Docket: 2009-3522(IT)I

BETWEEN:

DHANWANTTIE CHARRAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on March 10, 2010, at Toronto, Ontario

Before: The Honourable Justice G. A. Sheridan

Appearances:

Agent for the Appellant: Frank Dimarco
Counsel for the Respondent: Amit Ummat

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2004 taxation year is dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 20th day of April, 2010.

"G. A. Sheridan"

Sheridan J.

Citation: 2010TCC201
Date: 20100420
Docket: 2009-3522(IT)I

BETWEEN:

DHANWANTTIE CHARRAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Sheridan, J.

[1] The issue in this Informal Procedure appeal is whether in the 2004 taxation year the Appellant was entitled to an allowable business investment loss (ABIL) of $47,500.

[2] Pursuant to paragraph 38(*c*) of the *Income Tax Act*, a taxpayer's allowable business investment loss for a taxation year from the disposition of any property is ½ of the taxpayer's business investment loss for the year from the disposition of that property. Paragraph 39(1)(*c*) defines "business investment loss" as:

…

> 39(1) For the purposes of this Act,
>
> …
>
> (*c*) a taxpayer's business investment loss for a taxation year from the disposition of any property is the amount, if any, by which the taxpayer's capital loss for the year from a disposition after 1977
>
> (i) to which subsection 50(1) applies, or
>
> (ii) to a person with whom the taxpayer was dealing at arm's length of any property that is
>
> …

(iv) a debt owing to the taxpayer by a Canadian-controlled private corporation … that is

(A) a small business corporation,
(B) a bankrupt (within the meaning assigned by subsection 128(3)) that was a small business corporation at the time it last became a bankrupt, or
(C) a corporation referred to in section 6 of the *Winding-up Act* that was insolvent (within the meaning of that Act) and was a small business corporation at the time a winding-up order under that Act was made in respect of the corporation,

…

[3] The definition of "small business corporation" appears in subsection 248(1):

"small business corporation" - "small business corporation", at any particular time, means, subject to subsection 110.6(15), a particular corporation that is a Canadian-controlled private corporation all or substantially all of the fair market value of the assets of which at that time is attributable to assets that are

(*a*) used principally in an active business carried on primarily in Canada by the particular corporation or by a corporation related to it,

(*b*) shares of the capital stock or indebtedness of one or more small business corporations that are at that time connected with the particular corporation (within the meaning of subsection 186(4) on the assumption that the small business corporation is at that time a "payer corporation" within the meaning of that subsection), or

(*c*) assets described in paragraphs (*a*) and (*b*), including, for the purpose of paragraph 39(1)(*c*), a corporation that was at any time in the 12 months preceding that time a small business corporation, and, for the purpose of this definition, the fair market value of a net income stabilization account shall be deemed to be nil;

[4] Paragraph 50(1)(*a*) provides:

50(1) For the purposes of this subdivision, where

(a) a debt owing to a taxpayer at the end of a taxation year (other than a debt owing to the taxpayer in respect of the disposition of personal-use property) is established by the taxpayer to have become a bad debt in the year, or

…

and the taxpayer elects in the taxpayer's return of income for the year to have this subsection apply in respect of the debt or the share, as the case may be, the taxpayer shall be deemed to have disposed of the debt or the share, as the case may be, at the end of the year for proceeds equal to nil and to have reacquired it immediately after the end of the year at a cost equal to nil.

[5] Subparagraph 40(2)(*g*)(ii) provides:

a taxpayer's loss, if any, from the disposition of a property, to the extent that it is

…

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

…

is nil;

[6] In *Rich v. Her Majesty the Queen*[1], Rothstein, J.A. (as he then was) explained the operation of the ABIL provisions:

The ABIL Rules

4 In *Fundamentals of Canadian Income Tax*, 6th ed, (Toronto: Carswell, 2000) at page 423, Professor Krishna explains that an ABIL is a special type of capital loss that receives preferential treatment for income tax purposes. An ABIL arises on the disposition of shares or a debt of a small business corporation. A small business corporation is a Canadian-controlled private corporation that uses all or substantially all of its assets in an active business in Canada (see *Income Tax Act*, R.S.C. 1985 c. 1, (5th Supp.) subsection 248(1)).

5 Unless a lender is in the money-lending business, a bad debt would normally be treated as a capital loss. However, unlike ordinary capital losses, which

[1] [2004] 1 C.T.C. 308. (F.C.A.).

> may be deducted only against capital gains, an ABIL may be deducted against income from any source.

[7] It is common ground that the Appellant was not a money lender and that the corporation in question, Ontario Institute of Information Technology Inc. ("OIIT") was a "Canadian-controlled private corporation" in the business of teaching information technology skills to students enrolled in its programs. Mr. Charran was the president and sole shareholder of OIIT; at no time was the Appellant a shareholder of OIIT.

[8] The Appellant was represented at the hearing by her accountant, Frank Dimarco. Both she and her husband, Dean Charran, testified at the hearing. There were no witnesses for the Respondent.

[9] Sometime in 2001, OIIT began experiencing financial difficulties, probably because it had over-extended itself in acquiring computer equipment for use in its business. Wishing to help her husband with his failing enterprise, between August 2001 and March 2003, the Appellant made four withdrawals totalling $95,000 from her solely held personal line of credit. Each of these amounts was deposited into an account she held jointly with Mr. Charran. Once the funds were in their joint chequing account, Mr. Charran wrote cheques to OIIT and deposited them in the company's account. Each of the withdrawals from the Appellant's line of credit was at some point described in a letter of acknowledgment[2] (referred to collectively as the "Letters of Acknowledgment"). The amounts received by OIIT during this period were recorded in its Financial Statements[3] under the heading "Shareholder Loan".

[10] As it turned out, by July 2003, OIIT's financial difficulties had forced it to cease operations. In June 2003, Mr. Charran notified the relevant provincial authority of OIIT's discontinuation of its activities in order to permit its students to be transferred to another educational institution.

[11] In the end, the Appellant never recovered the $95,000 withdrawn from her line of credit and had to use her RRSP's to repay it; in 2003 and 2004, she reported as income RRSP withdrawals of $63,478[4] and $39,999[5], respectively. In her 2004 tax

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[2] Exhibits A-1, A-2, A-3 and A-4.

[3] Exhibit A-7.

[4] Exhibit A-5.

return, she claimed an ABIL of $47,500 on the basis that in that year, she had incurred a loss in respect of the $95,000 advanced to OIIT. It is from the disallowance of that loss that she appeals.

[12] Looking again at *Rich*, the facts in the present case are quite similar. In both cases, the taxpayers claimed an ABIL for an unrepaid loan made to a company operated by a family member. Unlike the taxpayer in *Rich*, the Appellant was not a shareholder. Paraphrasing the test applied in *Rich*, to establish that she is entitled to an ABIL of $47,500 the Appellant must satisfy all of the following criteria:

1. there was a debt of $95,000 owed to the Appellant by OIIT;

2. the debt was acquired for the purpose of gaining or producing income;

3. OIIT was an eligible small business in 2004; and

4. the debt became bad in 2004.

Was there a debt owed to the Appellant by OIIT?

[13] The short answer is no. As in any tax appeal, the Appellant had the onus of proving wrong the assumptions upon which the Minister of National Revenue based his assessment. Because of various gaps and inconsistencies in the oral evidence and the lack of reliable documentary evidence to support her characterization of the transactions, I am not convinced that there was a debt owed to the Appellant by OIIT. Rather, the evidence leads to the conclusion that the advances from her line of credit were lent, more likely given, to her husband for his use.

[14] Turning first to the poor state of the company's books and records, the Appellant had little to say on this aspect of OIIT's operations. Mr. Charran, however, blamed this defect on the incompetence of the company's former accountant and the general chaos that ensued when the business began to fail. The only documents produced in respect of the debt were the Letters of Acknowledgment pertaining to the Appellant's four advances. As is often the case in such circumstances, the Appellant said that because of the personal nature of their relationship, she and her husband did not think to prepare a formal written loan agreement between her and OIIT.

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[5] Exhibit A-6.

[15] The lack of supporting documentation is not necessarily fatal to a taxpayer's contentions, but it means there must be credible oral evidence to support the claims made. In the present case, while the testimony of the Appellant and Mr. Charran provided a plausible explanation for the absence of reliable records, it does not suffice to overcome its effect. The Letters of Acknowledgment in themselves are not particularly persuasive as they do not constitute a binding agreement between OIIT and the Appellant. Notwithstanding the dates shown in them, it is not clear to me when they were made or for what purpose. There is no reference in them to a repayment schedule for the amounts allegedly advanced to the company, hardly surprising since both the Appellant and Mr. Charran testified that this matter had never been considered.

[16] There being no supporting documentation, what can be gleaned from the oral evidence regarding the existence of a debt owed by OIIT to the Appellant? The Appellant's representative, Mr. Dimarco, rejected the Minister's position that because the Appellant's line of credit withdrawals were first deposited into a chequing account she held jointly with her husband, no debt was owed to her by OIIT. The Appellant's explanation for having proceeded in this fashion was that, at the time, it was her understanding that the terms of her line of credit precluded her from advancing amounts directly into the company's account.

[17] On its face, this strikes me as an unlikely restriction; even if that had been the Appellant's belief, however, it should have been a simple matter to verify the conditions attached to her line of credit account which, given the large sums involved and the alleged purpose of the advances, would have been worth investigating.

[18] All in all, it seems far more likely that the $95,000 withdrawn from the Appellant's line of credit between 2001-2003 was advanced not to OIIT but rather, to Mr. Charran. Even though the Appellant made the funds available and, as a joint holder of the chequing account, had authority to write cheques on that account, it was Mr. Charran who wrote all four of the cheques to OIIT and deposited them in the company's account. Depositing the funds first into their joint bank made them accessible to Mr. Charran who, as sole shareholder of the company, could write cheques to track what was, at that time, most likely intended to be a shareholder loan to OIIT. The company's financial problems had made it impossible for Mr. Charran to borrow additional funds from a third party lender. Only he was a shareholder in OIIT and the company's books refer only to a loan due to "the shareholder". (See Note 5 of Exhibit A-7.)

[19] Nor am I persuaded by Mr. Charran's explanation that this was merely a recording error of the company's former accountant. Later in his testimony, when trying to substantiate the existence of an agreement for OIIT to pay the Appellant interest of 8 per cent on the advances, Mr. Charran referred to *his* shareholder loan. That, he said, was the rate he was being paid in respect of *his* loan to the company. Notwithstanding this apparent contradiction, Mr. Charran did not offer further clarification as to how the $95,000 allegedly advanced to OIIT squared with that statement.

[20] In my view, the evidence falls short of establishing the existence of a debt between OIIT and the Appellant. While that is sufficient to dispose of the Appellant's appeal, in the event I am in error, I have considered the evidence in respect of the other ABIL criteria as if there had been a debt owed to the Appellant by OIIT.

Was the debt acquired for the purpose of producing income?

[21] Not being a shareholder of OIIT, the Appellant's only possibility for earning income on the $95,000 lay in the company's payment of interest on that amount. Even if the Letters of Acknowledgment were to be accepted as a loan agreement, they made no provision for the payment of interest to the Appellant. There was no other written agreement for the payment of interest and I did not find at all convincing Mr. Charran's testimony that there had been an oral agreement between OIIT and the Appellant for the payment of interest at a rate of 8 per cent. In support of his contention, he cited two reasons for having decided upon a rate of 8 per cent: first, that was what it was costing the Appellant to borrow the funds on her line of credit; and further, that was the rate he was receiving under his shareholder loan agreement with OIIT.

[22] If the first statement were true, the Appellant would have had no opportunity to earn income on the $95,000 as with a return of 8 per cent, she could have done no more than break even on her cost of borrowing. As to Mr. Charran's second justification, the weakness of his evidence in this regard has been discussed above.

[23] In these circumstances, there is no credible evidence that the Appellant acquired the debt for the purpose of gaining or producing income.

Was OIIT an eligible small business in 2004?

[24] No. As discussed further in the following paragraph, both the Appellant and Mr. Charran testified that by mid-2003, OIIT was no longer in "active" business as

required under the definition in subsection 248(1). Mr. Charran testified that no books and records were kept in 2004 because the company had ceased its operations prior to that time.

Did the debt become bad in 2004?

[25] To qualify for an ABIL in 2004, the debt owed to the Appellant by OIIT must have become bad in that taxation year. The evidence, however, leads to the conclusion that if there was a debt, it became bad in 2003. The evidence shows that OIIT stopped operating in 2003 when, according to the testimony of both the Appellant and Mr. Charran, it became "insolvent". By that time, OIIT had lost the accreditation necessary to carry on as an educational institution; from this it can be inferred that without students, it had no means of generating income. Furthermore, its assets were already so encumbered by 2001 that they were unavailable either as security for the Appellant's advances or to permit Mr. Charran to borrow any further amounts from third party lenders. The Appellant was candid in her testimony that at least by July 2003, she believed she had no hope of recovering the $95,000 she had advanced from her line of credit. Her words are supported by her actions; in 2003, the Appellant withdrew some $63,000 from her RRSP account to retire a substantial portion of her line of credit debt. Had there been any hope of repayment from OIIT in 2003, it is unlikely that she would have taken such a drastic step; not only did it reduce the balance in her RRSP account, it also triggered tax on the amount withdrawn. In these circumstances, I am satisfied that the debt became bad in 2003.

[26] While I have no doubt that the Appellant incurred a significant loss in her efforts to help her husband, I am unable to conclude on the evidence presented that that loss is deductible under the ABIL criteria. Accordingly, the appeal from the reassessment of the 2004 taxation year must be dismissed.

Signed at Ottawa, Canada, this 20th day of April, 2010.

"G. A. Sheridan"

Sheridan J.

CITATION:	2010TCC201
COURT FILE NO.:	2009-3522(IT)I
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APPEARANCES:

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