

**Date: 20070919**

**Docket: A-501-05**

**Citation: 2007 FCA 293**

**CORAM: NOËL J.A.  
NADON J.A.  
PELLETIER J.A.**

**BETWEEN:**

**JACK (JOHN) A. BOLEN**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

Heard at Winnipeg, Manitoba, on September 11, 2007.

Judgment delivered at Ottawa, Ontario, on September 19, 2007.

**REASONS FOR JUDGMENT BY:**

**NOËL J.A.**

**CONCURRED IN BY:**

**NADON J.A.  
PELLETIER J.A.**

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**Appellant**

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**REASONS FOR JUDGMENT**

**NOËL J.A.**

[1] This is an appeal from a decision of the Tax Court of Canada denying the deduction of legal fees claimed by the appellant in computing his income for his 1999, 2000 and 2001 taxation years, on the ground that they were incurred to recover capital property.

[2] The expenses in issue were incurred by the appellant to recover mining claims which were improperly withheld from him. The Minister of National Revenue (“the Minister”) reassessed the appellant on the basis that the legal fees could be deducted, but only at the annual rate of 7% applicable to eligible capital expenditures. The Tax Court Judge confirmed the reassessments.

## **RELEVANT FACTS**

[3] Mr. Bolen is a geologist and licensed prospector within the meaning of the *Mining Act*, R.S.O. c.M-14. He earns his living as a licensed prospector by staking out mining claims and obtaining leases (loosely referred to by the Tax Court Judge and herein as the “mining rights”) and selling them to mining companies for cash and other consideration, often shares of the acquiring company.

[4] Mr. Bolen transferred some of these mining rights to Wallbridge Mining Company LTG and Minescape Exploration Inc. (collectively referred to as Wallbridge/Minescape) in exchange for royalties and shares. Wallbridge/Minescape eventually defaulted on its obligations to Mr. Bolen and so, Mr. Bolen sued for the return of the mining rights.

[5] In the course of prosecuting his action, the appellant incurred legal fees in the amounts of \$19,458, \$25,599 and \$45,231 for the 1999, 2000 and 2001 taxation years respectively.

[6] The action was eventually settled and the appellant obtained the return of his mining rights in consideration of the surrender of the shares, which he had obtained in exchange. Mr. Bolen subsequently conveyed his mining rights to another mining company.

[7] In computing his income for the relevant taxation years, the appellant deducted the full amount of legal fees incurred to prosecute his legal action against Wallbridge/Minescape.

[8] The Minister reassessed the appellant on the basis that the claimed expenses were eligible capital expenditures within the meaning of section 14(5) of the *Income Tax Act*, 1985, c. 1, 5th Supp. (“the Act”). Eligible capital expenditures are a species of capital outlay which exceptionally can be deducted in the computation of income at the limited rate of 7% per year (paragraph 20(1)(b) of the Act).

[9] On appeal, the Tax Court Judge upheld the Minister’s reassessments. Mr. Bolen now appeals from the decision of the Tax Court Judge to the Federal Court of Appeal.

#### **TAX COURT OF CANADA DECISION**

[10] The Tax Court Judge acknowledged that Mr. Bolen was in the business of staking mining claims (which as noted, he referred to as mining rights) and then transferring them to mining companies in exchange for royalties and shares. He also found that the legal expenses were incurred to recover these claims. Nevertheless, he held that what he received as a result of the legal action was a capital asset.

[11] In reaching this conclusion, the Tax Court Judge quoted several passages from *Farmers Mutual Petroleums Ltd* [1968] S.C.R. 59 (“Farmers”) and *Sunshine Mining Co. v. Canada* [1975] F.C. 415 (“Sunshine”). Relying on these cases, the Tax Court Judge held that the mining rights which the appellant sought to recover were enduring assets and therefore capital in nature.

[12] The Tax Court Judge went on to hold that the legal expenses were capital expenditures, deductible at the rate of 7% allowed by the Minister.

### **ALLEGED ERRORS IN DECISION UNDER APPEAL**

[13] In support of his appeal, the appellant submits that the claims and leases which he conveyed to Wallbridge/Minescape were “mining property” within the meaning of subsection 35(2) of the Act. According to subsection 35(1), mining property when exchanged for shares is treated on an income account. It follows, according to the appellant, that the legal expenses are deductible in computing income.

[14] The appellant submits that the Tax Court Judge erred in failing to consider section 35 of the Act.

### **DECISION**

[15] The appeal must succeed. The cases on which the Tax Court Judge relied to support his conclusion dealt with mining rights held not as trading assets but for the long term (Reasons, paras. 20 to 27). There is no question that mining rights when so held are capable of being viewed as enduring assets and classified as capital property.

[16] However, in the case before him, the Tax Court Judge found as a fact that the appellant was in the business of staking claims, building them up and selling them to mining corporations

(Reasons, para. 15). He further accepted that the legal expenses were incurred in order to recover the claims which the appellant was in the business of trading (Reasons, para. 12).

[17] These findings, which are not challenged on appeal, are inconsistent with the conclusion reached by the Tax Court Judge and lead to the inevitable conclusion that the legal expenses were incurred on an income account.

[18] Section 35 of the Act while instructive is not determinative of the issue which the Tax Court Judge had to decide. Subsection 35(1) provides in its relevant part:

35. (1) Where a share of the capital stock of a corporation

(a) is received in a taxation year by an individual as consideration for the disposition by the individual to the corporation of a mining property or interest therein acquired by the individual as a result of the individual's efforts as a prospector, either alone or with others, or

...

(c) notwithstanding any other provision of this Act, no amount in respect of the receipt of the share shall be included

(i) in computing the income for the year of the individual or person, as the case may be, except as provided in paragraph 35(1)(d), ...

...

(d) in the case of an individual or partnership (other than a partnership each member of which is a taxable Canadian corporation), an amount in respect of the

35. (1) Si une action du capital-actions d'une société est:

a) soit reçue par un particulier, au cours d'une année d'imposition, en contrepartie d'un bien minier dont il a disposé en faveur de cette société ou d'un droit sur ce bien minier, acquis du fait de son activité de prospecteur, qu'il a exercée seul ou avec d'autres;

[...]

c) malgré les autres dispositions de la présente loi, aucune somme relative à la réception de l'action n'est incluse :

(i) dans le calcul du revenu pour l'année de ce particulier ou de cette personne, selon le cas, sous réserve de l'alinéa d),

[...]

d) dans le cas d'un particulier ou d'une société de personnes (à l'exclusion d'une société de personnes dont chaque associé est une société canadienne imposable), une

receipt of the share equal to the lesser of its fair market value at the time of acquisition and its fair market value at the time of disposition or exchange of the share shall be included in computing the income of the individual or partnership, as the case may be, for the year in which the share is disposed of or exchanged.

somme relative à la réception de l'action et correspondant au moindre de la juste valeur marchande de l'action au moment de son acquisition et de la juste valeur marchande de l'action au moment de sa disposition ou de son échange doit être incluse dans le calcul du revenu du particulier ou de la société de personnes, selon le cas, pour l'année où soit il est disposé de l'action, soit celle-ci est échangée;

(e) notwithstanding subdivision c, in computing the cost to the individual, person or partnership, as the case may be, of the share, no amount shall be included in respect of the disposition of the mining property or the interest therein, as the case may be,

e) malgré la sous-section c, aucune somme relative à la disposition du bien minier ou du droit sur celui-ci n'est incluse dans le calcul du coût de l'action pour le particulier, la personne ou la société de personnes, selon le cas;

[...]

...

[My Emphasis]

[19] The expression “mining property” is defined in turn as follows:

35. (2) “mining property” means

35. (2): «bien minier »

(a) a right, licence or privilege to prospect, explore, drill or mine for minerals in a mineral resource in Canada, or

a) Droit, permis ou privilège afférent à des travaux de prospection, d'exploration, de forage ou d'extraction relatifs aux minéraux d'une ressource minérale au Canada;

(b) real property in Canada (other than depreciable property) the principal value of which depends on its mineral resource content;

b) bien immeuble au Canada (sauf un bien amortissable) dont la valeur dépend principalement de sa teneur en ressources minérales;

[My Emphasis]

[20] Section 35 deals with the tax treatment of mining rights (defined as “mining property”) such as those held by persons like the appellant, who are in the business of staking land for minerals, establishing mining claims and trading them to mining companies in exchange for shares. It in effect defers any form of taxation resulting from the exchange until the shares are disposed of or further exchanged. Upon disposition, the prospector must include in income the lesser of the fair market value of the shares at the time of the exchange or at the time of the disposition (or further exchange).

[21] Counsel for the Minister brought to our attention the Technical Notes issued by the Department of Finance when section 35 was amended and enacted in its present form back in 1985.

The Notes explains both the purpose and operation of the 1985 amendment as follows:

**Nov. 1985 TN:** Section 35 provides special rules where a prospector or grubstaker receives share of the capital stock of a corporation in exchange for an interest in a mining property. Under existing provisions [i.e., under section 35 as it read prior to the 1985 amendment], the taxpayer is considered to have disposed of his interest in the mining property for nil proceeds and to have acquired the shares at nil cost. As a result, when the shares of the corporation are sold, the proceeds will be treated as a capital gain. In effect, therefore, the value of the mining property is taxed as a capital gain instead of being taxed at full rates that would ordinarily apply to business or employment income of prospectors or grubstakers.

The amendments to subsection 35(1) are consequential on the introduction of the lifetime capital gains exemption. They provide that the exchange of an interest in a mining property for shares of a corporation by a prospector or grubstaker will not result in a capital gain that qualifies for the lifetime capital gains exemption. However, half taxation of the gain will be preserved. Under the new rules, the lesser of the fair market value of the shares at the time of acquisition and the proceeds received on the sale of the shares will be included at the time of the sale. New paragraph 110(1)(d.2) provides a deduction for one-half of the amount included in income of a prospector or grubstaker will be maintained. In addition, the shares will have an adjusted cost base equal to the amount included in income. As a result, any



increase in the value of the shares after their acquisition by the taxpayer will be treated as a capital gain and will qualify for the capital gains exemption.

[22] The practical result which flows from the 1985 amendment for our purposes is that from that point on, the exchange of the mining property for shares results in an income inclusion equal to the lesser of the value of the shares at the time of the exchange or at the time they are disposed of (or further exchanged). Significantly, a capital loss cannot result from the exchange of the mining property and a capital gain can arise, but only with respect to an increase in the value of the shares occurring after the mining property has been exchanged.

[23] This particular tax treatment appears to take mining property outside the defined meaning of “capital property” under the Act, i.e., “... property ... the disposition of which [gives rise to] a capital gain or loss” (subsection 54(b)).

[24] Counsel for the Minister argued that the sole purpose of the 1985 amendment was to take away the lifetime capital gains exemption with respect to gains derived from the disposition of mining property, and that a capital gain “like” treatment was in effect maintained by reason of the 50% deduction provided under paragraph 110(1)(d.2) in the computation of taxable income. The suggestion appears to be that mining property should continue to be viewed as a capital property despite the treatment now provided by section 35.

[25] I accept that the purpose of the 1985 amendment was to take away the lifetime capital gains exemption with respect to mining property, while otherwise preserving a capital gain “like”

treatment through the paragraph 110(1)(d.2) deduction. However, one cannot ignore how this was achieved. Pursuant to the 1985 amendment, mining property is no longer treated as capital property and its disposition gives rise to an income treatment.

[26] That said, although section 35 was partially in play at the relevant time (paragraph 35(1)(a)), the operative portion (paragraph 35(1)(d)) had not been triggered given that the shares received by the appellant from Wallbridge/Minescape had not been disposed of or further exchanged. Indeed, the purpose of the legal action being the recovery of the mining property, the operative portion of section 35 would never apply if the action was to succeed, which turned out to be the case. It follows that the debate before the Tax Court Judge could not be resolved on the basis of the treatment given to mining property under section 35.

[27] Rather, it was incumbent upon the Tax Court Judge to review the evidence and determine the tax character of the appellant's mining rights based on how the appellant dealt with them. This is what the Tax Court Judge did. As already stated, he found as a fact that these rights were held in the course of trade, a conclusion from which the appellant's entitlement to the claimed deductions necessarily flows.

[28] For these reasons, I would allow the appeal, set aside the decision of the Tax Court, and giving the judgment that ought to have been given, I would refer the reassessments to the Minister

for reassessment on the basis that the appellant's legal fees incurred to recover his mining rights are deductible on an income account. Mr. Bolen shall be entitled to the costs of the appeal.

“Marc Noël”

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J.A.

“I agree  
M. Nadon J.A.”

“I agree  
J.D. Denis Pelletier J.A.”

**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

**DOCKET:** A-501-05

**(APPEAL FROM A JUDGMENT OF THE TAX COURT OF CANADA DATED  
AUGUST 18, 2005, NO. 2004-2399 (IT)I.)**

**STYLE OF CAUSE:** JACK (JOHN) A. BOLEN v. HER  
MAJESTY THE QUEEN

**PLACE OF HEARING:** Winnipeg, Manitoba

**DATE OF HEARING:** September 11, 2007

**REASONS FOR JUDGMENT BY:** NOËL J.A.

**CONCURRED IN BY:** NADON J.A.  
PELLETIER J.A.

**DATED:** September 19, 2007

**APPEARANCES:**

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