Docket: 2018-351(IT)I

BETWEEN:

MARIE-CLAUDE DÉPATIE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on January 15, 2019, at Montréal, Quebec.

Before: The Honourable Justice Réal Favreau

Appearances:

For the appellant:	The appellant herself
Counsel for the respondent:	Gabriel Girouard

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* and dated October 3, 2016, for the 2013 taxation year is allowed, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 28th day of May 2019.

"Réal Favreau"

Favreau J.

Citation: 2019 TCC 123
Date: 20190528
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BETWEEN:

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Appellant,

and

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REASONS FOR JUDGMENT

Favreau J.

[1] This is an appeal from an assessment made by the Minister of National Revenue (the Minister) under the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.), as amended (the Act), dated October 3, 2016, in which the Minister disallowed the deduction for a $64,052 business investment loss (BIL) claimed by the appellant for her 2013 taxation year.

[2] The Minister disallowed the BIL claimed by the appellant for the following reasons:

a) the appellant was not a shareholder of the Les Cantines Nutrec Inc. company (the Company);

b) the advances the appellant made to the Company had no interest rate and no repayment deadline; and

c) the loss the appellant incurred is nil because it results from the disposition of a debt that was not acquired in order to gain income from a business pursuant to subparagraph 40(2)(g)(ii) of the Act.

[3] At the hearing, the respondent admitted the following facts:

a) the balance of the advances the appellant made to the Company was $128,104 as at December 31, 2013;

b) the Company was carrying on a business; and

c) the Company's debt to the appellant became bad in 2013 when the Company ceased its activities.

[4] The appellant testified at the hearing to explain the circumstances surrounding the realization of the loss of $128,104.

[5] The appellant explained that, since its establishment in 1989, the Company was involved in managing cafeterias and that her mother, Diane Dépatie, was the sole shareholder and sole director of the Company. In 2002, Diane Dépatie and her two daughters, Marie-Claude and Annick, decided to change the Company's purpose and run a restaurant integrated into banquet halls. To do this, Diane Dépatie and her two daughters purchased, as undivided co-owners, a building located at 116 Chemin des Patriotes Est in Saint-Jean-sur-Richelieu (Iberville sector) (the building) for $220,000.

[6] The century-old building was 60,000 square feet and had three (3) banquet halls that could seat 350 people. The building was in an agricultural area but had an acquired right to carry out a commercial operation, but only as long as a business continued to be run there.

[7] The building was leased to the Company beginning in 2002 for an average rent of $2,500 per month, or $30,000 per year. The appellant's share of this rental income was $10,000 per year.

[8] According to the appellant, there was a verbal agreement between her, her mother and sister to operate the restaurant integrated into the banquet halls as a partnership. Each of them had a vote, and two out of three votes were required for a decision to be passed. The parties' intention was to share the future profits of the business equally.

[9] To achieve their objectives, the partners agreed to fund the business' operations through advances to avoid interest fees that otherwise would have been immediately payable to the financial institutions.

[10] According to the appellant, the partners' intent was to pay interest on the advances made to the Company and, for this purpose, the partners made sure that all amounts invested and all advance payment dates were noted in the Company's accounting books so that they could calculate the amounts they were owed with interest. The details on the advances the partners made to the Company and the repayments the Company made during the period from June 30, 2004, to December 30, 2013, were submitted into evidence.

[11] The appellant also stated that, according to the agreement, the Company had to make principal repayments to each partner before paying interest on the advances. The goal was to reduce the Company's interest fees until it became profitable.

[12] Between 2002 and 2013, the appellant made advances to the Company for a total amount of $233,279.42, and the Company repaid her $105,178.08 in 85 payments. The advances were made either by deposits to the Company's bank account or purchases of supplies for the restaurant. The advances made by each partner were not necessarily always equal. According to the financial report dated December 30, 2013, the advances to the Company totalled $388,127.79 and were distributed as follows:

Diane Dépatie =	$155,379.93
Marie-Claude Dépatie =	$128,104.34
Annick Dépatie =	$104,643.50

[13] The repayments of advances were made through cheques drawn on a Company bank account. Examples of advance repayment cheques were submitted into evidence. The memos on the cheques were either [TRANSLATION] "repayment" or "fund advance repayment" and sometimes "shareholder reimbursement". One example cheque submitted has a note stating that a reimbursement of bank fees of $120 is included, and another example has a note indicating that interest fees of $140 are included.

[14] The appellant explained that, during the years 2010 to 2013, she worked part-time for the Company and that her salary for each of those years according to the T4s provided was as follows:

2010:	$8,000
2011:	$10,578

2012: $7,828

2013: $6,396

[15] Annick also worked for the Company as the restaurant's developmental chef.

[16] The appellant attributed the business' financial difficulties to the 2008 recession and to floods that occurred in the region in 2011.

[17] Under the circumstances, the Company incurred the following operating losses for the fiscal years ended June 30, 2008, to June 30, 2013:

Fiscal years (June 30)	Losses
2008	$60,300
2009	$40,466
2010	$43,655
2011	$243,483
2012	$308,213
2013	$363,677

[18] Since all attempts to sell the business failed, the partners resigned themselves to selling the building. The building was sold in October 2013 to the sole buyer who submitted an offer, the Église Baptiste du Haut-Richelieu. The building sold for $550,000, and the partners realized a capital gain of $330,000, of which the appellant's share was $110,000.

[19] Diane Dépatie also testified at the hearing and explained that the new direction taken with the business in 2002 was a three-partner project that involved equal investments by each partner and an equal share of the profits. According to her, the fact that the appellant did not become a shareholder of the Company in 2002 was simply a technicality that she considered unimportant. She also explained that she claimed the loss she incurred for the advances made to the Company, which the Canada Revenue Agency allowed as a BIL because she was a shareholder in the Company.

Analysis

[20] The relevant provisions of the Act to determine entitlement to a BIL are reproduced below:

> Subdivision C – Taxable Capital Gains and Allowable Capital Losses
>
> For the purposes of this Act,
>
> . . .
>
> (c) a taxpayer's allowable business investment loss for a taxation year from the disposition of any property is 1/2 of the taxpayer's business investment loss for the year from the disposition of that property.
>
> Section 39: Meaning of capital gain and capital loss
>
> For the purposes of this Act,
>
> . . .
>
> (c) a taxpayer's business investment loss for a taxation year from the disposition of any property is the amount, if any, by which the taxpayer's capital loss for the year from a disposition after 1977
>
> (i) to which subsection 50(1) applies, or
>
> (ii) to a person with whom the taxpayer was dealing at arm's length of any property that is
>
> (iii) a share of the capital stock of a small business corporation, or
>
> (iv) a debt owing to the taxpayer by a Canadian-controlled private corporation (other than, where the taxpayer is a corporation, a debt owing to it by a corporation with which it does not deal at arm's length) that is
>
> (A) a small business corporation,
>
> (B) a bankrupt that was a small business corporation at the time it last became a bankrupt, or
>
> (C) a corporation referred to in section 6 of the *Winding-up Act* that was insolvent (within the meaning of that Act) and was a small business corporation at the time a winding-up order under that Act was made in respect of the corporation,

Section 40: General rules

(2) Limitations Notwithstanding subsection 40(1),

. . .

(g) a taxpayer's loss, if any, from the disposition of a property (other than, for the purposes of computing the exempt surplus or exempt deficit, hybrid surplus or hybrid deficit, and taxable surplus or taxable deficit of the taxpayer in respect of another taxpayer, where the taxpayer or, if the taxpayer is a partnership, a member of the taxpayer is a foreign affiliate of the other taxpayer, a property that is, or would be, if the taxpayer were a foreign affiliate of the other taxpayer, excluded property (within the meaning assigned by subsection 95(1)), of the taxpayer), to the extent that it is

. . .

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

Section 50: Debts established to be bad debts and shares of bankrupt corporation

(1) For the purposes of this subdivision, where

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

(b) a share (other than a share received by a taxpayer as consideration in respect of the disposition of personal-use property) of the capital stock of a corporation is owned by the taxpayer at the end of a taxation year and

(i) the corporation has during the year become a bankrupt,

(ii) the corporation is a corporation referred to in section 6 of the *Winding-up Act* that is insolvent (within the meaning of that Act) and in respect of which a winding-up order under that Act has been made in the year, or

(iii) at the end of the year,

(A) the corporation is insolvent,

> (B) neither the corporation nor a corporation controlled by it carries on business,
>
> (C) the fair market value of the share is nil, and
>
> (D) it is reasonable to expect that the corporation will be dissolved or wound up and will not commence to carry on business
>
> and the taxpayer elects in the taxpayer's return of income for the year to have this subsection apply in respect of the debt or the share, as the case may be, the taxpayer shall be deemed to have disposed of the debt or the share, as the case may be, at the end of the year for proceeds equal to nil and to have reacquired it immediately after the end of the year at a cost equal to nil.

[21] To be eligible to deduct a BIL pursuant to sections 38 and 39 of the Act, the appellant must show that she incurred a capital loss from the disposition of a property. Under section 50 of the Act, a taxpayer is deemed to have disposed of a debt owed to him or her at the end of the year for proceeds equal to nil if the debt has been shown to have become a bad debt in the year.

[22] In this case, only subparagraph 40(2)(g)(ii) of the Act is involved, and the evidence indicates that the appellant was never a shareholder of the Company.

[23] To prevent the loss the appellant incurred in respect of advances to the Company from being deemed nil under subparagraph 40(2)(g)(ii) of the Act, the appellant must show that the debt was acquired for the purpose of gaining income from a business or property.

[24] In this case, the advances were made without any documentation (loan agreements, notes, cheques or other evidence of money transfers), except for the accounting entries in the Company's books, and without specific terms regarding the interest rate, duration of the advances or the terms and conditions of repayment. In addition, the appellant has not demonstrated that she reported interest income generated by these advances in her income tax returns and that she has taken steps to recover the interest on these advances.

[25] However, in this case, my understanding of the facts is that the advances the appellant made to the Company, as well as the advances her mother and sister made, were used to fund the operations of the business carried out by the Company.

[26] In so doing, the appellant and her partners each ensured themselves (1) a job and a salary; (2) a rental income from leasing the building; (3) an increase in the building's value by maintaining its commercial purpose; and (4) a share in the profits realized through carrying out the business.

[27] After reviewing the evidence presented, I have concluded that an agreement did indeed exist between the appellant, her mother and her sister for the establishment and execution of the project to integrate a restaurant into banquet halls. This is firstly because the appellant and her mother gave credible and consistent testimonies and, secondly, because the appellant, her mother and her sister acted in a coordinated manner from 2002 to 2013. They purchased the building as undivided co-owners to rent it to the Company for a price below market value, but in the hopes of being able to increase the rent when the Company became profitable.

[28] Subsequently, the appellant, her mother and sister funded the Company's operations with a series of advances and principal repayments. Their shared intention was to have the Company pay interest on the advances, but, in actuality, there practically never were any interest payments because priority was placed on principal repayment. The Company kept adequate records for calculating interest on the advances.

[29] Lastly, the appellant, her mother and sister carried out the business of a restaurant integrated into banquet halls as a partnership and had to obtain a majority vote for a decision to be adopted. No legal documentation on this co-ownership was established because there was a relationship of trust between the appellant, her mother and sister. Under the circumstances, written agreements, contracts, share certificates and agreements are not really of importance.

[30] According to the evidence on record, the appellant's debt had a commercial objective, which was to earn income from the business. Once the business was profitable, the income could have been shared by paying a higher salary to the appellant, raising the rent to fair market value for the building's location and paying interest on the advances.

[31] In the case law, it is well established that there does not have to be a direct link between the debt to the taxpayer and the income they intend to earn. In *Byram v. Canada*, 1999 CanLII 7428 (FCA), Justice McDonald made the following observation:

> [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.

[32] In this case, even though the appellant was not a shareholder in the Company, proof of a sufficient link between the debt to the appellant and the potential income from the Company has been demonstrated. Consequently, it is appropriate to consider that the appellant's debt was acquired in order to gain income from a business or property, thus meeting the requirements of the exception set out in subparagraph 40(2)(g)(ii) of the Act.

[33] The appeal is allowed, and the assessment is referred back to the Minister for reconsideration and reassessment in order to allow the deduction for the $64,052 BIL.

Signed at Ottawa, Canada, this 28th day of May 2019.

"Réal Favreau"

Favreau J.

CITATION:	2019 TCC 123
COURT FILE NO.:	2018-351(IT)I
STYLE OF CAUSE:	MARIE-CLAUDE DÉPATIE AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	January 15, 2019
REASONS FOR JUDGMENT BY:	The Honourable Justice Réal Favreau
DATE OF JUDGMENT:	May 28, 2019

APPEARANCES:

For the appellant:	The appellant herself
Counsel for the respondent:	Gabriel Girouard

COUNSEL OF RECORD:

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