Docket: 2006-1275(IT)G

BETWEEN:

966838 ONTARIO INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Arthur Lee (2006-1277(IT)G)* and *Solidwear Enterprises Limited (2006-1278(IT)G)*, on October 28 and 29, 2008, at Toronto, Ontario,

By: The Honourable Justice C.H. McArthur

Appearances:

Counsel for the Appellant:	Blair W.M. Bowen
Counsel for the Respondent:	Donna Dorosh

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act*, notice of which is dated December 28, 2005, for the 2001 taxation year is allowed, without costs, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to claim a deductible business expense in the amount of $425,000 as advanced to Valleycroft Textiles Inc.

Signed at Ottawa, Canada, this 15th day of May, 2009.

"C.H. McArthur"

McArthur J.

Docket: 2006-1277(IT)G

BETWEEN:

ARTHUR LEE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *966838 Ontario Inc. (2006-1275(IT)G)* and *Solidwear Enterprises Limited (2006-1278(IT)G)*, on October 28 and 29, 2008, at Toronto, Ontario,

By: The Honourable Justice C.H. McArthur

Appearances:

Counsel for the Appellant:	Blair W.M. Bowen
Counsel for the Respondent:	Donna Dorosh

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2001 taxation year is dismissed, without costs.

Signed at Ottawa, Canada, this 15th day of May, 2009.

"C.H. McArthur"

McArthur J.

Docket: 2006-1278(IT)G

BETWEEN:

SOLIDWEAR ENTERPRISES LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of
966838 Ontario Inc. (2006-1275(IT)G) and *Arthur Lee (2006-1277(IT)G)*,
on October 28 and 29, 2008, at Toronto, Ontario,

By: The Honourable Justice C.H. McArthur

Appearances:

Counsel for the Appellant:	Blair W.M. Bowen
Counsel for the Respondent:	Donna Dorosh

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2001 taxation year is dismissed.

The Respondent is entitled to one set of costs.

Signed at Ottawa, Canada, this 15th day of May, 2009.

"C.H. McArthur"

McArthur J.

Citation: 2009 TCC 256
Date: 20090515
Docket: 2006-1275(IT)G
2006-1277(IT)G
2006-1278(IT)G

BETWEEN:

966838 ONTARIO INC.,
ARTHUR LEE and
SOLIDWEAR ENTERPRISES LIMITED,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

McArthur J.

[1] In these three appeals for the 2001 taxation year, heard on common evidence, the Appellants seek to deduct, from income, uncollectible advances made by them to Valleycroft Textiles Inc. ("VTI") in the following amounts:

(1)	Arthur Lee	$1,242,127.00
(2)	Solidwear Enterprises Limited	$1,943,471.00
(3)	966838 Ontario Inc.	$ 425,000.00

[2] Each of the Appellants has established that the outstanding balance of their respective advances to VTI was uncollectible following a voluntary assignment in bankruptcy made by VTI.

[3] The issue is whether the Appellants' advances may be deducted in computing income.

Facts

[4] Generally the facts are not in dispute, the parties having filed a Joint Brief of Documents and an Agreed Statement of Facts, as follows:

STATEMENT OF AGREED FACTS

THE APPELLANTS

1. The appellant, Arthur Lee ("Mr. Lee"), is an individual residing in the city of Toronto, Ontario.

2. The appellant, 966838 Ontario Inc. ("966838"), is a corporation incorporated pursuant to the laws of the province of Ontario and has its head office in Toronto, Ontario.

3. The appellant, Solidwear Enterprises Limited ("Solidwear"), is a corporation, amalgamated pursuant to the laws of the province of Ontario and has its head office in Toronto, Ontario.

RELATIONSHIP OF APPELLANTS

4. At all material times, Mr. Lee owned all of the issued and outstanding shares of 966838.

5. At all material times, Mr. Lee controlled Solidwear through a holding company and owned all of the common shares and 50 per cent of the Class A Special Shares of the holding company. The balance of Solidwear's Class A Special Shares were held by Mr. Lee's wife.

6. Mr. Lee ran the businesses of Solidwear, 966838 and Valleycroft Textiles Inc. ("Valleycroft") out of the same office premises, utilizing common office administrative staff.

FACTS COMMON TO ALL THREE APPEALS

7. At all material times, Mr. Lee owned 85 per cent of the share capital of Valleycroft, as well as an additional 10 per cent of the share capital, indirectly through a holding company.

8. At all material times, Solidwear carried on business as a garment manufacturer, producing highly specialized outerwear garments as well as basic knit apparel.

9. On or about January 31, 1999, Valleycroft Enterprises Inc., a predecessor in business of Valleycroft, entered into an agreement ("Agreement") with the John Forsyth Company Inc./La Compagnie John Forsyth Inc. ("John Forsyth") to purchase all of the assets and undertaking of the Penmans Textile Division of John Forsyth ("Penmans"). Penmans was a fabric dye house and knitting mill operation located in Cambridge, Ontario.

10. Following the acquisition of Penmans, Valleycroft Enterprises Inc. changed its name to Valleycroft Textiles Inc. (referred to above and hereinafter as "Valleycroft") on February 24, 1999.

VALLEYCROFT'S BANKRUPTCY

11. Valleycroft made a voluntary assignment in bankruptcy on June 28, 2001.

12. Each of Mr. Lee, 966838 and Solidwear have established that the outstanding balance of their respective advances to Valleycroft have become uncollectible for their respective 2001 taxation years.

SOLIDWEAR'S APPEAL

13. The Minister of National Revenue (the "Minister") reassessed Solidwear for its 2001 taxation year, notice of which was dated March 18, 2005, and disallowed the deduction Solidwear claimed in respect of its advances to Valleycroft of $1,943,471.00. The Minister concluded that Solidwear incurred a capital loss on account of the Valleycroft advances.

MR. LEE'S APPEAL

14. The Lee advances to Valleycroft totalled $1,242,127.37 as follows:

Date	Cheque No.	Payee	Amount
Dec. 14/98	6231	The Toronto Dominion Bank	$50,000
Feb. 1/99	97	The John Forsythe Co.	$154,000
Feb. 3/99	98	Valleycroft Textiles	$150,000
Feb. 9/99	99	Valleycroft Textiles	$100,000
Feb. 24/99	6	Valleycroft Textiles	$100,000
May 10/99	35	Valleycroft Textiles	$150,000
Jun 17/99	40	Valleycroft Textiles	$150,000
Jun 17/99	41	Valleycroft Textiles	$127,127.37
Jan. 6/00	82	Valleycroft Textiles	$261,000

15. The Minister reassessed Mr. Lee to disallow the amount of $1,242,127 claimed as a deduction in the computation of Mr. Lee's income for the 2001 taxation year. The Minister concluded that the Valleycroft Deduction was a business investment loss pursuant to paragraph 39(1)(c) of the *Income Tax*

Act, and, thereby allowed Mr. Lee a corresponding allowable business investment loss deduction ("ABIL") pursuant to paragraph 38(c) of the *Income Tax Act*.

966838'S APPEAL

16. Ontario Garment Finishers [1997] Limited ("OGF") amalgamated with Valleycroft on February 1, 2000, and continued in business as Valleycroft. The debt of OGF to 966838, which remained outstanding upon the amalgamation, became an obligation of Valleycroft. Valleycroft signed a written acknowledgment dated February 1, 2000 to 966838 acknowledging that 966838 had made various loans to it in the total amount of $425,000.00.

17. By reassessment, notice of which was dated December 28, 2005, the Minister disallowed 966838's claim for a deduction in the amount of $425,000.00 for its fiscal year ended August 31, 2001. The Minister concluded that 966838 incurred a capital loss on account of the Valleycroft advances.

18. The parties may tender additional evidence provided that the evidence is not contrary to the facts admitted above.

[5] The Appellant Arthur Lee has been involved in the garment business since 1985, primarily in the Toronto area. He holds a controlling interest in a number of corporations, including the two corporate Appellants, Solidwear Enterprises Limited ("Solidwear") and 966838 Ontario Inc. ("966838"), and VTI.

[6] At all times relevant to these appeals, Solidwear carried on business as a garment manufacturer, producing specialized outerwear garments as well as basic knit apparel. Mr. Lee was the President and sole director of Solidwear.

[7] Mr. Lee was also the sole director and President of both 966838 and VTI. According to 966838's Notice of Appeal, 966838 was used primarily as a vehicle for financing various businesses, including Solidwear and VTI.

[8] VTI operated a knitting mill and fabric dye house in Cambridge, Ontario, which had been acquired in January, 1999. It was intended that this would create an integrated manufacturing enterprise by providing fabrics to Solidwear, thereby eliminating the need to purchase fabric from out of the country suppliers and ensuring that Solidwear had a reliable source of high quality fabrics.

[9] In addition to Mr. Lee, Morris Sederoff, the comptroller (accountant) for the Appellants from about 1999 to June 2001, also testified on behalf of the Appellants.

Mr. Sederoff explained that the acquisition of the knitting mill operated by VTI was aimed at controlling costs.

[10] The advances at issue in these appeals were made under varying circumstances. Mr. Lee personally advanced a total of $1,242,127.37 to VTI in the following instalments:

Date	Amount
Dec. 14/98	$ 50,000.00
Feb 1/99	$154,000.00
Feb 3/99	$150,000.00
Feb 9/99	$100,000.00
Feb 24/99	$100,000.00
May 10/99	$150,000.00
Jun 17/99	$150,000.00
Jun 17/99	$127,127.37
Jan 6/00	$261,000.00

[11] The “Lee Advances” were documented simply as loans and occasionally as shareholder loans, and were evidenced by promissory notes. Although the notes were issued as interest bearing, a subsequent agreement clarified that this was in error and that the notes were non-interest bearing.

[12] The “Solidwear Advances” arose from different circumstances. The Royal Bank of Canada (“RBC”) originally financed VTI directly in 1999 but as of mid-June 2000, it required that Solidwear be primarily liable for VTI’s indebtedness because it was more financially secure. The Appellants rightly characterized this arrangement as RBC lending money to Solidwear, thereby enabling Solidwear to finance the operations of VTI.

[13] Following this new arrangement, VTI issued two promissory notes in favour of Solidwear totalling $962,403, which appear to correspond with the credit that had initially been advanced to VTI by RBC. These notes provided for the payment of interest at the commercial lending rate as set by RBC, plus 1.25% per annum and 2% per annum respectively. As stated, the outstanding amount advanced to VTI by Solidwear totalled $1,943,471.

[14] Mr. Lee testified that the purpose of the Solidwear advances was to maintain the viability of VTI, thereby ensuring the continuous supply of fabric to Solidwear. He added that as a newly created operation, VTI needed operating funds, and that the money was used to carry on its business.

[15] The amounts uncollectible by 966838 (the "966838 Advances"), totalling $425,000, were initially made by 966838 to Ontario Garment Finishers (1997) Ltd. ("OGF"), a former subsidiary of VTI. 966838 advanced funds to OGF for the same reason that Solidwear advanced monies to VTI, namely, to provide funding to a related corporation in order to create an integrated manufacturing enterprise with Solidwear at its centre. The repayment of the 966838 advances only became the obligation of VTI following an amalgamation between VTI and OGF. These advances resulted in a demand loan in favour of VTI bearing interest at prime rate plus 2% per annum.

[16] VTI supplied fabrics to Solidwear for over two years before making a voluntary assignment in bankruptcy on June 28, 2001. In keeping with the intent to create an integrated manufacturing enterprise, Solidwear fulfilled most of its fabric needs through purchases from VTI, which totalled over $7,000,000 during the relevant period. VTI made a voluntary assignment in bankruptcy on June 28, 2001, after the removal by the Federal Government of a tariff on imported fabric, which made it impossible for VTI to compete with cheaper imports.

[17] The Appellants claimed deductions from business income in respect of the uncollectible advances. The Minister reassessed each Appellant and disallowed the deductions claimed. The Minister concluded that the uncollectible advances resulted in capital losses to Solidwear and 966838, but permitted Mr. Lee a deduction in respect of an allowable business investment loss pursuant to paragraph 38*(c)* of the *Income Tax Act* (the "*Act*").

Positions Taken by the Parties

[18] The primary position taken by the Appellants is based upon their portrayal of the overall relationship between them and VTI as an integrated manufacturing enterprise. The Appellants characterize the Solidwear advances as fabric procurement costs incurred to secure a reliable and controllable source of supply, and as such, laid out for the purpose of gaining or producing income from Solidwear's business. The Lee and 966838 advances, counsel for the Appellants submitted, were made for the purpose of supporting and furthering the garment manufacture business, and as such were made in tandem with the Solidwear advances and formed an integral part of the overall business operations of Solidwear. Counsel argued that all these advances, once they became uncollectible, constituted losses arising in the ordinary course of business that were properly deductible in computing profit pursuant to general principles of income computation under subsection 9(1) of the *Act*.

[19] Alternatively, the Appellants submitted that they are entitled to a deduction in respect of the uncollectible advances under subparagraph 20(1)*(p)*(ii) of the *Act* on the basis that the losses were incurred from a money-lending business.

[20] The Respondent's position is that the advances made by the Appellants to VTI are properly characterized as losses of capital, the deduction of which from income is expressly disallowed by paragraph 18(1)*(b)* of the *Act*. In support of this, the Respondent argued that the creation and maintenance of the supply of fabric through VTI was viewed by the Appellants as a long-term investment as part of Mr. Lee's business plan. The Respondent adds that the funds advanced by Mr. Lee, either directly or indirectly, through other corporations he controlled, were for the purpose of protecting his substantial capital investment in VTI.

[21] In the Respondent's view, the advances to VTI were not primarily made for the purpose of increasing the profitability of the Appellants' business in the short term, but to provide working capital to VTI, a company which the Appellants hoped would continue to supply fabric to Solidwear for many years to come. In this way, the Respondent described the advances as being made to obtain an advantage of an enduring nature. She further argued that it would be improper to view the Appellants as an integrated business unit, if doing so resulted in ignoring their separate legal existence for tax purposes.

[22] She added that none of the Appellants were engaged in the business of lending money, and therefore, the deduction contemplated by subparagraph 20(1)*(p)*(ii) is not available.

Analysis

[23] As stated by Iacobucci J. in *Canderel Ltd. v. R.*, [1998] 1 S.C.R. 147, at paragraph 29, it is appropriate to begin the consideration of profit with subsection 9(1) of the *Act*. That subsection provides as follows:

> 9(1) Subject to this Part, a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year.

[24] While not defined in the *Act*, it is accepted that profit is inherently a net concept that allows for business expense deductions. At paragraphs 51 and 52 of *Canderel*, Iacobucci J. explained that in ascertaining profit, the taxpayer is free to adopt any method which is not inconsistent with (a) the provisions of the *Act*; (b) established case law principles or "rules of law"; and (c) well-accepted business and accounting principles.

[25] The *Act* provides, at paragraph 18(1)*(b)*:

> 18(1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of
>
> …
>
> *(b)* an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part;

[26] Before considering the income or capital issue, I will deal with the Appellants' alternative argument under subparagraph 20(1)*(p)*(ii). That provision expressly allows for deductions from income in respect of uncollectible loans or lending assets under certain circumstances.

[27] For a taxpayer to obtain the deduction provided for in clause 20(1)*(p)*(ii)(A), it must be established that:

> 16 …
>
> (a) the debts to be deducted arise from loans;
>
> (b) the ordinary business of the taxpayer must include the lending of money;
>
> (c) the loans giving rise to the bad debts must have been made in the ordinary course of the taxpayer's business of lending money; and
>
> (d) the loans giving rise to the bad debts must have become uncollectible in the year.[1]

[28] In *Loman Warehousing Ltd. v. Canada*, 99 DTC 1113, aff'd 2000 DTC 6610 (F.C.A.), Bowman J. explained at paragraph 25:

> 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. …
>
> [Emphasis added]

[29] It cannot be said that the ordinary business of Solidwear included the lending of money. The ordinary business of Solidwear was manufacturing outerwear garments and knit apparel. No evidence was presented that would facilitate a finding that money-lending is one of the ways in which Solidwear, as an ordinary part of its business operations, earns its income.

[30] The cases advanced by the Appellants as supportive of Solidwear's entitlement to deductions under subparagraph 20(1)*(p)*(ii) are distinguishable on their facts. In both *Wesco Property Developments Ltd. v. Canada (M.N.R.)*, 89 DTC 590, and *Discovery Research Systems Limited v. Canada*, 94 DTC 1510, the connection between the lending activity and the taxpayer's ordinary business was clearly evident. Such is not the case with Solidwear. Further, Solidwear would not have made the advances but for the actions taken by RBC. The Solidwear advances were not part of its ordinary business operations, and no deduction under clause 20(1)*(p)*(ii)(A) is available.

---

[1] *Bird v. R.*, [2000] 2 C.T.C. 2699 at para. 16.

[31] I have also concluded that the Lee advances were not made in the ordinary course of a business of lending money. Unlike Solidwear, Mr. Lee was a shareholder in VTI. Le Dain J. in *Chaffey v. Canada (M.N.R),* 78 DTC 6176 (F.C.A.) at paragraph 10 stated:

> 10 … In my opinion shareholder's advances do not constitute the business of lending money; they are simply a particular form by which capital is put into a company. The loans made by the partnership did not have as their principal object the accommodation of persons in return for income in the form of interest; they were merely a device for the financing of projects through which profit was to be made by other means.

[32] A shareholder relationship does not automatically preclude a finding that there was a business of lending money; however, a taxpayer would need to put forth clear evidence that the purpose of the advances related to the taxpayer's ordinary business, and not merely to a financing objective. In direct examination, Mr. Lee stated that the loans were made in effect to assist his business VTI to succeed. Furthermore, the Lee advances obviously did not have as their principal object the accommodation of persons in return for income in the form of interest because they were interest-free.

[33] In contrast to my findings above respecting Mr. Lee and Solidwear, I conclude that the ordinary business of 966838 did include the lending of money, and that the advances it made to VTI were made in the ordinary course of that business. As indicated above, these advances were secured by a demand loan from VTI bearing interest at prime rate plus 2% per annum.

[34] The Minister assumed that 966838 was in the business of investing capital in related corporations, but maintained the position that it was not in the business of lending money. In my view, for the purposes of clause 20(1)*(p)*(ii)(A), it is not material whether a taxpayer's business could be characterized as one of investing capital, provided that as an ordinary part of that business, the taxpayer engaged in the business of lending money. 966838's financial statements for the relevant time period show considerable interest income and report that loans receivable are its most substantial assets. Other interest-bearing loans made by 966838 included a $25,000 loan made in 1997 to Golf Mania Inc. that bore interest at 10% per annum, and a $350,000 demand loan made in 1997 to 1243314 Ontario Ltd. that bore interest at prime rate plus 2% per annum. It appears that almost the entire business operations of 966838 consisted of lending money. This is not surprising, given the Appellants' position that 966838 was incorporated as a financing vehicle. In conclusion, the 966838 loans are deductible under clause 20(1)*(p)*(ii)(A).

[35] Respondent's counsel referred to *Orban v. M.N.R.*, 54 DTC 148. That case and the cases referred to suggest that in order to qualify as a money-lender, it is necessary to publicly advertise one's willingness to lend money "to all and sundry", and that it is insufficient merely to lend money on a few occasions at remunerative rates of interest. No such requirements are provided for in the language of clause 20(1)*(p)*(ii)(A). The requirements, as I understand them, are first, that the taxpayer's ordinary business include, as part of it, the business of lending money, and second, that the loan is made or acquired in the ordinary course of that business. 966828 met these requirements.

[36] I now turn to the Appellants' primary argument with respect to the Lee and Solidwear advances to the effect that they are entitled to a deduction in keeping with the general principles of computing income under subsection 9(1) of the *Act*.

[37] Earlier, with respect to the section 20 argument, I concluded that the Lee advances and Solidwear advances were not made in the ordinary course of a business of lending money. The following comments of Pigeon J. in *Canada (M.N.R*). *v. Freud*, [1969] S.C.R. 75, at page 82 are therefore a useful starting point:

> It is, of course, obvious that a loan made by a person who is not in the business of lending money is ordinarily to be considered as an investment. It is only under quite exceptional or unusual circumstances that such an operation should be considered as a speculation. …

[38] Losses suffered from loans made or securities given for the purpose of providing working capital give rise to capital losses and not business losses. For example, in *Stewart & Morrison Ltd. v. Canada (M.N.R.)*, [1974] S.C.R. 477, 72 D.T.C. 6049, the taxpayer set up a subsidiary, supplied the capital needed and guaranteed a bank loan to enable the subsidiary to operate. Judson J. concluded at page 479:

> … The parent company provided working capital to its subsidiary by way of loans. These loans were the only working capital the American subsidiary ever had with the exception of the sum of $1,000 invested by Stewart & Morrison Limited for the acquisition of all of the issued share capital of its subsidiary. The money was lost and the losses were capital losses to Stewart & Morrison Limited. The deduction of these losses has been rightly found to be prohibited by s. 12(1)(b) of the *Income Tax Act*.

[39] In respect of the Lee advances, it is significant that Mr. Lee was a shareholder in VTI. In *Easton v. Canada*, [1998] 2 F.C. 44 (F.C.A.), Robertson J. explained that generally an advance made by a shareholder to or on behalf of the corporation will be treated as a loan extended for the purpose of providing the corporation with working capital. He explained the consequences of this in the event the loan is not repaid, at paragraph 16:

> 16 … In the event the loan is not repaid the loss is deemed to be of a capital nature for one of two reasons. Either the loan was given to generate a stream of income for the taxpayer, as is characteristic of an investment, or it was given to enable the corporation to carry on its business such that the shareholder would secure an enduring benefit in the form of dividends or an increase in share value. As the law presumes that shares are acquired for investment purposes it seems only too reasonable to presume that a loss arising from an advance or outlay made by a shareholder is also on capital account. The same considerations apply to shareholder guarantees for loans made to corporations. …

He added that there are two recognized exceptions to the general proposition that losses experienced on such loans are of a capital nature, at paragraph 17:

> 17 … First, the taxpayer may be able to establish that the loan was made in the ordinary course of the taxpayer's business. The classic example is the taxpayer/shareholder who is in the business of lending money or granting guarantees. The exception, however, also extends to cases where the advance or outlay was made for income-producing purposes related to the taxpayer's own business and not that of the corporation in which he or she holds shares. …
>
> [Emphasis added]

[40] It has been accepted that the first exception does not apply. The Appellants have concentrated their efforts on the second exception as underlined. As explained by Robertson J., this exception extends to cases where the advance or outlay was made for income-producing purposes related to the taxpayer's own business and not that of the corporation in which he or she holds shares.

[41] Correctly, the Respondent took the position that it would be improper to view the Appellants as an integrated business unit, if doing so meant ignoring their separate legal existence for tax purposes. Solidwear, VTI, and Mr. Lee are of course all separate persons for tax purposes, notwithstanding the Appellants' characterization of the business arrangement between them as an integrated enterprise.

[42] The existence of a corporation cannot be ignored so as to benefit the taxpayer when he has himself used this structure because it was advantageous to him at the time. In the Supreme Court of Canada judgment in *Kosmopoulos v. Constitution Insurance Co. of Canada*, [1987] 1 S.C.R. 2, Wilson J. stated at paragraphs 12 and 13:

> 12 As a general rule a corporation is a legal entity distinct from its shareholders: *Salomon v. Salomon & Co.*, [1897] A.C. 22 (H.L.). …

She added:

> 13 There is a persuasive argument that "those who have chosen the benefits of incorporation must bear the corresponding burdens, so that if the veil is to be lifted at all that should only be done in the interests of third parties who would otherwise suffer as a result of that choice": [L.C.B. Gower, *Modern Company Law* (4th ed. 1979)], at p. 138. Mr. Kosmopoulos was advised by a competent solicitor to incorporate his business in order to protect his personal assets and there is nothing in the evidence to indicate that his decision to secure the benefits of incorporation was not a genuine one. Having chosen to receive the benefits of incorporation, he should not be allowed to escape its burdens. He should not be permitted to "blow hot and cold" at the same time.

[43] This reasoning negates Mr. Lee's submission that he is personally entitled to a business deduction, since the garment manufacturing business was being operated not by him but by Solidwear and VTI. His evidence attests to the fact that the loans were not made so that he could personally earn business income, but in order that his corporations could do so. I find as a fact his advances were made to provide VTI with sufficient working capital to carry on its business, thereby securing an enduring benefit to him in the larger context of his garment manufacturing enterprise. Consequently, Mr. Lee's advances do not meet the second *Easton* exception, as they were made for the income-producing purposes of his corporations. It was these corporations that owned and operated the manufacturing business, not Mr. Lee. The losses resulting from the Lee advances are therefore capital in nature.

[44] Turning to the Solidwear advances, I accept that they were made to provide VTI with operating funds, ensuring a continuous supply of fabric to Solidwear. This was the most cost-effective way to operate the garment manufacturing enterprise.

[45] Appellants' counsel argued that the Solidwear advances were made for the purpose of earning income pursuant to paragraph 18(1)*(a)*. I cannot agree that if advances were made for the purpose of producing income from business, it follows that losses in respect of such advances are automatically on account of revenue.

As explained by Abbott J. in the Supreme Court of Canada decision in *British Columbia Electric Railway Co. v. Canada (M.N.R.)*, [1958] S.C.R. 133, since the main purpose of every business undertaking is presumably to make a profit, viewed from a distance both income expenses and capital outlays fit within the language of paragraph 18(1)*(a)*. Both are ultimately made "for the purpose of gaining or producing income". Consequently, determining whether an outlay is made for the ultimate purpose of gaining or producing income does not assist in characterizing the expenditure as on account of income or capital. In this regard, the remarks of Strayer J. in *Morflot Freightliners Limited v. Her Majesty the Queen*, 89 DTC 5182 are relevant. He explained, at pages 5184-5185:

> … Normally payments made by a parent company to a subsidiary to help finance the operations of a subsidiary are regarded as capital payments. …
>
> It has frequently been said in cases of this nature that one must try to characterize a situation from a practical business point of view to determine the intent with which the money was provided. … I believe the critical distinction here is as between the preservation of an enduring asset on the one hand and the expenditure of money for direct and more immediate gaining of profit through sales, or, as in this case, the earning of commissions. … Even though, as in the present case, the continuing successful existence of the subsidiary would have a substantial bearing on the success of the parent and in this sense might be said to be related to the production of income from the plaintiff's business, this does not alter the fact that the money advanced to the subsidiary was to obtain an advantage of an enduring nature and this made it a capital expenditure. … [Emphasis added]

[46] The present facts resemble those in *Stewart & Morrison Ltd*. In that case, as in the present appeals, a related corporation required capital to operate. Although it carried on business in its own name and right, it was controlled by its parent, in a manner similar to the control exercised by Mr. Lee over VTI, Solidwear, and 966838. As in *Stewart & Morrison Ltd.*, financing for the related corporation was arranged by the controlling entity.

[47] The Solidwear, Lee and 966838 advances provided the primary source of financing that enabled VTI to operate. From Solidwear's perspective, VTI was financed with the intention of providing it with the enduring benefit of a continuous source of supply of fabric. The Courts have consistently held that where an outlay is made with the intention of securing an asset or advantage of enduring benefit, the outlay is capital in nature (see *Gifford v. Canada*, [2004] 1 S.C.R. 411).

[48] Counsel for the Appellants argued that this intended benefit did not last beyond the fiscal period in 2001 as a result of VTI's bankruptcy, and so therefore

could not be considered an asset or advantage of an enduring nature. This may be so, but it is the intended purpose for the advance at the time it is made that is relevant, not whether the asset or advantage acquired proved to be enduring: see *Gifford v. Canada*, at paragraph 22. Clearly, the Solidwear advances and losses were capital in nature.

[49] Counsel for the Appellants forcefully emphasized that the losses in respect of the Solidwear advances are deductible pursuant to an "integral part of business operations" theory of loss deductibility. While Solidwear might have treated VTI as an important source of fabric, sight must not be lost of the fact that it was at all material times a separate corporate entity. Mr. Lee cannot have it both ways, treating the corporations as separate entities or lifting the corporate veil depending on his needs at any given time.

[50] The "integral part of business operations" theory appears to have arisen from *Associated Investors of Canada Ltd. v. Canada (M.N.R.)*, [1967] C.T.C. 138, which is readily distinguishable from the present facts. In *Associated Investors*, the Appellant employed salespeople on a commission basis but allowed a minimum drawing account. The difference between commissions earned and amounts drawn were carried on the Appellant's books as accounts receivable. The Appellant made the decision to write down these accounts. The Minister refused to allow a deduction in computing income on the grounds that the advances were capital transactions.

[51] In *Associated Investors*, Jackett J. did not appear to view the "integral part of business" explanation as a deviation from established principles governing the classification of expenditures as on account of either income or capital. He expressly found that the advances did not result in the acquisition of any asset or advantage of an enduring nature (see paragraph 17). The emphasis remained on the intended purpose of the expenditure. Given the finding that the Solidwear advances were made with the intention of creating an advantage of an enduring nature in the form of a reliable source of fabric, the *Associated Investors* case is of no assistance to the Appellants.

[52] Counsel for the Appellants also referred me to *Canada v. F.H. Jones Tobacco Sales Co.*, 73 DTC 5577 (F.C.T.D.), *Canada v. Lavigueur*, 73 DTC 5538 (F.C.T.D.), and *Panda Realty Limited v. M.N.R.*, 86 DTC 1266. The common element in these cases is that the principal object and purpose for the advancement of funds or the provision of a guarantee was the preservation of a stream of income. In this way, the advancement of funds or the provision of a guarantee could be seen as directly attributable to gaining or producing income. Such a motivation on the part of the

taxpayer distinguishes these cases from others, such as *Cathelle Inc. v. The Queen*, 2005 TCC 360, or *Stewart & Morrison Ltd.*, in which the primary purpose of the advance or guarantee was found to be the provision of working capital. As explained above, the Solidwear advances fall within this second category.

[53] The Appellants also relied on *Williams Gold Refining Co. of Canada v. Canada*, 2000 DTC 1829, the facts of which bear some resemblance to those of the present appeals. In that case, the appellant company claimed to be entitled to deductions in respect of bad debts in excess of $628,000 owed to it by a related company, W.G.R. Hollowforms Ltd. The objectives for creating the related company were twofold. One was to improve the profitability of the appellant by devoting some of the space in the buildings it occupied and some of the time of its employees to the new business. The other objective was to create an additional market for products manufactured by the appellant.

[54] As in the present appeals, one of the issues in *Williams Gold Refining* was whether the amounts in question could be deducted pursuant to the ordinary principles governing the computation of profit. After referring to *Stewart & Morrison Ltd.* and *Morflot Freightliners Limited*, Bowie J. found that the purpose of the Williams Gold loans was not to capitalize a new business venture but to improve the profitability of the appellant by providing an expanded market for its products and reducing overhead. He stated at paragraph 20:

> 20 Mr. Dimberio's evidence was to the effect that his purpose in creating Hollowforms was to improve the profitability of the Appellant, both by providing an expanded market for its products, and by reducing its overhead costs. He was not cross-examined as to this aspect of his evidence, and I accept it. The conclusion that the loans in question were not simply an alternate way of capitalizing the Hollowforms business is reinforced by an examination of the balance sheets of Hollowforms throughout the period … During all of that period it had paid up capital of $100,200.00, consisting of two preferred shares issued for $50,000.00 each, and 200 common shares issued for $1.00 each. There were also loans from shareholders in excess of $80,000.00 on the balance sheet throughout the period. [Emphasis added]

[55] Having concluded that the Solidwear advances were for the purpose of providing working capital to VTI, *Williams Gold Refining* is distinguishable and of no assistance to the Appellants. I would only add that in light of *British Columbia Electric Railway Co.* and *Stewart & Morrison Ltd.*, the principles of loss deductibility as applied in the *F.H. Jones Tobacco* line of cases should be approached

with caution and not as loopholes through which losses from financing activities may be deducted from income.

[56] The appeals in respect of the Lee advances and the Solidwear advances are therefore dismissed. The appeal in respect of the 966838 advances is allowed, with the result that 966838 is entitled to a deduction under clause 20(1)*(p)*(ii)(A). One set of costs is awarded to the Respondent being the predominantly successful party.

Signed at Ottawa, Canada, this 15th day of May, 2009.

"C.H. McArthur"

McArthur J.

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