Docket: 2009-215(IT)G

BETWEEN:

NEIL MACCALLUM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on June 13, 2011, at Fredericton, New Brunswick

Before: The Honourable Justice Valerie Miller

Appearances:

Counsel for the Appellant:	Andrew D. Rouse
Counsel for the Respondent:	Stan W. McDonald

JUDGMENT

The appeal from the reassessment under the *Income Tax Act*, notice of which is dated November 20, 2007, for the Appellant's 2003 taxation year is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to deduct the allowable business investment loss.

The appeals for 2004 and 2005 are dismissed.

The Appellant is awarded costs.

Signed at Ottawa, Canada, this 22nd day of June 2011.

"V.A. Miller"

V.A. Miller J.

Citation: 2011TCC316
Date: 20110622
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BETWEEN:

NEIL MACCALLUM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

V.A. Miller J.

[1] The issue in this appeal was whether the Appellant had incurred an allowable business investment loss ("ABIL") of $56,016 in his 2003 taxation year.

[2] There had been several issues raised in the Notice of Appeal; but, prior to the hearing, the Appellant withdrew all issues except the one relating to the ABIL.

[3] The claim for the ABIL was regarding a payment of $162,852.27 made by the Appellant to the Royal Bank of Canada (the "Bank") pursuant to his guarantee of a loan made by the Bank to Mitchco Construction Inc. ("Mitchco"), a company which was wholly owned by his son.

[4] By agreement of the parties, the only question before me was whether the debt incurred by the Appellant was acquired "for the purpose of gaining or producing income from a business or property" as required by subparagraph 40(2)(*g*)(ii) of the *Income Tax Act* (the "*Act*").

[5] Subparagraph 40(2)(*g*)(ii) of the *Act* reads:

> **40(2) Limitations** -- Notwithstanding subsection (1),
>
> (g) **[various losses deemed nil]** -- 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,

[6] It is clear that to satisfy subparagraph 40(2)(*g*)(ii) of the *Act*, the Appellant must provide evidence that his purpose in signing the guarantee was to gain or produce income from a business or property[1]. This requirement will be referred to as the business purpose test.

[7] The parties filed a Joint Statement of Facts ("Joint Statement") which is attached to these Reasons as Appendix I. The following are the facts from the Joint Statement which are pertinent to my decision.

(a) D & N Truck Lines Ltd. ("D & N") was primarily a trucking company operating throughout Ontario, Quebec, Atlantic Canada and the USA. D & N also carried on the business of a broker/shipper for owner/operators of trucks throughout Ontario, Quebec, Atlantic Canada and the USA.

(b) D & N was owned 100% by SeaReach Holdings Ltd. ("SeaReach").

(c) The Appellant owned 51% of SeaReach and his spouse, Lillian MacCallum, owned 49%.

(d) Mitchco Construction Inc. ("Mitchco") is owned 100% by Robert MacCallum.

(e) At all material times, Mitchco was a Canadian small business corporation.

(f) Robert MacCallum is the son of the Appellant.

(g) On February 15, 1996, Mitchco entered into a contract with the City of Miramichi (the "City") to construct a seawall for a sewage lagoon.

(h) On April 24, 1996, the City certified substantial performance of the contract by Mitchco.

(i) On June 6, 1996, the contract was completed and certified by the City.

(j) Beginning in February 1996 and continuing through until June 1996, D & N provided equipment and materials to Mitchco in the amount of $394,805 for the City contract. Mitchco was unable to pay D & N and the full amount remained due and owing to D & N.

(k) As a result of a dispute concerning payment by the City to Mitchco on the contract, Mitchco was in a very difficult position financially.

(l) In July, 1996, the Royal Bank of Canada (the "Bank") was pressing Mitchco to get its financial affairs in order. The Bank's account manager was made aware of the dispute between the City and Mitchco.

(m) On July 29, 1996, the Appellant provided a guarantee on a line of credit in favour of the Bank for Mitchco.

(n) On May 5, 1997, Mitchco's counsel sent a letter to Robert MacCallum and the Appellant wherein counsel provided a report on the chances of success of the possible action against the City.

(o) On May 7, 1997, Mitchco filed a Notice of Action and Statement of Claim against the City with the Court of Queen's Bench of New Brunswick. The Statement of Claim sought damages in the amount of $648,899.87 which covered only Mitchco's alleged, actual losses incurred in carrying out the contract. The Statement of Claim sought no further award except costs and pre-judgment interest.

(p) In January 2002, Mitchco paid the Appellant the amount of $50,819.15.

(q) The Bank required the Appellant as guarantor to pay the outstanding debt in the amount of $162,852.27. The Appellant honoured his guarantee to the Bank and paid this amount in June 2003.

(r) Mitchco ceased operation in September 2003.

(s) The Appellant was not a shareholder in Mitchco and was not entitled to a dividend.

[8] The only witnesses were the Appellant and his son, Robert MacCallum.

[9] They gave details of the dispute between the City and Mitchco and the circumstances which gave rise to the Appellant signing the guarantee to the Bank for Mitchco's loan. A summary of their testimony follows.

[10] It was their evidence that the contract with the City required Mitchco to supply rock material to meet specifications for R-1000 rock. This specification consisted of a mix of small and large rock. However, the City refused to accept R-1000 rock and insisted upon material that more closely conformed to rock which met the R-2000 standard. R-2000 rock is mainly large rock.

[11] To meet the R-2000 standard, Mitchco incurred substantial additional expenses.

[12] Mitchco wanted to ensure that it could document these additional expenses so it engaged an engineer to calculate and document them on a daily basis. Robert MacCallum also assisted with these calculations. As well, it engaged Jacques Whitford Engineering Co. ("Jacques"), a consulting company, to do a study on the rock being supplied.

[13] Jacques agreed with Mitchco that the rock being delivered was not in accord with the contract.

[14] Mitchco also sought an opinion from another engineering firm called Godfrey & Associates. This firm agreed with Mitchco and Jacques. It also verified the calculation of the extra expenses incurred by Mitchco.

[15] This data was used by Mitchco in its attempt to negotiate an increased contract price with the City. Prior to June 6, 1996, Mitchco made a number of claims in writing to the City. It was not successful.

[16] Mitchco's work under the contract was totally performed and certified by the City on June 6, 1996. It was paid the contract amount less a 60 day holdback of approximately $100,000.

[17] Robert MacCallum stated that Mitchco planned to file another claim with the City pursuant to the terms of the contract but it wanted to make certain that it received the amount of the holdback. In the meantime, the Bank knew that Mitchco had completed its contract with the City and it started to pressure Mitchco for payment of its line of credit.

[18] Both witnesses stated that the Appellant signed the guarantee with the Bank so that Mitchco could remain in business while its claim with the City was ongoing. The

claim with the City was made prior to the signing of the guarantee and both witnesses testified that, at that time, they were certain that this claim would be successful.

[19] The witnesses stated that the Appellant had two business purposes in signing the guarantee. One business purpose was to earn income from an Agreement he had with Mitchco (which I will discuss below). The other business purpose was to keep Mitchco in business so that the Appellant's company, D & N, could collect its receivable.

[20] According to Robert MacCallum, there was an Agreement between Mitchco and the Appellant whereby the Appellant would earn income in exchange for his guarantee. He stated that the Appellant was promised 10% of $394,805 (the amount that Mitchco owed to D & N) and 10% interest on any amounts the Appellant might have to pay on behalf of Mitchco.

[21] The Appellant's version of the Agreement was different than that stated by his son. He testified that he was promised 10% of the amount received from the City pursuant to Mitchco's claim and 10% interest on any amounts which he might have to pay on behalf of Mitcho. In cross examination, the Appellant stated he signed the guarantee on the basis that Mitchco would pay him 10% of its claim with the City.

[22] There was no documentation to support an Agreement between the Appellant and Mitchco.

[23] In cross examination, Robert MacCallum first stated that their controller, Ann Rickman, may have known about the Agreement between him and his father. Later he stated that he didn't recall telling anyone about the Agreement between him and his father.

[24] The Agreement between the Appellant and Mitchco was made in their office.

[25] There were no scheduled payments to the Appellant as he would only get paid when Mitchco was successful with its claim against the City.

[26] The Appellant felt that there was no risk in giving his guarantee. He stated that in July 1996 it was his opinion that he would not have to pay any amounts under the guarantee as Mitchco had a solid claim against the City. Its claim had been verified by two independent consulting firms. He was 99.9% confident that Mitchco would receive in excess of $648,000 from the City.

[27] However, in 1996, the City refused to negotiate with Mitchco and it engaged the services of a lawyer. In May 1997, Mitchco started an Action against the City in

the New Brunswick Court of Queen's Bench. In 2002 the Action was settled after it was discovered that Mitchco's main expert witness had lost the documents which supported his calculations.

[28] Mitchco settled its Action with the City for $125,000. After deduction for counsel fees and disbursements, it received $91,136.06. Mitchco paid $40,316.91 to Custom Paving, a creditor, and gave the balance to the Appellant ($50,819.15).

[29] Robert MacCallum stated that $50,819.15 was paid to his father to assist him with the amount that he would have to pay under the guarantee. Whereas, the Appellant testified that he received the above amount as a result of the Agreement between him and Mitchco.

[30] The testimony also disclosed that Mitchco and D & N occupied the same work space in the Appellant's basement. They shared the same controller, Ann Rickman, who was on staff. There was no evidence concerning who paid her wages. She was employed with D & N from 1992 until 2008.

[31] The Appellant acted as site supervisor for Mitchco for no remuneration. He was actively involved in its daily operations and he attended every meeting that Mitchco had with the City, with the engineering firms and with its litigation counsel.

Analysis

[32] Whether an Agreement existed between the Appellant and Mitchco is a factual determination. As a result, the credibility of the witnesses is of prime importance.

[33] The Appellant and his son testified that there was an Agreement between Mitchco and the Appellant whereby the Appellant would earn income as a result of giving his guarantee. They both agreed that there were two parts to the Agreement but their evidence was inconsistent with respect to the exact contents of the first part of this Agreement.

[34] According to Robert MacCallum, the first part of the Agreement was that the Appellant would receive 10% of Mitchco's debt to D & N ($39,481). Whereas, according to the Appellant, the first part of the Agreement was that he would receive 10% of the amount which Mitchco received from the City.

[35] The Agreement was not in writing. No one, including their controller of many years, was ever told about this Agreement.

[36] The amount that Mitchco gave to the Appellant after it settled its litigation with the City was not in accord with either version of the alleged Agreement. In addition, the Appellant did not treat the amount of $50,819 as his profit from the litigation. Instead, he deducted it from the amount of $162,852.27 which he had to pay to the Bank under the guarantee. He then claimed the difference ($112,033) as a Business Investment Loss.

[37] Transactions between family members which are allegedly made for a business purpose will be closely scrutinized.

[38] On a review of the evidence, I find that the alleged Agreement between the Appellant and Mitchco did not exist.

[39] It was the Respondent's position that this was a family loan. The Appellant incurred the debt to help his son in a business venture and there was no business purpose for the debt. Counsel relied on the fact that the Appellant performed duties for Mitchco on a daily basis. He was never paid nor did he ever seek to be paid for his services.

[40] I do find that one of the reasons the Appellant signed the guarantee on behalf of Mitchco was to help his son. It may even have been his primary reason. However, that does not prevent the Appellant from meeting the requirements of subparagraph 40 (2)(*g*)(ii) of the *Act*. In *Rich v R*[2], Rothstein J.A., as he then was, stated:

> The Minister agrees that, though gaining or producing income need not be the exclusive or even the primary purpose of the loan, as long as it was one of its purposes, that is sufficient to meet the requirements of subparagraph 40(2)(*g*)(ii) (see *Ludmer c. Ministre du Revenu national*, [2001] 2 S.C.R. 1082 (S.C.C.) at para. 50).

[41] There does not have to be a direct link between the debt incurred by a taxpayer and the income he intends to earn. In *Byram v. R*[3], McDonald J.A. noted:

> 16 … While subparagraph 40(2)(g)(ii) requires a linkage between the taxpayer (i.e. the lender) and the income, there is no need for the income to flow directly to the taxpayer from the loan.
>
> …
>
> 21 It is equally clear that the anticipation of dividend income cannot be too remote. It is trite law that sections 3 and 4 of the Act, in conjunction with the rules set out in subdivisions (a) through (d) of division B, establish that the income of a taxpayer is to be determined on a source by source basis. Furthermore, the availability of certain deductions under the Act, including subparagraph 40(2)(g)(ii),

> require that some regard be given to the source of income that is relevant to the deduction. Accordingly, a deduction cannot be so far removed from its corresponding income stream as to render its connection to the anticipated income tenuous at best. This does not preclude a deduction for a capital loss incurred by a taxpayer on an interest-free loan given to a related corporation where it had a legitimate expectation of receiving income through increased dividends resulting from the infusion of capital.

[42] In the Joint Statement, the Respondent agreed that Mitchco was indebted to D & N for $394,805. She also agreed that this indebtedness was in existence in July 1996 when the Appellant signed the guarantee.

[43] I find that the Appellant has shown that one of his purposes for signing the guarantee in July 1996 was to support the continued existence of Mitchco, and thereby protect and collect a very significant source of earnings for D & N[4] and for himself.

[44] This purpose was not too remote to satisfy the requirements of subparagraph 40(2)(*g*)(ii) of the *Act.*

[45] There was substantial evidence with respect to the business relationship between Mitchco and D & N and the Appellant. The Appellant was the majority shareholder of SeaReach which was the only shareholder of D & N. The only other shareholder in SeaReach was the Appellant's spouse.

[46] The Appellant acted in a reasonable manner and with consideration for his own commercial interest. He is entitled to deduct the ABIL.

[47] The appeal is allowed and costs are awarded to the Appellant.

Signed at Ottawa, Canada, this 22nd day of June 2011.

"V.A. Miller"

V.A. Miller J.

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[1] *Cadillac Fairview Corp. v R.* (1996), 97 D.T.C. 405 (TCC) at paragraph 10
[2] 2003 FCA 38 at paragraph 8
[3] [1999] 2 C.T.C. 149 (FCA)

[4]*F. H. Jones Tobacco Sales Co.*, [1973] C.T.C. 784(FCTD*); McKissock v R*, [1997] 1 C.T.C. 2182 (TCC)

Appendix I

BETWEEN

NEIL MACCALLUM

APPELLANT

-and-

HER MAJESTY THE QUEEN

RESPONDENT

JOINT STATEMENT OF FACTS

The Appellant and the Respondent, by their solicitors, admit the truth of the following facts with respect to the above appeal in conjunction with any other evidence put before the Court, provided that such admissions are made for the purpose of this proceeding and any appeal there from:

A: GENERAL

1. The Appellant's address is 42 Archie Lane, Miramichi Bay, New Brunswick, E1N 6P3.
2. By Notices of Assessment dated July 29, 2004, September 1, 2005, and June 1, 2006, for the 2003, 2004 and 2005 taxation years respectively, the Minister of National Revenue (the "Minister") initially assessed the Appellant as filed.
3. By Notices of Reassessment dated November 20, 2007, the Minister reassessed the Appellant with respect to an allowable business investment loss, standby charges and a shareholder benefit as well as other adjustments not at issue on this appeal. The Minister assessed as follows:

	2003	2004	2005
ABIL disallowed	112,032.00		
Standby charge		11,190.00	13,307.00
Shareholder benefits		1,600.00	1,600.00

4. The Appellant filed a valid Notice of Objection with respect to the above Notices of Reassessment on February 13, 2008.
5. By Notice of Confirmation dated October 22, 2008, the Minister confirmed the reassessments.

6. D & N Truck Lines Ltd. (“D & N”) was primarily a trucking company operating throughout Ontario, Quebec, Atlantic Canada and the USA. D & N also carried on the business of a broker/shipper for owner/operators of trucks throughout Ontario, Quebec, Atlantic Canada and the USA.
7. D & N was owned 100% by SeaReach Holding Ltd. (“SeaReach”).
8. The Appellant owned 51% of SeaReach and his spouse, Lillian MacCallum, owned 49%.
9. Mitchco Construction Inc. (“Mitchco”) is owned 100% by Robert MacCallum.
10. At all material times, Mitchco was a Canadian small business corporation.
11. Robert MacCallum is the son of the Appellant.
12. By letter, dated November 12, 2010, the Appellant gave notice that he was withdrawing/abandoning this appeal with regard to the issues of standby charges and shareholder benefits. The ABIL claimed in the 2003 taxation year therefore is the only outstanding issue before the Court.

B: ALLOWABLE BUSINESS INVESTMENT LOSS

13. On February 15, 1996, Mitchco entered into a contract with the City of Miramichi (the “City”) to construct a seawall for a sewage lagoon.
14. On April 24, 1996, the City certified substantial performance of the contract by Mitchco.
15. On June 6, 1996, the contract was completed and certified by the City.
16. Beginning in February 1996 and continuing through until June 1996, D & N provided equipment and materials to Mitchco in the amount of $394,805.00 for the City Contract. Mitchco was unable to pay D & N and the full amount remained due and owing to D & N.
17. As a result of a dispute concerning payment by the City to Mitchco on the contract, Mitchco was in a very difficult position financially.
18. In July, 1996, the Royal Bank of Canada (the “Bank”) was pressing Mitcho to get its financial affairs in order. The Bank’s account manager was made aware of the dispute between the City and Mitchco.
19. On July 29, 1996, the Appellant provided a guarantee on a line of credit in favour of the Royal Bank of Canada for Mitchco.
20. On May 5, 1997, Mitchco’s counsel sent a letter to Robert MacCallum and the Appellant wherein counsel provided a report on the chances of success of the possible action against the City.
21. On May 7, 1997, Mitchco filed a Notice of Action and Statement of Claim against the City with the Court of Queen’s Bench of New Brunswick. The Statement of Claim sough damages in the amount of $648,899.87 which covers only Mitchco’s alleged, actual losses incurred in carrying out the

contract. The Statement of Claim sought no further award except costs and pre-judgment interest.

22. In January 2002, Mitchco paid the Appellant the amount of $50,819.15.
23. The Royal Bank required the Appellant as guarantor to pay the outstanding debt in the amount of $162,852.27. The Appellant honoured his guarantee to the bank and paid this amount in June 2003.
24. Mitchco ceased operation in September, 2003.
25. The Appellant was not a shareholder in Mitchco and was not entitled to a dividend.

ALL OF WHICH IS REPSECTFULLY SUBMITTED.

CITATION:	2011TCC316
COURT FILE NO.:	2009-215(IT)G
STYLE OF CAUSE:	NEIL MACCALLUM AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Fredericton, New Brunswick
DATE OF HEARING:	June 13, 2011
REASONS FOR JUDGMENT BY:	The Honourable Justice Valerie Miller
DATE OF JUDGMENT:	June 22, 2011

APPEARANCES:

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