

Docket: 2017-1842(IT)G

BETWEEN:

JOHN RANDALL SCOTT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 21, 2019, at North Bay, Ontario.

Before: The Honourable Justice Robert J. Hogan

Appearances:

Counsel for the Appellant: Gregory J. DuCharme

Counsel for the Respondent: Dominik Longchamps

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* is allowed in part only, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached reasons for judgment. The parties are to bear their own costs.

Signed at Ottawa, Canada this 10th day of January 2020.

“Robert J. Hogan”

Hogan J.

Citation: 2020 TCC 4
Date: 20200110
Docket: 2017-1842(IT)G

BETWEEN:

JOHN RANDALL SCOTT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Hogan J.

I. Introduction

[1] This is an appeal by John Randall Scott (the “Appellant”) from an assessment issued by the Minister of National Revenue (the “Minister”) under subsection 160(1) of the *Income Tax Act* in the circumstances described immediately below.

II. Partial Statement of Agreed Facts

[2] At the outset of the hearing, the parties filed a partial Statement of Agreed Facts, which reads as follows:

1. Daniel William Clayton Scott (Hereinafter “**Daniel**”) is the brother of the Appellant, John Randall Scott.
2. During the 1995 to 2005 taxation years, Daniel W. Scott was an airplane pilot employed by Air Canada.¹
3. Between 1999 and 2014, Daniel Scott was involved in a dispute with the Canada Revenue Agency (Hereinafter the “**CRA**”) over the computation of

¹ Daniel is referred to in my reasons for judgment as Captain Scott.

his income for the 1995 to 2001 taxation years. This dispute led to a Tax Court of Canada appeal bearing the file number 2003-3579(IT)G.

4. On October 20, 2000, the CRA reassessed Daniel in regards to the 1996 and 1997 taxation years.
5. On July 26, 1999, the CRA reassessed Daniel in regards to the 1998 taxation year.
6. The CRA reassessed Daniel in regards to the 1999 taxation year on March 5, 2001, on May 3, 2001 and on November 29, 2002.
7. On December 2, 2002, the CRA reassessed Daniel in regards to the 2001 taxation year.
8. On April 5, 2004, the CRA reassessed Daniel in regards to the 2002 taxation year.
9. On April 4, 2005, the CRA reassessed Daniel in regards to the 2003 taxation year.
10. On September 20, 2007, the CRA reassessed Daniel in regards to the 2005 taxation year.
11. On June 7, 2013, a Settlement was reached by Daniel and the Attorney General of Canada in the Tax Court of Canada appeal bearing the file number 2003-3579(IT)G. Attached to this Statement of Agreed Facts as **Annex 1** are copies of the Consent to Judgment and of the Tax Court of Canada Judgment.
12. On January 15, 2014, the CRA reassessed Daniel in respect of the 1996, 1997, 1998, 1999 and 2001 taxation years. On May 5, 2014 the CRA reassessed the [*sic*] Daniel in respect of the 2002 and 2005 taxation years.

The Outstanding Amounts of the Underlying Tax Debt

13. On January 16, 2006, Daniel had a tax liability of \$126,603.42 with respect to his 1997, 1998, 1999, 2001, 2002, 2003 and 2005 taxation years.
14. On May 22, 2015, Daniel had a tax liability of \$233,835.56 with respect to his 1996, 1997, 1998, 1999, 2001, 2003 and 2005 taxation years. Attached to this Statement of Agreed Facts as **Annex 2** is a copy of the Particulars of Assessment explaining the amount of the tax liability.
15. In February 2016, the CRA granted taxpayer relief to Daniel. The effect of this relief was to cancel the arrears interest that had accrued during the period between March 17, 2009 and July 26, 2013 in respect of the tax liability of

Daniel for the 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2004 and 2005 taxation years. The interest cancelled totalled \$58,312.07.

16. Attached to this Statement of Agreed Facts as **Annex 3** is a copy of a Statement of Account Analysis accurately setting out the tax liability of Daniel at the various times mentioned above.
17. Daniel formulated a Request for Taxpayer Relief to the CRA which is dated December 31, 2009. No interest was cancelled with respect to this request. The Respondent does not know whether this request was considered or adjudicated.
18. Daniel formulated a Request for Taxpayer Relief to the CRA which is dated April 7, 2017. The CRA has not yet responded to this request.

The Transfers

19. On December 16, 2005, Daniel transferred \$104,000.00 to the Appellant via Wire Transfer.
20. On December 19, 2005, Daniel transferred \$500.00 to the Appellant via Wire Transfer.
21. On January 16, 2006, Daniel transferred \$120,000.00 to the Appellant via Wire Transfer.

The Assessment pursuant to 160(1) of the *Income Tax Act*

22. On May 22, 2015, the Minister issued a Notice of assessment in which the Appellant was assessed \$224,500.00 pursuant to subsection 160(1) of the *Income Tax Act*.
23. The [A]ppellant served on the Minister a Notice of Objection dated August 11, 2015 pursuant to section 165 of the *Income Tax Act*.
24. On January 28, 2017, the Minister issued a Notice of Confirmation in regards to the May 22, 2015 assessment.
25. The Appellant filed a Notice of Appeal on April 18, 2017 with the Tax Court of Canada.

III. Contextual Background

Captain Scott

[3] The evidence shows that Captain Scott has resided in the Turks and Caicos Islands since December of 1993. From that time onwards only the portion of his employment income that related to services performed by him in Canada for Air Canada was subject to Canadian income tax.

[4] According to Captain Scott, the Canadian airlines and the Canada Revenue Agency (the "CRA") had agreed to a formula that would be applied to determine how non-resident pilots would be taxed on their employment income earned in respect of international flights. Air Canada applied this formula to determine its withholding tax obligations. Because Captain Scott was assigned to international routes, a large portion of his employment income was not taxable in Canada.

[5] According to Captain Scott, the CRA retroactively modified its policy. This resulted in a much larger portion of Captain Scott's income being subject to Canadian tax.

[6] Captain Scott hired counsel to challenge the assessments issued against him. His case proceeded very slowly both at the administrative level and before the Court. It was only in 2013 that Captain Scott's appeals were settled following a consent to judgment.

[7] In 2005, Captain Scott retired from Air Canada. He opted to receive a lump sum payment from the Air Canada pension plan in lieu of an annuity. The lump sum payment was transferred to a registered retirement savings plan ("RRSP").

[8] In 2007, Captain Scott wound up his RRSP and paid Part XIII withholding tax on the funds that he withdrew. This money was invested offshore.

[9] Captain Scott acknowledges that he maintained a joint bank account in Canada from 2005 to 2007 with his brother, the Appellant. He also acknowledges that he transferred \$224,500 to his brother in three installments of \$104,000, \$500 and \$120,000, the whole as set out in the partial Statement of Agreed Facts.

[10] According to Captain Scott, these funds were borrowed by his brother under an oral agreement. The witness testified that he felt no need to document the loan because he trusted that the Appellant would honour his obligation to repay the borrowed money when he had sufficient funds to do so. He viewed the arrangement as a revolving line of credit. Under this arrangement, the Appellant could borrow and then repay when he had the money to do so. He testified that his

brother used the funds to make the down payment on a newly built condo in Burlington, Ontario.

[11] The Appellant also testified that he borrowed the funds to help pay for a newly built condo that he owned and lived in for approximately one year.

[12] The evidence reveals substantial inconsistencies in both witnesses' testimony. Moreover, the Appellant's explanation of the reasons why he borrowed a large sum of money from Captain Scott changed significantly when he was confronted with objective evidence presented by the Respondent that contradicted his version of the facts. These inconsistencies are discussed below in the section entitled "Analysis".

IV. Positions of the Parties

The Appellant

[13] The Appellant submits that he borrowed the funds from his brother. The borrowed money was repayable upon demand. According to the Appellant, this loan does not give rise to a transfer of property within the meaning of subsection 160(1).

[14] Alternatively, if the loan contracted by the Appellant does constitute a transfer of money by Captain Scott to the Appellant, the Appellant submits that his promise to repay the loan constitutes consideration for the purpose of subsection 160(1). According to the Appellant, the fair market value of the loan is equal to its principal amount. As a result, subsection 160(1) does not apply because the transferred property and the consideration were of equal value.

[15] The Appellant raises a further alternative argument for my consideration in the event that I reject both of the aforementioned arguments and conclude that subsection 160(1) applies. The Appellant submits that the assessment issued against him should be reduced by the amount of interest subsequently waived by the Minister under the fairness package that was included in the tax liability of Captain Scott and used in determining the basis of the assessment against the Appellant.

The Respondent

[16] The Respondent denies that the arrangement between the Appellant and his brother constitutes a loan. In this regard, the Respondent submits that the Appellant and his brother were not credible or reliable witnesses. The Respondent places particular emphasis on the fact that neither the Appellant nor his brother was able to explain why the money was allegedly borrowed by the Appellant and what the borrowed money was used for. According to the Respondent, it is simply implausible that the Appellant cannot recall the purpose of the arrangement. The Respondent submits that the Appellant and Captain Scott are deliberately refusing to divulge the reason why funds were transferred by Captain Scott to the Appellant because to do so would not be helpful to the Appellant's case.

V. Analysis

Subsection 160(1) reads as follows:

160. (1) Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to

(a) the person's spouse or common-law partner or a person who has since become the person's spouse or common-law partner,

(b) a person who was under 18 years of age, or

(c) a person with whom the person was not dealing at arm's length,

the following rules apply:

(d) the transferee and transferor are jointly and severally liable to pay a part of the transferor's tax under this Part for each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of sections 74.1 to 75.1 of this Act and section 74 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, in respect of any income from, or gain from the disposition of, the property so transferred or property substituted therefor, and

(e) the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of

(i) the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and

(ii) the total of all amounts each of which is an amount that the transferor is liable to pay under this Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year,

but nothing in this subsection shall be deemed to limit the liability of the transferor under any other provision of this Act.

[17] Subsection 160(1) applies when the following four conditions are satisfied:

(i) **The transferor must have a tax liability at the time of the transfer.**

The existence of a tax debt is not disputed here. The quantum, however, is challenged by the Appellant because part of the interest that was included in Captain Scott's tax liability at the time of the transfer and used in establishing the amount of the Appellant's liability under subsection 160(1) was subsequently forgiven under the fairness package.

(ii) **There must be a transfer.** The Appellant disputes that a transfer occurred, because the funds were borrowed by the Appellant.

(iii) **The parties are not dealing at arm's length.** This fact is undisputed in the present case.

(iv) **The parties are jointly liable to the extent that the amount paid by the transferee is less than the fair market value of the transferred property.** As noted above, the Appellant argues that the fair market value of the loan is equal to the fair market value of the transferred property.

(i) Did Captain Scott loan the Appellant the funds that were transferred to him?

[18] I would like to underscore the reasons why I have rejected the Appellant's claim that he borrowed the transferred funds from his brother.

[19] The Appellant points out that he and his brother both testified that the funds at issue in this matter were loaned by Captain Scott to the Appellant. The Appellant invites me to accept this testimony as truthful because it is corroborated by objective evidence. In this regard, it was pointed out that Captain Scott was retired from Air Canada when the funds were transferred to the Appellant. Captain Scott testified that his net worth was approximately one million dollars at that time.

[20] The evidence reveals that when Captain Scott retired from Air Canada he planned to retire permanently. While he ultimately accepted employment with foreign airlines a short time later, he claims that his future earnings potential and his net worth were insufficient for him to transfer the funds at issue to his brother without consideration.

[21] In these circumstances, according to the Appellant, the only plausible explanation is that the transferred funds were loaned to him by Captain Scott. The fact that the Appellant repaid the money to Captain Scott supports this allegation.

[22] For the reasons that follow, I respectfully disagree with the Appellant's position.

[23] During his examination for discovery, the Appellant testified that he used the alleged borrowed money to pay the balance of the purchase price (the "shortfall") of a newly constructed condo that was not covered by the amount that he had borrowed from a financial institution, which mortgage loan was guaranteed by the Appellant's mother. The Appellant indicated that this was the sole purpose of the loan. In response to an undertaking given with respect to a further question regarding the loan, his story changed: he said that he used the alleged borrowed money to pay for the condo and to fund his living expenses.

[24] At trial, the Appellant implied once again that he had used the borrowed money principally to pay the balance of the purchase price for the condo. On cross-examination, the Appellant admitted that he had used his own savings to pay the shortfall, save for an amount of approximately \$4,000, which was satisfied with a small portion of the transferred funds.

[25] While the evidence appears to show that the Appellant did not have sufficient cash flow to pay the carrying costs of the condo, those carrying costs totalled \$24,000 at most over the one-year period during which the Appellant held the condo. Even if I accept the Appellant's testimony as true, at best, the Appellant can only account for the use of 10% of the transferred funds.

[26] The evidence shows that the Appellant had rarely borrowed money prior to the acquisition of the condo. He lived very modestly. He had borrowed a small amount to purchase a car and may have had some small amounts of credit card debt that he paid on a regular basis. The evidence also shows that he has not become indebted in any significant way since he sold the condo.

[27] With this background in mind, I find it implausible that the Appellant cannot provide a clear explanation of what he did with the transferred funds. While I am cognizant of the fact that fourteen years have passed since the funds were transferred by Captain Scott to the Appellant, it stretches credibility to the breaking point to suggest that the Appellant cannot recall what he did with the substantial sum of money received from his brother. I believe that a person who is adverse to debt will recall the circumstances surrounding an alleged large loan and the terms and conditions thereof.

[28] The conclusion that I arrive at is that the parties have chosen not to divulge the true purpose of their arrangement either because it is not helpful to the Appellant's appeal or because it may jeopardize the Appellant's tax filing positions with respect to the purchase and sale of the condo or some other transaction. In the end, I am left to speculate on the reasons why the parties entered into this arrangement.

[29] As noted, there are many other inconsistencies between Captain Scott's and the Appellant's evidence. During examination for discovery, the Appellant testified that he believed the loan was interest-bearing. This angered the Appellant because, he claims, he was made aware of this feature many months after the funds were transferred to him. At the hearing however, he appeared to imply that he now accepts that the alleged loan was interest-free.

[30] Captain Scott testified that the parties had spent little time defining the terms and conditions of the loan. According to Captain Scott, there was no fixed term for repayment of the loan. He expected that his brother would repay the alleged loan only when he had sufficient funds to do so. He also acknowledged that he would not have sued his brother for repayment of the funds if his brother failed to repay the alleged borrowed money.²

[31] Generally speaking, the hallmark of a loan is the existence of an obligation to repay the borrowed money either upon demand, at the expiration of a term or upon an event of default.

² Captain Scott's evidence suggests that his brother was not obliged to repay the transferred funds. Even if I was to accept Captain Scott's evidence as truthful, which I do not, I would be inclined to dismiss the appellant's appeal. Captain Scott's portrayal of the arrangement describes, at best, an unenforceable moral arrangement between related parties. Such an arrangement does not amount to consideration for the purpose of subsection 160(1).

[32] In contrast to Captain Scott's version of the facts, the Appellant says he believed that the loan was repayable upon demand. Captain Scott admitted this was not the case because his brother simply did not have the financial wherewithal to agree to repay the loan upon demand. This is why he expected to be repaid only when his brother had sufficient funds to repay.

[33] Considering the evidence as a whole, I find that the Appellant and Captain Scott are not reliable or credible witnesses. Furthermore, the sparse and incomplete documentary evidence that the Appellant produced is insufficient to prove the existence of a loan.

[34] Our tax system is based on the principle of self-assessment. The reason for this is that taxpayers are much better placed than the government to explain the relevant circumstances surrounding events, arrangements or transactions that may give rise to tax liability. The system depends on taxpayers maintaining proper records, or at the very least, testifying truthfully about the material facts of their transactions when they contest an assessment raised by the Minister that is based on different assumed facts. If a taxpayer is unwilling to divulge material facts related to an alleged verbal agreement entered into between related parties, or provides inconsistent explanations, or seeks to mislead the Court, the Court can disregard his or her testimony as a whole. In the instant case, I believe that both Captain Scott and the Appellant know the reason for their arrangements but are unwilling to divulge the true purpose of their transactions because to do so would be unhelpful to the Appellant's case.

[35] In the end, because the Appellant and his brother have chosen to conceal the purpose of their arrangement, they were unable to provide consistent answers to the Respondent's questions concerning the circumstances surrounding, and the features of, their transactions. On the basis of the above, I find that the Appellant has failed to establish that he borrowed the money that he admitted was transferred to him by his brother. As a result, the conditions that give rise to the application of subsection 160(1) are satisfied.³

³ The parties appear to accept the premise that money transferred pursuant to a loan does not constitute a transfer for the purpose of subsection 160(1). I do not have to dispose of this issue because I conclude that the Appellant failed to establish that he borrowed the transferred funds from Captain Scott. That said, I believe a loan does give rise to a transfer. Money is property. Money changes hands when funds are borrowed by a taxpayer. The dollars returned to the lender are not the same property that was initially transferred to the transferee. If one accepts the theory that a loan does give rise to a transfer, a transferor and transferee wishing to circumvent subsection 160(1) could simply agree to a non-interest bearing loan repayable in 40 years. In my opinion, a loan, whether interest-bearing or not, gives rise to a transfer of property for the purpose of subsection 160(1). If a non-interest-bearing loan is at issue, a

(ii) Should the Appellant's tax liability be reduced by the amount of interest that was subsequently forgiven by the Minister?

[36] Both parties acknowledge that the amount assessed against the Appellant includes interest owed by Captain Scott that was subsequently forgiven by the Minister under the fairness package. They agree that the amount of forgiven interest that pertains to the assessment is \$50,538.

[37] The Appellant argues that his assessment should be reduced as he should not be obliged to pay an amount greater than the amount Captain Scott is obliged to pay in respect of the period covered by the Appellant's assessment. The Respondent submits that the interest forgiveness is not retroactive in application. According to the Respondent, the tax liability of Captain Scott was \$233,835. Therefore, no adjustment should be made in this regard.

[38] If I accept the Respondent's position, the Appellant could end up owing a greater amount than his brother, Captain Scott. Subsection 160(1) makes the transferee jointly and severally responsible with the transferor for all or a lesser part of the transferor's tax liability if the amount is determined under subparagraph 160(1)(e)(ii). Because the liability is joint and several under subsection 160(1), I am of the opinion that the transferee's tax liability cannot exceed the transferor's tax liability.

[39] Before the interest forgiveness, Captain Scott's tax liability was \$233,835 when the funds were first transferred to his brother. This included interest of \$149,350.27 of which \$50,302.95 was subsequently forgiven. After interest forgiveness, Captain Scott's liability works out to \$183,532. This is the lesser of the two amounts calculated under paragraph 160(1)(e). Therefore, the Appellant's tax liability should be reduced from \$224,500, *i.e.* the fair market value of the transferred property, to \$183,532.

Conclusion

reasonable discount rate should be applied at the time that the funds are advanced to a the taxpayer in order to determine the fair market value of the loan.

[40] For all of these reasons, the appeal is allowed in part only and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with these reasons for judgment. The parties are to bear their own costs.

Signed at Ottawa, Canada this 10th day of January 2020.

“Robert J. Hogan”

Hogan J.

CITATION: 2020 TCC 4

COURT FILE NO.: 2017-1842(IT)G

STYLE OF CAUSE: JOHN RANDALL SCOTT v. HER
MAJESTY THE QUEEN

PLACE OF HEARING: North Bay, Ontario

DATE OF HEARING: October 21, 2019

REASONS FOR JUDGMENT BY: The Honourable Justice Robert J. Hogan

DATE OF JUDGMENT: January 10, 2020

APPEARANCES:

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