Docket: 2010-696(IT)G

BETWEEN:

VON REALTY LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on June 28 and 29, 2011, at Toronto, Ontario

Before: The Honourable Justice F.J. Pizzitelli

Appearances:

Counsel for the Appellant:	Louise R. Summerhill and Marni Pernica
Counsel for the Respondent:	Stan W. McDonald and Lee-Ann Conrod

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JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* (the "*Act*") for the Appellant's taxation year ending January 31, 2005, is allowed, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the following bases:

1. That the initial 6.75% of the Appellant's interest in the Joint Venture was the acquisition of a capital property, and accordingly, 20.25% (or $170,984.12) of the gain shall be treated as a capital gain while the balance of the gain (79.75% or $673,381.88) shall be treated as business income.

2. The Respondent is awarded party and party costs in accordance with the Tariff.

Signed at Ottawa, Canada, this 8th day of July 2011.

"F.J. Pizzitelli"

Pizzitelli J.

Citation: 2011 TCC 345
Date: 20110708
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BETWEEN:

VON REALTY LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Pizzitelli J.

[1] The issue to be decided in this matter is whether the sale of the Appellant's interest in land resulting in a gain of $844,366 is taxable as a capital gain or income from business in its 2005 taxation year.

[2] The parties filed a Joint Partial Statement of Facts which confirms the following facts; namely, that the Appellant was a private corporation and a taxable Canadian corporation incorporated in British Columbia in 1977 with a business address in Aurora, Ontario. Mr. Patrick Harrison was the sole shareholder at the relevant times and the Appellant had a taxation year ending January 31. On July 30, 1996, the Appellant purchased a 6.75% interest in an existing Joint Venture with three other parties, the sole asset of which was land located in Kelowna, British Columbia (the "Property") and on February 24, 2001, the Joint Venture was reorganized and the Appellant ended up with a one-third interest in the Joint Venture in conjunction with two of the other original parties. On September 23, 2004, being within the Appellant's 2005 taxation year, the Appellant sold its interest in the Property and realized its gain above, the amount of which is not in dispute.

[3] The Appellant filed its 2005 tax return on the basis the disposition of its interest in the Property was a capital gain, and hence, included one-half of the above gain into income as a taxable capital gain, being $422,183. The Minister of National Revenue (the "Minister") initially assessed the Appellant as filed on May 2, 2005, but reassessed by Notice of Reassessment on January 30, 2009, by including the full amount of the gain as business income and denying the taxable capital gain, having characterized the Property as inventory instead of capital property. The Appellant filed a Notice of Objection on April 29, 2009, and the Minister issued a Notice of Confirmation on February 17, 2010, confirming its reassessment, resulting in the appeal before us.

[4] From the evidence at trial, it is also not disputed that Mr. Patrick Harrison graduated as a Kinesiologist in about 1981 and then moved with his wife, a physiotherapist, to Kelowna, British Columbia, where his wife found work. It was in Kelowna that the Harrisons became friends with William Von Niessen and his wife, a local real estate agent and developer who assisted them with the purchase of their first home in 1982. Although the Harrisons moved back to Ontario in 1986, they remained friends with the Von Niessens and got together during March and Christmas breaks, with Mr. Harrison testifying they returned to British Columbia at least twice a year.

[5] Mr. Harrison was interested in assisting people in wheelchairs and started a corporation named Special Health Systems Ltd. that grew into a manufacturer and distributor of wheelchairs and medical equipment which became quite successful. The Harrisons, through their holding corporation 1155805 Ontario Inc., sold their business in 1995 for about $6.6 million pursuant to an agreement in which Mr. Harrison was required to give a two-year non–competition covenant and remain as an employee for one year. His employment ended about September 1996, after which he testified he spent time with this children to make up for the time lost with them while he had dedicated his efforts to growing his business, played tennis, took scuba diving and flying lessons, joined the board of directors of a non–profit organization named Community Home Assistance for Seniors or CHAFE, assisted a friend with the start-up of his business by driving a delivery truck for him without pay and looked for and bought a cottage by the spring of 1997. In 1997, the Harrisons planned for and took their two children, then aged 11 and 12 out of school in the fall for a two-month trip to Australia and other destinations. While in Australia, Mrs. Harrison expressed an interest in alpacas and upon their return to Ontario, Mr. Harrison spent his time researching alpacas, travelling to Western Canada to see alpaca farms and learn about their lodging and feed and returning to

Ontario to supervise the building of barns and fences on his parents-in–law's farm in order to establish an alpacas farming business with his wife which operated from 1998 to 2006. Mr. Harrison testified farming was his main occupation during this period and that apart from the purchase of his home and cottage, he never dealt with real estate of any kind other than his involvement with the Property to be discussed and I accept his testimony as forthright and credible in this regard.

[6] With respect to the Property, there is no dispute that the Property was originally owned by a Mr. Barry Brocklebank, who sold his interest to a joint venture which included himself, R127 Enterprises Ltd. ("R127"), a corporation owned by Gebhard Wager, and Pegasus Enterprises Ltd. ("Pegasus"), a corporation owned by William Von Niessen, all of whom entered into a Joint Venture Agreement dated August 17, 1990, to develop and sell the subdivided lots (the "Joint Venture Agreement"). The above parties had a respective 50%, 25% and 25% interest in the Joint Venture.

[7] In or about 1996, Mr. Harrison became aware from discussions with his friend, William Von Niessen, that Mr. Von Niessen was having some cash flow difficulties with some of his development projects including the Joint Venture and Mr. Von Niessen inquired as to whether Mr. Harrison could loan him some funds. After some time and repeated requests for a loan by Mr. Von Niessen, Mr. Harrison agreed to loan his friend $250,000 for a return of $50,000, resulting in a 25% net return. After seeking legal advice, it was agreed that Mr. Harrison would use a corporate vehicle to loan Mr. Von Niessen's company, Pegasus, the money and take security. Since the Joint Venture Agreement prohibited any Joint Venture member from encumbering the Property for its own loans, the structure used was that Mr. Harrison purchased an inactive corporation owned by Mr. Von Niessen, which was the Appellant, for the sum of $1.00 and flowed money from his corporation 1155805 Ontario Inc., which was flush with cash from the previous sale of Special Health Systems Ltd., to the Appellant in order to fund the loan to Pegasus, (later also used to make future loans or investments in the Joint Venture). There is evidence that Mr. Harrison had to file nil tax return filings to bring the Appellant up to date and I accept that the Appellant was an inactive corporation at the time its shares were purchased by Mr. Harrison for $1.00. The loans from 1155805 Ontario Inc. above and in turn the Appellant's subsequent loans to and investments in the Joint Venture were also recorded in the financial statements of the Appellant. Pegasus, with the consent of the other Joint Venture members, entered into an agreement with the Appellant dated July 30, 1996, pursuant to which Pegasus transferred a 6.75% interest in the Joint Venture to the Appellant under terms which included the right to buy the interest back for $300,000 in

Pegasus' favour within a one-year period of time (the "6.75% Agreement") as well as Pegasus retaining the right to vote the entire 25% interest including the Appellant's 6.75% and other terms which will prove relevant in this matter and upon which the Appellant relies upon to evidence its position that this acquisition of Property was as security for the loan and not to engage in the business of the Joint Venture.

[8] Mr. Harrison testified, and his testimony was unchallenged by the Respondent, that from the time of making the initial investment above, the day-to-day affairs of the Joint Venture were run by Mr. Von Niessen and he had no involvement in the Joint Venture other than to stay in touch with Mr. Von Niessen once or twice a month, no more than he would have contacted Mr. Harrison as a friend, according to Mr. Von Niessen's testimony, and it was during such conversations that Mr. Harrison became aware that things were not going well and the City of Kelowna was only prepared to approve 36 lots of the 120 requested by the Joint Venture. Mr.Harrison had no dealings with the City, nor even at this point had met Mr. Brocklebank, the 50% owner. He did admit to having met Mr. Wager before as he had lived next door to the Wagers at one point in Kelowna prior to his involvement.

[9] It appears things continued to go poorly for the Joint Venture and that Mr. Brocklebank was actively trying to sell his 50% interest to the City, which created problems for the Joint Venture which had been faced with increasing demands from the City for more parkland dedication from the Property. Mr. Brocklebank also received a third party offer for his interest from a party who had not even contacted the other Joint Venture members, prompting the other members to become concerned and negotiate with Mr. Brocklebank for the sale of his interest to them. As the other members had no available funds to effect the purchase of Mr. Brocklebank's interest, Mr. Harrison, who had been informed of the difficulties, agreed to be the financier and fund the purchase price of Mr. Brocklebank's interest for $600,000 plus disbursements not to exceed $20,000.

[10] Pursuant to an agreement dated February 24, 2001, made between R127, Pegasus, the Appellant and the three individual principals of these corporations (the "Second Purchase Agreement"), the Appellant agreed to provide funds for the purchase of Mr. Brocklebank's 50% interest, which was to be paid back from mortgage financing by the Joint Venture and afterwards the Appellant was to pay funds to Pegasus and R127 totalling $295,000 in order to purchase a further interest in the Joint Venture so as to end up, with the other two, as equal Joint Venture members .The evidence is that the Joint Venture did not borrow

against the Property to repay the Appellant the funds it advanced to purchase Mr. Brocklebank's interest but that the Appellant still acquired the one-third interest. The Second Purchase Agreement also contained terms obliging each of the three members to carry on as equal partners and use the Property to secure the financing needs of the Joint Venture unlike the earlier Joint Venture Agreement. The parties also agreed to meet and agree on a revision to the Joint Venture Agreement which was never done.

[11] After retaining municipal counsel to assist them in dealing with the City and being unsuccessful, and having encountered difficulties with Mr. Wager who was refusing to approve loan packages sought by the Joint Venture and who became uncooperative, Pegasus and the Appellant finally agreed to sell their total two-thirds' interest to R127, Mr. Wager's company, for $3.7 Million, resulting in the disposition of the Appellant's interest giving rise to this appeal.

Position of the Parties

[12] The Appellant takes the position that the disposition of his interest in the Property should result in a capital gain as it is a capital property and the Appellant's interest in the Joint Venture was not an adventure or concern in the nature of trade, and hence the Appellant was not in the business of property development and sale. The Appellant's main argument in support of its position is that the Appellant acquired an interest in the Joint Venture initially as security for a loan and then increased its interest in the Joint Venture to protect its investment and never had any intention to be in the business of property development via the Joint Venture nor had ever been in such business either before or after its involvement in the Joint Venture. The Respondent argues the opposite; that the Property is inventory and hence its disposition by the Appellant gives rise to a full income inclusion under the *Income Tax Act* of Canada (the "*Act*") and that the Appellant had the necessary intention to be in the business of property development, or at least had the intention to sell the property for a profit if the development never proceeded, simply because that was the stated purpose of the Joint Venture when it agreed to become a member.

The Law

[13] The relevant provisions of the *Act* are set out below:

> 3 The income of a taxpayer for a taxation year for the purposes of this Part is the taxpayer's income for the year determined by the following rules:

(*a*) determine the total of all amounts each of which is the taxpayer's income for the year (other than a taxable capital gain from the disposition of a property) from a source inside or outside Canada, including, without restricting the generality of the foregoing, the taxpayer's income for the year from each office, employment, business and property,

(*b*) determine the amount, if any, by which

(i) the total of

(A) all of the taxpayer's taxable capital gains for the year from dispositions of property other than listed personal property, and

(B) the taxpayer's taxable net gain for the year from dispositions of listed personal property,

exceeds

(ii) the amount, if any, by which the taxpayer's allowable capital losses for the year from dispositions of property other than listed personal property exceed the taxpayer's allowable business investment losses for the year,

…

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

…

38 For the purposes of this Act,

(*a*) subject to paragraphs (*a.1*) to (*a.3*), a taxpayer's taxable capital gain for a taxation year from the disposition of any property is ½ of the taxpayer's capital gain for the year from the disposition of the property;

…

39(1) For the purposes of this Act,

(*a)* a taxpayer's capital gain for a taxation year from the disposition of any property is the taxpayer's gain for the year determined under this subdivision (to the extent of the amount thereof that would not, if section 3 were read without reference to the expression "other than a taxable capital gain from the disposition of a property" in paragraph 3(*a*) and without reference to paragraph 3(*b*), be included in computing the taxpayer's income for the year or any other taxation year) from the disposition of any property of the taxpayer other than

(i) eligible capital property,

(i.1) an object that the Canadian Cultural Property Export Review Board has determined meets the criteria set out in paragraphs 29(3)(*b*) and (*c*) of the *Cultural Property Export and Import Act* and that has been disposed of,

(A) in the case of a gift to which subsection 118.1(5) applies, within the period ending 36 months after the death of the taxpayer or, where written application therefor has been made to the Minister by the taxpayer's legal representative within that period, within such longer period as the Minister considers reasonable in the circumstances, and

(B) in any other case, at any time,

to an institution or a public authority in Canada that was, at the time of the disposition, designated under subsection 32(2) of that Act either generally or for a specified purpose related to that object,

(ii) a Canadian resource property,

(ii.1) a foreign resource property,

> (ii.2) a property if the disposition is a disposition to which subsection 142.4(4) or (5) or 142.5(1) applies,
>
> (iii) an insurance policy, including a life insurance policy, except for that part of a life insurance policy in respect of which a policyholder is deemed by paragraph 138.1(1)(*e*) to have an interest in a related segregated fund trust,
>
> (iv) a timber resource property; or
>
> (v) an interest of a beneficiary under a qualifying environmental trust;
>
> …
>
> 248(1) In this Act,
>
> …
>
> "*business*" includes a profession, calling, trade, manufacture or undertaking of any kind whatever and, except for the purposes of paragraph 18(2)(*c*), section 54.2, subsection 95(1) and paragraph 110.6(14)(*f*), an adventure or concern in the nature of trade but does not include an office or employment; …

Analysis

[14] The parties argued this matter primarily on the basis of whether or not the acquisitions by the Appellant of its interest in the Joint Venture and hence its Property constituted "an adventure or concern in the nature of trade" as included in the definition of "business" in subsection 248(1) of the *Act* above. There was no argument brought forth by either party that if the transactions in question did not fall within the definition of a business that they would not automatically be treated as capital property and in fact both parties relied upon the Supreme Court of Canada decision in *Friesen v. Canada*, [1995] 3 S.C.R. 103, which clearly acknowledges the dichotomy in the *Act* between capital gains treatment and business income treatment of property further reflected in the definitions of business, inventory and capital gains above. In paragraph 28 of *Friesen*, Major J., writing for the majority, stated:

> 28 … The Act defines two types of property, one of which applies to each of these sources of revenue. Capital property (as defined in s. 54(b)) creates a capital gain or loss upon disposition. Inventory is property the cost or value of which is relevant to the computation of business income. The Act thus creates a simple system which recognizes only two broad categories of property. …

[15] Although "an adventure or concern in the nature of trade" is not defined in the *Act*, established jurisprudence abounds on the subject and the leading case of *Happy Valley Farms Ltd. v. Her Majesty the Queen*, 86 DTC 6421 (F.C.T.D.), which adopted many of the tests set out in the earlier case of *Minister of National Revenue v. Taylor*, 56 DTC 1125 (Exch. Ct.), spoke to the several tests used by the Courts in determining the issue. Rouleau J. listed such tests in paragraph 14 of *Happy Valley Farms*:

> 14 Several tests, many of them similar to those pronounced by the Court in the *Taylor* case, have been used by the courts in determining whether a gain is of an income or capital nature. These include:
>
> 1. *The nature of the property sold.* Although virtually any form of property may be acquired to be dealt in, those forms of property, such as manufactured articles, which are generally the subject of trading only are rarely the subject of investment. Property which does not yield to its owner an income or personal enjoyment simply by virtue of its ownership is more likely to have been acquired for the purpose of sale than property that does.
>
> 2. *The length of period of ownership.* Generally, property meant to be dealt in is realized within a short time after acquisition. Nevertheless, there are many exceptions to this general rule.
>
> 3. *The frequency or number of other similar transactions by the taxpayer.* If the same sort of property has been sold in succession over a period of years or there are several sales at about the same date, a presumption arises that there has been dealing in respect of the property.
>
> 4. *Work expended on or in connection with the property realized.* If effort is put into bringing the property into a more marketable condition during the ownership of the taxpayer or if special efforts are made to find or attract purchasers (such as the opening of an office or advertising) there is some evidence of dealing in the property.

> 5. *The circumstances that were responsible for the sale of the property.* There may exist some explanation, such as a sudden emergency or an opportunity calling for ready money, that will preclude a finding that the plan of dealing in the property was what caused the original purchase.
>
> 6. *Motive.* The motive of the taxpayer is never irrelevant in any of these cases. The intention at the time of acquiring an asset as inferred from surrounding circumstances and direct evidence is one of the most important elements in determining whether a gain is of a capital or income nature.

[16] Counsel for the Appellant argued that there were additional factors to consider from her reading of the authorities and Interpretation Bulletin IT-218R and it is clear that the decision in *Happy Valley Farms* and following decisions require each case to be determined on its own facts and a consideration of all the relevant facts and circumstances with no single factor necessarily being determinative of the issue. Some of the factors she alluded to can be considered in the broader context of the several factors of *Happy Valley Farms* and others in addition thereto and reference will be made to those relevant factors below. There is no doubt, however, that the intention of the taxpayer at the time of acquiring an asset is the most important criteria to examine as Rouleau J. confirmed in paragraph 15 of *Happy Valley Farms*:

> 15 While all of the above factors have been considered by the courts, it is the last one, the question of motive or intention which has been most developed. That, in addition to consideration of the taxpayer's whole course of conduct while in possession of the asset, is what in the end generally influences the finding of the court.

[17] Even if a taxpayer has as his main intention the acquisition of an investment property to produce investment income, a gain may be taxed as income under the "secondary intention" test. In paragraph 16 of *Happy Valley Farms*, Rouleau J. described this test as follows:

> 16 … This has meant, in some cases, that even where it could be established that a taxpayer's main intention was investment, a gain on the sale of the asset would be held *taxable* as income if the court believed that, at the time of acquisition, the taxpayer had in mind the possibility of selling the asset if his investment project did not, for whatever reason, materialize. …

[18] The parties in fact addressed the majority of their arguments to the intention factor. It should be noted that while the Appellant spoke of the intention of Patrick

Harrison, the sole shareholder of the Appellant as being reflective of the corporate Appellant's intention, the Respondent argued that the intention of Mr. Harrison is not the appropriate intention to consider but rather the corporate Appellant's intention is the one to consider and that it must be inferred from the intention of the Joint Venture which it joined.

[19] While the intention of the Joint Venture is certainly one to consider as one of the factors or circumstances in this matter, I must agree with counsel for the Appellant that the Respondent is simply not correct in law to suggest the intention of a corporate taxpayer's management is not reflective of its intention. In *Bosa Bros. Construction Ltd. v. R.*, 96 DTC 6193 (F.C.T.D.), Nadon J., as he was then, restated the principles on relevant intention with reference to the purchase of real estate investments, by adopting those stated by Joyal J. in *Marsted Holdings Ltd. et al. v. The Queen*, 86 DTC 6200 (F.C.T.D.) who in turn quoted Christie A.C.J. of the Tax Court of Canada in *Leonard Reeves Incorporated v. Minister of National Revenue*, 85 DTC 419 at 421 that:

> … If the appellant is a corporation, the relevant intentions to be attributed to it are those which the natural person by whom it was managed and controlled had for it: …

[20] The intention of the Appellant's sole President and shareholder, Mr. Patrick Harrison, is the relevant intention to impute to the Appellant, just as would be the intention of the Board of Directors, shareholders, controlling minds or other persons found to be in control of a corporation for the purposes of the *Act*. It is trite to say that it is only through the decisions and actions of such persons that a corporate entity can express itself.

[21] In addressing the intention of the Appellant, the Court must have regard to the time at which such intention must be scrutinized. In the sixth factor listed above by Rouleau J. in *Happy Valley Farms*, the time was specifically determined to be the time at which the asset was acquired. In the matter at hand, there are in fact two acquisition dates; the first being July 30, 1996, when the Appellant acquired a 6.75 % interest in the Joint Venture pursuant to the 6.75% Agreement and February 24, 2001, being the time the Appellant acquired a further interest in the Joint Venture pursuant to the Second Purchase Agreement so as to raise his interest to one-third. In my view, each acquisition must be analysed using the factors to determine whether such acquisition constituted the acquisition of a capital property or inventory for carrying on business, as intentions may indeed change between acquisitions of interests in similar properties.

[22] Since the bulk of the parties' arguments centered on the intention of the Appellant, I propose to analyse the intention of the parties with respect to each acquisition date above and will consider other factors in determining whether the acquisition was an adventure or concern in the nature of trade while doing so.

1. 6.75% Interest

[23] There is no doubt in my mind that the Appellant did not intend to acquire its initial interest in the Property other than as security for a loan arrangement. The evidence of the Appellant, corroborated by Mr. Von Niessen, clearly indicates that Mr.Von Niessen approached Mr. Harrison for a loan and later repeated his requests for same when not initially successful. Mr. Harrison obtained the benefit of legal advice and it was decided that such a loan to a friend was only wise if adequate security was given. As Mr. Von Niessen did not have the ability to grant personal security and was prohibited by the terms of the Joint Venture Agreement from encumbering his interest in the Joint Venture for personal reasons without the unanimous consent of the other members, then the only security available was the transfer of an interest in the Joint Venture held by Mr. Von Niessen's corporation, Pegasus. Mr. Harrison's attorneys created a plan whereby Mr. Harrison would acquire a British Columbia corporation to undertake the transaction, which ended in the acquisition of the inactive Appellant by Mr. Harrison to be used for such purpose, and the sum of $250,000 was advanced to Pegasus who in turn transferred a 6.75% interest in the Joint Venture to the Appellant.

[24] The Respondent argues that the documents submitted as evidence are the main indicators of the Appellant's intentions, and in this regard, I agree they are certainly important. In my view, the 6.75% Agreement supports the position of the Appellant. Notwithstanding that paragraph 3 of such agreement states that both the Appellant and Mr. Harrison acknowledge having read the Joint Venture Agreement and agree to be bound by it, which is a requirement of the Joint Venture Agreement as a condition to the transfer of any interest, the balance of such 6.75% Agreement clearly evidences the intention of all the parties, including all the other members of the Joint Venture Agreement, that the Appellant's ownership in the Joint Venture was intended to be short lived. Paragraph 2(c) of the agreement grants Pegasus the right to repurchase the interest within one year at the Agreed Price of $300,000 representing the initial $250,000 intended to be loaned and the agreed upon return of $50,000. The Appellant itself, and not Pegasus, had the option of extending the time for such repurchase option by one year pursuant to paragraph 2(d) of the agreement, further evidencing its intention to make every

attempt to not end up with the property. It should be noted that paragraph 4 of the Agreement contained the consent of the remaining Joint Venture members to the repurchase by Pegasus of such interest without any further consent or approval and thus waiving any right of refusal they otherwise had under the Joint Venture Agreement.

[25] Moreover, I agree with the Appellant that the agreement was designed to keep the Appellant out of the obligations and management of the Joint Venture as Paragraph 2(a) exonerates the Appellant from any obligations to pay any mortgage obligations pursuant to the existing mortgage registered against title to the Property and paragraph 2(e) give Pegasus retention of voting rights over the interest acquired.

[26] The terms of the 6.75% Agreement fully support the argument that the transaction was designed to mimic a loan transaction giving security. However, other factors support this position. Neither the Appellant, having been a dormant corporation at the time of acquisition by Mr. Harrison, nor Mr. Harrison were engaged in the business of real estate development. As is clear from the facts above, Mr. Harrison was a Kinesiologist who went into the business of selling wheelchairs and medical equipment followed by alpaca farming. Neither his history nor education tie him to real estate development and the evidence is clear that apart from his purchases of his homes and cottage he had not engaged in the purchase of any other real estate interests either before or since the acquisition of his interests in the Joint Venture. There are simply no other similar transactions conducted by the Appellant or its principal.

[27] It is also clear that neither the Appellant nor its principal, Mr. Harrison, expended any work in connection with the Property or Joint Venture until the Appellant acquired its second interest. The evidence is that Mr. Harrison kept in informal contact with Mr. Von Niessen as a friend and had no involvement in the management of the Joint Venture nor in any decisions affecting it. The evidence is that Mr. Harrison had not even met the main Joint Venture member, Mr. Brocklebank, at the time of its acquisition or for some time after until the time of acquiring a greater interest due to the sale of Mr. Brocklebank’s 50% interest. In fact, Mr. Harrison was living in Ontario and busy with other interests, including spending time with his children, travelling, taking scuba diving and flying lessons and starting an alpaca farm, rather than be concerned with the Joint Venture. All of these facts suggest he had no intention of being in the business of real estate.

[28] While I agree with the Respondent that the nature of the property, a 60-acre undeveloped piece of vacant land, was not in its state usable for producing investment income and that there was never any intention to develop it for such purposes, and that the clear intention of the Joint Venture was to develop and sell residential building lots, I do not agree this factor would be conclusive as to support the Respondent's position with respect to the initial acquisition. The intention of the Appellant clearly trumps such consideration as the Appellant in my view did not intend to have any ongoing ownership of the Property, seeing it only as security for its loan made to Pegasus. In *Orzeck v. Minister of National Revenue*, [1987] 2 C.T.C. 2318, a case relied upon by the Respondent, Tremblay J. of the Tax Court stated at paragraph 37:

> The principle criterion is the taxpayer's intention. In fact, all the other criteria serve only to aid in determining the taxpayer's intention.

[29] The intent of the Appellant was not to participate in the Joint Venture and this is borne out by the reality of the circumstances surrounding his involvement in the initial acquisition. His actions in not only playing a passive role but effectively playing no real role at all in the ongoing decisions and management of the Joint Venture, coupled by his lack of background, education or experience in such business and the terms of the Agreement effectively shielding him from such involvement or obligations support the oral evidence of the Appellant's principal and his credibility. While I agree with the Respondent's point that the case of *Regal Heights Ltd. v. Minister of National Revenue*, [1960] S.C.R. 902, made it clear that "what actually happened is more important than idealistic intentions which are not carried out," I do not agree with the Respondent's position that what actually happened is that the Appellant knowingly joined a Joint Venture engaged in the business of real estate for the purpose of furthering that goal. As I said, what actually happened is that the Property interest acquired was intended only as security, a capital result.

[30] In *Van Dongen v. R.*, 90 DTC 6633 (F.C.T.D.) relied upon by the Appellant, the Federal Court - Trial Division denied the taxpayer a write down of inventory as a deduction against income on the basis that the lands acquired by the taxpayer from his sons were acquired to protect an investment in a loan made to the son who could not repay the loan when due. The amount of the loan and interest due exceeded the value of the lands acquired and the taxpayer had sought to write off the difference. The Court denied his expense on the grounds the properties acquired were not inventory and at paragraph 38, Cullen J. stated:

> 38 … It was obvious from the plaintiff's own evidence and that of his son Casey that there was no intention by the plaintiff to resell the properties or otherwise deal with them in a business-like manner. The properties held by the plaintiff were held to secure a loan, and if the plaintiff got his money back at ten percent interest the paper title would revert to the son or to a purchaser, and Casey would keep any profit.

[31] In the case at hand, the 6.75% Agreement evidences the same intention by the Appellant to give back title once he was repaid the initial $250,000 plus agreed return of $50,000 for a total of $300,000 and contemplated it would occur within a year or two. The evidence of both the Appellant and Mr. Von Niessen support that view and the conduct of the Appellant in not getting involved in the Joint Venture or voting or paying the outstanding Joint Venture mortgage support the fact the Appellant had no intention and did not deal with the Property interest in a business-like manner and accordingly was not engaged in an adventure or concern in the nature of trade with respect to this first acquisition of Property.

2. Acquisition of Balance of Property Interest

[32] On February 24, 2001, the Appellant acquired a further interest in the Property so as to give it a one-third interest in the Joint Venture. The circumstances surrounding the purchase described above relate to the purchase of an existing Joint Venture member's 50% interest; namely that of one Mr. Brocklebank to avoid him selling to a third party relatively unknown to the remaining members. The interest was purchased pursuant to the Second Purchase Agreement above mentioned.

[33] The Appellant argues the purchase was necessary to protect the Appellant's existing investment in the Joint Venture and that the Appellant had no other choice but to make such further investment as it was the only one of the remaining Joint Venture members that had the financial means to do so and by not doing so its interest in the Property would be at risk since a new 50% owner, relatively unknown to them, would make the ongoing Joint Venture plans uncertain.

[34] The Appellant relies on the cases of *Farmer Construction Ltd. v. R.*, 84 DTC 6331 (F.C.T.D.) and *R. v. Greenington Group Ltd.*, 79 DTC 5026 (F.C.T.D.), as supporting its argument that property acquired to protect a loan or investment did not result in creating an adventure or concern in the nature of a trade. In *Farmer Construction*, an unpaid contractor purchased a single use building it was hired to construct. The Court found in that case that, due to the nature of the property being a single use building and the difficulties in selling or renting it out, that the

intention of the taxpayer was to complete and operate the building until a buyer came along and that since possibility of resale at that time was not feasible, the taxpayer was acquiring the asset to reduce or possibly eliminate a substantial loss. In *Greenington Group*, a general contractor involved in institutional construction had surplus funds and had loaned funds to a developer for interim financing to enable the construction of a golf course, swimming pool and parking lot on property owned by the borrower and took mortgage security on the property. When the loan defaulted and the borrower fought foreclosure actions the taxpayer arranged to buy the property. The Court held that the intention of the taxpayer was not to make a profit but to cut his losses and recover amounts due on the loan and interest if possible and had no reason to expect to be able to sell the property at a profit at that point. Accordingly, when an unsolicited offer presented itself, he sold resulting in an unexpected profit.

[35] In both the above cases, the Court found that the taxpayer was protecting his initial investment, whether it was unpaid contract amounts as in *Farmer Construction* or unpaid loans as in *Greenington Group* consistent with the argument of the Appellant that it was protecting its initial investment. However, in both those cases, the Courts also found that at the time of acquisition the facts and circumstances suggested the intention of both parties was to cut their losses or recoup their initial investment and not make a profit as the feasibility for doing so did not reasonably exist. In my view, the case at hand differs from the above two cases in that I find the evidence supports the position of the Respondent that the Appellant's intention was to make a profit and not just protect its investment or reduce its loss.

[36] The Second Purchase Agreement suggests the Appellant had wholeheartedly become an equal partner in the venture. In the first paragraph of that document, the parties agreed to restructure the Joint Venture so the parties had equal one-third interests and states:

> … to this day forward carry on as equal partners, accepting that decisions required by the venture must be unanimous. As equal partners, they agree to share the liability of financing the development of the Joint Venture Property using the Joint Venture Property as security, in contrast to the existing Joint Venture Agreement.

[37] This provision demonstrates that the Appellant was abandoning his earlier role of not being involved in management and decision-making in favour of taking a fully active role and the testimony of Mr. Von Niessen confirms that in fact the

Appellant was involved in all decisions and kept appraised of all matters affecting the development. Unlike with his first purchase of interest, the Appellant had learned a little from the experience and felt he had something to contribute and his view were solicited by the other members or sought by right of his one-third interest.

[38] The Appellant's main argument is that the Appellant had no choice but to be involved as it was the only one of the group with the means to fund the buyout of Mr. Brocklebank's 50% interest and thus avoid the imposition of an unknown new member on them. The difficulty I have with this argument is that if the Appellant was in such position and had, as it testified earlier, considered the project to belong to the other members, why did it not just loan the monies to the remaining members or joint venture and take back mortgage security on the Joint Venture property for the loan and even the initial loan. It seems to me the Appellant had other options to protect and even enhance its security but did not explain why no such other options were considered.

[39] Just as confusing to me is why, if the Appellant was the only one with funds, did it not acquire Mr. Brocklebank's entire 50% interest which together with its 6.75% existing interest would have given him control over the Joint Venture if the protection of his interest was the intended goal? Instead, the Appellant enters into an agreement whereby the parties agree to later secure financing to not only pay him out but to cover the costs of the planned activities and any associated carrying costs, suggesting he was agreeing to allow the Property to fund the ongoing requirements of the Joint Venture. If the intention of the Appellant was only to protect his investment, it seems inconsistent to advance a further amount in excess of $600,000, being over twice his initial investment, without taking hard security when he had the chance and agreeing to allowing all the Property to stand as security to fund the further requirements of the Joint Venture. The second last bullet of the Second Purchase Agreement clearly states that :

> The new financing will pay out the loan from Von Realty to conclude the purchase of Brocklebank shares and leave a residual working fund for the future activities toward approvals for development.

[40] Clearly, the Appellant was not only interested in recovering its investment, it was interested in the completion of the development and obviously the profit from it.

[41] Furthermore, the Second Purchase Agreement has the Appellant agreeing to pay the sum of $250,500 to R127 and $45,000 to Pegasus after all of the activities listed had been completed, including amendment to the Joint Venture Agreement and the securing of new financing for the Joint Venture to repay his $600,000 plus loan and provide working capital. The Appellant thus committed to payment of another $295,500 to the remaining members of the Joint Venture as part of his acquisition of his one-third interest. Considering the third party offer submitted to Mr. Brocklebank was for $550,000 plus a percentage of ultimate profit from the Joint Venture and the parties negotiated to purchase his interest for a clean $600,000, it stands to reason that if a 50% interest was worth $600,000 to an arm's length party then the whole Joint Venture interest must have been worth about $1,200,000. The only logical reason a person would agree to pay $295,500 for an additional 26.68% of the Joint Venture interest, which is only a 5% discount based on a fair value of $1,200,000 for the whole, is that the Appellant expected the Joint Venture would make a profit and it did; a significant one on final sale of the property. The fact the Second Purchase Agreement mentions no interest rate for the $620,000 loan portion also suggests the Appellant was expecting to obtain a return on Joint Venture profits rather than on the loan.

[42] All of the above points in my view to the Appellant having changed its intention from the initial loan secured by an interest in the Property when it first acquired a 6.75% interest to investing and committing as a full-fledged partner in the Joint Venture whose sole purpose was to develop and sell vacant land as building lots - land that had no real capacity to earn investment income. While the Joint Venture Agreement refers to the sale of gravel and soil from the lands, the evidence of Mr. Niessen was that this was only a possibility and a standard provision in an agreement and that soil and gravel must sometimes be purchased instead of sold in preparing the land so I attribute no real intention to earn investment income from the project. In any event, no such sale could occur until the parties cleared the land as part of its development activities so any such sales would only be incidental to the main purpose of earning business income. As I said earlier, the nature of the property itself would generally suggest it could only be developed for profit as it had no existing means of producing investment income and there were no plans for it to do so.

[43] There is also evidence that, after the Appellant acquired his further interest, further work was expended on the Property, not only by the greater involvement by the Appellant's principal, Mr. Harrison, but by the fact the members retained a municipal lawyer to attempt to deal with the City of Kelowna's demands for the project in an attempt to further it along, albeit unsuccessfully. This fact

demonstrates the Appellant's involvement in the Joint Venture and its intention to see the project through as opposed to encouraging a quick sale to recover or minimize the risk of loss.

[44] Frankly, the other factors pointed to by the Appellant's counsel such as the length of ownership, up to eight years for the first acquisition and three years for the second as well as suggestion that its cash infusions into the Joint Venture instead of financing and leveraging its investment like most developers would allegedly do, are not in my view conclusive either way. The fact the Appellant had the means to make a cash investment suggestive of making a capital investment, is not more convincing in these circumstances than accepting that the only reason it was asked to make an investment in the first place and later given an equal position in the Joint Venture was because it had the financial means to do so. As for the circumstances surrounding the ultimate sale of the property, although the difficulties with R127 and Mr. Wager that eventually led to the sale by the Appellant and Pegasus to R127 may not have been anticipated, the evidence is that the parties negotiated the sale as part of a strategy to either sell their interests or buy the others and I can give no weight to the circumstances of the sale in deciding the nature of the Property.

Conclusion

[45] For the above reasons, I find that the initial 6.75% of the Appellant's interest in the Joint Venture was the acquisition of a capital property, and accordingly, I find that 20.25% of the gain shall be treated as a capital gain while the balance of the gain shall be treated as business income and direct the Minister of National Revenue to reassess the taxation of the gain in such manner. The Respondent shall be entitled to normal party and party costs in this matter in accordance with the Tariff.

Signed at Ottawa, Canada, this 8th day of July 2011.

"F.J. Pizzitelli"

Pizzitelli J.

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