Docket: 2006-2996(IT)G

BETWEEN:

THE TORONTO-DOMINION BANK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 5, 6, 7, 8 and 9, 2009, at Toronto, Ontario

Before: The Honourable Justice L.M. Little

Appearances:

Counsel for the Appellant:	Al Meghji Pooja Samtani
Counsel for the Respondent:	Donald G. Gibson Pascal Tétrault

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the 1989 taxation year is dismissed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 3rd day of June 2010.

"L.M. Little"

Little J.

Citation: 2010 TCC 275
Date: 20100603
Docket: 2006-2996(IT)G

BETWEEN:

THE TORONTO-DOMINION BANK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Little J.

A. Facts:

[1] The Appellant is a large corporation within the meaning of the *Income Tax Act* (the "*Act*").

[2] The Appellant filed Notices of Appeal to the following Notices of Reassessment issued by the Minister of National Revenue (the "Minister") for its 1989 taxation year ending October 31, 1989:

Notice of Reassessment Number	Date of Notice
3810298	October 7, 1994
3953034	February 13, 1997
-	February 25, 2004

[3] The appeal was heard in Toronto, Ontario from October 5 to October 9, 2009.

[4] At the commencement of the hearing, the parties filed a Statement of Agreed Facts (Exhibit A-1). The Statement reads as follows:

The parties to this proceeding admit, for the purposes of this proceeding only, the truth of the following facts, and the authenticity of the documents cited herein:

A. The Appellant – Corporate Profile

1. The Toronto-Dominion Bank (the "**Appellant**") is a taxable Canadian corporation and a large corporation within the meaning of the *Income Tax Act* (Canada), R.S.C. 1985, c.1 (5th Supp.) (the "**Act**"), as applicable to the 1989 taxation year of the Appellant (the "**1989 Taxation Year**").

2. The Appellant is a chartered bank listed in Schedule I of the *Bank Act* (Canada) (the "**Bank Act**").

3. In the course of its business, the Appellant engages directly and through its subsidiaries in four principal lines of business: Canadian personal and commercial banking; wealth management; wholesale banking; and U.S. personal and commercial banking.

B. Oxford Development Group Ltd.

4. At all relevant times:

(a) Oxford Development Group Ltd. ("**Oxford**") was a large commercial real estate company involved in the development, acquisition, and management of commercial and retail properties in Canada and the U.S.;

(b) the late Mr. G. Donald Love ("**Mr. Love**"), then Chairman of the Board of Directors and President of Oxford, was the sole beneficial shareholder of Kent Holdings Ltd. ("**Kent**");

(c) Mr. Love and members of his family (collectively, the "**Love Family**") were the sole beneficial shareholders of Loford Properties Ltd. ("**Loford**");

(d) the Appellant did not own 50% or more of the shares of Oxford, Holdings (as defined below), Kent or Loford; and

(e) none of Mr. Love, Oxford, Holdings, Kent or Loford owned 50% or more of the shares of the Appellant.

5. In January 1976, the Appellant first acquired a participating interest in Oxford, then a public company, when it purchased 82,000 Series A Preferred shares of Oxford for $902,000 (or $11.00 per share).

6. In April 1978, the Appellant purchased 205,000 common shares of Oxford for $2,562,500 (or $12.50 per share) and in November 1979, the Appellant subscribed for an additional 50,000 Series A Preferred shares of Oxford for $804,776.25 (or $16.10 per share), resulting in total holdings of 337,000 common and preferred shares.

C. The Privatization of Oxford

7. In 1979, the Love Family directly or indirectly owned less than 10% of the issued and outstanding shares of Oxford. The other shareholders of Oxford then included, among other members of the public, the Appellant.

8. Commencing with the incorporation of 91922 Canada Limited on May 11, 1979, the Love Family undertook transactions to acquire by private purchase, approximately 75% of the issued and outstanding shares of Oxford.

9. On December 19, 1979, the Appellant agreed to participate in the privatization by making available to 91922 Canada Limited a line of credit of $255,000,000 and by transferring its shares of Oxford to 91922 Canada Limited.

10. On January 15, 1980, the Appellant entered into a Shareholders' Agreement (the "**Shareholders' Agreement**") with Mr. Love, Kent and Loford (collectively, the "**Love Group**")

(a) the Appellant subscribed for 51,200 common shares, 285,800 Class A shares and 313,000 Class B shares of 91922 Canada Limited for aggregate consideration of $16,900,000 (or $26.00 per share), comprising a cash payment of $8,138,000 and the 337,000 shares held by the Appellant in Oxford;

(b) Kent subscribed for 801,555 common shares and Loford subscribed for 173,445 common shares of 91922 Canada Limited for consideration of $20,840,430 and $4,509,570, respectively. In full satisfaction of such consideration, Kent transferred 801,555 common shares and Loford transferred 173,445 common shares of Oxford to 91922 Canada Limited.

11. Each of the Appellant, Kent, and Loford jointly elected with 91922 Canada Limited in prescribed form to have the provisions of subsection 85(1) of the Act apply to the share transfer. The amounts agreed to by the Appellant and

91922 Canada Limited in the joint election were deemed pursuant to paragraph 85(1)(a) of the Act to be the cost to the Appellant of the three classes of shares received on the exchange as follows:

Class of Shares	**Number of Shares**	**Deemed Cost**
Common	51,200	$1,331,200
Class A	285,800	$2,938,076
Class B	313,000	$8,138,000
Total	**650,000**	**$12,407,276**

12. Each of the shares held by the Appellant in 91922 Canada Limited was fully participating and ranked equally with each other share of the company with respect to the payment of dividends and the distribution of assets on winding up.

13. The Class A and Class B shares were convertible into common shares, at the option of the holder, on a sale of the shares to any third party which was not a Canadian chartered bank. The Class B shares were convertible into Class A shares at the option of the holder. Neither the Class A nor the Class B shares had voting rights.

14. As of January 18, 1980, 91922 Canada Limited had acquired by private purchase from five other shareholders, approximately 70.5% of the issued and outstanding shares of Oxford.

15. On January 18, 1980, 91922 Canada Limited extended a cash offer to purchase from the other public shareholders of Oxford, the balance of the issued and outstanding shares, which offer was accepted on or before May 20, 1980.

16. On October 29, 1980, Oxford amalgamated with 91922 Canada Limited pursuant to the provisions of the *Companies Act* (Alberta) and continued its operations as “Oxford”. The shares then held by the Appellant in 91922 Canada Limited were replaced by an equivalent number of shares with identical share attributes in the amalgamated entity.

17. Following the privatization of Oxford, and at all relevant times thereafter:

(a) Oxford was a private corporation for purposes of the Act;

(b) the Appellant held 40% of the total issued and outstanding shares of Oxford, but its voting interest in Oxford never exceeded 5% to ensure compliance with the Bank Act;

(c) the shares were beneficially held by the Appellant through a nominee corporation (called “Bantor Company”) as agent, and were held on capital account;

(d) the balance (60%) of the issued and outstanding shares of Oxford were held directly or indirectly by the Love Group; and

(e) the Appellant had two representatives (out of at least five but no more than six) on the Board of Directors of Oxford, namely, Messrs. Ernest C. Mercier and Ronald E. Ruest.

D. Dividend Payments & Reinvestments: 1982-1988

18. This paragraph summarizes the transactions described more particularly in paragraphs 19 to 32 below. Between 1982 and 1988, the Appellant and the Love Group received dividends from Oxford. Apart from the dividend payment on May 5, 1988, the Appellant reinvested between 77 and 100 percent of each of the other dividend payments ($78,600,000 in aggregate), by subscribing for a total of 241,666 Class E shares of Oxford for a total subscription price of $72,499,800. The Love Group similarly reinvested between 77 and 100 percent of each of the other dividend payments ($117,900,024 in aggregate), by subscribing for a total of 362,500 Class D shares of Oxford at a total subscription price of $108,750,000. The Appellant and the Love Group maintained their respective 40 and 60 percent proportionate share ownership of Oxford at all relevant times.

19. On July 29, 1982, Oxford declared and paid dividends of $22,000,000 (or $13.538 per share) from earnings on the common, Class A and Class B shares outstanding at that time. Oxford elected under subsection 83(2) of the Act that the dividends on the common shares be capital dividends. The portion of the dividend paid to the Appellant was $8,800,000 (or 40%), in respect of its 51,200 common shares, 285,800 Class A shares and 313,000 Class B shares. The portion of the dividend paid to the Love Group was $13,200,000 (or 60%), in respect of its common shares.

20. On July 29, 1982, by way of a Special Resolution of the shareholders of Oxford, two new classes of shares were authorized for issuance, namely the Class D and Class E shares. The Class D and Class E shares were non-voting par value shares. They were fully participating and had the same rights as to dividends and distribution on winding up as the common, Class A and Class B shares.

21. The Board of Directors of Oxford set the subscription price of the Class D and Class E shares at $300.00 per share and assigned a par value of $1.00 to each share.

22. On July 29, 1982:

(a) the Appellant subscribed for 22,667 Class E shares of Oxford at a subscription price of $6,800,100. Accordingly, Oxford credited $22,667 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($6,777,433 or $299.00 per share) was credited to its contributed surplus account; and

(b) the Love Group subscribed for 34,000 Class D shares of Oxford at a subscription price of $10,200,000. Accordingly, Oxford credited $34,000 (or $1.00 per Class D share) to its share capital, and the balance of the subscription price ($10,166,000 or $299.00 per share) was credited to its contributed surplus account.

23. On April 15, 1983:

(a) Oxford declared and paid dividends of $27,000,000 (or $16.615 per share) from earnings on the common, Class A and Class B shares. Oxford elected under subsection 83(2) of the Act that the dividends on the common shares be capital dividends. The portion of the dividend paid to the Appellant was $10,800,000 (or 40%), in respect of its 51,200 common, 285,800 Class A and 313,000 Class B shares. The portion of the dividend paid to the Love Group was $16,200,000 (or 60%), in respect of its common shares;

(b) the Appellant subscribed for 30,667 Class E shares of Oxford having a par value of $1.00 each, at a subscription price of $9,200,100 (or $300.00 per share). Accordingly, Oxford credited $30,667 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($9,169,433 or $299.00 per share) was credited to its contributed surplus account; and

(c) the Love Group subscribed for 46,000 Class D shares of Oxford having a par value of $1.00 each, at a subscription price of $13,800,000 (or $300.00 per share).

Accordingly, Oxford credited $46,000 (or $1.00 per Class D share) to its share capital, and the balance of the subscription price ($13,754,000 or $299.00 per share) was credited to its contributed surplus account.

24. On December 28, 1983:

(a) Oxford declared and paid dividends of $10,000,013 (or $5.152 per share) from earnings on the common, Class A, Class B, Class D and Class E shares. Oxford elected under subsection 83(2) of the Act that the dividends on the common and Class D shares be capital

dividends. The portion of the dividend paid to the Appellant was $4,000,005 (or 40%), in respect of its 51,200 common, 285,800 Class A, 313,000 Class B and 53,334 Class E shares. The portion of the dividend paid to the Love Group was $6,000,008 (or 60%), in respect of its common Class D shares;

(b) the Appellant subscribed for 12,000 Class E shares of Oxford having a par value of $1.00 each, at a subscription price of $3,600,000 (or $300.00 per share). Accordingly, Oxford credited $12,000 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($3,588,000 or $299.00 per share) was credited to its contributed surplus account; and

(c) the Love Group subscribed for 18,000 Class D shares of Oxford having a par value of $1.00 each, at a subscription price of $5,400,000 (or $300.00 per share). Accordingly, Oxford credited $18,000 (or $1.00 per Class D share) to its share capital, and the balance of the subscription price ($5,382,000 or $299.00 per share) was credited to its contributed surplus account.

25. On April 30, 1984:

(a) Oxford declared and paid dividends of $12,500,008 (or $6.990 per share) from earnings on the common, Class A, Class B, Class D and Class E shares. Oxford elected under subsection 83(2) of the Act that the dividends on the common and Class D shares be capital dividends. The portion of the dividend paid to the Appellant was $5,000,003 (or 40%), in respect of its 51,200 common, 285,800 Class A, 313,000 Class B and 65,334 Class E shares. The portion of the dividend paid to the Love Group was $7,500,005 (or 60%), in respect of its common and Class D shares;

(b) the Appellant subscribed for 15,000 Class E shares of Oxford having a par value of $1.00 each, at a subscription price of $4,500,000 (or $300.00 per share). Accordingly, Oxford credited $15,000 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($4,485,000 or $299.00 per share) was credited to its contributed surplus account; and

(c) the Love Group subscribed for 22,500 Class D shares of Oxford having a par value of $1.00 each, at a subscription price of $6,750,000 (or $300.00 per share). Accordingly, Oxford credited $22,500 (or $1.00 per Class D share) to its share capital, and the balance of the subscription price ($6,727,500 or $299.00 per share) was credited to its contributed surplus account.

26. On July 30, 1984:

(a) Oxford declared and paid dividends of $10,000,003 (or $5.477 per share) from earnings on the common, Class A, Class B, Class D and Class E shares. Oxford elected under subsection 83(2) of the Act that the dividends on the common and Class D shares be capital dividends. The portion of the dividend paid to the Appellant was $4,000,001 (or 40%), in respect of its 51,200 common, 285,800 Class A, 313,000 Class B and 80,334 Class E shares. The portion of the dividend paid to the Love Group was $6,000,002 (or 60%), in respect of its common and Class D shares;

(b) the Appellant subscribed for 10,666 Class E shares of Oxford having a par value of $1.00 each, at a subscription price of $3,199,800 (or $300.00 per share). Accordingly, Oxford credited $10,666 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($3,189,134 or $299.00 per share) was credited to its contributed surplus account; and

(c) the Love Group subscribed for 16,000 Class D shares of Oxford having a par value of $1.00 each, at a subscription price of $4,800,000 (or $300.00 per share). Accordingly, Oxford credited $16,000 (or $1.00 per Class D share) to its share capital, and the balance of the subscription price ($4,784,000 or $299.00 per share) was credited to its contributed surplus account.

27. On October 31, 1984:

(a) Oxford declared and paid dividends of $10,000,000 (or $5.398 per share) from earnings on the common, Class A, Class B, Class D and Class E shares. Oxford elected under subsection 83(2) of the Act that the dividends on the common and Class D shares be capital dividends. The portion of the dividend paid to the Appellant was $4,000,000 (or 40%), in respect of its 51,200 common, 285,800 Class A, 313,000 Class B and 91,000 Class E shares. The portion of the dividend paid to the Love Group was $6,000,000 (or 60%), in respect of its common and Class D shares;

(b) the Appellant subscribed for 10,667 Class E shares of Oxford having a par value of $1.00 each, at a subscription price of $3,200,100 (or $300.00 per share). Accordingly, Oxford credited $10,667 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($3,189,433 or $299.00 per share) was credited to its contributed surplus account; and

(c) the Love Group subscribed for 16,000 Class D shares of Oxford having a par value of $1.00 each, at a subscription price of $4,800,000 (or $300.00 per share). Accordingly, Oxford credited $16,000 (or $1.00 per Class D share) to its share capital, and the balance of the subscription price ($4,784,000 or $299.00 per share) was credited to its contributed surplus account.

28. On May 23, 1985:

(a) Oxford declared dividends of $20,000,000 (or $10.643 per share) from earnings on the common, Class A, Class B, Class D and Class E shares. In respect of the Class A, Class B and Class E shares, the dividends were paid on November 29, 1985. Oxford elected under subsection 83(2) of the Act that the dividends on the common and Class D shares be capital dividends. The portion of the dividend paid to the Appellant was $8,000,000 (or 40%), in respect of its 51,200 common, 285,800 Class A, 313,000 Class B and 101,667 Class E shares. The portion of the dividend paid to the Love Group was $12,000,000 (or 60%), in respect of its common and Class D shares;

(b) the Appellant subscribed for 1,816 Class E shares of Oxford having a par value of $1.00 each, at a subscription price of $544,800 (or $300.00 per share). Accordingly, Oxford credited $1,816 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($542,984 or $299.00 per share) was credited to its contributed surplus account; and

(c) the Love Group subscribed for 40,000 Class D shares of Oxford having a par value of $1.00 each, at a subscription price of $12,000,000 (or $300.00 per share). Accordingly, Oxford credited $40,000 (or $1.00 per Class D share) to its share capital, and the balance of the subscription price ($11,960,000 or $299.00 per share) was credited to its contributed surplus account.

29. On November 29, 1985, the Appellant subscribed for 24,850 Class E shares of Oxford having a par value of $1.00 each, at a subscription price of $7,455,000 (or $300.00 per share). Accordingly, Oxford credited $24,850 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($7,430,150 or $299.00 per share) was credited to its contributed surplus account.

30. On December 31, 1985:

(a) Oxford declared and paid dividends of $85,000,000 (or $43.683 per share) from contributed surplus on the common, Class A, Class B, Class D and Class E shares. Oxford elected under subsection 83(2) of

the Act that the dividends on the common and Class D shares be capital dividends. The portion of the dividend paid to the Appellant was $33,999,991 (or 40%), in respect of its 51,200 common, 285,800 Class A, 313,000 Class B and 128,333 Class E shares. The portion of the dividend paid to the Love Group was $51,000,009 (or 60%), in respect of its common and Class D shares;

(b) the Appellant subscribed for 113,333 Class E shares of Oxford having a par value of $1.00 each, at a subscription price of $33,999,900 (or $300.00 per share). Accordingly, Oxford credited $113,333 (or $1.00 per Class E share) to its share capital, and the balance of the subscription price ($33,886,567 or $299.00 per share) was credited to its contributed surplus account; and

(c) the Love Group subscribed for 170,000 Class D shares of Oxford having a par value of $1.00 each, at a subscription price of $51,000,000 (or $300.00 per share). Accordingly, Oxford credited $170,000 (or $1.00 per Class D share) to its share capital, and the balance of the subscription price ($50,830,000 or $299.00 per share) was credited to its contributed surplus account.

31. On May 5, 1988, Oxford, declared and paid dividends of $2,000,000 (or $0.897 per share) from contributed surplus on the common, Class A, Class B, Class D and Class E shares. Oxford elected under subsection 83(2) of the Act that the dividends on all these classes of shares be capital dividends. The portion of the dividend paid to the Appellant was $800,000 (or 40%), in respect of its 51,200 common, 285,800 Class A, 313,000 Class B and 241,666 Class E shares. The portion of the dividend paid to the Love Group was $1,200,000 (or 60%), in respect of its common and Class D shares.

32. Summarized in Appendix I are the dividend payments made by Oxford to the Appellant between the years of 1982 and 1988 (each a "**Dividend Payment**" and collectively, the "**Dividend Payments**"), and the reinvestments by the Appellant in the Class E shares of Oxford (the "**Reinvestments**"). A shorter summary follows:

Oxford Fiscal Year Ended	Dividend Payment	Portion Reinvested		Portion Retained	
	($ millions)	($ millions)	%	($ millions)	%
March 31, 1983	8.8	6.8	77.3	2.0	22.7
March 31, 1984	10.8	9.2	85.2	1.6	14.8
	4.0	3.6	90	0.4	10
December 31, 1984	5.0	4.5	90	0.5	10
	4.0	3.2	80	0.8	20
	4.0	3.2	80	0.8	20
December 31, 1985	8.0	0.5 + 7.5	100	0.0	0
	34.0	34.0	100	0.0	0
December 31, 1988	0.8	0.0	0	0.8	100

	$79.4	$72.5	91.3%	$6.9	8.7%

E. Accounting & Tax Treatment of the Dividend Payments

33. Each of the Dividend Payments was made out of either the current or retained earnings of Oxford, except for the final two payments on December 31, 1985 and May 5, 1988, which were made out of the contributed surplus account of Oxford.

34. In computing its income for financial accounting purposes and in accordance with generally accepted accounting principles, the Appellant included in its earnings, the full amount of the Dividend Payments received by it from Oxford, other than the December 31, 1985 and May 5, 1988 Dividend Payments.

35. Other than the dividends which were elected to be capital dividends (that is, the Dividend Payments on the common shares and the May 5, 1988 Dividend Payment), the Appellant included in computing its income under Part I of the Act, the full amount of the Dividend Payments received by it on the Class A, Class B and Class E shares of Oxford pursuant to subsection 82(1) and paragraph 12(1)(j), and deducted such amount pursuant to subsection 112(1) in computing its taxable income.

F. The 1988 Disposition

36. On February 21, 1987, the Appellant exchanged its shareholdings in Oxford for identical shares in Oxford Holdings Ltd. ("**Holdings**"), the successor corporation to Oxford. This exchange was effected on a tax-deferred basis pursuant to the provisions of section 85.1 of the Act.

37. On December 1, 1988, the Appellant and Loford terminated the Shareholders' Agreement. On the same date, the Appellant disposed of its shares of Holdings in the following manner (the "**Disposition**"):

(a) Holdings redeemed the 51,200 common, 285,800 Class A and 313,000 Class B shares held by the Appellant at a price of $46.809 per share, for an aggregate purchase price of $30,425,850, payable in cash. Of the aggregate purchase price, $14,522,860 was deemed by subsection 84(3) to be a dividend for purposes of the Act (the "**Deemed Dividend**"), and the balance ($15,902,990) represented proceeds of disposition in accordance with the definition of "proceeds of disposition" in paragraph 54(h). Holdings elected under subsection 83(2) to have Deemed Dividend treated as a capital dividend for the purposes of the Act; and

(b) Loford acquired the 241,666 Class E shares of Holdings held by the Appellant at a price of $46.809 per share, for an aggregate purchase price of $11,312,150, paid in cash.

38. Following the disposition of its shares of Holdings, the Appellant acquired the following shares in Oxford Properties Canada Ltd. (an Oxford affiliate):

(a) 2,000,000 common shares for cash consideration of $3,200,000; and

(b) 1,792,000 First Preferred Shares (with a face value of $44,800,000) for cash consideration of $36,288,000.

G. The Tax Consequences

39. The Appellant allocated the total proceeds received on the Disposition ($41,738,000) among the common, Class A, Class B, and Class E shares pro rata based upon the number of shares.

40. In computing its income under Part I of the Act for the 1989 Taxation Year, the Appellant reported:

(a) a capital loss of $61,187,650 in respect of the Class E shares, which amount was reduced to $52,243,540, following the application of subsection 112(3) of the Act;

(b) capital losses of $78,533 and $480,099 in respect of the common and Class B shares, respectively, which were reduced to nil following the application of subsection 112(3); and

(c) a capital gain of $4,054,346 in respect of the Class A shares.

41. Summarized in Appendix II are the calculations (subject to rounding) underlying the amounts reported by the Appellant in respect of the Disposition.

42. In computing its taxable income under Part I of the Act for the 1989 Taxation Year, the Appellant included the two-thirds taxable capital gain reported on the Class A shares ($2,702,897), which when offset by the two-thirds allowable capital loss reported on the Class E shares ($34,829,027) resulted in the Appellant reporting a net allowable capital loss of $32,126,129 (the "**Capital Loss**").

H. The Reassessments

43. Pursuant to paragraph 152(3.1)(a) of the Act, the normal reassessment period in respect of the 1989 Taxation Year would have expired on or about

January 1, 1995. Prior to the expiry thereof, the Minister of National Revenue (the "**Minister**") asked for and the Appellant provided a waiver extending such reassessment period as it related to the determination of the Capital Loss.

44. By way of a reassessment, notice of which was dated October 7, 1994 (the "**1994 Reassessment**"), the Minister reassessed the Appellant in respect of the 1989 Taxation Year and, among other things, disallowed in full the Capital Loss reported in respect of the Disposition. The Appellant duly objected to the 1994 Reassessment by way of a Notice of Objection dated December 29, 1994.

45. The Appellant filed a Notice of Revocation of Waiver on May 3, 2002.

46. Notices of Reassessment dated February 13, 1997 and February 25, 2004 (the "**1997 and 2004 Reassessments**") were issued by the Minister in respect of taxes payable by the Appellant under Part I of the Act for the Taxation Year. The 1997 and 2004 Reassessments left the disallowance of the Capital Loss as originally assessed.

47. The Appellant duly objected to 1997 and 2004 Reassessments by way of Notices of Objection dated May 12, 1997 and March 15, 2004, respectively.

B. Issue:

[5] Whether the Appellant, as a result of a series of transactions, has artificially or unduly created or increased the amount of loss suffered on the disposition of the Class E shares issued by Oxford to the Appellant.

C. Analysis and Decision:

The Appellant's Position:

[6] Counsel for the Appellant maintains that the cost of the shares should be determined by reference to the consideration it paid to acquire them, and that the loss should be allowed as deductible in full.

[7] Counsel for the Appellant admits that the capital loss was deemed by subsection 112(3) of the *Act* to be $48,189,193.

[8] Counsel for the Appellant notes that the Minister failed to obtain a valuation of the Class E shares and that there was an extensive delay caused by the action or inaction by the Minister's officials.

[9] The Appellant filed a waiver and, in my opinion, nothing turns on the fact that the Minister did not obtain a valuation of the Class E shares or that there was an extensive delay before the Reassessments were issued by the Minister.

[10] At paragraph 30 of his written argument, Mr. Meghji, counsel for the Appellant said:

> The only provision regarded as potentially relevant to the denial of the Capital Loss was subsection 245(1) of the Act, as it read prior to its repeal…

[11] Mr. Meghji maintains that section 55(1) of the *Act* was repealed and is *prima facie* inapplicable (paragraph 33). I do not agree. It is clear that subsection 55(1) was in effect at the time of this transaction.

[12] Mr. Meghji also maintains that the evidence indicates that the disposition of the Oxford shares owned by the Appellant was not preordained and therefore section 55(1) of the *Act* is inapplicable. Note: I deal with this point later in the Reasons.

[13] At paragraph 57 of the Transcript, Mr. Meghji referred to the subscription price of the shares ($300 per share) and asked his witness, Robert Teskey, to comment. The evidence from Mr. Teskey was:

> Q. Was it your intention, at the time that you suggested $300 per share, to suggest fair market value as the measure? Was it your intention to suggest the fair market value of the shares when you suggested $300?
>
> A. I think I was looking for a number that could be justified as not being grossly away from fair market value. It clearly wasn't science. It was a number that, given the circumstances, appeared to make sense.

(Emphasis added)

(Transcript, Examination in Chief of Mr. Teskey, pages 86 and 87)

[14] At paragraph 73 of his argument, Mr. Meghji says:

> The Crown has gone so far as to allege that one of the driving purposes of the Transactions, in fact the only "*offensive*" purpose, must have been to enable the TD Bank to "*get around*" the operation of 112(3).

Subsection 152(9)

[15] Generally, subsection 152(9) of the *Act* states that the Minister may advance an alternative argument in support of an assessment at any time after the "normal reassessment period" which is a defined term pursuant to subsection 152(3.1) of the *Act*. Paragraphs 152(9)(*a*) and 152(9)(*b*) provide an exception to the above rule where the taxpayer is no longer able to adduce evidence without leave of the court and it is not appropriate in the circumstances for the court to order the evidence to be adduced.

[16] This provision was added to the *Act* in response to the decision of the Supreme Court of Canada in *Continental Bank of Canada v. The Queen*, [1998] 2 S.C.R. 358. In this case, it should be noted that the new argument was raised for the first time at the hearing before the Supreme Court.

[17] A number of cases, most notably *The Queen v. Loewen*, 2004 D.T.C. 6321, address the ability of the Minister to make new factual allegations after the Reassessment. In the case at hand, the Minister is asserting a new basis for the Reassessment but is not making any new factual allegations. Paragraphs 152(9)(*a*) and 152(9)(*b*) do not appear to be relevant since there is no new factual basis for the Reassessment and thus no additional evidence the Appellant needs to adduce in response.

[18] The leading case on subsection 152(9) is *Walsh et al. v. The Queen*, 2007 D.T.C. 5441. In *Walsh*, the Minister sought an Order to amend its pleadings to include sections and arguments to uphold the assessment if the taxpayers were not residents of Canada. The Court also noted that in *Anchor Pointe Energy Ltd. v. The Queen*, 2003 F.C.A. 294, it was held that there is no argument to be made between a new basis of assessment and a new argument in support of an assessment with respect to the scope of subsection 152(9). The Court in *Walsh* then outlined the following conditions which apply when the Minister seeks to reply on subsection 152(9):

> [18]…1) the Minister cannot include transactions which did not form the basis of the taxpayer's reassessment;
>
> 2) the right of the Minister to present an alternative argument in support of an assessment is subject to paragraphs 152(9)(*a*) and [152(9)](*b*), which speak to the prejudice to the taxpayer; and

> 3) the Minister cannot use subsection 152(9) to reassess outside the time limitations in subsection 152(4) of the Act, or to collect tax exceeding the amount in the assessment under appeal.

[19] Without further discussion of the above criteria, the Court concluded that none of these conditions apply to the facts at hand.

[20] In *RCI Environment Inc. v. The Queen*, 2009 D.T.C. 5037, Justice Noël of the Federal Court of Appeal said that subsection 152(9) allows the Minister to "advance an alternative argument in support of an assessment <u>at any time</u> after the normal reassessment period" (emphasis added). The Court held that the amendments were permissible, as found by the Tax Court Judge, since the alternative position invoked additional provisions of the *Act* but did not result in additional tax. The Court also noted the fact that these amendments were announced well before the trial began and the taxpayer did not argue that evidence was not available to refute this new basis for reassessment.

[21] Counsel for the Appellant argues that subsection 152(9) does not give the "Minister an absolute right to plead an alternate ground", quoting from *Walsh*. I think that counsel for the Appellant is correct on this point. The Minister's right to plead an alternate ground is restricted by paragraphs 152(9)(*a*) and 152(9)(*b*) and by the conditions outlined in *Walsh*.

[22] I have concluded that subsection 152(9) will operate to allow the Minister to introduce the subsection 112(3) argument, even at this late stage in the proceeding. As for procedural fairness, I have determined that there has been no breach since the Appellant was given time to respond to the subsection 112(3) argument through written representations.

<u>Subsection 112(3)</u>

[23] Subsection 112(3) of the *Act* is a stop-loss rule reducing a loss from disposition of a share that is capital property, where the taxpayer received capital dividends on that share. More specifically, paragraph 112(3)(*b*) reduces the amount of a capital loss realized on the disposition of a share by the total amount of tax free dividends including dividends that are deductible by the corporation, non-taxable capital dividends and life insurance capital dividends. This provision does not apply where the dividends were received at a time when the taxpayer and non-arm's length persons owned five per cent or less of any class of shares of the corporation, provided

that the taxpayer owned the particular share(s) throughout the 365 day period that ended immediately before the disposition.

[24] Counsel for the Appellant argues that subsection 112(3) applies to a loss determined without reference to subsection 112(3) and that this means the loss to which subsection 112(3) applies is the loss determined after the application of subsection 55(1). The Appellant further asserts that subsection 112(3) cannot be applied in the manner the Minister proposes to counter alleged abuse since the loss is not artificial or undue and the Minister has not pleaded or relied on any other anti-avoidance provision.

The Respondent's Position:

[25] The Respondent argued that subsection 112(3) should apply to reduce the loss on the Class E shares. The Respondent correctly notes the tax policy rationale for subsection 112(3) is that when a company receives tax free dividends on shares it should not be able to claim a loss on the disposition of the shares to the extent of the dividends received. The Respondent argues that subsection 112(3) should be interpreted in such a way to prevent its effect from being avoided where a taxpayer arranges to receive new classes of shares that are identical with the old shares. More specifically, in the case at hand, counsel for the Respondent argues that the newly created Class E shares are virtually identical with the pre-existing common, Class A and Class B shares, with the only difference being that the common shares carry voting rights, a difference which the Respondent says is not important. Counsel for the Respondent contends that the court should rely on subsection 33(2) of the *Interpretation Act*, R.S.C. 1985, c. 1-21 to find that the word "share" in the subsection 112(3) provision includes the plural, being "shares". Further, counsel for the Respondent asserts that subsection 112(3) should apply where a taxpayer arranges to receive new classes of shares that are identical to existing classes of shares. I do not find that subsection 112(3) applies as asserted by the Respondent since the loss created cannot be applied against a different class of shares, no matter how similar the share attributes are.

[26] Counsel for the Respondent referred to subsection 55(1). He said that it is a well-known fact that parties acting in concert have been found to be at non-arm's length. According to the Respondent, parties acting in concert have the ability to manipulate the situation, where they are indifferent as to a particular aspect of a transaction, but where choosing one option over another can produce a substantial tax advantage (i.e. the subscription price of the Class E shares). The Respondent continues by stating that the parties in this case are in the exact same economic

position whether it is $300 per share with a par value of $1, or $30 per 10 shares with a par value of $0.10, but the tax loss is three times greater by choosing the former over the latter.

[27] I note that this is not a case where the price of the shares is determined by the stock market, but rather it is a case where, to use Mr. Thomson's words, the price was determined by a "partnership [of two]" who enjoyed a "nice cozy relationship". Justice Webb held in *The Toronto-Dominion Bank* v. *The Queen*, 2008 D.T.C. 3937 that the onus of proof with respect to the arm's length issue rests with the Appellant to establish that Mr. Love and his companies were dealing at arm's length with the Appellant. The Appellant has advanced little evidence on this point and thus I find that Mr. Love and the Appellant were at non-arm's length during the relevant time period.

[28] Notwithstanding the fact that former section 55 was contained in Division B, Subdivision c, this does not mean that when applying it, the rest of the *Act* may be ignored. The opening words "for the purposes of this subdivision" simply mean that this provision is a complete avoidance code for dealing with capital gains and losses. The Appellant advances an ordering argument which would be tantamount to reading in the words "having regard only to the provisions of this subdivision" into the former section 55. There is no merit in the Appellant's ordering argument as the Court cannot read words into a section.

[29] I wish to note that there are two possible variations of this subsection which could be applied, subsection 55(1) as it read before its repeal and the version of this subsection that existed during the transitional period. It appears that for subsection 55(1) to be invoked, one needs to have a sale or other disposition of property, so in the case at bar the transitional provision has to apply since the sale occurred during the period in which the transitional provision was in effect.

[30] The word "series" is the subject of much debate in this case. Counsel for the Appellant said that the Minister had (prior to written arguments) always proceeded on the basis that the former subsection 55(1) would be engaged only if the disposition was part of a single series of transactions that commenced prior to September 13, 1988 and was completed before 1989.

[31] It is noted that the word "series" does not appear in subsection 55(1) as it read before the transitional provision came into effect. Counsel for the Respondent argued that the word "series" that was used in the transitional provision is used in its ordinary sense, as an English word, and does not encompass the requirement of

preordination. It is asserted that the requirement of preordination is a judicial gloss added to the word by the House of Lords when dealing with a series of step transactions in a substantive tax avoidance context. Counsel for the Respondent said that it is not conceivable that Parliament would have intended the word "series" in the three month transitional provision to have the meaning of subsection 55(1) plus the requirement of a preordained common law series, without the benefit of subsection 248(10).

[32] Counsel for the Appellant disagrees on this point, saying that the transitional provision does not create a distinct régime and that the subsection applies only to a common law series of transactions.

[33] I have concluded that the ordinary meaning should be given to the word "series" and, therefore, it is not necessary to consider whether there was an element of preordination.

[34] Counsel for the Respondent made the following argument:

> The operative words in former s. 55(1) in relation to a disposition of property are that "artificially or unduly…created a loss". They are similar to the words in former s. 245(1) in relation to an expense that would "unduly or artificially reduce the income". Therefore cases dealing with the interpretation of former s. 245 are relevant in interpreting former s. 55. The major factual difference will usually be timing. Some sales take a long time to happen, so there will likely be a shorter time between the avoidance facts and the challenged expense, than between the avoidance facts and the challenged disposition.
>
> In *Novopharm*, 2003 DTC 5195, Justice Rothstein resolved a lingering debate when he said at paragraphs 28 and 34 that "the *Fording Coal Ltd.* approach should be followed" in interpreting former s. 245. At paragraph 24, he listed the following factors established by *Fording Coal* to assess whether a deduction unduly or artificially reduced income for the purposes of s. 245(1): (1) would the deduction, if permitted, be contrary to the object and spirit of the *Income Tax Act*; (2) are the transactions giving rise to the deductions made in accordance with normal business practice; and (3) were the transactions entered into for *bona fide* business purposes?
>
> The Appellant takes the view that these factors are cumulative, in the sense that all must exist to reach the conclusion that the avoidance provision applies. The Respondent takes the opposite view, and says that where the object and spirit of the Act has been sufficiently affronted, some business

> practice or purpose will not save the day. This approach is more consistent with Justice Strayer's decision in *Fording Coal*, 95 DTC 5672 (FCA), where in paragraph 49 he spoke of "one indicator" that a deduction artificially reduced income. It suggests that what he had in mind were non-cumulative criteria.

[35] One of the leading decisions on subsection 55(1) is *The Queen v. Nova Corporation of Alberta*, 97 D.T.C. 5229, where the Federal Court of Appeal held that the provision did not apply. In that case, Nova, through a series of transactions, acquired shares with an adjusted cost base of $42 million and nominal fair market value. Subsequently, Nova disposed of these shares and claimed a capital loss of nearly $42 million. There were two sets of shares that were acquired by Nova. An arm's length third party, Carma, held preferred shares of Allarco that had an adjusted cost base of $16.5 million, but nil market value. Allarco created three tiers of subsidiaries to facilitate this transaction. Carma then caused the Allarco shares to be sold to the third tier subsidiary for $1 and this company acquired the adjusted cost base of the shares. Nova bought from the second tier subsidiary the only issued and outstanding share of the third tier subsidiary which owned the loss shares. The third tier subsidiary was liquidated causing Nova to acquire the loss shares with the high adjusted cost base. Nova sold these shares to an arm's length third party for $1 and claimed the loss.

[36] Justice McDonald, who wrote a concurring Judgment, made the following comment at page 5234 regarding subsection 55(1):

> …there is a precondition to the application of the subsection: the taxpayer must have done something to artificially or unduly increase his losses from disposition. That is, it is not enough that there be a loss, or that a loss be artificially or unduly increased in amount. For the subsection to apply, it requires that "he" – the taxpayer - have increased the amount of his loss from disposition.
>
> The term "loss from disposition" is defined in subparagraph 40(1)(*b*)(i) of the Act as the amount by which the adjusted cost base (ACB) exceeds the taxpayer's proceeds of disposition of the property. On a plain reading of subsection 55(1), then, the taxpayer must have done something to influence either the adjusted cost base or the proceeds of disposition in order to have artificially or unduly increased his losses.
>
> […]
>
> …The ACB's of the shares were inherited by the taxpayer, and the shares were disposed of for their market value, which was nothing. The losses claimed by the taxpayer came about through the inheritance of ACB's, and this inheritance came

> about through operation of the Act. The taxpayer did nothing but avail himself of the provisions as they then existed.

[37] The Court in *Nova* noted that a loss cannot be artificial or undue if it arises by specific operation of the *Act*. The Court held that there was no indication that the provisions of the *Act* causing the loss to essentially be transferred to an arm's length party were stretched beyond their plain meaning. While it was clear that the tax loss claimed by the Appellant was in excess of its actual loss on the transaction, a restricted scope was given to the interpretation of subsection 55(1). The Court held that subsection 55(1) is not a broad anti-avoidance provision and its scope cannot be expanded beyond its plain meaning where there is no ambiguity. The dissent focused on the fact that there was a deviation of the rollover provisions caused by the Appellant which means that the Appellant may reasonably be considered to have unduly or artificially increased the adjusted cost base.

[38] *Hollinger Inc. v. The Queen*, [1998] 4 C.T.C. 2424, followed *Nova* since the transaction at issue was similar, i.e., a transfer of losses between arm's length parties. However, in this case, the loss was from a U.S. company to a Canadian taxpayer.

[39] In *Les Industries S.L.M. Inc. v. Her Majesty The Queen*, 2000 D.T.C. 6648, the Federal Court, Trial Division, hearing an appeal from the Tax Court of Canada, held that subsection 55(1) applied to one of the two transactions at issue. A wholly-owned subsidiary of the Appellant, Manufacture St-Laurent Inc. ("St-Laurent"), was to be sold for $1 to one of the shareholders of the Appellant but before the sale, St-Laurent declared a $1 million dollar stock dividend which caused the shares to increase by this amount. When the shares were sold as intended, the Appellant realized a capital loss of $1 million. The *Nova* decision referred to above was distinguished on the basis that the declaration of the $1 million dollar share dividend by St-Laurent has to be attributed to the Appellant because of the degree of control exercised by the latter over the subsidiary. Further, the declaration of the dividend "had the direct consequence of increasing the ACB of the Appellant's shares which led to the loss in question". The Court held that the Appellant artificially created a loss within the meaning of subsection 55(1).

[40] Subsection 55(1) was also considered by Justice Mogan in *216663 Ontario Limited v. The Queen,* 98 D.T.C. 1628. Justice Mogan held that creating, subscribing for, issuing and redeeming the Class B shares were transactions which brought the taxpayer within the scope of subsection 55(1). After considering the phrase "artificially or unduly" as per the *Nova* decision*,* Justice Mogan held that the taxpayer did something to affect its loss by removing $4.9 million from the

subsidiary for the sole purpose of reducing the fair market value of the common and Class A shares of the subsidiary.

> [29] I cannot resist the conclusion that the loss created by the Appellant on the disposition of the common and Class A shares of [the subsidiary] was both artificial and undue. It was artificial (i.e., simulated or fictitious) in the sense that the sale of the common and Class A shares of [the subsidiary] on February 1, 1988, when joined with the issue and redemption of the Class B shares, did not result in a loss at all but in a significant financial gain to the Appellant. It was undue (i.e., excessive) in the sense that the Appellant was permitted to report a big loss when the Appellant had in fact realized a big gain.

[41] The case at hand most closely resembles that of *216663 Ontario*. The Appellant "did something" to trigger or increase the loss by subscribing for Class E shares at an inflated price of $300 per share.

[42] I have used the word inflated in the above paragraph because I have concluded that the Appellant paid too much when it purchased the Class E shares at $300 per share.

[43] I have reached the conclusion that the price of $300 per share was inflated for the following reasons:

(a) In paragraph [13] above I quoted Mr. Teskey when he explained why he picked $300 per share for the Class E shares. Mr. Teskey said that picking the number of $300 per share was not science and it was not fair market value. Mr. Teskey said:

> "It was a number that, given the circumstances, appeared to make sense."

(Transcript Volume 1, page 87, lines 1-2)

(b) In his written argument counsel for the Respondent said at paragraph 51:

> This is not a case where the "price" of the Class D and Class E shares was determined in the open market. It is a case where, to use Mr. Thompson's word, the price was determined by a "partnership [of two]," and those who enjoyed "a nice cozy relationship".

I agree with this comment.

(c) Counsel for the Appellant argued that the price paid by the Appellant for the class E shares did not matter because Oxford and the Appellant (the only two shareholders involved) each paid the same price for similar shares. While this point may be correct "qua shareholder," the overpayment paid for the shares by the Appellant increases the price of the Class E shares for the purpose of determining the cost base of the shares acquired by the Appellant.

(d) I also note that during his testimony Mr. Teskey said:

> The difference was that PriceWaterhouse [the Appellant's accounting firm] introduced what they called a blockage factor of 45 per cent. The result of that was that rather than getting my number [Note $300 per share], you got a number of about half. […] it was about $142 per share.

(Transcript Volume II, page 319, lines 11-16)

(e) I also wish to note that the Class E shares of Oxford were acquired over several years and it is likely that the fair market value of the shares of Oxford fluctuated during this period.

[44] In paragraph [40] above, I referred to Justice Mogan's decision in *216663 Ontario*, where Justice Mogan held that the taxpayer did something to affect its loss. In my opinion, the Appellant also "did something" when it arranged to have Holdings redeem the Class A and Class B shares, instead of redeeming these shares directly, thus causing the gain on the shares to arise separately.

[45] In this connection, I refer to paragraphs 11 and 12 of the Respondent's written argument where he said:

> 11. Accordingly, the Appellant further stretched the capital loss on disposition by having the common, Class A and Class B shares redeemed, which triggered a deemed dividend which was tax free for the Appellant. This deemed dividend at redemption ultimately resulted in a small capital loss on the common and Class B shares that was reduced to nil after the application of s. 112(3), and in a small capital gain on the Class A shares. The disposition of the Class E shares resulted in a substantial loss affected by a limited grind and a small gain on the Class A shares.
>
> 12. The loss was also achieved by the allocation of the proceeds of disposition on a pro rata basis at $46.81 per share on all of the shares held by the Appellant,

> notwithstanding the difference in subscription price of $26 (common, Class A and Class B shares) versus $300 for the “special” Class E shares.

I agree with the comments of counsel for the Respondent.

[46] Based upon the reasons as outlined above, the appeal is dismissed with costs.

Signed at Ottawa, Canada, this 3rd day of June 2010.

"L.M. Little"

Little J.

CITATION:	2010 TCC 275
COURT FILE NO.:	2006-2996(IT)G
STYLE OF CAUSE:	The Toronto-Dominion Bank and Her Majesty The Queen
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	October 5, 6, 7, 8 and 9, 2009
REASONS FOR JUDGMENT BY:	The Honourable Justice L.M. Little
DATE OF JUDGMENT:	June 3, 2010

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