

Docket: 2006-1769(IT)I

BETWEEN:

MARILYN E. MARTIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on May 28, 2007, at Calgary, Alberta.

Before: The Honourable Gerald J. Rip, Associate Chief Justice

Appearances:

Counsel for the Appellant: David Reesor
Counsel for the Respondent: Daniel Segal

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 2001, 2002 and 2003 taxation years are dismissed.

Signed at Ottawa, Canada, this 13th day of June 2007.

"Gerald J. Rip"

Rip A.C.J.

Citation: 2007TCC339
Date: 20070613
Docket: 2006-1769(IT)I

BETWEEN:

MARILYN E. MARTIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Rip, A.C.J.

[1] Marilyn E. Martin appeals from income tax assessments for 2001, 2002 and 2003 in which the Minister of National Revenue ("Minister"), pursuant to subparagraph 20(1)(l)(ii) and paragraph 20(1)(p) of the *Income Tax Act* ("Act"), denied Mrs. Martin's deduction of a reserve for doubtful debts (and a deduction for bad debts) in computing her income from a business. The Minister denied the deduction on the basis that Mrs. Martin's ordinary business did not include the lending of money.¹

[2] At all relevant times Mrs. Martin was a lawyer practising in partnership with Mr. David Reesor in Calgary. Her clients included Natural Springs Canada Inc. ("Natural Springs") and its wholly-owned subsidiary, Tri-Pure Water Ltd. ("Tri-Pure"). Natural Springs was listed on the Alberta Stock Exchange and, later on, the Canadian Venture Exchange.

¹

From the pleadings it was not clear whether this was the sole issue before me or if another issue was whether the debts were doubtful. Counsel agreed that I need not consider the doubtful debt issue. Also, the assessments in issue were not produced. The pleadings suggest the assessments in issue refer to both doubtful debts (subpara. 20(1)(l)(ii)) and bad debts (para. 20(1)(p)). There may be some inconsistency in the assessments.

[3] Tri-Pure owned and operated a water bottling business. Natural Springs had also owned Polypah Industries Inc., a company that manufactured plastic bottles; it ceased operations in 1995.

[4] The original promoters and shareholders of Natural Springs transferred their interests in the company and by December 1991, Mrs. Martin was President and Director of Natural Springs. She owned approximately five percent of the issued shares of Natural Springs, her husband, about seven percent. Mr. Reesor and three other persons were also directors. Mrs. Martin was also President and sole director of Tri-Pure. During this time she continued to practice law; however, ten percent of her time was then devoted to law and the balance to Natural Springs and Tri-Pure.

[5] Mrs. Martin stated she got involved with Natural Springs with the view to "expanding my opportunity beyond the law firm". She said she was looking "to escape law". She made the loans to enable the companies to be successful. By insisting on proper security and being an "insider" she was confident she would be repaid on account of capital and would be paid interest. Natural Springs had raised \$180,000 in an initial share offering. At the time of the loans she preferred to make the loans rather than having either company go to the bank for a line of credit.

[6] Natural Springs was incorporated in 1987 and until a little after it acquired Tri-Pure, it also sold bottled water. Natural Springs had started its water business from a plant in a Hutterite community. The plant was financed by the community and Natural Springs paid a royalty to the community. The arrangement with the community "collapsed" in 1997 and Natural Springs then transferred its "line" to Tri-Pure in Calgary.

[7] Starting in 1997, Mrs. Martin commenced making a series of loans to Natural Springs and Tri-Pure. Mrs. Martin explained that Natural Springs and Tri-Pure were "start-up" companies and "start-ups" usually required funding. Natural Springs had financial problems since incorporation. Her law firm and another director also agreed to lend money to the companies. The loans by her were payable on demand as to capital and interest; the interest rate was 20 percent per year, simple interest.

[8] Mrs. Martin testified that she loaned money to the companies because they required additional working capital. Tri-Pure or Natural Springs — it is not clear which company — had negotiated at least three contracts for supply of water and expected profits from these contracts. Mrs. Martin had confidence in the future. However, the "deals" collapsed, the last one in 2001.

[9] The first loan to Natural Springs in the amount of \$1,500 was on October 15, 1997; a second loan of \$10,000 was made on June 16, 1998, a third loan of \$9,000 was made on July 10, 1998 and a final loan, in the amount of \$1,000 was made on September 13, 2000. In all, Mrs. Martin loaned Natural Springs \$21,500. There were no repayments of capital.

[10] Mrs. Martin advanced funds to Tri-Pure on 14 occasions, the first loan of \$3,000 was made on November 3, 1997, the last loan also of \$3,000, was made on September 1, 2000. The aggregate of loans to Tri-Pure was \$48,955.94,² payments on capital totalled \$2,618.39.

[11] Neither company paid Mrs. Martin any interest on the loans nor did she demand interest. Each month Mrs. Martin sent to each company a statement indicating, among other things, the dates and amounts of the loans and the interest accrued to the end of the month in respect of each loan. As at December 31, 2003, Tri-Pure had accrued interest owing of \$43,615.11. As at September 31, 2000, Natural Springs owed accrued interest of \$659.73 with respect to the loan of September 13, 2000.

[12] Each loan by Mrs. Martin to Natural Springs and Tri-Pure was secured. Each company's directors approved each loan to their corporation and authorized or ratified the granting of a promissory note by the corporation recording the terms of the particular loan. In 1994 Natural Springs granted to Reesor Martin a general and continuing security, including a general assignment of book debts, to secure its debt to Reesor Martin. Tri-Pure guaranteed the debt of Natural Springs to Reesor Martin. In 1998 Reesor Martin and another creditor agreed to subordinate their respective security interests in the assets of Natural Springs and Tri-Pure to the interests of the appellant and her husband, who also advanced funds.

[13] All security agreements were registered by Mrs. Martin in accordance with Alberta securities legislation. Notices were filed as required by the Alberta Stock Exchange, the Alberta Securities Commission and, later, the British Columbia Securities Commission. In other words, Mrs. Martin and the corporations dealt

² On January 1, 2000, the principal amount owing by Natural Springs in the amount of \$20,500 plus accrued interest owing to Mrs. Martin of \$6,406.30 was assigned by Natural Springs to Tri-Pure in payment for molds purchased by Tri-Pure from Natural Springs. Mrs. Martin advanced Natural Springs an additional \$1,000 on September 13, 2000. Reesor Martin, the appellant's law firm, assigned to Mrs. Martin \$9,037.55 of debt Tri-Pure owed to the firm. These amounts are reflected in the total principal owed by Tri-Pure to Mrs. Martin.

with the loans in the same conservative and businesslike manner as would be done by an institutional lender.

[14] Mrs. Martin explained that the loans she made to Natural Springs and Tri-Pure were essentially open lines of credit so long as she was content with the security and the business operations of the companies. She never intended to convert the loans to equity. The interest rate of 20 percent permitted her to recover the interest she paid on money borrowed to lend to the companies, risk and a rate of return for profit. Mrs. Martin used her own funds and money borrowed from personal Visa and Mastercard credit cards to fund the loans. She borrowed \$13,618.39 from these sources to make loans to Tri-Pure and \$11,500 for loans to Natural Springs. Approximately 40 percent of amounts she advanced to these corporations were borrowed as at the end of 1999 and approximately 50 percent were borrowed at the end of 2000. The balance of borrowed amounts were reduced in future years. Interest rates Mrs. Martin paid for the borrowed funds, she said, ranged between 15 percent and 18 percent per year.

[15] At no time did Mrs. Martin hold herself out as a money lender. She did not advertise as such nor did she do anything to tell the world she was in the money lending business. She did not maintain a separate bank account for her money lending activity. The only loans Mrs. Martin made were to Natural Springs and Tri-Pure. Again, she made the loans fully expecting to be repaid.

[16] Once the third opportunity to supply water collapsed in the fall of 2001, Mrs. Martin decided to execute on her security against both companies. This was done on December 1, 2001. Assets were seized; however, title to the assets remained with debtors so as to permit Tri-Pure to carry on in the ordinary course. The hope was that the company's goodwill would continue and permit an ordinary sale of the business as a going concern. Mrs. Martin looked for a potential purchaser of equipment and of the operating company, including the leases of the premises from where operations were carried out. In the meantime she managed the business operations. At all times Natural Springs made the necessary reports to the Alberta Securities Commission and filed financial statements with the pertinent stock exchanges.

[17] There is no doubt Mrs. Martin treated her loans as would an institutional and cautious lender of money. As an "insider" she knew each company's potential. She obtained the maximum security possible for her advances. She saw the loans as an opportunity to make money.

[18] On the other hand Mrs. Martin was a lawyer with a law practice, even though 90 percent of her time was devoted to Natural Springs and Tri-Pure. She did not hold herself out as a money lender. She dealt with only two borrowers, both in whom she had an interest, direct or indirect. The principal amounts of the loans were payable on demand; the interest on the loans was payable on demand. No such demands were made, except for \$2,618 of principal. There was no continuous income stream from the loans that a person whose ordinary business includes the lending of money would expect.

[19] It is doubtful Mrs. Martin was carrying on a money lending business, let alone that such a business was her ordinary business within the meaning of subparagraph 20(1)(l)(ii) of the *Act*. The provision reads as follows:

20. (1) 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:

(l) a reserve determined as the total of

...

(ii) where the taxpayer is a financial institution (as defined in subsection 142.2(1)) in the year or a taxpayer whose ordinary business includes the lending of money, an amount in respect of properties (other than mark-to-market properties, as defined in that subsection) . . .

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 :

l) la provision égale au total des montants suivants :

[...]

(ii) si le contribuable est une institution financière au sens du paragraphe 142.2(1) au cours de l'année ou si son activité d'entreprise habituelle consiste en tout ou en partie à prêter de l'argent, un montant au titre de biens (sauf un bien évalué à la valeur du marché au sens de ce paragraphe) [...]

[20] Paragraph 20(1)(p) of the *Act* permits the deduction of bad debts, provided that the loan was made by a taxpayer whose ordinary business includes the lending of money.

[21] In *Loman Warehousing Ltd. v. Canada*³, Bowman J., as he then was, explained that:

25 The expression "whose ordinary business includes the lending of money" requires a determination of just what the taxpayer's "ordinary business" is. The ordinary business of the appellant is warehousing, not lending money to other companies in the group. Some effect must be given to the word "ordinary". It implies that the business of lending money be one of the ways in which the company as an ordinary part of its business operations earns its income. It also implies that the lending of money be identifiable as a business. . . .

[22] Bonner J., emphasized the effect that must be given to the word "ordinary" in the phrase "ordinary business": *Yunger v. Canada*⁴.

[23] Appellant's counsel argued that the facts in these appeals are similar to those in *Discovery Research Systems Ltd. v. Canada*⁵. Assuming that case was correctly decided, the basic facts are quite different from those before me. For example, the taxpayer in that case made loans to nine different corporations; the lender owned no shares in three of the borrowing corporations. Also, the loan agreements contained a specific rate of interest and terms of repayment.

[24] On the facts before me, it is quite a stretch to conclude that Mrs. Martin's ordinary business was or included the lending of money. Firstly, she was in the business of practising law; secondly, she was an officer and director of the two corporations to which she devoted most of her time. There is no evidence, either, that the law firm's ordinary course of business included the lending of money. Mrs. Martin made no effort, nor was she inclined to lend money to other persons. That she ensured that the loans were well secured, that the directors of each borrower approved the loans, that she sent monthly statements to the two corporations, does not make the loans a business activity. Cautious investors not in the business of lending money may normally do the same. The money Mrs. Martin advanced to the two corporations was on capital account, not in the course of business. Even if one concludes that the loans were ventures in the nature of trade and thus a

³ 99 DTC 1113, [1999] T.C.J. No. 341 (QL), para. 25, aff'd 2000 DTC 6610, [2000] F.C.J. No. 1717.

⁴ 2000 DTC 2153, [2000] T.C.J. No. 329, para. 15 (QL).

⁵ 94 DTC 1510 (TCC), [1994] T.C.J. No. 107 (QL).

business within the meaning of subsection 248(1) of the *Act*, such a business is not one's "ordinary" business.

[25] The appeals are dismissed.

Signed at Ottawa, Canada, this 13th day of June 2007.

"Gerald J. Rip"

Rip A.C.J.

CITATION: 2007TCC339

COURT FILE NO.: 2006-1769(IT)I

STYLE OF CAUSE: MARILYN E. MARTIN v. HER MAJESTY
THE QUEEN

PLACE OF HEARING: Calgary, Alberta

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REASONS FOR JUDGMENT BY: The Honourable Gerald J. Rip, Associate
Chief Justice

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APPEARANCES:

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Counsel for the Respondent: Daniel Segal

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