

BETWEEN:

JOHN SMITH,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 5, 2009, at Windsor, Ontario.

Before: The Honourable Justice Robert J. Hogan

Appearances:

For the Appellant: The Appellant himself

Counsel for the Respondent: Jack Warren

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the 2003 taxation year is allowed in part, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the grounds that the taxpayer realized a capital loss of \$62,160 in respect of the Loan for his 2003 taxation year. All other aspects of the assessment shall remain unchanged.

It is further ordered that the filing fee in the amount of \$100 be reimbursed to the Appellant.

Signed at Ottawa, Canada, this 12th day of January 2010.

"Robert J. Hogan"

Hogan J.

BETWEEN:

JOHN SMITH,

Appellant,

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REASONS FOR JUDGMENT

Hogan J.

I. Introduction

[1] John Smith, (the “Appellant”), loaned \$62,160 (the “Loan”) to 142281 Ontario Inc. (“Ontario Inc.”) a corporation wholly owned by his son, to finance the acquisition by Ontario Inc. of a Dixie Lee franchise operation. The Appellant deducted the full amount of the Loan as a write off for a bad debt under subparagraph 20(1)(p)(ii) for his 2003 taxation year. The write off is contested by the Minister of National Revenue (the “Minister”).

II. Issues for Determination

[2] The issues for determination have to do with whether the three conditions prescribed in subparagraph 20(1)(p)(ii) of the *Income Tax Act*, Canada (the “Act”) have been met as follows:

- (a) Does the Appellant’s ordinary business include the lending of money?
- (b) Was the Loan made in the ordinary course of the Appellant’s money lending business? and
- (c) Was the Loan established to be uncollectible?

III. Factual Background

[3] The Appellant testified that he had approached the local banks in his home area when he finished school for the purpose of borrowing a modest amount of money to start a business venture with a friend. His loan application was turned down because he had no collateral to offer the bank and no track record in business. A family friend loaned the funds to the Appellant which allowed him to launch his career in business

[4] The Appellant alleges that he was touched by the confidence expressed by the family friend in making the Loan and promised himself that he would help entrepreneurs to finance new business ventures when he would be in a position to do so. The Appellant testified that in January of 1993 he was able to repay the kindness that he enjoyed by loaning two acquaintances \$75,000 each to finance a new business venture. These loans were outstanding for only a brief period of time. The Appellant did not charge interest on the loans. In the Appellant's words he made these initial loans in recognition of the fact that he benefited from a similar gesture at the outset of his business career.

[5] An additional seven loans were made over a 13 years period spanning from April 1993 to November 2006, as follows:

<u>DATE</u>	<u>BORROWER</u>	<u>PRINCIPAL AMOUNT</u>		<u>SOURCE OF FUNDS</u>
January 13, 1993	Brent Gilbert Ward	\$75,000.00	promissory note	Personal line of credit
January 13, 1993	Kenneth James Holdaway	\$75,000.00	promissory note	Personal line of credit
April 1993	Barry Austin Suitor	\$75,000.00	12% promissory note	Personal line of credit
October 15, 1993	STN Incorporated	\$150,000.00	6% promissory note	Cash holdings
January 20, 1995	Brent Gilvert Ward	\$8,715.47	8% promissory note	Personal line of credit
August 28, 1995	The Dufflebag Inc.	\$25,000.00	promissory note, 20% of profits	Personal line of credit
March 15, 2003	1422812 Ontario Inc.	\$62,160	PLC rate + 3% promissory note	Personal line of credit
July 30, 2004	Canquest Communications (Canada) Inc.	\$50,000.00	8% promissory note	Personal line of credit
November 8, 2006	701742 Ontario Inc.	\$31,000.00	PLC rate +1% promissory note	Personal line of credit
April 14, 2008	701742 Ontario Inc.	\$44,474.26	9% promissory note	Personal line of credit
September 25, 2009	Canquest Communications (Canada) Inc.	\$20,000.00	PLC rate +1% promissory note	Personal line of credit
October 28, 2009	Canquest Communications (Canada) Inc.	\$28,000.00	PLC rate +1% Promissory note	Personal line of credit
		<u>\$651,683.36</u>		

[6] The third loan to Barry Suitor was made allegedly for the same reasons as the first two loans described in paragraph 4 above.

[7] Loans were made to 701742 Ontario Inc., Canquest Communications (Canada) Inc. and STN Incorporated because the Appellant owned shares in each of these corporations. In each of these cases, the corporations needed funding for their operations. The evidence shows that the Appellant was inclined to make these loans because he wanted to preserve or enhance the value of his equity investment. These loans had the characteristics of a capital investment. Ultimately STN Incorporated declared bankruptcy and the Appellant recovered only \$70,000 of the \$150,000 loan.

[8] The Dufflebag Inc. (“Dufflebag”) company was established by the Appellant’s brother-in-law. The Appellant was to receive 20% of the shares of Dufflebag and 20% of the income through the payment of dividends assuming this venture was profitable. This loan also had the characteristics of an investment. This company failed a short time after Walmart opened a large surface store in the area.

[9] 701742 Ontario Inc. is wholly owned by the Appellant. This corporation owns rental property. The Appellant testified that the proceeds loaned to the company were used to repay a mortgage loan that fell due. The Appellant testified that it was cheaper for him to borrow funds personally on a line of credit and loan the funds to the corporation than to cause the corporation to repay its outstanding loan by contracting a new mortgage loan. This loan has the characteristics of a long term capital investment.

[10] At trial, the Respondent admitted that the Loan made was uncollectible in 2003. This means that only the first two issues listed on page two of this judgment need to be considered by me.

IV. Analysis

[11] Determining whether or not a money lending business exists is a question of fact. To be successful in his appeal, the Appellant must demonstrate that there is a degree of system and continuity in the loans that he has made. I believe that the evidence shows that the Appellant has failed to satisfy this burden.

[12] First, the Loan at issue in this appeal was the only loan made by the Appellant in that year. Secondly, this was the first loan made in eight years. The transaction that

preceded this loan was the loan made to Dufflebag on August 28, 1995. The Appellant was to receive 20% of the shares of Dufflebag with the remainder of the shares to be held by his brother-in-law. In all there was only four loans made by the Appellant to unrelated parties. These latter transactions were made over a two year period beginning in January of 1993 and ending on January 20, 1995.

[13] Over the years the Appellant reported very little net interest income from the loans he made. The small amount of income that was reported was declared as investment income and not business income. This is consistent with the fact that the loans were made on capital account and generated property income. The losses realized by the taxpayer leaving aside the loss incurred on the loan to Ontario Inc. was much larger than the amount of net investment income reported by the taxpayer. Out of the 12 loans made over a course of 16 years, six of the loans were shareholders advances and two of the other loans were to related parties. Only four loans were made to unrelated parties. Two of these loans were interest free. The Appellant has failed to demonstrate that he has loaned money on a regular and continuous basis which is the hallmark of a money lending business.

[14] The evidence also shows that the loan to Ontario Inc. was made to allow the Appellant's son to establish his first business venture. In fact, the Appellant made it clear during his testimony that he viewed his son's business venture to be of high risk. The prior owner of the restaurant was compelled to sell the business because it was failing. It is clear that the Appellant wanted to assist his son in his first business venture and did so knowing that it was a high risk venture. The Loan was made for affiliation reasons and was not made in the ordinary course of a money lending business.

[15] The Appellant argued in the alternative that he was entitled to a capital loss in respect of the Loan for his 2003 taxation year. The Respondent did not dispute this position.

V. Conclusion

[16] For all of these reasons, I allow the Appellant's appeal, in part, and order that the assessment be referred back to the Minister for reassessment on the grounds that the taxpayer realized a capital loss of \$62,160 in respect of the Loan for his 2003 taxation year. All other aspects of the assessment shall remain unchanged.

Signed at Ottawa, Canada, this 12th day of January 2010.

"Robert J. Hogan"

Hogan J.

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PLACE OF HEARING: Windsor, Ontario

DATE OF HEARING: November 5, 2009

REASONS FOR JUDGMENT BY: The Honourable Justice Robert J. Hogan

DATE OF JUDGMENT: January 12, 2010

APPEARANCES:

For the Appellant: The Appellant himself

Counsel for the Respondent: Jack Warren

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

For the Respondent: John H. Sims, Q.C.
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