Docket: 2001-3739(IT)G

BETWEEN:

PIERRE BENOIT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on September 8, 2004, at Montréal, Quebec

Before: The Honourable Justice Brent Paris

Appearances:

Counsel for the Appellant: Jacques Renaud

Counsel for the Respondent: Susan Shaughnessey

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the 1997 taxation year is allowed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 16th day of February 2005.

"Brent Paris"

Paris J.

Translation certified true
on this 29th day of September 2005.

Daniela Possamai, Translator

Citation: 2005TCC135
Date: 20050216
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BETWEEN:

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Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Paris J.

[1] This is an appeal from a notice of reassessment dated July 13, 1998, issued by the Minister of National Revenue (the "Minister") for the 1997 taxation year. The issue is whether the Appellant is entitled to net capital loss carryforwards in the amount of $33,750 he allegedly incurred in 1992.

[2] The loss carryforwards were not claimed when the Appellant filed his income tax return for the year at issue because he thought he was entitled to a capital gain deduction equal to the amount of the capital gain for that year. However, in the notice of reassessment, the Minister reduced the capital gain deduction and, as a result, the Appellant is seeking to reduce capital gains by carrying forward net capital losses.

[3] The Appellant alleges having incurred a capital loss of $45,000 in 1992 following investments he made in a business raising jump horses. He wants to carry forward the amount of the alleged allowable capital loss, that is, 75 per cent of $45,000 as a net capital loss to the 1997 taxation year.

[4] The Minister denied the Appellant's claim because, in his opinion, the Appellant did not demonstrate that in 1992 he incurred a loss from the disposition

of a debt or other right to receive an amount acquired by the Appellant for the purpose of gaining or producing income from a business or property within the meaning of subparagraph 40(2)(*g*)(ii) of the *Income Tax Act* (the "Act").

Evidence

[5] The Appellant is a Montréal businessman. Through his "Hôtel Nelson Inc." holding company, he operates a restaurant with 135 employees. Some time prior to fall 1990 he met René Corneiller, who trained jump horses and participated in equine competitions. The Appellant was aware that Mr. Corneiller had won many competitions and was impressed by his talent in this field. In fall 1990, he proposed to Mr. Corneiller that they establish a business together breeding competition horses. It was agreed, according to the Appellant, that he would provide the required capital and that Mr. Corneiller would provide talent and labour. There was no written contract; however, the Appellant indicated that their intention was to build a company of which they were equal shareholders. According to the Appellant, his purpose was to generate profits from the business based on the prices won.

[6] The Appellant also met with Mr. Corneiller's accountant who told him that some of his clients had invested in Mr. Corneiller's activities, that is horses and competitions, and that it was a good opportunity.

[7] The Appellant stated that he began to invest capital in the business by issuing a $15,000 cheque dated September 9, 1990, payable to "Corban Enrg.". He issued another $5,000 cheque to Corban Enrg. dated November 9, 1990. He wrote a memo on the first cheque stating [translation]: "for the purchase of Twist & Shout 50% final payment." On the second cheque he wrote [translation] "for 50% purchase of Twist & Shout". He explained that those payments represented the purchase of a 50% interest in a horse named Twist & Shout of which Mr. Corneiller was the owner. The horse was then to be transferred to the company he and Mr. Corneiller planned to incorporate at the time.

[8] However, instead of establishing a new company, the Appellant and Mr. Corneiller used an existing inactive company of which the Appellant owned all the shares. According to an excerpt from the Registraire des Entreprises (Système CIDREQ), the company's name was changed to "Les Écuries Corben" ("Les Écuries"). The Appellant was unable to say whether any shares were transferred to Mr. Corneiller.

[9] On December 20, 1990, the Appellant and Mr. Corneiller obtained a line of credit in the amount of $25,000 to finance their business. They also opened a bank account under the name Les Écuries. The amount of $22,000 was transferred from the line of credit to the company's account. That amount was to be used, in part, to purchase a horse from a seller in Vermont and, also, to cover the business expenses incurred by the company.

[10] The operations of Les Écuries took place on a stable adjacent to Mr. Corneiller's residence in Sutton, Quebec. The Appellant stated that he visited the premises twice and that he saw horses he thought belonged to Les Écuries. The dates of the visits were not mentioned.

[11] However, the only bank account statements of Les Écuries filed in evidence showed little business activity for the period from January to March 1991 and in early August 1991 the Appellant realized that the business turned out to be a total loss. It seems Mr. Corneiller became ill and could no longer care for the horses. At that point, the Appellant took steps to ensure a $25,000 cheque would be issued by his company Hôtel Nelson Inc. to Mr. Corneiller to reimburse the line of credit, which was done on August 9, 1991.

[12] Subsequently, the Appellant wanted nothing to do with the business and did not attempt to recoup the losses he incurred. He later learned that Mr. Corneiller had passed away.

[13] During an audit of the company Hôtel Nelson Inc. in 1994, it was discovered that the company had included in its business expenses the $25,000 paid to Mr. Corneiller by the Appellant to reimburse the line of credit. Considering that the amount was used to settle the Appellant's personal debt, the auditor disallowed the expense and added that amount to the Appellant's income as shareholder income. Following these events, the Appellant, through his representatives, attempted to deduct his losses from Les Écuries in computing his income for the 1992 taxation year. In support of that claim, the Appellant's representatives filed income tax returns for Les Écuries for the years ending December 31, 1991 and 1992. The financial statements attached to the tax returns revealed expenses in the amount of $21,492 not applied against any income in 1991 and expenses in the amount of $375 not applied against any income in 1992. The only assets consisted of $94 in cash and loans to a director in the amount of $4,050. As for liabilities, they consisted of $25,067 owing to an administrator and did not carry any interest. However, the Appellant was unaware of the information contained in those documents.

[14] According to the testimony of René Paradis, an auditor with the Canada Revenue Agency and responsible for the Hôtel Nelson Inc. case during the audit in 1994, the Appellant's representatives submitted the two cheques made out to Corban Enreg. (the same cheques filed in evidence in the case at bar) in support of the claim for losses on behalf of the Appellant personally. At the time, the representatives indicated that the Appellant invested $20,000 in a partnership company called Corban Syndicate and provided a copy of the company's financial statements for the fiscal year ending December 31, 1990.

[15] Counsel for the Respondent also filed a copy of the facts and reasons submitted in support of the notice of objection served on behalf of the Appellant to the notice of reassessment at issue where it is indicated in paragraph 1:

[Translation]

> From 1990 to 1992, Pierre Benoit (hereinafter referred to as "the objector") invested in a partnership company (Corban Enrg.) and in a private company (Les Écuries Corben Inc.);

The Act

[16] The relevant provisions are paragraph 39(1)(*b*) and subparagraph 40(2)(*g*)(ii) of the Act, which, in the case at bar, read as follows:

> **Meaning of capital gain and capital loss.**
>
> 39(1) For the purposes of this Act,
> . . .
>
> (*b*) a taxpayer's capital loss for a taxation year from the disposition of any property is the taxpayer's loss for the year determined under this subdivision . . . from the disposition of any property . . . .
>
> 40(2) **Limitations.**
>
> . . .
>
> (*g*) a taxpayer's loss, if any, from the disposition of a property, to the extent that it is

> (ii) a loss from the disposition of a debt or other right to receive an amount, unless the debt or right, as the case may be, was acquired by the taxpayer for the purpose of gaining or producing income from a business or property (other than exempt income) or as consideration for the disposition of capital property to a person with whom the taxpayer was dealing at arm's length,

[17] In other words, the Act prescribes that a capital loss from the disposition of a debt is deemed to be nil, unless the debt was acquired for the purpose of gaining or producing income from a business or property.

Analysis

[18] I propose to deal with the amounts paid by the Appellant to Corban Enrg. and those he advanced to Les Écuries separately.

[19] In the case of the former, the first issue to be determined is whether the Appellant demonstrated, on balance of probabilities, that those amounts would result in any debt that could have been subject to a disposition as required by subsection 39(1) of the Act mentioned above.

[20] Counsel for the Appellant submits that the payments of $15,000 and $5,000 represented equity interest in Les Écuries. According to him, those payments were to be used to purchase a horse (Twist & Shout) which was then to be transferred to the company at the time of its incorporation. From that perspective, the payments were an investment in the company.

[21] However, the evidence supporting the two cheques is problematic. I am not satisfied that the Appellant demonstrated that he acquired a debt through those payments. In any case, it is far from being clear that those funds were invested in Les Écuries. Some of the evidence contradicts that claim. First, the Appellant did not explain the reason he paid those amounts to Corban Enrg. considering he thought that Mr. Corneiller was the owner of the horse Twist & Shout. There was nothing to suggest that the Appellant purchased the horse from Corban Enrg.

[22] Second, I note that, up until his notice of appeal was served, the Appellant's argument seems to have been that the amounts were paid to acquire an interest in Corban Enrg. Submissions to that effect were also made to the auditor in 1994. However, during his examination for discovery, the Appellant confirmed that he was never a member of the partnership company and that he knew nothing about it

(Exhibit I-1, page 36, question 167). In the financial statements filed in evidence, the Appellant's name did not appear on the list of members of Corban Enrg. It should be noted that the nature of the events that took place should have been clearer in the Appellant's memory at the time, in 1994, than during the hearing of the case under review.

[23] In light of all these contradicting facts, I do not accept the Appellant's testimony as to his intentions regarding these payments. In the absence of other evidence that he acquired a debt following the payments he made for the purpose of gaining or producing income from a business or property, I am of the opinion that this aspect of the appeal should be dismissed.

[24] As for the $25,000 paid out by Hôtel Nelson Inc. to pay the line of credit of the company Les Écuries, I accept that the payment was made on behalf of the Appellant. The Minister assumed as much by adding the amount to the Appellant's income personally for 1991.

[25] Furthermore, it is obvious that the Appellant's purpose, in providing the original advances to Les Écuries from the line of credit, was to capitalize the company. It remains to be decided whether the advances were made for the purpose of gaining or producing income.

[26] As for Counsel for the Respondent, she suggested that the Appellant's purpose could not have been the required one because the venture did not have the capability to show a profit that could have been divided among shareholders afterwards.

[27] Contrary to the Respondent's argument, it does not seem to me that a taxpayer must demonstrate that a company in which he or she invested has a reasonable expectation of profit in order to prevent the loss of his or her investment from being deemed nil. What is important is the taxpayer's purpose and not his or her business acumen.

[28] However, in determining whether a taxpayer is motivated by hopes of gaining or producing income from a business or property, as prescribed by subparagraph 40(2)(g)(ii), the Court can take into account the commercial side of the taxpayer's business when there is a personal element or personal motivation attached to the business (see *Rich v. The Queen*, [2003] F.C. 493, paragraph 10, *supra*). Where such an element is present, the Court must be satisfied that the taxpayer's behaviour is in accordance with the accepted business standards in order

to conclude that his or her motivation was that of gaining or producing income (see *Stewart v. The Queen*, [2002] 2 S.C.R. 645 at paragraph 55).

[29] In the case at bar, the only personal element alleged by the Minister with respect to the Appellant's participation in Les Écuries was that he had a partiality for horses. As for the Appellant, he denied that suggestion and stated that he never rode horses at the stable of Les Écuries. I am not convinced that there is, in the facts, a personal element to the Appellant's investment in Les Écuries and for that reason it is unnecessary to review the commercial side of the investment.

[30] To decide whether the Appellant's purpose or one of his purposes was that required by subparagraph 40(2)(*g*)(ii) of the Act, the test to be applied is that described by Iacobucci J. in *Symes* v. *The Queen*, [1993] 4 S.C.R. 695 at page 736:

> As in other areas of law where purpose or intention behind actions is to be ascertained, it must not be supposed that in responding to this question, courts will be guided only by a taxpayer's statements, ex post facto or otherwise, as to the subjective purpose of a particular expenditure. Courts will, instead, look for objective manifestations of purpose, and purpose is ultimately a question of fact to be decided with due regard for all of the circumstances.

[31] In the circumstances of this case, I find that the Appellant's purpose in capitalizing Les Écuries was to earn income in the form of dividends. I accept his testimony that he expected to earn profits from his participation in the company and I note what the Federal Court of Appeal stated in *Byram* v. *Canada*, [1999] F.C.J. No. 92 at paragraph 22 which also dealt with the issue of whether a loss incurred by a taxpayer was deemed to be nil under subparagraph 40(2)(*g*)(ii):

> The shareholders of a company are directly linked to that corporation's future earnings and its payment of dividends. Where a shareholder provides a guarantee or an interest free loan to that company in order to provide capital to that company, a clear nexus exists between the taxpayer and the potential future income. [See *Gordon* v. *Her Majesty the Queen*, 96 D.T.C. 1554 (T.C.C.) at 1558]. Where a loan is made for the purpose of earning income through the payment of dividends, this connection is sufficient to satisfy the purpose requirement of subparagraph 40(2)(g)(ii).

[32] The Appellant's statements as to his intention to gain or produce income were not contradicted. On the contrary, they were confirmed by the Appellant's

behaviour, such as the company's establishment, his meeting with Mr. Cornellier's accountant and his visits to the stable.

[33] I therefore conclude that the Appellant had the intention required to not deem his loss in the amount of $25,000 to be nil. As a result, the Appellant was entitled to carry forward a net capital loss from 1992 to 1997 in the amount of $18,650.

[34] For all these reasons, the appeal is allowed in part with costs.

Signed at Ottawa, Canada, this 16th day of February 2005.

"Brent Paris"

Paris J.

Translation certified true
on this 29th day of September 2005.

Daniela Possamai, Translator

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APPEARANCES:

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For the Respondent:	Susan Shaughnessey

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