:

> **(1) Deductions permitted in computing income from business or property.** Notwithstanding paragraphs 18(1)(*a*), (*b*) and (*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:
>
> …
>
> **(c) Interest** - an amount paid in the year or payable in respect of the year (depending on the method regularly followed by the taxpayer in computing the taxpayer's income), pursuant to a legal obligation to pay interest on
>
> (i) borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt or to acquire a life insurance policy),
>
> …
>
> or a reasonable amount in respect thereof, whichever is lesser;

[11] The Supreme Court of Canada in *Shell Canada Ltd. v The Queen* [1999] 3 SCR 622 held at page 637 that paragraph 20(1)(c) has four elements:

> (1) the amount must be paid in the year or be payable in the year in which it is sought to be deducted;
>
> (2) the amount must be paid pursuant to a legal obligation to pay interest on borrowed money;
>
> (3) the borrowed money must be used for the purpose of earning non-exempt income from a business or property; and
>
> (4) the amount must be reasonable, as assessed by reference to the first three requirements.

[12] There is no dispute between the parties that the two requisite elements described in *Shell Canada* in (1) and (2) above have been met. The Appellant borrowed the money pursuant to a loan agreement and agreed to pay interest at a rate of 7.125 percent to the borrower, Delcan and did pay the interest.

[13] The only dispute is whether the $234,000,000 expressed in Canadian funds borrowed from Delcan was used by the Appellant for the purpose of earning income from the common shares it acquired in Tim's U.S. and whether the amount of interest was reasonable; namely whether the requisite elements describe in *Shell Canada* in (3) and (4) above have been met.

<u>Analysis</u>

[14] There is clearly confusion between the parties position regarding the relevant analysis of the third requisite element in subparagraph 20(1)(c)(i) as referred to in *Shell Canada* above which requires that "the borrowed money must be used for the purpose of earning non-exempt income from a business or property;".

[15] It is clear the provision requires us to first identify the use of the borrowed money and then its purpose. There is no dispute by either party that the direct use of the borrowed money must first be ascertained as required by the Supreme Court in *Singleton v The Queen*, 2001 SCC 61, [2001] 2 SCR 1046, at paragraph 26, where Major J. stated:

> 26 Only the third element is at issue in this appeal: the borrowed money must be used for the purpose of earning non-exempt income from a business. The *Shell* case confirmed that the focus of the inquiry is not on the purpose of the borrowing *per se*, but is on the taxpayer's purpose in using the money. McLachlin J. agreed with Dickson, C.J. in *Bronfman Trust* that the inquiry must be centered on the use to which the taxpayer put the borrowed funds. …

[16] It is also clear that the only issue in *Singleton*, as the Respondent has pointed out, was on the "use" of the borrowed funds. There was no dispute as to the purpose portion of the requirement. That is the context of *Singleton*. *Singleton* did not have to decide if the purpose test was also met, thus why the focus of the inquiry was only on the "use" component. The borrowed funds, once injected into the law partnership, had an income earning purpose; namely to earn income from the law firm. There was no argument as to another purpose, unlike the case at hand.

[17] In my view the Appellant confuses the use and purpose analyses of the requirement. Frankly, the wording of the Respondent's assumption in paragraph 14(m) of its Amended Reply gives some reason for such confusion where it is stated:

> m) at the time that the investment in additional common shares in Tim U.S. was made, the appellant's sole purpose for investing in new common shares and sole use for the funds borrowed from Delcan was to arrange for funds to be available to Wendy's at zero interest while generating an interest expense in the hands of the appellant;

[18] In such assumption the Respondent appears to both be acknowledging that the funds were used to acquire the shares and arrange the questioned loan to Wendy's. However, it is also clear that the Respondent also assumed in its Amended Reply and confirmed in argument at trial that the use of the funds by the Appellant was to acquire shares in Tim's U.S. Specifically, in clause 14(g)(iv) of the Amended Reply the Respondent assumes;

> (iv) on or about March 26, 2002 the appellant used the proceeds of the Loan to acquire additional common shares of its wholly owned U.S. subsidiary, Tim U.S.;

[19] There is no dispute as to the direct use of the borrowed funds so no issue of tracing the funds to the use in applying the "use" test arises as in the *Bronfman Trust v The Queen*, [1987] 1 SCR 32 case. The only issue in dispute is the "purpose". In effect, the only question that must be answered here is whether the common shares were acquired for the purpose of earning non-exempt income.

[20] In *Ludco Enterprises Ltd. et al v The Queen*, 2001 SCC 62, [2001] 2 SCR 1082, Iacobucci J. clearly considered the *Shell Canada* and *Bronfman Trust* decisions and their focus of inquiry as to the "use" factor and concluded in paragraph 45 that "… the law relating to the matter of the taxpayer's "purpose" was not fully elaborated on in that case".

[21] At par 46, Iacobucci J. distinguishes *Singleton* as well:

> 46 In the case at bar, and in contrast to *Singleton*, *supra*, there is no dispute as to the particular use that the borrowed funds were put to: they were directly used to purchase shares in the Companies. Rather, the focus of the inquiry is on whether the taxpayers' purpose in so using the funds was to earn income within the meaning of s. 20(1)(*c*)(i). Consequently, in the present appeal, the Court is asked for the first time to explicate the law on two of the central concepts in s. 20(1)(*c*)(i): "purpose" and "income".

[22] In this case, like *Ludco*, there is no dispute the funds were used to purchase shares and likewise the focus of our inquiry must be on whether there was an income-earning purpose in acquiring those shares as earlier stated.

[23] It must be noted and there is no dispute between the parties that *Ludco* also made it clear that it is not necessary that the sole purpose must be to earn non-exempt income and that such purpose may also be an ancillary purpose. In fact here the Appellant argues that if the Court finds the investment in shares was not to earn dividend income as its main purpose, it was at least an ancillary one. The Respondent's position is that the Appellant's sole purpose for investing in the new common shares was to arrange for funds to be available to Wendy's at zero percent interest while generating an interest expense in the hands of the Appellant, and hence there was no other purpose.

[24] The Supreme Court informs us in *Ludco* as to the appropriate test for determining the purpose for interest deductibility under subparagraph 20(1)(c)(i) at paragraphs 54 and 55:

> 54 Having determined that an ancillary purpose to earn income can provide the requisite purpose for interest deductibility, the question still remains as to how courts should go about identifying whether the requisite purpose or earning income is present. What standard should be applied? In the interpretation of the Act, as in other areas of law, where purpose and intention behind actions is to be ascertained, courts should objectively determine the nature of the purpose, guided by both subjective and objective manifestations of purpose: … In the result, the requisite test to determine the purpose for interest deductibility under s. 20(1)(*c*)(i) is whether, considering all the circumstances, the taxpayer had a reasonable expectation of income at the time the investment was made.
>
> 55 Reasonable expectation accords with the language of purpose in the section and provides an objective standard, apart from the taxpayer's subjective intention, which by itself is relevant but not conclusive. It also avoids many of the pitfalls of the other tests advanced and furthers the policy objective of the interest deductibility provision aimed at capital accumulation and investment, as discussed in the next section of these reasons.

[25] It is clear from *Ludco* that the test must be applied at the time the investment is made, namely at the date the Appellant acquired the shares in Tim's U.S., and furthermore that "all the circumstances must be considered".

[26] The language of "all the circumstances must be considered" is very broad. In my view, such language cannot be consistent with any position that would suggest the use of the funds by the subsidiary or other members of the group cannot be considered nor that any series of transactions related to the direct investment

cannot be considered. While *Singleton* made it clear that there was no room to consider a series of transactions in determining the "use" of the funds for the "use" test components, i.e. that the direct use is the test that must be ascertained, the determination of the "purpose" for buying the shares does not preclude looking at the indirect use of the funds or any other relevant factor. All circumstances must be considered. In this regard, it seems that the Respondent's reference to "use" in paragraph 14(m) of the Amended Reply above discussed accords with this premise.

[27] Moreover, *Ludco* makes it clear in paragraphs 57 to 63 when discerning what is meant by "income" that subparagraph 20(1)(c)(i) "refers to income generally, that is an amount that would come into income for taxation purposes, not just net income". This clearly contemplates in my view that some types of income, such as capital gains or even dividend income, may often be derived from indirect uses of the money invested in shares of a corporation that owns subsidiaries or has investments in other corporations like the case at hand. Major J. in *Ludco* in fact goes on in paragraph 63 thereof to discuss that the object of the section is "… create an incentive to accumulate capital with the potential to produce income by allowing taxpayers to deduct interest costs associated with its acquisition" and thus concludes that the taxpayer need only have a reasonable expectation of creating "gross income" instead of net income. These arguments clearly support an argument that monies borrowed for the purposes of creating wealth indirectly would fall within the purpose of the section.

[28] As the Appellant himself has pointed out in argument, *Canadian Helicopters Ltd. v The Queen*, 2002 FCA 30, 2002 DTC 6805, a decision of the Federal Court of Appeal, allowed interest deductibility on borrowings of that taxpayer who used the proceeds of the borrowing to advance an interest-loan to its parent and who in turn did the same to its parent to fund the acquisition of another company. The Court held that the appellant's ability to earn management fees from the acquired company met the purpose test. This is entirely consistent with the principles of *Ludco* above described that allows the Court to look at all circumstances including the ultimate use of the borrowed funds to establish an income-earning purpose, even in the context of a series of transactions.

[29] The Appellant also suggests that the Court should not treat the Appellant and Tim's U.S. or its subsidiary Tim's Finance (Buzz Co.) as the same taxpayer who borrowed the funds in deference to the principle of respecting their individual existence or not piercing the corporate veil and relies on the Federal Court of Appeal's decision in *The Queen v Merban Capital Corp.*, [1989] FCJ No. 712, 89

DTC 5404. Frankly, there is no dispute here that it is the Appellant and not any of its subsidiaries who borrowed the funds in this matter so such decision has little relevance to the matter at hand. In *Merban* the Court found the subsidiaries were the borrower and in essence the taxpayer there could not deduct interest incurred by it as a guarantor. In any event, the Supreme Court of Canada has addressed the tests as to "use" and "purpose" since the 1989 decision in *Merban* through *Bronfman Trust*, *Singleton* and *Ludco* as above discussed and it is clear that for the "purpose" test in paragraph 20(1)(c), the use of the funds by the borrower subsidiaries can be considered as part of all the circumstances.

[30] I now turn my attention to analyzing the evidence pertaining to the circumstances of this case.

[31] Can it be said that the Appellant had the reasonable expectation to earn income; either immediate or future dividend income or even increased capital gains as a result of the purchase of shares at the time of such purchase? I simply cannot agree this was a reasonable expectation of the Appellant at the time of such purchase for the following reasons:

> 1. The Appellant was already the sole shareholder of Tim's U.S. at the time of purchase of additional shares. The evidence is clear that Tim's U.S. had lost substantial monies in the previous 4 years prior to the purchase date. The evidence is that the losses went from $12,000,000 in 1999, to $8,000,000 in 2000 to $4,000,000 in 2001 to $480,000 in 2002. Regardless of the obviously reversing trend which the Appellant points to, it is pretty clear Tim's U.S. was not in a position financially to pay any immediate or short term dividends at the time of purchase of shares. This is particularly relevant when one considers that the loan evidence by the Note was only intended to be outstanding for a short period of time and was in fact only outstanding for about 7 months. There was also no history of payment of past dividends, obviously due to past losses at least in part.
>
> 2. The evidence of the Appellant's own witnesses, namely P.H, the former CEO and T.M., the former CFO confirmed that the group had a policy of no returns on investments, i.e. dividends, until all capital expenditures were funded. The evidence from these witnesses and the 10 year plan submitted into evidence suggest at least a plan for substantial capital investments to increase the number of stores in the U.S. over the next 10 years. The net income projected from such

increased stores shown on the plan for 2003 to 2010 are not projected to exceed the increase in capital expenditures for any years during that period, let alone in total so there is no indication of any monies being available for dividends during that period in light of the stated policy.

3. The 10 year plan itself has a line item for dividends to be paid and zero dividends were planned.

4. Notwithstanding that the Appellant has lead evidence showing dividends were in fact paid in 2007 to 2012, ranging from $100,000 per year from 2007 to 2009, $1,000,000 for each of 2010 and 2011 and $500,000 in 2012, the evidence is also that in 2006 the Tim Hortons group was spun out of the Wendy's group and so a different ownership matrix applied that was not part of the circumstances at the time of the investment and no evidence was lead to suggest this was in the cards at the time of investing in the shares in 2002. If it was, one would think the projections on dividends in the 10 year plan would have showed it.

5. There is no mention of any potential for dividends to be paid in any of the planning memorandums of J.G., in any of the resolutions of the directors of the Appellant or Tim's U.S. or Tim's Finance (Buzz Co.) discussed in more detail later or anywhere else, let alone in the 10 year plan previously discussed.

6. The Appellant was already the sole shareholder of Tim's U.S. at the time of purchasing additional shares in March, 2002. Whatever quantative income earning capacity or benefit it had *per se* in its capacity as sole owner did not change as a result of its new investment in Tim's U.S. unless it can be demonstrated that the new investment could be expected to create or increase the chances for dividends or at least an increase in the value of its Tim's U.S. shares. The fact the funds used to buy the new shares were immediately loaned to Wendy's without interest for about 7 months after which funds were paid back in full suggests no obvious expectation that those funds created or were expected to create any income for Tim's U.S. so as to increase its ability to pay dividends or increase the value of its shares for the future income benefit of the Appellant.

7. The funds loaned to Wendy's on an interest free basis were also intended to be a short term temporary loan at the time of its advance. The Appellant's own witnesses testified, as earlier mentioned, that they were aware the loan evidenced by the Note had to be reorganized and replaced and evidence from the planning memorandum of J.G., the tax advisor to the group indicates a revised plan as early as May 2002 that was put into effect resulting in the repayment of the Note in full in November of 2002, with delays explained due to the group's preoccupation with other matters, including the repurchase of the shares of one of the Tim Horton's group initial founders. The testimony explaining why there were delays in implementing the revised plan suggests it was the intention to loan funds out for an even shorter period of time. The testimony of the Appellant's witnesses also confirmed that they knew of the potential tax problems above mentioned prior to the initial loan advance under the Note and that it had to be fixed thus the revised memorandum and repayment of the Note.

8. There is no credible evidence any portion of the funds invested in Tim's U.S. were used or intended to be used for any other purpose other than to loan monies to Wendy's on an interest free basis at the time of the investment in Tim's U.S. shares. Notwithstanding the Appellant pointing to the Director's Resolution of the Appellant dated March 8, 2002 that monies be used to purchase the shares in Tim's U.S. were expected was to be used to repay debt by Tim's U.S. and fund future capital expenditures, thus supporting an argument the purpose of the funds was to create wealth through the accumulation of capital for the subsidiary and thus indirectly for it, it is clear no repayment of debt was made and no direct capital expenditures were made as all the funds were lent to Wendy's. In fact, the Resolution of the Board of Directors of Tim's U.S. dated the same date as the Appellant's Director's Resolution refers to a current indebtedness of the subsidiary to Wendy's of $50,000 and authorizes the company, "upon receipt of the aforesaid capital contribution" to repay accounts payable to Wendy's up to the amount of the capital contribution and to lend any remaining amounts to Wendy's at such interest rate (including without interest). The capital contribution far exceeded the amount of the stated indebtedness to Wendy's yet none was paid. No mention is even made of a capital expenditure. Interesting enough, the CEO of the Appellant, P.H. was a director of Tim's U.S. and attended

both meetings as did a few other directors or invitees of both meetings. Notwithstanding both companies being represented by many of the same people at meetings held at the same day and time, no funds were used to pay any indebtedness of Tim's U.S. to Wendy's nor used for capital expenditures. The only logical conclusion I can draw from this is that all the members of the group intended and were aware all the money was going back to Wendy's.

I should also like to add that I give little weight to the Appellant's argument that subsection 89(3) of the *Companies Act* of Nova Scotia requires the Court to treat the proceedings reflected in the Minutes of the Directors of the Appellant as true. The provision provides that:

> Until the contrary is proved, every general meeting of the company or meeting of directors or managers in respect of proceedings whereof minutes have been so made shall be deemed to have been duly held and convened, and all proceedings had thereat to have been duly had, and all appointments of directors, managers or liquidators shall be deemed to be valid.

There is no dispute as to the directors meeting of the Appellant evidenced by the above mentioned Resolution dated March 8, 2002 having been duly held and convened. There is however clear evidence that the funds were indeed not used by Tim's U.S. to repay capital or fund future capital expenditures as stated in the Resolution so the contrary has been proven in my view.

I also take note of the fact that while the share subscription was on March 26, 2002 the Note from Wendy's dated March 27, 2002 has a schedule attached which shows almost two-thirds of the loan to Wendy's (i.e. US 96,000,000 being the Canadian dollar equivalent of $152,000,000) was advanced to it prior to March 26, 2002 with the balance on March 27, 2002; all suggesting most of the subscription funds were never even intended to be expended through Tim's U.S., regardless of the inconsistent purposes stated for the ultimate use of those funds.

9. One of the Appellant's witness, one M.K, who joined the group in 2005 and thus did not have first-hand knowledge of the transactions in issue, testified she reviewed the computer data records obtained and

archived from the PeopleSoft system used by the Wendy's group after the Tim Horton's group was spun out of the Wendy's group in 2006 and found evidence that capital expenditures were made in late 2002 to acquire and build a new U.S. location in Newark, Ohio that was approved by Tim's U.S. Real Estate Acquisition Committee ("REAC") in February, 2002. Her evidence is that the location was completed sometime in December, 2002. There is no evidence these payments were made from the monies advanced through the Note or otherwise, although the Appellant, through the same witness, lead evidence that another affiliated corporation in the Group, T.H.D. Donut (Delaware), Inc. ("THDD"), the U.S. Franchisor, was the cheque writing entity for Tim's U.S., as well as other U.S. entities, that would have expended all amounts and recorded them in a journal as an increase in inter-company advances. Likewise, all amounts received by THDD as rents on behalf of Tim's U.S. would be recorded as a reduction to inter-company balances. In essence her testimony is that a total of $821,305 was expended on the Newark, Ohio store between September 15 and December 27, 2002 and that such inter-company advances were reconciled at a later date. She testified that to the extent THDD did not have the funds from its streams of franchise royalties as franchisor, that Wendy's would advance those funds to it to meet its cheque writing obligations; the obvious suggestions being that capital expenditures were made on behalf of Tim's U.S. in 2002 and that Wendy's advanced those funds ultimately through THDD thus demonstrating the monies loaned to Wendy's from Tim's U.S. did find their way back when needed.

With respect to the Appellant, what evidence is there that any of the funds from the loan represented by the Note found its way to Tim's U.S. instead of from the internal sources of THDD which had an income stream as the U.S. Franchisor or even partly from Tim's U.S. rental income stream? There was no evidence of same or that any amount in the inter-company loan accounts between Wendy's and THDD, or THDD and Tim's U.S. for that matter, related to the specific store as there is no evidence as to when the bills were even paid. The problem I have is that such evidence is simply not conclusive on its own. The bigger problem I have is that such evidence is directly contrary to the documentary evidence contained in the Joint Book of Documents entered into evidence on consent as Exhibit A-1, which at Tab 6 contains a resolution of Buzz Co., (later

renamed Tim's Finance) authorizing that a demand for repayment of the Note be made and that on November 4, 2002 the Demand for Payment, being Tab 7 of Exhibit A-1 was made, the last paragraph of which reads:

> NOW THEREFORE, the Lender hereby demands payment on November 4, 2002 of U.S. $147,654,000, being the full principal amount payable under the Note.

Demand for Payment was satisfied by Wendy's on November 4, 2002 by the issuance of a new debt obligation for the same amount to bear interest previously described as the New Note.

The Demand for Payment of 100 percent of the original amount lent to Wendy's pursuant to the Note and the actual repayment of 100 percent of that amount, seven months later, is evidence enough that there were no off setting amounts claimed against Tim's U.S. as a result of any inter-company loan reconciliations.

Frankly, the Appellant's attempts to suggest the proceeds of the original Note were somehow in play through the cheque writing structure of the group utilizing THDD and reconciliation of inter-company accounts appears nothing more than smoke and mirrors.

I might also add that the Appellant's attempt to show repayments of capital by Tim's Finance to Tim's U.S. in September of 2003 of $50,000 and in 2004 to 2006, through the evidence of M.K. is of no assistance. Nor is the evidence from the 2005 tax return of Tim's U.S. entered into evidence by the Appellant evidencing an increase in capital expenditures of about $39,000,000 over the previous year, which M.K. testified she helped prepare but which are unsigned and for which no evidence was tendered to prove they were actually filed or why they even had to be filed when the evidence of the same witness is that for U.S. tax purposes Tim's U.S. was consolidated within Wendy's returns. These repayments or capital expenditures fall within the life of the New Note, not the original Note which was extinguished almost a year beforehand.

It also follows that such structure cannot support any special circumstances exception that would warrant the granting of interest deductibility within the meaning the Appellant alleges was created in *Bronfman Trust*. In fact, I do not take *Bronfman Trust* to create an exceptional circumstances test that allows deductibility of interest where the court looks at an ineligible indirect use of the funds and grants a deduction of interest in special circumstances as it is clear to me Dickson C.J. was actually referring to looking at the indirect use of funds as part of focusing on the "purpose" test, not the "use" test. At page 54, the former Chief Justice stated:

> Even if there are exceptional circumstances in which, on a real appreciation of a taxpayer's transactions, it might be appropriate to allow the taxpayer to deduct interest on funds borrowed for an ineligible use because of an indirect effect on the taxpayer's income-earning capacity, I am satisfied that those circumstances are not presented in the case before us. It seems to me that, at the very least, the taxpayer must satisfy the Court that his or her *bona fide* <u>purpose</u> in using the funds was to earn income. (Emphasis added.)

In *Bronfman Trust*, the Court held that the borrowing of funds to pay a capital allocation to a trust beneficiary had no direct income earning nature or use. In *Bronfman Trust* as in *Singleton*, the focus of the analyses was on the use, not the purpose and *Bronfman Trust* can be distinguished on that basis and the reference to exceptional circumstances are *obiter dictum*. *Bronfman Trust* cannot be said to create any exceptional circumstances exception test, although in fairness, the learned Justice certainly kept the door open to such possibility, but in light of *Ludco*, it seems that a consideration of indirect use of funds and the indirect benefit or income it may create for the taxpayer is now clearly relevant after finding an eligible use, but only for the purpose of analyzing the purpose test. In any event, in the case at hand, the Appellant has an eligible direct use, namely, the purchase of common shares so there is no need to consider an exceptional circumstances exception in the context of an ineligible use.

10. Finally, I would like to comment on the Appellant's contention that it always had the subjective intention to earn income from its purchase of the said shares because the group plan had always been

for Tim's U.S. to charge interest on its loan to Wendy's. If interest had been charged, we would not be here today. Oddly, the Appellant argues and thus implicitly agrees that the indirect use of the invested funds is a factor to consider.

While the evidence of the Appellant's former CEO, P.H. and its tax advisor, J.G. clearly indicated that the Note was initially intended to be interest bearing, the evidence is somewhat ambivalent as to that intent. As seen earlier, in the Minutes of the Board of Director's meeting of Tim's U.S. dated March 8, 2002, authorizing the loan to Wendy's, it is clear that the funds could be loaned to Wendy's "at such interest rate (including without interest) as may be acceptable to any one or more of the officers of the Company." Clearly, when the loan was authorized, the parties indicated a possible intention to loan it interest free. What is also clear is that any intention to charge interest clearly changed at the time the loan was made since the Note was in fact non-interest bearing. The evidence is also clear from such aforesaid witnesses that the charging of interest created potential tax problems with State taxes, and the Thin Capitalization and Foreign Accrual Property provisions of the *Act* and that they were aware at the time of the loan that the plan would have to be changed but needed to go ahead. The loan could have been delayed until these issues were addressed to the satisfaction of the Appellant but was not. No explanation has ever been offered as to why the loan proceeded in any event or why it needed to go ahead. What is clear is that the loan did proceed on an interest free basis as reflected in the Note and I can only assume that any tax concerns were not sufficient to delay the transaction and that getting money to Wendy's was the overriding concern. I am not convinced there was any subjective intention at the time of the loan to charge interest and that objectively, the opposite appears true.

[32] In analyzing all the evidence pertaining to the circumstances of this case, I simply cannot find that the Appellant had any reasonable expectation of earning non-exempt income of any kind, directly or indirectly, at the time of its purchase of additional shares in Tim's U.S. on or about March 26, 2002.The evidence clearly and unambiguously only points to the sole purpose of the borrowed funds as being to facilitate an interest free loan to Wendy's while creating an interest deduction for the Appellant. Accordingly, there is no need for me to consider the

Respondent's other argument that the interest in question would not be reasonable under the provision in issue.

[33] The appeal is dismissed with costs to the Respondent. If either party is not satisfied with this cost order, they may make submissions as to costs within 45 days for my consideration.

Signed at Ottawa, Canada, this 6th day of March 2015.

"F.J. Pizzitelli"

Pizzitelli J.

CITATION:	2015 TCC 60
COURT FILE NO.:	2012-3125(IT)G
STYLE OF CAUSE:	THE TDL GROUP CO. AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATES OF HEARING:	February 24, 25 and 26, 2015
REASONS FOR JUDGMENT BY:	The Honourable Justice F.J. Pizzitelli
DATE OF JUDGMENT:	March 6, 2015

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