Docket: 2004-3092(IT)G

BETWEEN:

177795 CANADA INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on October 26 and 27, 2006, at Montréal, Quebec.

Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the Appellant:	Claude P. Desaulniers
Counsel for the Respondent:	Jane Meagher Martin Gentile

JUDGMENT

The appeal from the assessment under the *Income Tax Act* for the 1992 taxation year is dismissed with costs, in accordance with Tariff B of the *Tax Court of Canada Rules (General Procedure)*.

Signed at Ottawa, Canada, this 27th day of September 2007.

"Lucie Lamarre"

Lamarre J.

Translation certified true

on this 20th day of February 2008.

François Brunet, Revisor

Citation: 2007TCC569
Date: 20070927
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REASONS FOR JUDGMENT

Lamarre J.

[1] The Appellant is appealing from an assessment made on January 22, 2004, for the taxation year ending July 31, 1992. During that period, the Appellant operated its business under the name Sofati Ltée (Sofati). All reference to Sofati in the partial agreement on the facts as well as in these Reasons for Judgment concerns the Appellant, as it is the same entity.

[2] The partial agreement on the facts produced by the parties reads as follows:

[TRANSLATION]

> 1. The Appellant is a corporation duly incorporated and the addresss of its principal place of business is as follows: 1 Place Ville Marie, Suite 1812, Montréal, Quebec H3B 3M4.
>
> 2. The assessment was issued on January 22, 2004, for the taxation year ending July 31, 1992.
>
> 3. The Appellant is a corporation which, during the taxation year ending July 31, 1992, operated a construction business.

4. During the 1992 taxation year, the Appellant reported business income of over $17,000,000 from a training and turnkey construction contract abroad, namely North Africa.

5. In an assessment dated June 25, 1996, for the 1992 taxation year, the Minister of National Revenue (the “Minister”) considered that the Appellant was not entitled to any non-capital loss from previous years and carried forward the amount of $2,499,358 as a non-capital loss to subsequent years.

6. On September 10, 1996, the Appellant objected to the assessment of June 25, 1996.

7. More than seven years after the Notice of Objection was filed, that is to say, on January 22, 2004, the Minister issued a reassessment to increase from $2,499,358 to $7,922,562 the losses allowable for the 1992 taxation year, that is $4,094,913 from previous taxation years and $3,827,649 from subsequent taxation years.

8. In doing so, however, the Minister disallowed a portion of the amount of $19,884,674 claimed as loss by the Appellant in 1988, the disallowed portion being $16,036,040.

9. The Appellant objected to the Minister’s assessment within the prescribed time limit. The Minister confirmed the assessment in a decision dated May 4, 2004.

10. Preston Parkway Joint Venture (“PPJV”) was incorporated under the *Partnership Act* of the State of Texas.

11. The financial and fiscal year of PPJV was the calendar year.

12. Prior to December 1, 1987, the interest in PPJV was held by Louis G. Reese Inc., (hereinafter “Reese”) (99%), and Preston Parkway Development Company (hereinafter “PPDC”), (1%), two American residents.

13. As of November 30, 1987, the assets of PPJV consisted principally of real property the cost of which was US$32,000,000 and the fair market value (hereinafter “FMV”) was US$16,000,000.

14. As of November 30, 1987, the real property was subject to a mortgage of US$28,000,000 held by the Bank of New York.

15. By contract signed on December 15, 1987, Sofati Ltée and Westmount Parc Towers Inc., both Canadian residents, purchased 99% and 1% of PPJV, respectively.

16. The contract of purchase for its interest in the PPJV was signed by Sofati Ltée on December 15, 1987, retroactive to December 1, 1987.

17. Under an undated "Escrow Indemnity Agreement" taking effect December 1, 1987, Reese and PPDC undertook to indemnify the purchasers, that is, Sofati Ltée and Westmount Park Towers Inc., against all claims by potential creditors listed in the agreement, including the US$12,000,000 owed to the Bank of New York following the auction of the real property; such indemnity ended on the first business day after December 1, 1991, in two cases, and the first business day after December 1, 1989, in other cases; to that end, part of purchase price of US$390,000 was withheld to be remitted upon resolution of the claims or on the date the indemnity ended.

18. On December 1, 1987, the Bank of New York, which held a mortgage on the real property project developed by PPJV, purchased it by submitting a bid of US$16,000,000; that consideration was used to reduce the debt owed to the Bank to US$12,000,000 as it was originally US$28,000,000 (for the present purposes, all figures have been rounded to the nearest million).

19. The debtor (PPJV) was informed for the first time on October 12, 1987, that the real property would be seized and sold, if it defaulted on the mortgage payment. It was also informed at least twenty-one days prior to the date of the seizure that the property would be seized and sold.

20. When Sofati Ltée purchased its interest in PPJV, it was aware that the real property would be seized by the Bank of New York and sold at a loss.

21. As for the balance owing on the debt to the Bank of New York, about US$12,000,000, it was paid on December 23, 1987, by PPJV to Columbia Capital Corporation to whom the Bank of New York sold it.

22. On December 18, 1987, the Bank of New York gave Columbia Capital Corporation (hereinafter "CCC"), a Canadian corporation, a promissory note in the amount of US$12,146,467.28, owed by PPJV.

23. On December 23, 1987, CCC borrowed US$12,146,467.28 from the Bank of Montréal.

24. On December 23, 1987, CCC loaned US$12,146,467.28 to PPDC.

25. On December 23, 1987, PPDC paid US$12,146,467.28 to PPJV.

> 26. On December 23, 1987, PPJV reimbursed US$12,146,467.28 to CCC.
>
> 27. Since the cost of the real property for PPJV was US$32,000,000, PPJV reported a loss of US$16,000,000. Moreover, the participants in PPJV at the end of its financial year ending December 31, 1987, deducted their share of the US$16,000,000 in computing their 1988 income.
>
> 28. Sofati Ltée claimed 99% of the US$16,000,000, that is CDN$19,884,674, as a loss in computing income for its fiscal year ending July 31, 1988, and carried forward a portion of that loss, that is CDN$16,036,040, as a deduction in computing income for its fiscal year ending July 31, 1992.
>
> 29. Since September 1989, PPJV has had a real property investment in Texas which generates annual profits.

[3] The Respondent refused to carry over the loss of CDN$16,036,040 on the ground that when Sofati purchased its share in Preston Parkway Joint Venture (PPJV), its intention was not to carry on business with a view to profit from the activities of PPJV. Consequently, the Respondent claims that Sofati did not become a member of a partnership within the meaning of the *Income Tax Act* (ITA) and cannot claim entitlement to the loss incurred by PPJV under section 96 of the ITA. In other words, the Respondent submits that PPJV was not a partnership for Canadian tax purposes when the loss related to the sale of the real property was incurred by PPJV.

[4] Alternatively, the Respondent submits that even if PPJV was a partnership within the meaning of section 96 of the ITA, no loss is attributable to Sofati for its fiscal year ending July 31, 1988 (therefore it could not be carried forward to the fiscal year ending July 31, 1992). According to the Respondent, pursuant to subsection 10(1) of the ITA and section 1801 of the *Income Tax Regulations* (Regulations), the cost of the property for PPJV as of December 1, 1987, that is the date on which it became a partnership within the meaning of the ITA, was the fair market value on that date, that is US$16,000,000. Considering that the proceeds of disposition of the real property were also US$16,000,000, no loss could be attributed to Sofati.

[5] The Appellant challenges the two submissions made by the Respondent. On the one hand, it submits that it became a member of PPJV, a partnership within the meaning of the ITA, during the financial year of PPJV ending December 31, 1987, and that, as such, it is entitled, in computing income for its fiscal year ending July

31, 1988, its portion of the loss of PPJV for its financial year ending December 31, 1987, and to carry forward to the next years, namely July 31, 1992, the portion of that non-deducted loss in the preceding taxation years. Moreover, the Appellant submits that the loss of PPJV is not nil but rather amounts approximately to US$16,000,000, which represents the difference between the cost of the real property project, US$32,000,000, and the proceeds of disposition during the 1987 taxation year, that is approximately US$16,000,000.

Legislative provisions

[6] The relevant legislative provisions of the ITA to which the parties made reference are as follows:

> ***Income Tax Act***
>
> **SECTION 10: Valuation of inventory.**
>
> **(1)** For the purpose of computing income from a business, the property described in an inventory shall be valued at its cost to the taxpayer or its fair market value, whichever is lower, or in such other manner as may be permitted by regulation.
>
> **Section 10(2)**
>
> **(2) Idem.** Notwithstanding subsection 10(1), for the purpose of computing income for a taxation year from a business, the inventory at the commencement of the year shall be valued at the same amount as the amount at which it was valued at the end of the preceding taxation year for the purpose of computing income for that preceding year.
>
> . . .
>
> **Subdivision j−Partnerships and their members**
>
> **SECTION 96: GENERAL RULES.**
>
> **(1)** Where a taxpayer is a member of a partnership, the taxpayer's income, non-capital loss, net capital loss, restricted farm loss and farm loss, if any, for a taxation year, or the taxpayer's taxable income earned in Canada for a taxation year, as the case may be, shall be computed as if
>
> (*a*) the partnership were a separate person resident in Canada;
>
> (*b*) the taxation year of the partnership were its fiscal period;
>
> . . .

> (*g*) the amount of the loss of the partnership for a taxation year from any source or sources in a particular place were the loss of the taxpayer from that source or from sources in that particular place, as the case may be, for the taxation year of the taxpayer in which the partnership's taxation year ends, to the extent of the taxpayer's share thereof.

. . .

Income Tax Regulations

Part XVIII
Inventories
. . .

VALUATION

> **1801.** Except as provided in section 1802, for the purpose of computing the income of a taxpayer from a business, all the property described in all the inventories of the business may be valued at its fair market value.

Existence of a partnership within the meaning of the ITA

[7] The principal issue is whether the Appellant was a member of a partnership within the meaning of the ITA when the losses claimed were incurred by PPJV such that it could deduct those losses from its income pursuant to section 96 of the ITA.

[8] The term "partnership" is not defined in the ITA. In *Backman v. Canada*, [2001] 1 S.C.R. 367, 2001 SCC 10, at paragraph 17, the Supreme Court of Canada confirmed the principle that a taxpayer seeking to deduct Canadian partnership losses under section 96 of the ITA must satisfy the definition of partnership that exists under the relevant provincial law. Thus, the Supreme Court of Canada pointed out that even in respect of foreign partnerships, for the purposes of section 96 of the Act, the essential elements of a partnership that exist under Canadian law must be present.

[9] In the case at bar, the civil law applies. During the period in issue, articles 1830 and 1831 of the *Civil Code of Lower Canada* (C.C.L.C.) were in force.

[10] Articles 1830 and 1831 C.C.L.C. read as follows:

TITLE ELEVENTH
OF PARTNERSHIP

CHAPTER FIRST
GENERAL PROVISIONS

> **Art. 1830.** It is essential to the contract of partnership that it should be for the common profit of the partners, each of whom must contribute to it property, credit, skill, or industry.
>
> **Art. 1831** Participation in the profits of a partnership carries with it an obligation to contribute to the losses.
>
> Any agreement by which one of the partners is excluded from participation in the profits is null.
>
> An agreement by which one partner is exempt from liability for the losses of the partnership is null only as to third persons.

[11] In Québec, according to the doctrine,[1] there are three essential elements to the formation of a partnership, in accordance with the law applicable during the period in issue. First, it is necessary to determine the existence of a real intention on the part of all parties to enter into a partnership agreement. Second, each partner must make some contribution to the formation of the partnership, whether it be monetary or other (such as a partner's personal qualities for instance). And finally, a partnership cannot be formed but with a view to profit. Similarly, for a partnership agreement to exist, there must be an agreement on the sharing of profits among the partners. As for the sharing of losses, they are assumed to be divided equally among the partners.

[12] In *Bourboin v. Savard* [1926], 40 C.B.R. 68, Mr. Justice Rivard, of the Court of King's Bench (predecessor of the Quebec Court of Appeal), stated as follows at pages 70 and 71:

> A contract of partnership has three essential characteristics: (1) the pursuit of a common purpose consisting of the realization of a profit; (2) the constitution of a common fund through the contributions that each makes of his property, credit, skill or industry; and (3) participation in the profits, which entails the obligation to share in the losses, absent any agreement to the contrary.

[1] Albert Bohémier and Pierre-Paul Côté. *Droit commercial général*, Volume 2, 3rd edition, Montréal, Les éditions Thémis, 1985, Chapter II, Les sociétés, pp. 16-19.

> These three characteristics mean that there must be among both parties the intention, juridically proved, to pursue in common, with the help of everyone's contributions, the realization of a profit; in other words, for there to be a partnership, it is necessary, absent an express contract, that it be clearly apparent from the facts that both of the purported partners intend to form a contract of partnership and not some other contract that might be more or less analogous with the partnership. That is what the authorities have referred to as *affectio societatis* comes down to.
>
> 1. C.c., 1830; Fuzier-Herman, Rep., Vo Sociétés, No. 3; D.A. Sup. Vo Société, 134.

[13] Furthermore, in *Backman*, *supra*, the Supreme Court of Canada stated that ". . . to ascertain the existence of a partnership the courts must inquire into whether the objective, documentary evidence and the surrounding facts, including what the parties actually did, are consistent with a subjective intention to carry on business in common with a view to profit" (paragraph 25). Moreover, ". . . a taxpayer's overriding intention is not determinative of whether the essential ingredient of "view to profit" is present. It will be sufficient for a taxpayer to show that there was an ancillary profit-making purpose" (cf. *Backman*, *supra*, at paragraph 23).

[14] In the case at bar, it is clear that the Appellant's overriding intention when it acquired almost all the interests in PPJV was to recover tax losses. In fact, by investing the sum of US$390,000, it sought deductions in the amount of CDN$19,000,000. Indeed, counsel for the Appellant was clear on that point. It is precisely for that purpose that the Appellant preferred to invest in PPJV rather than to make an offer directly to the Bank of New York (BONY) to reacquire the property (which was the only asset of PPJV), after the Bank seized it.

[15] However, in the wake of *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298, the Appellant can claim to be in a partnership if it can prove that by investing in PPJV, it had as an ancillary purpose the intent to carry on business in common, with the other members, with a view to profit.

[16] The difficulty, in the case of bar, arises from the fact that the evidence that the intent of the Appellant and Westmount Park Towers Inc. (WPTI) was to profit by investing in PPJV is rather based on what happened after the American partners of PPJV, under whose control the claimed loss incurred, withdrew from the partnership. Indeed, the overall evidence shows that the American partners relinquished their interests in PPJV in favour of the Appellant and its sister company WPTI when there were no longer any assets in PPJV, and therefore, never had the intent to carry on business in common with a view to profit as partners of PPJV. Of course, the transfer of interests in PPJV was effected in two steps, first

through documents indicating the transfer of 99% of the interests in PPJV belonging to Louis G. Reese in favour of the Appellant and WPTI and then by other documents indicating the transfer of 1% of the interests in PPJV belonging to Preston Parkway Development Company ("PPDC"). However, all this happened concomitantly on December 15, 1987, and retroactively to December 1, 1987, immediately prior to the seizure of the only asset of PPJV by BONY. It is however quite clear from the evidence that Louis G. Reese and PPDC were no longer partners in PPJV retroactively to December 1, 1987, and that all the evidence pertaining to the steps taken by Sofati, or its president, Michel Gaucher, on behalf of PPJV, no longer legally involved the former American partners.

[17] That being said, the evidence offered before me reveals the following main points.

[18] Sofati first made its mark in major engineering contracts abroad. In 1986, Sofati began to diversy by becoming involved in the real estate industry, first by converting property into condominiums in Montréal with its sister company, WPTI, then in the United States, by investing in both thermal power plants and real estate. Thus, Sofati was introduced to Grubb & Ellis, a real estate brokerage company in Dallas, Texas.

[19] At the request of Sofati, on October 8, 1987, Grubb & Ellis provided him with a study on the the real estate market in Texas in which it was reported that it had reached a low and that the experts recommended investing as they expected an increase in the value of real estate in the years to come (Exhibit A-1, Tab 31). At the time, Sofati had a net worth of approximately CDN$70,000,000, liquid assets of approximately CDN$10,000,000 and sales in excess of CDN$150,000,000. In October 1987, the Sofati group met with a certain Louis G. Reese, an American who had invested in PPJV in 1984 with an American entity, PPDC, for the construction project of a commercial building, the Sherry Plaza, in Dallas, Texas. The US$32,000,000 project was financed by BONY up to US$28,000,000. When Sofati was introduced to Mr. Reese, BONY had already informed PPJV that it intended to repossess the property following the default on the debt payment. The building was then 95% completed and there were many potential lessees in sight.

[20] According to Michel Gaucher, the intention was to develop long-term projects with Mr. Reese. It was also in his interest to form a partnership with him in order to make a tax profit from the losses PPJV was about to incur following the imminent foreclosure by BONY of Sherry Plaza, which was the only asset held by PPJV.

[21] Therefore, on November 16, 1987, Sofati, through another numbered company, undertook to acquire the interests of Mr. Reese and PPDC in PPJV, which at the time was 99% controlled by Mr. Reese. That agreement is entitled "Summary of Proposed Acquisition of Joint Venture Interests in Preston Parkway Joint Venture," and reads as follows (Exhibit A-1, Tab 48):

> Summary of Proposed Acquisition
> of Joint Venture Interests in
> Preston Parkway Joint Venture
>
> This will serve as a binding memorandum of understanding between 158723 Canada Inc. (the "Purchaser") and Louis G. Reese Inc. and Preston Parkway Development Company (the "Vendors") for the Purchaser, or its nominee, to acquire either 99% or 100%, at the option of the Purchaser, of the Joint Venture interests in the Preston Parkway Joint Venture (the "Joint Venture"). Summaries of the facts surrounding the Joint Venture and a summary of the steps required to complete the transaction are as follows:
>
> Summary of Facts
>
> 1. Two corporations, Louis G. Reese Inc. (99%) and Preston Parkway Development Company (1%) own all of the joint venture interests in the Joint Venture. Louis G. Reese controls both Joint Venturers.
>
> 2. The Joint Venture is a general partnership according to Texas law.
>
> 3. The cost of the Joint Venture property (the "Property"), to the Joint Venture, for Canadian income tax purposes, is approximately $29 million U.S. The debt against the property, to the Bank of New York, (the "Bank"), is approximately $26 million. $3 million of the cost of the Property was financed by equity.
>
> 4. The Joint Venture has been in existence at all times since its original acquisition of the Property and continues to exist. The Joint Venture will continue to exist for such period of time as the purchasers of the Joint Venture interests require and the Vendors will make such amendments to the Joint Venture agreement as the Purchaser reasonably requires to ensure this.
>
> 5. The only activity ever undertaken by the Joint Venture has been the acquisition of the Property and the construction thereon of Sherry Plaza, which was constructed for the purpose of resale. Louis Reese has an

extensive history of speculating in real estate and at times also acts as a real estate broker.

6. The Bank is proposing to foreclose on the Property in either early December or early January (foreclosures happen in Texas only on the first Tuesday of each month). At the foreclosure, the Bank is expected to bid in for the Property at $16 million.

7. Sherry Plaza is a small strip mall for high end retail shopping and an office building. The project is currently 95% complete and the Bank will finance the completion. The building is less than 10% leased at this time. If the building could be leased at pro forma rates, it would have a projected value of $38 million U.S.

8. The Bank has agreed to sell the deficiency amount of the debt, (the "Debt Deficiency") as established on foreclosure, for a nominal sum. This debt will be purchased by a nominee of Peters & Co. Limited ("Peters") (the "Peters Nominee"), that is arm's length from the current Joint Venturers. After purchasing the Debt Deficiency from the Bank, Peters Nominee will loan the original Joint Venturers an amount equal to the Debt Deficiency amount. The original Joint Venturers will contribute this amount to the Joint Venture and the Joint Venture will repay the Peters Nominee the Debt Deficiency.

   Alternatively, at the option of the Purchaser, an attempt will be made to get the Bank to lend funds to the original partners on foreclosure, with the partners contributing such amount to the Joint Venture and the Joint Venture repaying the Bank.

9. On foreclosure, the Bank will grant the Joint Venture an option to reacquire the property at any time, within the next three years, at the amount of the Bank's outstanding debt immediately prior to foreclosure, compounded at 10% per annum or at such other amount as the Purchaser may agree. This option will expire on an arm's length sale by the Bank.

   The Bank will also give the Joint Venture reasonable access to the Property for the purposes of leasing such Property. The Joint Venture shall bear its own expenses for this leasing program. The Bank will retain the right to approve of all leases.

10. Immediately after the foreclosure and the refinancing of the Deficiency Amount, the Purchaser shall acquire the Joint Venture interests for a payment of 4¢ per $1, calculated on the difference, as determined by a "Big 8" accounting firm, between the "costs" of the Property, for Canadian income tax purposes, and the amount that the Property is sold

> for on the foreclosure. The maximum on which such amount will be payable is $14 million U.S.
>
> 11. In addition to the agreement between the Joint Venture and the Bank with respect to the Property, the Purchaser may request an agreement between the Joint Venture and Mr. Reese pursuant to which the Joint Venture has the right to participate with Mr. Reese on future real estate transactions for a period of time. Such agreement will be as agreed on between the parties, but this purchase of Joint Venture interests will proceed regardless of whether such agreement can be reached.
>
> 12. Any reasonable costs of the transaction, including a commission to Bruce Harbour at Henry S. Miller Co., shall be borne by the Purchaser.
>
> 13. Any potential liabilities of the Joint Venture arising before closing are the responsibility of the Vendors and the Purchaser may require the Vendor to satisfy such liabilities before closing.
>
> 13.5 The Vendor shall use its best effort to obtain the cooperation of the bank, as required herein, but shall not be held liable for any lack of such cooperation.
>
> 14. All documentation should be completed by November 27, or such later date as the Purchaser and Vendors may agree, with closing to occur immediately after foreclosure and the refinancing of the Debt Deficiency. Closing is not to be later than December 31, 1987.
>
> 15. If only 99% of the Joint Venture interests are acquired by the Purchaser the Purchaser may acquire such interests from such of the Vendor as it so desires.
>
> 16. This agreement is made as of November 16, 1987, 4:30 p.m., Calgary, Alberta time.

[22] During his testimony, Michel Gaucher stated that the purpose of the agreement was to ensure the continuation of the “Joint Venture” which made the loan arrangement and undertook the construction of the real property project, the Sherry Plaza. According to him, the continuation of PPJV was ensured by that agreement.

[23] I note that in the agreement, the parties took the trouble to provide in paragraph 4 that PPJV would continue to exist for the period of time required by the purchasers and that the vendors would make the necessary amendments to the

"Joint Venture Agreement" to accommodate the purchasers. Although that clause appears to have been inserted to ensure the continuity of the "Joint Venture," as stated by Mr. Gaucher, I find it hard to interpret this as expressing a common intention to form a partnership with a view to share profits on future projects. On the contrary, it rather suggests that the vendors wanted to relinquish their interests in PPJV and did whatever was required to satisfy the purchasers for the purposes of the acquisition of PPJV to their advantage. Indeed, the real intention of the purchasers appeared in paragraph 3, as care was taken to indicate the cost of the asset held by PPJV for Canadian income tax purposes.

[24] What happened is that, on November 30, 1987, the vendor partners amended the original agreement of PPJV which provided that the sole purpose of the partnership was to purchase and develop what then became the Sherry Plaza (Exhibit A-1, Tab 1) to extend its ambit to future real estate investments and the future resale of the properties (Exhibit A-1, Tab 2).

[25] Similarly, I note that the purchasers intended to acquire the interests in PPJV only after the foreclosure by BONY and the refinancing of the debt (paragraphs 10 and 14 of the agreement of November 16, 1987). However, in the "Escrow and Indemnity Agreement" (Exhibit A-1, Tab 8), not dated but effective December 1, 1987—under which the purchasers undertook to pay the vendors the sum of US$390,000 to be withheld to ensure that the purchasers were not required to assume debt incurred by PPJV prior to December 1, 1987—it is stated in the preambule to paragraph D, that BONY repossessed the property after the vendors transferred their interests in PPJV to the purchasers. Moreover, the transfer of the vendor's interests to the purchasers took place only on December 15, 1987, that is 15 days after BONY repossessed the property, retroactive to December 1, 1987 (see "Assignments of Joint Venture Interest ," Exhibit A-1, Tabs 4 and 6). It seems, therefore, that the formula for the transfer of interests changed at some point, which suggests that the purchasers were the ones who orchestrated everything, not with the purpose of forming a partnership with the American partners with a common view to profit, but rather to ensure the documents were in order so as to be able to claim the coveted tax loss. Moreover, the testimony of Nancy Orr, V.P. Finance for Sofati, indicates that, according to her, the transaction was retroactive to December 1, 1987, to ensure "that nothing happened between the time they close the transaction and the debt . . . with [BONY], . . . was funded" (p. 125 shorthand notes). That does not reflect an intent to form a partnership with Mr. Reese and PPDC, even for a very short period of time, in PPJV, but rather to ensure that they would not be liable for the heavy debt on which Sofati would later claim a tax loss.

[26] Furthermore, paragraph 5 of the agreement of November 16, 1987, indicates that Mr. Reese only invested in PPJV with the intent to build the Sherry Plaza for the sole purpose of resale, as he had a reputation as a speculator in real estate. On December 1, 1987, immediately prior to the repossession of the Sherry Plaza by BONY, it granted PPJV, which was still represented by Louis G. Reese, a non-exclusive option to purchase ("Option Agreement," Exhibit A-1, Tab 9), by which PPJV could within the next three years offer to purchase the property for the amount of the debt prior to the foreclosure (US$28,000,000), plus all sums of money advanced by BONY for the completion of the property and interest compounded at the rate of 10% per year. PPJV paid US$80,000 for that option. According to Ms. Orr, it was Sofati who paid that sum. However, that is not reported in the financial statements of PPJV for its financial year ending December 31, 1987 (no advance by a partner is entered, see Exhibit A-1, Tab 29). There is however an acknowledgement by BONY of a payment in the amount of US$55,000 by PPJV and a US$25,000 credit, in satisfaction of the payment of US$80,000. That acknowledgement of payment is dated December 18, 1987, and signed by Sofati on behalf of PPJV (Exhibit A-1, Tab 10). This therefore suggests that it is Sofati that in fact paid that sum.

[27] It seems to me that all this does not reflect to the intent expressed by Mr. Gaucher in his testimony, that is to develop long-term projects with Mr. Reese. Indeed, Mr. Reese himself did not seem interested in recovering the property he built for resale purposes. Moreover, according to paragraph 11 of the agreement of November 16, 1987, nothing obliged Mr. Reese to engage in future transactions with the purchasers, as Mr. Gaucher seemed to suggest.

[28] It is however true that on December 15, 1987, PPJV, represented by Sofati, signed a "Right of First Opportunity Agreement" with Louis G. Reese (Exhibit A-1, Tab 11). In that agreement, Louis G. Reese undertook to report on all real estate development projects in Dallas in which he would invest so as to give PPJV the option to earn a 25% interest in such a future project, in consideration of a contribution by PPJV of 33⅓% of the amounts to be invested by the partners in the project. That agreement was valid for a period of three years or less if PPJV did not express an interest after three proposals by Louis G. Reese in which he would invest.

[29] However, after December 1, 1987, in September 1989, PPJV only invested in one project, the Highland Park Shopping Village in Texas, for an amount of

US$175,000 (Exhibit A-1, Tab 30), a project in which Louis G. Reese was not at all involved.

[30] On May 6, 1988, PPJV, represented by Michel Gaucher, made an offer to BONY to reacquire the Sherry Plaza for US$12,000,000. Ms. Orr conducted analyses, using a conservative approach, which determined that an additional US$7,500,000 had to be invested to make the project profitable. In that offer, Mr. Gaucher offered to make a US$1,500,000 deposit, to secure a second mortgage in the amount of US$8,500,000 and to provide a promissory note for US$2,000,000. The US$1,500,000 was to be financed by a first mortgage in the amount of US$4,000,000, of which the balance would be used to complete the work. In all, US$3,500,000 was expected to be funded through the leases to be signed (Exhibit A-1, Tab 20). In his testimony, Mr. Gaucher indicated that when the agreement was signed on November 16, 1987, was represented in paragraph 7 that the property could be worth US$38,000,000 if leased according to market projections. According to him, he viewed it as an opportunity with the possibility of making an immediate profit. However, no market research was conducted in that respect. In any event, the offer to purchase of May 6, 1988, which was not submitted under the option to purchase signed on December 1, 1987, was not accepted by BONY, which gave priority to Trammel Crow, who had advised Mr. Gaucher on the possibilities of real estate investment in Texas, including Sherry Plaza. Mr. Gaucher stated that he was not informed beforehand of the parallel offer of Trammel Crow, which bought out the property from BONY for US$14,000,000. He did not think it was even worth suing them because he did not sign a non-competition clause with them and did not want to antagonize one of the largest real estate firms in Texas.

[31] At the same time, in April 1988, Sofati retained the services of Gordon Capital, a Toronto firm specializing in "merchant banking," to make a proposal with Prudential Bache Securities Inc. (a merchant bank that was always looking for a developer willing to invest), to restructure the First Republic Bank of Texas. Sofati stated that it was willing to advance US$10,000,000 (Exhibit A-1, Tab 46). That proposal was made on behalf of "Michel Gaucher Investment Group."

[32] Michel Gaucher explained that he did not want to associate PPJV with his proposal, following the recent financial woes of PPJV with BONY. But, if his proposal was accepted, he planned to invest through PPJV. In the end, the proposal did not materialize.

[33] Subsequently, around 1989, Sofati invested in the Steinberg food chain, in the province de Quebec. According to Mr. Gaucher, Sofati poured CDN$16,000,000 into that venture which extended over a period of six years (until 1994). Thus, although one of the vice-presidents of Sofati continued to explore the real estate market in Texas, and despite the opportunity that was offered to PPJV to further invest in Highland Park Shopping Village in 1991 (Exhibit A-1, Tab 41), it was not taken up and PPJV did not make any more investments after that.

[34] In the meantime, Sofati continued to manage thermal power plants in the United States until 2000.

Analysis

[35] In *Backman*, *supra*, at paragraphs 20 and 28, the Supreme Court of Canada made the following observations:

> 20 The existence of a valid partnership does not depend on the creation of a new business because it is sufficient that an existing business was continued. Partnerships may be formed where two parties agree to carry on the existing business of one of them. It is not necessary to show that the partners carried on a business for a long period of time. A partnership may be formed for a single transaction. As was noted by this Court in *Continental Bank*, *supra*, at para. 48, "[a]s long as the parties do not create what amounts to an empty shell that does not in fact carry on business, the fact that the partnership was created for a single transaction is of no consequence." Furthermore, to establish the carrying on of a business, it is not necessary to show that the parties held meetings, entered into new transactions, or made decisions: *Continental Bank*, *supra*, at paras. 31-33. . . .
>
> . . .
>
> 28 In this case, the alleged partnership held two assets: the Dallas Apartment Complex and a one percent working interest in an Alberta oil and gas property. We agree with the Federal Court of Appeal that the facts in this case indicate that at the time they entered into the transactions at issue, the Canadians did not intend to carry on business with a view to profit in respect of the Dallas Apartment Complex. Once the Canadians acquired their interests in the alleged partnership, the apartment complex was owned only briefly before it was disposed of in accordance with the option granted to the American partners and according to a pre-determined closing agenda. As was contemplated in *Continental Bank*, *supra*, a partnership can be formed for a brief period of time. It was also acknowledged in that case that the parties need not hold meetings or make decisions, and that the passive receipt of rent can constitute a business. However, in *Continental Bank*, *supra*, the business of the partnership was pre-existing and continued after the partnership was formed. In this case, there was no continuity of a business, in fact, one of the first acts of the alleged partnership was effectively to terminate the Commons' former business of managing the apartment complex. Furthermore, there was no evidence provided to show that the Canadians intended to make a profit during the term of their involvement with the apartment complex. Consequently, in the time between the entry of the Canadians and the disposition of the Dallas Apartment Complex, the Canadians were not, judging from all the surrounding circumstances, carrying on business in common with a view to profit in respect of that asset..

[36] In my opinion, as in *Backman*, the Appellant did not prove that it agreed with the American partners to carry on business in common with a view to profit from the activities of PPJV. It is true that right before the repossession of the

property by BONY, the partnership contract was amended to provide for the possibility of investing in real property projects other than the Sherry Plaza, and that indeed, two years later, PPJV finally invested US$175,000 in a real property project it still has. However, considering the circumstances surrounding the entire transaction, those facts alone do not pursuade me that Louis G. Reese, PPDC and the Appellant had the intention to carry on business in common with a view to profit. In my opinion, that was the key element that had to be proven by the Appellant, which it failed to do.

[37] In *Backman*, at paragraphs 41, 42 and 43, the Supreme Court of Canada made the following observations:

> 41 It follows from fundamental principles of partnership law that in order for a person to enter and become a new partner of a valid and pre-existing partnership, that person and the existing members of the partnership must satisfy the essential elements of a valid partnership at the time of the entry of the new partner. That is, they all must be carrying on business in common with a view to profit. In this regard, we agree with the conclusion of the Federal Court of Appeal that "the entry of new persons . . . will be considered to constitute the creation of a new partnership, provided of course, that the requisite components of the definition . . . are satisfied" (para. 51). In particular, we agree with the Federal Court of Appeal's approval of para. 3-04 of *Lindley & Banks on Partnership*, *supra*, where the conventional legal view is stated as follows:
>
>> The law, ignoring the firm, looks to the partners composing it; any change amongst them destroys the identity of the firm; what is called the property of the firm is their property, and what are called the debts and liabilities of the firm are their debts and their liabilities.
>
> 42 A validly constituted partnership, therefore, is a continuing entity so long as none of the statutory or contractual events of dissolution occurs and the composition of that partnership remains the same. A partnership agreement may facilitate a change in the composition of a partnership by providing that "the partnership continues" upon the entry or withdrawal of partners, but that does not obviate the need for persons intending to enter the partnership as partners to meet the essential criteria of a valid partnership. Those criteria are fundamental and cannot be avoided simply by contract alone. This result is consistent with the view that formation of a partnership does not depend solely on contractual arrangements but must also satisfy the essential ingredients of a partnership described by this Court in *Continental Bank*, *supra*.

> 43 Since we have already found that at the time of entering into the transactions at issue the alleged partners did not possess the essential ingredients of partnership as described in *Continental Bank*, *supra*, we cannot accede to the appellant's position on this issue.

[38] The present case differs from *Spire Freezers Ltd. v. Canada*, [2001] 1 S.C.R. 391, 2001 SCC 11, where the Supreme Court of Canada found, at paragraph 24, that ". . . during the short time the American and Spire Freezers Ltd. were involved, they ran the HCP condominium project and Tremont as a business in common. The partnership subsisted and continued to carry on a business after the withdrawal of the Americans. At all relevant times, then, there were partners managing assets. At some point, all partners were associated in the management of the Tremont apartment building. In other words, at all times there was a carrying on of business in common."

[39] In *Spire Freezers*, as in the instant case, the series of transactions occurred on the same day. The Supreme Court of Canada seems to have considered that there was a carrying on of business in common between the new partners and the former partners whereas it considered that that was not the case in *Backman* for the following reasons:

> 20 However, despite the similarities between the transactions in this case and those in *Backman*, there are some essential differences. For example, in respect of whether there was a carrying on of business, it is notable that there is a significant difference between the subordinate assets in *Backman* and *Spire* in terms of the degree of effort required of the appellants and expended by them in management. In *Backman*, the subordinate asset was a one percent interest in an oil and gas property, purchased for the sum of $5,000 during the transition between American and Canadian control of the alleged partnership. The alleged partnership in *Backman* had no significant management control over that asset, nor did the acquisition of that asset represent a continuation of a pre-existing business of one of the putative partners. When production was shut down shortly after purchase, no other investments in oil and gas were made. Thus, in *Backman*, the alleged partnership was "an empty shell that does not in fact carry on business" (see *Backman*, *supra*, at para. 20). In this case, the subordinate asset held by the partnership was the entire interest in an apartment building. The property management business that was associated with that asset was pre-existing and continued by the Canadians. Tremont required a substantial management effort which the appellants provided, and from which they benefited by generating profit. As noted by Robertson J.A., "the partnership continued to hold title to a profit-generating asset, namely, the apartment building, for at least a decade after the sale of the condominium development" (para. 57 (emphasis in original)).

[40] In this case, the only asset of PPJV was seized immediately after the retroactive withdrawal of the American partners. Even though the purposes of the partnership were amended prior to their withdrawal, I am satisfied that, in view of the evidence, neither Mr. Reese nor PPDC had an intention to carry on business in common with a view to profit with the Appellant and WPTI. Indeed, no investment was made with them after that. The objectives sought by the Appellant after the withdrawal of Mr. Reese and PPDC, and the time and money invested by the Appellant, were not to carry on the business operated by PPJV while it was under American control. Mr. Reese and PPDC never held themselves out as partners of the Appellant and WPTI. On the contrary, in all the documentation with BONY, Mr. Reese clearly indicated that he and PPDC were selling their interests to new investors.

[41] In my opinion, this case is closer to *Backman* than to *Spire Freezers* and *Continental Bank*. It also differs from *Water's Edge Village Estates (Phase II) Ltd. v. Canada*, [2003] 2 F.C. 25, 2002 FCA 291, cited by counsel for the Appellant. At paragraph 27, Noël J. made the following observations:

> 27 The subsequent finding that the U.S. partners did not intend to carry on business in common with the Canadian partners during this period is, in my respectful view, contrary to the evidence. That the U.S. partners agreed to remain in that capacity in order to insure the continued existence of the partnership (reasons, paragraph 41) is consistent (not inconsistent) with their continued intention to carry on business in common. Furthermore, Klink's financial statements for the period ending 31 December 1991 reveal that the U.S. partners actually shared in the financial results of the partnership for that period (Appeal Book, volume IV, page 641). According to subsection 4(c) of the British Columbia *Partnership Act*, R.S.B.C. 1996, c. 348, "the receipt by a person of the share of the profits of a business is proof in the absence of evidence to the contrary that he or she is a partner in the business". There was no evidence to the contrary.

[42] The facts are clearly different here.

[43] I therefore find that the Appellant did not demonstrate that it was a member of a partnership within the meaning of subsection 96(1) of the *ITA* for the purposes of the deduction of the loss incurred by PPJV in its financial year ending December 31, 1987. It is therefore with good reason that the Minister did not allow it to carry forward the loss of CDN$16,036,040 to its 1992 taxation year.

[44] In view of this finding, I will not have to rule on the quantum of the loss under section 10 of the ITA and section 1801 of the *Regulations*.

[45] The appeal is dismissed with costs, in accordance with Tariff B of the Court, in favour of the Respondent.

Signed at Ottawa, Canada, this 27th day of September 2007.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 20th day of February 2008.

François Brunet, Revisor

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