

Docket: 2011-3317(IT)G

BETWEEN:

HILL FAI INVESTMENTS LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeals heard on May 26 and November 25 and 26, 2014,  
at Ottawa, Ontario.

Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the Appellant: Rod A. Vanier

Counsel for the Respondent: April Tate

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**JUDGMENT**

The appeals from the reassessments made under the *Income Tax Act* for the taxation years ended September 30, 2006, September 30, 2007 and September 30, 2008 are dismissed, with costs.

Signed at Ottawa, Canada, this 30th day of June 2015.

"Lucie Lamarre"

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Lamarre A.C.J.

Citation: 2015 TCC 167  
Date: 20150630  
Docket: 2011-3317(IT)G

BETWEEN:

HILL FAI INVESTMENTS LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

### **REASONS FOR JUDGMENT**

Lamarre J.

#### Introduction

[1] These are appeals against reassessments made by the Minister of National Revenue (**Minister**) disallowing the deduction of a capital loss in the amount of \$382,219.31 claimed by the appellant for the year ended September 30, 2006, which in turn had an impact on the appellant's tax liability for the taxation years ended September 30, 2005, September 30, 2006, September 30, 2007 and September 30, 2008 (see paragraphs 4 and 7 of the Amended Reply).<sup>1</sup>

[2] In the calculation of its taxable income for the year ended September 30, 2006, the appellant claimed to have disposed of a receivable having an adjusted cost base of \$382,219.31 for proceeds of disposition equal to zero, resulting in a loss in the amount of \$382,219.31 (Amended Reply, paragraph 12 (i)).

[3] The appellant's records indicated that the receivable consisted of the following loans and advances the appellant claims to have made to Chun Fai Holdings Ltd. (**Chun Fai**), an affiliated corporation:

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<sup>1</sup> In the Amended Reply, at par. 10, the respondent stated: "In the course of the Minister's review following the filing of the Notice of Objection, the Appellant asked the Minister to allow the Appellant to claim a further capital loss in the amount of \$442,000." At the hearing, however, counsel for the appellant explicitly stated that the sole amount at issue was \$382,219.31 (Transcript, November 26, 2014, page 3).

a. Chun Fai Holdings – Land	\$ 110,000.00
b. Chun Fai Holdings – Security	3,766.88
c. Chun Fai Holdings – Interest	236,455.25
d. Chun Fai Holdings – General	31,997.18 <sup>2</sup>
Total	\$ 382,219.31

[4] Hill Fai says the debts became bad debts in its 2006 taxation year, thus allowing it to dispose of the debts pursuant to subsection 50(1) of the *Income Tax Act (ITA)* and claim the capital losses under paragraph 39(1)(b) of the ITA.

[5] The respondent is of the view that the appellant did not dispose of a debt within the meaning of subsection 50(1) of the ITA and therefore cannot claim the capital losses. She disputes that the debts even existed, and if they did exist, that they could properly be said to have become bad. Alternatively, the respondent argues that if Hill Fai did dispose of a debt within the meaning of subsection 50(1), Hill Fai did not acquire the debt for the purpose of gaining or producing income from a business or property, and therefore Hill Fai's loss from the disposition of the debt is nil pursuant to paragraph 40(2)(g) of the ITA.

[6] The reasons given by the respondent for her position are set out in paragraphs 12(k) to (o) of the Amended Reply, which read as follows:

- (k) the notes payable by Chun Fai to the Appellant were non-interest bearing;
- (l) there were no specific terms of repayment for the notes payable by Chun Fai to the appellant;
- (m) no attempts were made to collect the amounts owing from Chun Fai to the Appellant prior to the Appellant's claim that the debt had been disposed of;
- (n) As of September 30, 2006, the Appellant continued to hold a mortgage receivable from Chun Fai in the amount of \$442,000;

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<sup>2</sup> It should be noted that in the Amended Reply, this amount was written as \$31,977.18, but the correct amount – based on a total claim of \$382,219.31 and on other documents – is \$31,997.18.

- (o) The Appellant did not have documentation to support the source of funds to the Appellant, the advance of funds by the Appellant to Chun Fai or the disposition of the receivable in the course of the year ended September 30, 2006;

[7] As a secondary matter, Hill Fai takes exception to the Minister's requirement during the assessment, objection and appeal stages that Hill Fai file documents supporting the relevant loan transactions that led to the 2006 capital loss claim. First, Hill Fai says it reported the transactions in 1994 on the balance sheets it submitted to the Minister, and therefore the Minister has been aware of the transactions since that date. Second, Hill Fai says that the ITA only requires taxpayers to keep records for six years, and since the loan transactions occurred in 1994, Hill Fai only had an obligation to keep documents until 2000.

[8] The respondent says that, pursuant to subsections 230(1), 230(4) and 230(6) of the ITA, the six-year time limit is calculated from the end of the last taxation year to which the documents relate. Since Hill Fai claimed the capital losses in 2006, the Respondent argues that time began to run at the end of the 2006 taxation year.

[9] As a result of the foregoing, the respondent is of the view that during the taxation year ended September 30, 2006 the appellant did not incur capital losses within the contemplation of paragraphs 39(1)(b) and 40(1)(b) of the ITA in the amount of \$382,219.31 and that the appellant is therefore not entitled to deduct under sections 3 and 111 of the ITA any resulting carry-over amount in the calculation of its taxable income for the taxation years ended September 30, 2005, September 30, 2007 and September 30, 2008.

### Relevant Statutory Provisions

*Income Tax Act*  
R.S.C. 1985, c. 1 (5th Supp.)

**39 (1) Meaning of capital gain and capital loss** – For the purposes of this Act,

...

(b) a taxpayer's capital loss for a taxation year from the disposition of any property is the taxpayer's loss for the year determined under this subdivision (to the extent of the amount thereof that would not, if section 3 were read in the manner described in paragraph (a) of this subsection and without reference to the

expression "or the taxpayer's allowable business investment loss for the year" in paragraph 3(d), be deductible 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) depreciable property, or
- (ii) property described in any of subparagraphs 39(1)(a)(i), (ii) . . .

...

**40 (1) General rules** – Except as otherwise expressly provided in this Part

...

- (b) a taxpayer's loss for a taxation year from the disposition of any property is,
  - (i) if the property was disposed of in the year, the amount, if any, by which the total of the adjusted cost base to the taxpayer of the property immediately before the disposition and any outlays and expenses to the extent that they were made or incurred by the taxpayer for the purpose of making the disposition, exceeds the taxpayer's proceeds of disposition of the property, and
  - (ii) in any other case, nil.

**40 (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
  - (i) a superficial loss,
  - (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;

**50 (1) Debts established to be bad debts and shares of bankrupt corporation** – 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

...

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.

**General**

**230 (1) Records and books** – Every person carrying on business and every person who is required, by or pursuant to this Act, to pay or collect taxes or other amounts shall keep records and books of account (including an annual inventory kept in prescribed manner) at the person's place of business or residence in Canada or at such other place as may be designated by the Minister, in such form and containing such information as will enable the taxes payable under this Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined.

...

**(4) Limitation period for keeping records, etc.** – Every person required by this section to keep records and books of account shall retain

(a) the records and books of account referred to in this section in respect of which a period is prescribed, together with every account and voucher necessary to verify the information contained therein, for such period as is prescribed; and

(b) all other records and books of account referred to in this section, together with every account and voucher necessary to verify the information contained therein, until the expiration of six years from the end of the last taxation year to which the records and books of account relate.

...

**(6) Exception where objection or appeal** – Where a person required by this section to keep records and books of account serves a notice of objection or where that person is a party to an appeal to the Tax Court of Canada under this Act, that person shall retain every record, book of account, account and voucher necessary for dealing with the objection or appeal until, in the case of the serving of a notice of objection, the time provided by section 169 to appeal has elapsed or, in the case of an appeal, until the appeal is disposed of and any further appeal in respect thereof is disposed of or the time for filing any such further appeal has expired.

## Facts

[10] It is not in dispute in these appeals that at all material times, Gilbert Tam and his spouse, Swallow Tam, each owned 50 percent of Hill Fai's outstanding shares. They also each held 25 percent of Chun Fai's outstanding shares, and Swallow Tam held the remaining 50 percent of the shares in trust for Gordie Tam (Amended Reply, paragraphs 12(a), (b) and (c)). Hill Fai and Chun Fai are therefore affiliated persons as that term is defined in subparagraph 251.1(1)(c)(iii) of the ITA.

[11] In 1985, Hill Fai bought a property at 673-679 Somerset Street in Ottawa. The property included a building and an adjacent lot. Gilbert Tam testified that the property was then severed so that the vacant lot could be developed, and Chun Fai was incorporated for this purpose in 1992.<sup>3</sup> The respondent disputed whether a severance actually occurred, but what was not in dispute was that by 1994 Hill Fai owned 673-679 Somerset Street while Chun Fai owned 681-685 Somerset Street, which was the property with the vacant lot.

[12] Chun Fai initiated construction of a building on its property and hoped to make money by renting units to tenants. It took out a \$450,000 line of credit with Toronto-Dominion Bank ("TD"), and either Mr. and Mrs. Tam or Mr. Tam alone personally guaranteed the line of credit.

[13] In 1994, Hill Fai took out a \$450,000 mortgage with TD on its Somerset Street property. Hill Fai says it then loaned these funds to Chun Fai. Mr. Tam and Mr. K. Eapen Koshy, an accountant Hill Fai retained to prepare the corporation's 2006 tax returns, testified there were various reasons for the loan, including the

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<sup>3</sup> Chun Fai's incorporation date can be seen in the notes to its 1993 financial statements in Exhibit A-1, Tab 5A.

following: Mr. Tam wanted to settle the line of credit with TD since he had personally guaranteed it; Chun Fai had no credit to itself borrow the funds from the bank; the funds were needed to help finish the building; and Hill Fai could get a better interest rate from the bank than Chun Fai since Hill Fai had a healthier balance sheet.<sup>4</sup>

[14] The notes to Chun Fai's financial statements for its year ended May 31, 1995<sup>5</sup> and to Hill Fai's financial statements for its year ended September 30, 1996<sup>6</sup> say that Hill Fai's \$450,000 loan to Chun Fai is non-interest bearing and has no specific terms of repayment. However, Mr. Tam testified that the interest rate on that loan was two percent higher than the rate Hill Fai was paying TD on the mortgage. Since the mortgage interest rate was prime plus two or three percent, the interest rate on Hill Fai's loan to Chun Fai would have been prime plus four or five percent.<sup>7</sup> The Respondent disputes that Hill Fai charged Chun Fai any interest on the loan.

[15] On top of the \$450,000 loan, Hill Fai says it also transferred land to Chun Fai in 1994 and, in connection with this transfer, incurred a receivable from Chun Fai of \$110,000. Hill Fai's 1996 financial statements say that this loan also is non-interest bearing and has no specific terms of repayment.<sup>8</sup>

[16] In total, Hill Fai says it loaned or advanced \$560,000 to Chun Fai in 1994.

[17] Once Chun Fai's building became operational, it had difficulty finding tenants and began losing money. By 2002, according to its financial statements for that year,<sup>9</sup> it had total liabilities of about \$1.3 million against assets of about \$918,000. Chun Fai had listed its property for sale around 2000 or 2001, but a sale was only closed in 2003, the selling price being \$623,442.<sup>10</sup>

[18] Mr. Tam testified that, after other mortgages registered against Chun Fai's property were paid off,<sup>11</sup> Chun Fai used the net sale proceeds (amounting to about

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<sup>4</sup> November 26 transcript, page 5, lines 24-27.

<sup>5</sup> Exhibit A-1, Tab 5C.

<sup>6</sup> Exhibit A-1, Tab 3.

<sup>7</sup> May 26 transcript, page 113, lines 9-18.

<sup>8</sup> Exhibit A-1, Tab 3.

<sup>9</sup> May 26 transcript, page 125, line 16 to page 126, line 14.

<sup>10</sup> May 26 transcript, page 126, line 15 to page 127, line 18.

<sup>11</sup> The reporting letter from Chun Fai's lawyer, at Exhibit R-2, Tab 7, lists these mortgages. The first is described at page 4 of the letter: \$98,922.20 went to TD to discharge a

\$419,000) to repay creditors other than Hill Fai because these creditors were charging higher rates of interest than Hill Fai.<sup>12</sup> Mr. Tam testified that once Chun Fai sold its property it effectively ceased carrying on business. According to Chun Fai's financial statements for the year ended 2004,<sup>13</sup> Chun Fai had liabilities of about \$736,000 against assets of about \$2,000. The debts owed to Hill Fai were still unpaid.

### Issues

[19] The issues in these appeals are as follows:

1. Did Hill Fai dispose of debts totalling \$382,219.31 during its 2006 taxation year pursuant to subsection 50(1) of the ITA, such that it is entitled to claim capital losses related to those debts?
2. In the alternative, did Hill Fai incur the debts for the purpose of gaining or producing income from a business or property under subparagraph 40(2)(g)(ii) of the ITA?
3. Pursuant to subsection 230(1), 230(4) or 230(6) of the ITA, when was Hill Fai no longer required to keep documents relating to the loan transactions and the capital loss claim?

### Analysis

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previous first mortgage in favour of TD. Mr. Tam testified that this was a small business loan from TD to Chun Fai (see May 26 transcript, page 128, lines 15-27). The second mortgage is described on the first unnumbered page after page 6: \$75,000 to the Federal Business Development Bank ("FBDB"). Mr. Tam testified that the FBDB did not specifically have a mortgage on Chun Fai's property but had a mortgage on Hill Fai's. Since this mortgage predated the severance of the property, in order to complete the sale Chun Fai had to pay off the FBDB mortgage in order to obtain full release of the parcel after the severance (see May 26 transcript, page 128, line 28 to page 129, line 23).

<sup>12</sup> May 26 transcript, page 129, line 24 to page 130, line 21.

<sup>13</sup> Exhibit A-1, Tab 6B.

Issue 1: Disposition of debts pursuant to subsection 50(1)

[20] According to paragraph 50(1)(a), a taxpayer (Hill Fai) may elect to be considered as having disposed of a debt that it has established to have become bad in the year. Where the taxpayer makes this election, it is deemed to have disposed of the debt for no proceeds and to have reacquired it at no cost. The taxpayer may then claim a capital loss pursuant to 39(1)(b), as it disposed of the debt for nil proceeds.

[21] There appears to be no issue regarding whether the taxpayer made a proper election. Mr. Koshy testified that he made the election,<sup>14</sup> and the respondent did not dispute this.

[22] In order to comply with subsection 50(1) and then claim a capital loss under paragraph 39(1)(b), Hill Fai must establish that:

- a. There were debts of \$382,219.31 owed to it by Chun Fai;
- b. The debts became bad in 2006.<sup>15</sup>

a) *Did Chun Fai owe the amount of the debts claimed by Hill Fai?*

[23] Hill Fai must first establish what amounts it loaned to Chun Fai. The parties fundamentally disagree over whether these debts existed: Hill Fai says it loaned the funds to Chun Fai, while the Respondent says no such debts were owed.

[24] Before examining whether each of the specific debts claimed by Hill Fai was actually owed to Hill Fai, it is worth reviewing the general evidence Hill Fai presented at trial.

Witnesses

[25] Hill Fai called two witnesses. The first was Mr. Koshy, who was first retained by Hill Fai in 2007 to prepare the corporation's 2006 tax returns. Mr. Koshy testified that "by implication" he was also retained by Chun Fai to prepare its returns. In preparing these returns, Mr. Koshy had to rely on the work of two people who had prepared Hill Fai's and Chun Fai's earlier returns:

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<sup>14</sup> May 26 transcript, page 13, lines 20-28 and page 14, lines 11-15.

<sup>15</sup> *Fisher v The Queen*, 2013 TCC 216 (General Procedure) (under appeal to the Federal Court of Appeal).

Hubert Joy, now deceased, a certified general accountant who apparently prepared the corporations' returns from 1993 to 1996, in which period the 1994 loans to Chun Fai were made; and Karl von Bloedau, an accountant who was Mr. Koshy's predecessor on the files. While it was unclear when Mr. von Bloedau both began and ceased preparing the corporations' returns, Mr. Koshy testified that before him it was Mr. von Bloedau who had handled the files.

[26] Mr. Koshy testified that Mr. Joy had died by the time he became involved, and so he had no opportunity to discuss the files with Mr. Joy. Mr. Koshy also testified that he tried to meet with Mr. von Bloedau to obtain information on the files, but Mr. von Bloedau refused to provide any help or documents. The only thing Mr. von Bloedau provided was a disk containing data. Mr. Koshy did not pursue any further contact with Mr. von Bloedau and he testified that at best Mr. von Bloedau did simple bookkeeping and this was all that Mr. Koshy could use from Mr. von Bloedau.

[27] Mr. Koshy appeared reluctant to acknowledge that the financial statements he had prepared, which led to claiming the capital losses, may not be reliable because of a lack of source documentation or because the documents prepared by the previous accountants were not themselves reliable. His position was that he interviewed Mr. and Mrs. Tam, met with their lawyer, reviewed as many documents as possible and did the best he could. He acknowledged, however, that there were no loan agreements and no promissory notes. Given that Mr. Koshy was not the accountant on the file when the 1994 transactions took place, that he had almost no contact with the previous accountants and that his involvement with Hill Fai only began with the 2006 returns, he is at best an interpreter of most of the original documents and events that led to Hill Fai claiming the capital losses in question. I would therefore assign little weight to his testimony regarding the events that preceded the filing of the 2006 return.

[28] Hill Fai's other principal witness was Mr. Tam. He was the president of both Hill Fai and Chun Fai and was also a shareholder and director of both corporations. On several occasions, it was difficult to assess Mr. Tam's testimony because he seemed to have difficulty either understanding the questions put to him or communicating an answer. He testified that his English was good enough to communicate, but there were many instances when he either explicitly said he did not understand the questions or where he did not seem to recognize that he was being asked to provide an answer. Simple questions had to be repeated because he did not understand them. On other occasions, his testimony contradicted the answers he gave at discovery. Whether the contradictions were the result of a

language barrier, faulty recollections or other factors is difficult to say. I am therefore hesitant to assign significant weight to Mr. Tam's testimony, particularly where there may have been contradictions with his other oral evidence or the documentary evidence.

### Documentary evidence

[29] It is perhaps useful, first of all, to note what documentary evidence was not presented at trial. Mr. Koshy and Mr. Tam testified that no loan agreements or promissory notes were prepared in connection with the debts, and therefore none could be produced in evidence. They also testified that they made requests to TD for copies of cancelled cheques, Hill Fai's mortgage application to TD and records relating to Chun Fai's sale of property in 2003, but that the records had been destroyed.

[30] The primary – and practically only – documentary evidence presented to support the debts' existence was various financial statements of both Hill Fai and Chun Fai. Each of these statements was prepared by either Mr. Joy or Mr. von Bloedau. Mr. Joy's statements were not audited but were more complete than Mr. von Bloedau's, which were also unaudited<sup>16</sup> and essentially consisted of a balance sheet and an income statement. Counsel for the Respondent demonstrated that there were some discrepancies both in Mr. von Bloedau's documents and between those documents and Mr. Koshy's documents.<sup>17</sup> Mr. Koshy agreed in his testimony that there appeared to be errors in those documents.<sup>18</sup> Mr. Koshy also agreed that Mr. von Bloedau's documents and data were a starting point for his own work, and he stated that even though they were a "bad starting point" they needed to be used at some point in order to prepare the 2006 returns.<sup>19</sup>

[31] I also note that Hill Fai's financial statements for its year ended September 30, 1995, were not presented as evidence despite the fact that its financial statements for 1993, 1994 and 1996 were presented. The 1995 statements would have been useful for the sake of continuity between Hill Fai's preceding and

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<sup>16</sup> See Mr. von Bloedau's reporting letter, Exhibit R-6.

<sup>17</sup> See for example: (1) the discussion about the discrepancy in the number of shares between the trial balance and the balance sheet, May 26 transcript, page 76, line 17 to page 82, line 21; (2) the lack of clarity regarding a \$300,000 mortgage receivable, May 26 transcript, page 82, line 26 to page 87, line 8; and (3) the discrepancy between a trial balance and a balance sheet, May 26 transcript, page 87, line 9 to page 91, line 3.

<sup>18</sup> May 26 transcript, page 100, lines 3-10.

<sup>19</sup> May 26 transcript, page 97, line 3 to page 99, line 5.

subsequent statements and for the sake of comparability with Chun Fai's statements so that it could be seen how each entity was recording the relevant entries.

[32] As for the returns prepared by Mr. Koshy, his testimony tended to show that he conducted a review of all available records and sources of information. However, he was handicapped by not being able to speak with Mr. Joy or in any meaningful way with Mr. von Bloedau and by having no loan agreements, cancelled cheques, promissory notes or other source documentation to work with. Mr. Koshy, by his own admission, was relying on poor work done by Mr. von Bloedau. When Mr. Koshy was asked how he came up with the claim in Hill Fai's 2006 return for \$382,219.31 in capital losses, Mr. Koshy said the figure was based on his firm's investigations, the financial statements of Hill Fai and Chun Fai, and his discussions with Hill Fai's lawyer.<sup>20</sup> In my view, given the evidence regarding the documentation that was available, this is not a solid basis for the claim.

[33] Given all of the above, I would assign little weight to Mr. von Bloedau's documents and Mr. Koshy's documents. Several errors were noted in Mr. von Bloedau's documents, and while Mr. Koshy appears to have been diligent in his work in preparing the documents, he was forced to rely on poor documentation or no documentation as a starting point. I would assign some weight to Mr. Joy's documents since they were prepared contemporaneously with the events in question. However, since Mr. Joy is deceased, he was obviously unavailable to testify and explain the figures and notes in the statements he prepared from 1993 to 1996. Moreover, the problem with respect to Mr. Joy's statements is the same as that which presents itself with regard to all of the statements: there was no source documentation provided in evidence to support the figures in the statements.

[34] The only other somewhat relevant document was a corporate resolution by Hill Fai's directors dated September 16, 1994, allowing TD to register a \$450,000 mortgage against Hill Fai's Somerset Street property.<sup>21</sup> However, this document serves only as evidence of Hill Fai's mortgage loan from TD; it does nothing to support the existence of any of the debts that make up the claim for capital losses of \$382,219.31.

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<sup>20</sup> May 26 transcript, page 14, lines 3-10.

<sup>21</sup> Exhibit A-1, Tab 4.

[35] I will now turn to determining whether each of the specific debts claimed did in fact exist.

The claim for a debt of \$110,000 – "Land"

[36] Hill Fai claims that this debt arose from its transfer of land to Chun Fai.<sup>22</sup> However, it was never made clear what specific transfer was involved. The most likely transfer would presumably have been the severance of Hill Fai's property which led to Chun Fai taking over the vacant lot portion of the property. However, this was never explained in any detail.

[37] Hill Fai also provided no explanation of how this debt arose. There was therefore no evidence as to whether it was an advance, a loan, an assumption of a mortgage or something else. The first mention in any financial statements of Chun Fai owing a debt of \$110,000 to Hill Fai for a land transfer is in Hill Fai's statements for its year ended September 30, 1994.<sup>23</sup> These statements record "Loans and Advances" to "Associated Corporations" of \$560,000, and a note to the statements<sup>24</sup> states that this amount is made up of a \$450,000 mortgage on Chun Fai's property, which Hill Fai is committed to pay, and a balance of \$110,000 associated with a land transfer.

[38] However, these statements are severely at odds with Chun Fai's financial statements for its year ended May 31, 1995,<sup>25</sup> which came after Hill Fai's 1994 statements. Those statements say that Chun Fai only owes Hill Fai \$450,000;<sup>26</sup> there is no mention of a debt to Hill Fai of \$110,000. However, the notes do say there are private loans of \$110,000 owed to individuals who are not shareholders of Chun Fai.<sup>27</sup> Since Hill Fai, although not a shareholder of Chun Fai, was not an individual either, there was no debt of \$110,000 owed to Hill Fai according to these statements. Moreover, this recording in Chun Fai's 1995 statements of a \$110,000 debt owed to non-shareholder individuals is a repetition of the same entry in Chun Fai's statements for its year ended May 31, 1994. Hill Fai's and Chun Fai's statements are therefore directly at odds with each other. When Mr. Tam was asked in cross-examination whether Hill Fai's claim of a \$110,000 bad debt from Chun Fai was really the \$110,000 debt that Chun Fai owed to non-

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<sup>22</sup> Notice of Appeal, Section A, paragraph 5.

<sup>23</sup> Exhibit A-1, Tab 2.

<sup>24</sup> See Note 5 of those financial statements.

<sup>25</sup> Exhibit A-1, Tab 5C.

<sup>26</sup> See "Loans Payable" on the balance sheet and Note 4(b).

<sup>27</sup> See "Loans Payable" on the balance sheet and Note 4(a).

shareholder individuals, as described in Chun Fai's statements, he answered that he could not remember.<sup>28</sup>

[39] In none of Chun Fai's financial statements presented to the Court is there any specific mention of Chun Fai owing \$110,000 to Hill Fai in connection with a land transfer. The \$110,000 bad debt claim was never explained in oral testimony. Its only relevant specific appearance in the evidence is in Hill Fai's 1994 and 1996 financial statements. In my view, these financial statements alone do not provide sufficient evidence that Chun Fai owed Hill Fai \$110,000 in connection with a land transfer.

[40] I am therefore not satisfied that the debt of \$110,000 with respect to "Land" existed.

The claim for a debt of \$3,766.88 – "Security"

[41] Practically no information was given to support the existence of this debt. Mr. Tam testified that Chun Fai gave no security to Hill Fai for the \$450,000 loan from Hill Fai.<sup>29</sup> The first time the financial statements record a debt owed by Chun Fai to Hill Fai relating to "security" is in Hill Fai's 1996 financial statements, which say that Hill Fai had \$648,149 in loans and advances receivable from Chun Fai.<sup>30</sup> A note to the 1996 financial statements states that this amount was made up of a series of special-purpose transactions, namely:

Mortgage Funding on Building	442,000
Land Transfer Transaction	110,000
<b>Security Fees Paid</b>	<b>1,192</b>
Interest on Mortgage	<u>94,957</u>
	648,149

[Emphasis added.]

[42] No further explanation for this bad debt claim was provided, nor was any documentation presented to explain these special-purpose transactions. Given my earlier assessment of the financial statements and in view of the lack of

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<sup>28</sup> November 25 transcript, page 70, line 26 to page 71, line 5.

<sup>29</sup> November 25 transcript, page 84, lines 13-19.

<sup>30</sup> Exhibit A-1, Tab 3, See "Loans & Advances-Associated Corporations" in the balance sheet and Note 4.

information supporting this debt, I am not satisfied that the debt of \$3,766.88 for "Security" existed.

The claim for a debt of \$236,455.25 – " Interest"

[43] Of all the bad debts claimed by Hill Fai, this one was the most unclear. It was never apparent from the evidence whether this debt claim represented the interest Hill Fai was supposedly charging Chun Fai in relation to the \$450,000 loan to Chun Fai, or whether the debt was simply Hill Fai taking the costs consisting of its interest payments to TD on its \$450,000 mortgage and passing them on to Chun Fai as a loan or advance. The evidence was contradictory.

[44] Mr. Tam testified that on Hill Fai's \$450,000 loan to Chun Fai, Hill Fai charged interest of prime plus four or five percent.<sup>31</sup> This testimony directly contradicts Chun Fai's 1995<sup>32</sup> and 2002<sup>33</sup> financial statements and Hill Fai's 1996 financial statements,<sup>34</sup> all of which state that Hill Fai's \$450,000 loan to Chun Fai was non-interest bearing and had no specific terms of repayment. When counsel for the respondent pointed out the discrepancy to Mr. Tam and suggested his earlier testimony was wrong, his response was that this was not necessarily the case, that he may have just misunderstood the question, that he had sent everything to his accountant to prepare and that some accounting questions he could not answer.<sup>35</sup> This does not inspire confidence in his earlier testimony that Hill Fai was charging interest to Chun Fai.

[45] Counsel for Hill Fai suggested that interest was being charged but that there was no obligation for Chun Fai to pay it. Such an obligation, he suggested, only arose if Chun Fai was making money, a suggestion Mr. Tam agreed with. Since Chun Fai only lost money, it never had an obligation to pay interest.<sup>36</sup> However, this does not square with the notes to the 1995 and 1996 financial statements indicating that the \$450,000 loan to Chun Fai was non-interest bearing. While I do have reservations about the reliability of the 1995 and 1996 financial statements given the lack of source documentation, on the matter of whether interest was being charged I prefer them as evidence over Mr. Tam's evidence, for the following reasons. These statements were prepared contemporaneously with the

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<sup>31</sup> May 26 transcript, page 113, lines 9-18.

<sup>32</sup> Exhibit A-1, Tab 5C, Note 4(b).

<sup>33</sup> Exhibit A-1, Tab 6A, Note 4.

<sup>34</sup> Exhibit A-1, Tab 3, Note 4.

<sup>35</sup> November 25 transcript, page 18, line 1 to page 19, line 14.

<sup>36</sup> November 25 transcript, page 89, line 25 to page 90, line 12.

events; if interest was indeed being charged but not due, the notes could have stated this. Instead, the statements consistently said that the loans to Chun Fai were non-interest bearing. Furthermore, Mr. Tam's testimony was contradictory and unreliable.

[46] The first time any interest-related debt is recorded is in Hill Fai's 1996 statements as part of Hill Fai's \$648,149 in loans and advances receivable from Chun Fai.<sup>37</sup> Note 4 to the statements states that the interest debt was one of the following special-purpose transactions:

Mortgage Funding on Building	442,000
Land Transfer Transaction	110,000
Security Fees Paid	1,192
<b>Interest on Mortgage</b>	<b><u>94,957</u></b>
	648,149

[Emphasis added.]

[47] This would appear to suggest that the interest debt is merely Hill Fai taking its own interest costs related to the TD mortgage and claiming them as a loan or advance to Chun Fai. Indeed, in a letter he sent to a Canada Revenue Agency ("CRA") appeals officer in 2011,<sup>38</sup> Mr. Koshy says that the interest balance of \$236,455.25 (the interest amount being claimed in these appeals) was the interest Hill Fai paid on the TD mortgage it assumed on behalf of Chun Fai.<sup>39</sup>

[48] Mr. Koshy testified that Chun Fai never paid any interest to Hill Fai<sup>40</sup> and that it appeared from the documents available to him that the computation and reporting of interest by both Hill Fai and Chun Fai simply ceased after the debt reached about \$236,000.<sup>41</sup> He speculated that, since Chun Fai likely had no ability to pay interest because of its financial situation, perhaps the accountant and the directors of both corporations decided not to continue calculating the debt.<sup>42</sup>

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<sup>37</sup> Exhibit A-1, Tab 3, See "Loans and Advances-Associated Corporations" in the balance sheet and Note 4.

<sup>38</sup> Exhibit R-1, Tab 24.

<sup>39</sup> Ibid., third paragraph.

<sup>40</sup> May 26 transcript, page 23, lines 17-22.

<sup>41</sup> May 26 transcript, page 22, lines 23-26.

<sup>42</sup> May 26 transcript, page 22, line 27 to page 23, line 4.

[49] In any event, there was no documentation provided, besides the financial statements, to support the existence of the interest debt. There were no calculations offered and no documents related to the TD mortgage, such as bank statements or other records, that could have substantiated the interest figure. I am therefore not satisfied that the \$236,455.25 "Interest" debt existed.

The claim for a debt of \$31,997.18 – " General"

[50] Once again, there was precious little evidence to support the existence of this debt. This figure, or any seemingly related debt, never appeared in any of the financial statements.

[51] The only explanation provided for this amount was a letter Mr. Koshy wrote to the Audit Division of the CRA in 2008 in response to the CRA's request for various documents, including invoices for the \$31,997.18 claim.<sup>43</sup> To support the claim, Mr. Koshy provided a copy of a cheque for \$30,000.00.<sup>44</sup> The handwritten notation accompanying the cheque seems to suggest that the cheque was for legal fees and real estate commission, but nothing more is evident. Not only does the amount of the cheque not correspond with the claim for \$31,997.18, but the cheque itself sheds no light on the "General" claim itself or to what it related to. Counsel for Hill Fai never presented evidence on what this debt represented.

[52] Counsel for the respondent further noted that a 2006 trial balance prepared by Mr. Koshy<sup>45</sup> shows that the "General" amount appears to be \$38,878.56.<sup>46</sup> Mr. Tam agreed in cross-examination that there was a mistake in the trial balance,<sup>47</sup> which only casts further doubt on this debt.

[53] Given the foregoing, I am not satisfied that the \$31,997.18 "General" debt existed.

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<sup>43</sup> Exhibit R-1, Tab 22.

<sup>44</sup> This was discussed in testimony, November 25 transcript, page 62, line 24 to page 65, line 16. In the letter at Exhibit R-1, Tab 22, Mr. Koshy writes on the first page, at the second bullet point, that he is providing a copy of a cheque to support the claim; he also notes this on the third page of Tab 22 at 1D. The cheque itself is at page 115.14.

<sup>45</sup> Exhibit R-1, Tab 22, page 115.11.

<sup>46</sup> Exhibit R-1, Tab 22, page 115.11, line 1224.

<sup>47</sup> November 25 transcript, page 67, line 28 to page 68, line 2.

## Conclusion

[54] Hill Fai has failed to provide sufficient evidence to support the existence of the debts totalling \$382,219.31 claimed as capital losses.

[55] Indeed, this appears to have been the case ever since the CRA began auditing this file. When a CRA appeals officer asked Mr. Koshy in 2011 for supporting documentation, including invoices and copies of agreements,<sup>48</sup> for each of the claims, Mr. Koshy replied that the accounts were created by the former accountant (presumably Mr. von Bloedau), who was refusing to cooperate. Therefore, he concluded, "details regarding these specific amounts are not available."<sup>49</sup>

[56] Mr. Tayub Abdul, an auditor with the CRA who eventually took over the Hill Fai file, testified that there was never any source documentation to support the debts recorded in the financial statements. Mr. Abdul acknowledged in cross-examination that there have been times when he has allowed a claim for deductions without source documentation because the claim is reasonable. But he added that Hill Fai's claims were not reasonable because there was no continuity in the financial statements. I agree with that assessment. The financial statements provided as evidence never seemed to be in alignment, and there was no other documentation presented to support the specific debts that led to Hill Fai's claim for capital losses. Therefore, Hill Fai has failed to prove that Chun Fai owed it debts totalling \$382,219.31.

b) *Did the debts become bad in 2006?*

[57] Given my conclusion that Hill Fai has not convinced me of the existence of the debts totalling \$382,219.31, there is no need to move on to the second step and determine whether the debts became bad in 2006.

## Conclusion

[58] Hill Fai has failed to show that it disposed of a debt under paragraph 50(1)(a) of the ITA.

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<sup>48</sup> Exhibit R-1, Tab 25, page 1.

<sup>49</sup> Exhibit R-1, Tab 24, page 1 of the letter, second paragraph.

Issue 2: Respondent's alternative argument

[59] There is also no need to analyze the alternative question of whether the alleged bad debts were incurred for the purpose of gaining or producing income from a business or property under subparagraph 40(2)(g)(ii). Hill Fai is therefore unable to claim a capital loss of \$382,219.31 under paragraph 39(1)(b) of the ITA.

Issue 3: Pursuant to s. 230(1), 230(4) or 230(6) of the ITA, when was Hill Fai no longer required to keep documents relating to the loan transactions and the capital loss claim?

[60] Subsection 230(1) of the ITA requires taxpayers to keep records for the purpose of the administration of the ITA.

[61] Subsection 230(4) of the ITA requires that the books and records be kept for six years from the end of the last taxation year to which they relate.

[62] Finally, subsection 230(6) of the ITA says:

**230.** (6) Where a person required by this section to keep records and books of account serves a notice of objection or where that person is a party to an appeal to the Tax Court of Canada under this Act, that person shall retain every record, book of account, account and voucher necessary for dealing with the objection or appeal until, in the case of the serving of a notice of objection, the time provided by section 169 to appeal has elapsed or, in the case of an appeal, until the appeal is disposed of and any further appeal in respect thereof is disposed of or the time for filing any such further appeal has expired.

[63] Subsection 248(1) of the ITA defines "record" as including invoices and "any other thing containing information":

**248.** (1) "record" includes an account, an agreement, a book, a chart or table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher, and any other thing containing information, whether in writing or in any other form.

[64] The question in this appeal is therefore to which year do the loan transaction records "relate": 1994 as argued by Hill Fai or 2006 as argued by the respondent?

[65] In *Tibilla v The Queen*,<sup>50</sup> it was held that the six-year period starts running not on the date the event took place, but rather on the date the taxpayer made his claim. In *Tibilla*, the taxpayer bought and renovated a rental property in 2002. The taxpayer sold the property in 2007 and was audited for capital gains in 2010. The taxpayer argued that the six-year period during which he was required to keep the supporting documents for the renovation expenses started running in 2002. That interpretation was held to be incorrect and the Court ruled that the six-year period started running on the date the expenses were claimed. In that case, the expenses had been claimed in 2007 for the purpose of reducing the capital gain on the sale of the rental property. The Court's interpretation was based on the context of subsection 230(4):

The reference to the expiration of six years from the end of the last taxation year to which the books and records relate is to be read in context. Here, I am of the view that, even though the expenses were incurred in 2002, the last taxation year to which the vouchers relate is the year in which the appellant claimed the expenses in order to reduce his capital gain, which he realized in 2007. Therefore, the vouchers could not be destroyed before the later of the expiration of six years after 2007 (subsection 230(4)) and the date on which his appeal is finally disposed of (subsection 230(6)).<sup>51</sup>

[66] Applied to these appeals, the ruling in *Tibilla* means that the relevant tax event occurred in 2006 when Hill Fai claimed the \$382,219.31 in capital losses. Under subsection 230(4), Hill Fai was therefore required to keep the relevant records for six years starting from the end of its 2006 taxation year.

[67] Moreover, pursuant to subsection 230(6), Hill Fai was required to keep the relevant records until this appeal is finally disposed of. Hill Fai therefore has no basis under the ITA for claiming that it was not required to keep the relevant records.

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<sup>50</sup> *Tibilla v. The Queen*, 2013 TCC 215 (General Procedure), aff'd. 2014 FCA 227.

<sup>51</sup> *Tibilla*, TCC, at par. 38.

Conclusion

[68] For all of these reasons, I would dismiss the appeals with costs.

Signed at Ottawa, Canada, this 30th day of June 2015.

"Lucie Lamarre"

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Lamarre A.C.J.

CITATION: 2015 TCC 167  
COURT FILE NO.: 2011-3317(IT)G  
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MAJESTY THE QUEEN  
PLACE OF HEARING: Ottawa , Ontario  
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