

BETWEEN:

JOHN LATHAM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeals heard on common evidence with the appeal of Diane Latham  
(2012-759(IT)I) on June 11, 2014, at Edmonton, Alberta.

Before: The Honourable Justice Steven K. D'Arcy

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Margaret McCabe Paige McPherson

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**JUDGMENT**

In accordance with the attached Reasons for Judgment, the appeals with respect to the reassessments made under the *Income Tax Act* (the “*Act*”) for the Appellant’s 2005 and 2006 taxation years are allowed, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

- (1) for the 2005 taxation year, Farmers Feed and Supply Ltd. did not confer a benefit on the Appellant;
- (2) for the 2006 taxation year, the Appellant is not deemed under subsection 84(2) of the *Act* to have received a dividend from Farmers Feed and Supply Ltd.; and,
- (3) all penalties are vacated.

Costs in the amount of \$1,500 are awarded to the Appellant.

Signed at Ottawa, Canada, this 26<sup>th</sup> day of March 2015.

“S. D’Arcy”

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D’Arcy J.

BETWEEN:

DIANE LATHAM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on common evidence with the appeals of John Latham  
(2012-758(IT)G) on June 11, 2014, at Edmonton, Alberta.  
Before: The Honourable Justice Steven K. D'Arcy

Appearances:

Agent for the Appellant: John Latham  
Counsel for the Respondent: Margaret McCabe  
Paige McPherson

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**JUDGMENT**

In accordance with the attached Reasons for Judgment, the appeal with respect to the reassessment made under the *Income Tax Act* (the “*Act*”) for the Appellant’s 2006 taxation year is allowed, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is not deemed under subsection 84(2) of the *Act* to have received a dividend from Farmers Feed and Supply Ltd..

All penalties are vacated.

Costs in the amount of \$500 are awarded to the Appellant.

Signed at Ottawa, Canada, this 26<sup>th</sup> day of March 2015.

“S. D’Arcy”  
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D’Arcy J.

Citation: 2015 TCC 75  
Date: 20150326  
Docket: 2012-758(IT)G

BETWEEN:

JOHN LATHAM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent;

AND BETWEEN:

Docket: 2012-759(IT)I

DIANE LATHAM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

### **REASONS FOR JUDGMENT**

D'Arcy J.

[1] The Minister of National Revenue (The “Minister”) reassessed the Appellant John Latham for his 2005 taxation year to include in income shareholder appropriations of \$94,000. She reassessed each of John Latham and the Appellant Diane Latham for their 2006 taxation years to include in income a deemed dividend of \$67,501. The Minister also assessed John Latham a gross negligence penalty of \$10,486 in respect of his 2005 taxation year.

[2] At the commencement of the hearing, counsel for the Respondent informed the Court that the Minister was prepared to consent to a reduction in the deemed dividends from \$67,501 to \$44,842.

[3] All amounts assessed relate to John and Diane’s shareholdings in Farmers Feed and Supply Ltd. (“Farmers”).

[4] The Appellants disagree with the reassessments.

[5] The two appeals were heard together on common evidence.

[6] I heard from two witnesses: Mr. John Latham and Mr. Travis McAllister. Mr. McAllister is an auditor with the Canada Revenue Agency.

[7] I found Mr. Latham to be a credible witness.

### **Summary of Facts**

[8] The Appellants incorporated Farmers in 1989 to operate an agricultural livestock feed mill in Stony Plain, Alberta. Unfortunately, the mill was lost in early 1998 because of a fire.

[9] In 1999, after settling a dispute with its insurance company, Farmers built a new building on its land. Farmers rented most of the building to third parties; however, it also rented a portion of the building to a related company. The related company, Old Mill Feed, Seed & Pet Supply Ltd., sold feed and other types of seed.

[10] All of the assets of Farmers, including the building, were sold in early 2005 pursuant to a foreclosure action.<sup>1</sup> Farmers ceased operations in 2006.

### **First Issue: Payment of \$94,000 by Farmers to John Latham**

[11] In November 2000, Farmers established two credit facilities with the Canadian Imperial Bank of Commerce (the “CIBC”): a \$50,000 operating line and a \$322,778 demand loan. Farmers provided a \$400,000 collateral mortgage as security for the demand loan. Mr. Latham provided an unlimited guarantee with respect to the operating line, secured by an assignment to the CIBC of \$100,000 of his personal investments (the “Guarantee”).<sup>2</sup>

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<sup>1</sup> Transcript, page 69, testimony of John Latham.

<sup>2</sup> Exhibit A-1.

[12] On April 19, 2002, lawyers for the CIBC sent Mr. Latham a letter informing him that the bank intended to enforce the security provided by Mr. Latham in respect of the Guarantee.<sup>3</sup>

[13] Mr. Latham testified that he transferred \$100,000 of investments he held in a personal portfolio service account with the CIBC to that bank as a payment under the Guarantee. He noted that he attempted to obtain written evidence from the CIBC of the actual transfer of the investments. However, the CIBC informed Mr. Latham that it had destroyed the records.<sup>4</sup>

[14] Mr. Latham considered the \$100,000 payment he made under the Guarantee to be a loan from himself to Farmers. Farmers never recognized Mr. Latham's payment under the Guarantee in its books and records.<sup>5</sup>

[15] After the CIBC took the collection action, Farmers was able to obtain new financing from a private lender. In early 2005, this private lender seized all of the assets of Farmers pursuant to a foreclosure action (the "Foreclosure Action"). Farmers' building, equipment and assets were sold for \$600,000.<sup>6</sup> On March 24, 2005, Farmers received \$117,976 from the sale of its assets.<sup>7</sup> This represented the net proceeds from the sale after the payment of outstanding debts and the foreclosure expenses.

[16] Mr. Latham testified that \$94,000 of the \$117,976 remained after the payment of the remaining debts of Farmers. Farmers paid the \$94,000 to Mr. Latham in March of 2005.<sup>8</sup>

[17] It is the Respondent's position that the \$94,000 represents a shareholder benefit that should be included in Mr. Latham's income pursuant to subsection 15(1) of the *Income Tax Act* (the "Act"). Mr. Latham argued that Farmers paid the \$94,000 to him in 2005 as a partial repayment of amounts he had paid personally to the CIBC in 2002 pursuant to the Guarantee.

[18] I accept Mr. Latham's evidence with respect to his provision of the Guarantee and the subsequent payment by him of \$100,000 pursuant to the

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<sup>3</sup> Exhibit A-2.

<sup>4</sup> Transcript, pages 28 and 31, testimony of John Latham.

<sup>5</sup> *Ibid.*, pages 28-29.

<sup>6</sup> *Ibid.*, pages 68-69.

<sup>7</sup> Exhibit R-8.

<sup>8</sup> Exhibit R-8; Transcript, pages 32 and 70, testimony of John Latham.

Guarantee. Once Mr. Latham paid this amount, it represented an amount owed by Farmers to Mr. Latham. The payment of the \$94,000 in 2005 represented partial repayment of the amount owed by Farmers to Mr. Latham as a result of his payment under the Guarantee. It was not a shareholder's benefit.

[19] The Respondent placed significant weight on the fact that the payment was not recorded in the books and records of Farmers. As I will discuss shortly, a number of Farmers' transactions, including transactions relied upon by the Respondent, were not recorded in its books and records.

### **Second Issue: Deemed Dividend**

[20] Subsection 84(2) of the *Act* deems a dividend to be paid on a class of shares of a Canadian resident corporation where it is found that, on the winding-up or discontinuance of the corporation's business, funds or property of the corporation have been distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders of the particular class of shares of the corporation.

[21] The parties agree that Farmers ceased operations in 2006. The evidence before me is that it held no assets at the time it ceased to operate its business. Further, there is no evidence before me that any specific funds or property of Farmers were distributed to or appropriated by the Appellants in 2005 or 2006 (or any other year).

[22] It is the Minister's position that at the time Farmers ceased operations, its books and records showed substantial retained earnings.<sup>9</sup> Counsel for the Respondent argued that, in such a situation, funds or property of Farmers must have been distributed or otherwise appropriated to or for the benefit of Farmers' shareholders. As a result, subsection 84(2) applies to deem Farmers to have paid a dividend to the Appellants.

[23] Mr. Latham argued that there could not have been a deemed dividend in 2006 for the simple reason that Farmers had no assets in 2006 that could have been transferred to the Appellants.

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<sup>9</sup> At the time of the reassessment, the Minister assumed that the retained earnings equalled \$202,102. At the commencement of the hearing, counsel for the Respondent informed the Court that the Minister now believes the amount was \$165,747.

[24] I must first consider whether the CRA correctly determined that Farmers had substantial retained earnings at the time it ceased operations.

[25] Mr. McAllister explained to the Court how he determined the amount of the retained earnings. He noted that Mr. Latham provided the CRA with electronic data that contained a number of entries he had made on an accounting software program called QuickBooks.

[26] Mr. McAllister provided the electronic data to the CRA's electronic commerce audit support department ("ECAS"). ECAS then inputted the data into a program called IDEA. ECAS subsequently provided the IDEA program with the inputted data to Mr. McAllister.

[27] Mr. McAllister then printed various reports that purport to show various balance sheet and income accounts of Farmers. He identified these reports as trial balances. Mr. McAllister also prepared some simple income statements for Farmers.<sup>10</sup>

[28] The Court was not provided with any financial statements for Farmers. It is clear from the testimony of both Mr. Latham and Mr. McAllister that the data provided by Mr. Latham to Mr. McAllister did not contain several key transactions, including the sale of Farmers' assets in early 2005.

[29] Notwithstanding the deficiencies in the data, Mr. McAllister used the data to calculate amounts that he felt represented the retained earnings of Farmers at the time it ceased operations. He then calculated the amount that the Minister assessed as a deemed dividend under subsection 84(2). He explained the calculations as follows:

A As the business had ceased to operate per Mr. Latham because its only asset had been disposed of and it really had been confirmed that it had ceased to operate with the lack of income in 2006, we determined that since there was still a balance of the retained earnings and ultimately the corporation got struck, that those retained earnings would have to be -- or should be paid out as dividends to the shareholders.

Q How was the amount of those dividends calculated?

A We took the retained earnings from the 2006 financials, which is basically the same from the May 31, 2005 financials, and then we reduced the

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<sup>10</sup> Exhibits R-9, R-10, R-11, R-12, R-13, R-14, R-15, R-16 and R-18.



amount by the 94,000 for the shareholder appropriations that we had assessed in the 2005 year to Mr. Latham, and then we also gave credit for the hundred dollars of the share capital, and then subsequently that amount was determined to be the dividends to the -- assessed to each of Mr. Latham and his wife, Ms. Latham, in accordance with their share holdings.<sup>11</sup>

[30] In summary, Mr. McAllister took the amount he calculated as retained earnings for Farmers, subtracted the \$94,000 the Minister believed was appropriated in 2005 and \$100 for paid-up capital. He treated the remainder as a deemed dividend.

[31] I cannot accept this calculation. Mr. McAllister determined that the book value of Farmers' assets on May 31, 2005 and May 31, 2006 was \$749,576.91<sup>12</sup> and that it had retained earnings of \$202,102 on each of those dates.<sup>13</sup> However, he testified that the sale of Farmers' assets in 2005 was not included in the data he used to calculate these amounts.

[32] The evidence before me is that, pursuant to the Foreclosure Action, all of the assets of Farmers were sold in early 2005 for \$600,000. If I accept Mr. McAllister's calculation of the book value of Farmers' assets at the time of the disposition thereof, then Farmers suffered a loss of at least \$149,576 on the sale of its assets.<sup>14</sup> In fact, the loss was higher since Farmers was required to pay its foreclosure expenses. The Respondent filed a document, Exhibit R-20, which shows that the CRA assumed that the foreclosure expenses were about \$77,000. This means Farmers suffered a loss on the disposition of its assets of approximately \$227,000.<sup>15</sup> That loss wiped out the retained earnings of \$202,102 calculated by Mr. McAllister.

[33] In summary, the Minister based her reassessment of the deemed dividend solely on Mr. McAllister's determination that Farmers had \$202,102 of retained earnings when it was dissolved. The evidence before me is that Farmers did not have any retained earnings when it ceased carrying on its business in 2006. In short, there is no evidence before me to support a finding that funds or property of Farmers were distributed or otherwise appropriated to or for the benefit of the Appellants.

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<sup>11</sup> Transcript, pages 110-111, testimony of Travis McAllister.

<sup>12</sup> Exhibits R-16 and R-18.

<sup>13</sup> Transcript, pages 110-111, testimony of Travis McAllister.

<sup>14</sup> \$749,576.91-\$600,000.

<sup>15</sup> \$749,576.91-\$600,000+\$77,000.

[34] For the foregoing reasons the appeals are allowed.

[35] The reassessment in respect of John Latham's 2005 taxation year is referred back to the Minister for reconsideration and reassessment on the basis that Farmers did not confer a benefit on Mr. Latham.

[36] The reassessments in respect of John Latham's 2006 taxation year and Diane Latham's 2006 taxation year are referred back to the Minister for reconsideration and reassessment on the basis that the Appellants are not deemed under subsection 84(2) to have received a dividend from Farmers.

[37] All penalties are vacated. John Latham is awarded costs of \$1,500. Diane Latham is awarded costs of \$500.

Signed at Ottawa, Canada, this 26<sup>th</sup> day of March 2015.

“S. D’Arcy”

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D'Arcy J.

CITATION: 2015 TCC 75

COURT FILE NO.: 2012-758(IT)G, 2012-759(IT)I

STYLE OF CAUSE: JOHN LATHAM v. HER MAJESTY THE QUEEN and DIANE LATHAM v. HER MAJESTY THE QUEEN

PLACE OF HEARING: Edmonton, Alberta

DATE OF HEARING: June 11, 2014

REASONS FOR JUDGMENT BY: The Honourable Justice Steven K. D'Arcy

DATE OF JUDGMENT: March 26, 2015

APPEARANCES:

For the Appellants:	John Latham
Counsel for the Respondent:	Margaret McCabe Paige MacPherson

COUNSEL OF RECORD:

For the Appellant:

Name:	
Firm:	

For the Respondent:

William F. Pentney Deputy Attorney General of Canada Ottawa, Canada
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