Docket: 2015-3366(IT)I

BETWEEN:

ATLANTIC THERMAL STAR LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on March 31, 2016, at Halifax, Nova Scotia

Before: The Honourable Justice Dominique Lafleur

Appearances:

Agent for the Appellant:	Doug Rudolph
Counsel for the Respondent:	Stan W. McDonald
	Heidi Collicutt

JUDGMENT

The appeal from the determinations made under subsection 152(1.1) of the *Income Tax Act* for the 2008 and 2010 taxation years, notices of which are dated November 14, 2014, is dismissed, without costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 31st day of May 2016.

"Dominique Lafleur"

Lafleur J.

Citation: 2016TCC135

Date: 20160531

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BETWEEN:

ATLANTIC THERMAL STAR LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

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REASONS FOR JUDGMENT

Lafleur J.

A. OVERVIEW

[1] Atlantic Thermal Star Limited (the "Appellant") had filed a notice of appeal in respect of notices of determination of loss dated November 14, 2014 issued by the Minister of National Revenue (the "Minister") pursuant to subsection 152(1.1) of the *Income Tax Act*, R.S.C., 1985, c. 1 (5th supp.), as amended (the "*ITA*") for the Appellant's fiscal years ending September 30, 2008 (the "2008 taxation year") and September 30, 2010 (the "2010 taxation year"), which were confirmed on June 29, 2015, disallowing a bad debt expense in the amount of $14,919 for the 2008 taxation year and disallowing a cumulative eligible capital deduction in the amount of $4,996 for the 2010 taxation year.

[2] The Minister initially assessed the Appellant for the 2008 taxation year and the 2010 taxation year by notices dated September 30, 2009 and October 13, 2011, respectively.

B. THE FACTS

[3] The Minister based on the following facts the determination of the Appellant's losses for the 2008 taxation year and the 2010 taxation year:

i) The Appellant was a corporation resident in Canada that operated a heating and cooling products business;

ii) The principal shareholder of the Appellant was Michael Backman ("Mr. Backman");

iii) The Appellant's fiscal year end was September 30;

iv) From 2001 to December 31, 2004, Mr. Backman was involved in a partnership carrying on the same business as the Appellant's;

v) On January 2, 2005, Mr. Backman acquired his partner's interest and continued as a sole proprietor;

vi) On June 29, 2006, Mr. Backman incorporated the Appellant, transferring the assets of the sole proprietorship to the Appellant, filing election form T2057 to give notice to the Minister of this transfer (and the election under the provisions of section 85 of the *ITA*);

vii) In election form T2057 filed with the Minister, a transfer of goodwill in the amount of $103,197 was identified from Mr. Backman to the Appellant, which issued a note payable to Mr. Backman in that amount;

viii) The fair market value of the goodwill transferred from Mr. Backman to the Appellant was nil;

ix) The Appellant did not have a debt in the amount of $14,919 that became a bad debt in the 2008 taxation year;

x) The Appellant did not include a debt in the amount of $14,919 in computing income in the 2008 taxation year or any preceding taxation years.

[4] The Appellant was represented by Mr. Doug Rudolph, a bookkeeper – accountant. At the beginning of the hearing, Mr. Rudolph informed the Court that Mr. Backman would not testify. Mr. Backman had no intention to testify, being probably out of the country at this time. Furthermore, according to Mr. Rudolph, the appeal had been brought by the Appellant on a question of principle rather than need; since, even if the appeal is dismissed, the Appellant would not have a resulting tax liability, having sufficient deductions to shelter any taxes.

[5] The only witness for the Appellant was Mr. Rudolph.

[6] According to Mr. Rudolph, Mr. Backman made the determination that a debt became a bad debt and thereby acted as a reasonable person and in good faith. Furthermore, according to Mr. Rudolph, the value of the goodwill was determined by Deloitte & Touche ("Deloitte") on January 1, 2005, when Mr. Backman bought out his partner's interest. In addition, the Appellant noted at the hearing that the transfer of goodwill from Mr. Backman to the Appellant effective was on September 30, 2006, and not on June 29, 2006.

[7] Mr. Rudolph filed various exhibits (A–1 to A–13), on consent, including the following exhibits:

i) Exhibit A–1 Timeline – it states that, from the time the Canada Revenue Agency (the "CRA") sent a letter to the Appellant advising the Appellant that an audit was undertaken to the date of the hearing, more than 5 years have elapsed;

ii) Exhibit A–4 Transaction Detail by Account and Exhibit A–5 Customer Balance Detail – according to Mr. Rudolph, these exhibits state that the amount of $14,919 claimed as a bad debt in the 2008 taxation year was included in the income of the Appellant during the 2008 taxation year or a prior year;

iii) Exhibit A–6 Profit and Loss – it states that 1.88% of the total sales of the Appellant for the 2008 taxation year represents bad debt. According to Mr. Rudolph, that amount is reasonable in that industry. Mr. Rudolph added that 3 to 5% of total sales becoming bad debt should be acceptable in that industry;

iv) Exhibit A–7 Letter from Deloitte dated October 4, 2011 – it states how the calculation of the amount of the goodwill was made at the time Mr. Backman acquired his partner's interest in the partnership; according to that letter, the amount of the goodwill was $105,864 at that time, namely on January 1, 2005. Then, the letter contains also the following paragraph: "On September 30, 2006, Mr. Backman transferred the business to a newly incorporated company on a tax-deferred basis pursuant to section 85 of the Income Tax Act. With respect to the goodwill, an amount equal to 4/3 of the CEC balance of $77,398 was elected as the proceeds of disposition";

v) Exhibit A–8 E-Mail from James MacGowan – it contains, according to Mr. Rudolph, follow-up comments made by Deloitte and sent to the CRA explaining again the method used to establish the fair market value of the goodwill as of January 1, 2005; and

vi) Exhibit A–10 Calculation of Goodwill by Deloitte and Exhibit A–13 Eligible Capital Property Summary of the Appellant – these exhibits were prepared by Mr. Rudolph.

[8] Under cross-examination, Mr. Rudolph admitted that he was neither the accountant nor the bookkeeper of the Appellant during the taxation years in issue. Also, he admitted that he was not an expert in respect of the business carried on by the Appellant, who would be qualified to testify as to what is a reasonable ratio for bad debt to total sales.

[9] No one from Deloitte testified at the hearing. Finally, Mr. Rudolph admitted that he was told that Exhibit A–8 was a follow-up comment from Deloitte addressed to the CRA and that he was not involved in the drafting or the sending of that document.

[10] The Respondent called one witness at the hearing, Ms. Joanne Caryi, an employee of the CRA who prepared the valuation report of the goodwill. Her report was filed as Exhibit R–1. According to that report, the value of the goodwill as of September 30, 2006 was nil. In her testimony, Ms. Caryi admitted that in order to make that valuation, she had limited information.

C. THE ISSUES

(1) Is the Appellant entitled to a deduction for bad debt expenses in the amount of $14,919 for the 2008 taxation year under paragraph 20(1)(*p*) of the *ITA*?

(2) Is the Appellant entitled to a deduction as cumulative eligible capital in the amount of $4,996 for the 2010 taxation year under paragraph 20(1)(*b*) of the *ITA*?

(3) Is the Appellant entitled to costs under subsection 11.2(1) of the *Tax Court of Canada Rules (Informal Procedure)*, SOR/90-688b, as amended (the "*Rules*")?

D. SUBMISSIONS OF THE PARTIES

(1) In respect of the bad debt deduction in the amount of $14,919 under paragraph 20(1)(p) of the ITA for the 2008 taxation year

[11] The Appellant is of the view that an amount of $14,919 may be deducted under paragraph 20(1)(*p*) of the *ITA* as a bad debt for the 2008 taxation year. According to Mr. Rudolph, Mr. Backman made the determination that a debt became a bad debt and thereby acted as a reasonable person and in good faith. Furthermore, as stated in Exhibits A–4 and A–5, the amount of $14,919 was added to the income of the Appellant for the 2008 taxation year or a previous year. Consequently, all the requirements of paragraph 20(1)(*p*) of the *ITA* are met.

[12] The Respondent is of the view that the assumptions of facts relied upon by the Minister in that respect were not demolished by the Appellant, since Mr. Backman did not testify at the hearing; furthermore, Mr. Rudolph was not involved with the affairs of the Appellant during the taxation years in issue. Accordingly, the assumption of facts relied upon by the Minister, namely that the Appellant did not have a debt in the amount of $14,919 that became a bad debt in the 2008 taxation year, have not been demolished by the Appellant. Consequently, the Appellant is not entitled to a bad debt deduction in the 2008 taxation year.

(2) In respect of the cumulative eligible capital deduction in the amount of $4,996 under paragraph 20(1)(b) of the ITA for the 2010 taxation year

[13] The Appellant is of the view that the Minister is statute-barred from challenging the value of the goodwill, since that value was established in 2005.

[14] Alternatively, if this Court concludes that the CRA could challenge the value of the goodwill, the Appellant is of the view that the fair market value of the goodwill was correctly determined by Deloitte, an independent, arm's length party and it is not equal to a nil amount. Accordingly, the Appellant is entitled to a deduction in the amount of $4,996 under paragraph 20(1)(*b*) of the *ITA* for the 2010 taxation year. The Appellant also submits that the valuation made by the CRA was not made by an independent party.

[15] The Respondent is of the view that, as stated in Exhibit R–1, the fair market value of the goodwill is nil; accordingly, the Appellant is not entitled to a deduction for cumulative eligible capital in respect of the goodwill for the 2010 taxation year. Furthermore, the deduction was claimed in respect of the 2010 taxation year and the Respondent's challenge is not statute-barred.

(3) In respect of costs

[16] Mr. Rudolph asks that costs be awarded to the Appellant for the delays occasioned by the CRA in completing the audit, the incompetency of CRA auditors, the difficult process of dealing with the CRA, the stress and deterioration of Mr. Backman's health caused by this whole process, and for the CRA failing to respect the rights guaranteed to the Appellant by the *Taxpayer Bill of Rights*. Mr. Rudolph submits that subsection 11.2(1) of the *Rules* allows me to award costs to the Appellant.

[17] Since the Appellant did not prove any disbursements, the Respondent is of the view that subsection 11.2(1) of the *Rules* does not allow me to award costs to the Appellant.

E. DISCUSSION

(1) Burden of proof

[18] Under subsection 152(8) of the *ITA*, an assessment under the *ITA* is deemed to be valid and binding notwithstanding any error, defect of omission in the assessment:

152(8) Assessment deemed valid and binding — An assessment shall, subject to being varied or vacated on an objection or appeal under this Part and subject to a reassessment, be deemed to be valid and binding notwithstanding any error, defect or omission in the assessment or in any proceeding under this Act relating thereto.	**152(8) Présomption de validité de la cotisation** — Sous réserve des modifications qui peuvent y être apportées ou de son annulation lors d'une opposition ou d'un appel fait en vertu de la présente partie et sous réserve d'une nouvelle cotisation, une cotisation est réputée être valide et exécutoire malgré toute erreur, tout vice de forme ou toute omission dans cette cotisation ou dans toute procédure s'y rattachant en vertu de la présente loi.

[19] Subsection 152(1.2) of the *ITA* provides, *inter alia*, that Division I of the *ITA*, which contains subsection 152(8), applies to a notice of determination of losses made under subsection 152(1.1) of the *ITA*.

[20] As explained by Justice L'Heureux-Dubé in *Hickman Motors Ltd v Canada*, [1997] 2 SCR 336 at paras 92–95, [1997] SCJ No 62 (QL), the initial onus of the taxpayer consists in demolishing the assumptions relied upon by the Minister to issue the assessment by making out a *prima facie* case that said assumptions are inaccurate. Then, the burden of proof shifts on the Minister, who must prove the assumptions relied upon. The relevant paragraphs of L'Heureux-Dubé J's reasons are as follows:

> 92 It is trite law that in taxation the standard of proof is the civil balance of probabilities: *Dobieco Ltd. v. Minister of National Revenue*, [1966] S.C.R. 95, and

that within balance of probabilities, there can be varying degrees of proof required in order to discharge the onus, depending on the subject matter: *Continental Insurance Co. v. Dalton Cartage Co.*, [1982] 1 S.C.R. 164; *Pallan v. M.N.R.*, 90 D.T.C. 1102 (T.C.C.), at p. 1106. The Minister, in making assessments, proceeds on assumptions (*Bayridge Estates Ltd. v. M.N.R.*, 59 D.T.C. 1098 (Ex. Ct.), at p. 1101) and the initial onus is on the taxpayer to "demolish" the Minister's assumptions in the assessment (*Johnston v. Minister of National Revenue*, [1948] S.C.R. 486; *Kennedy v. M.N.R.*, 73 D.T.C. 5359 (F.C.A.), at p. 5361). The initial burden is only to "demolish" the exact assumptions made by the Minister but no more: *First Fund Genesis Corp. v. The Queen*, 90 D.T.C. 6337 (F.C.T.D.), at p. 6340.

93 This initial onus of "demolishing" the Minister's exact assumptions is met where the appellant makes out at least a *prima facie* case: *Kamin v. M.N.R.*, 93 D.T.C. 62 (T.C.C.); *Goodwin v. M.N.R.*, 82 D.T.C. 1679 (T.R.B.). In the case at bar, the appellant adduced evidence which met not only a *prima facie* standard, but also, in my view, even a higher one. In my view, the appellant "demolished" the following assumptions as follows: (a) the assumption of "two businesses", by adducing clear evidence of only one business; (b) the assumption of "no income", by adducing clear evidence of income. The law is settled that unchallenged and uncontradicted evidence "demolishes" the Minister's assumptions: see for example *MacIsaac v. M.N.R.*, 74 D.T.C. 6380 (F.C.A.), at p. 6381; *Zink v. M.N.R.*, 87 D.T.C. 652 (T.C.C.). As stated above, all of the appellant's evidence in the case at bar remained unchallenged and uncontradicted. Accordingly, in my view, the assumptions of "two businesses" and "no income" have been "demolished" by the appellant.

94 Where the Minister's assumptions have been "demolished" by the appellant, "the onus . . . shifts to the Minister to rebut the *prima facie* case" made out by the appellant and to prove the assumptions: *Magilb Development Corp. v. The Queen*, 87 D.T.C. 5012 (F.C.T.D.), at p. 5018. Hence, in the case at bar, the onus has shifted to the Minister to prove its assumptions that there are "two businesses" and "no income".

95 Where the burden has shifted to the Minister, and the Minister adduces no evidence whatsoever, the taxpayer is entitled to succeed: see for example *MacIsaac, supra*, where the Federal Court of Appeal set aside the judgment of the Trial Division, on the grounds that (at p. 6381) the "evidence was not challenged or contradicted and no objection of any kind was taken thereto". See also *Waxstein v. M.N.R.*, 80 D.T.C. 1348 (T.R.B.); *Roselawn Investments Ltd. v. M.N.R.*, 80 D.T.C. 1271 (T.R.B.). Refer also to *Zink, supra*, at p. 653, where, even if the evidence contained "gaps in logic, chronology, and substance", the taxpayer's appeal was allowed as the Minister failed to present any evidence as to the source of income. I note that, in the case at bar, the evidence contains no such "gaps". Therefore, in the case at bar, since the Minister adduced no evidence

> whatsoever, and no question of credibility was ever raised by anyone, the appellant is entitled to succeed.
>
> [Emphasis added]

[21] The reasons justifying the placing of the initial onus on the taxpayer to demolish the Minister's assumptions of facts are well explained in prior cases decided by the Supreme Court of Canada.

[22] In *Anderson Logging Co v The King*, [1925] SCR 45 at 50, [1925] 2 DLR 143, Duff J (as he then was) wrote:

> First, as to the contention on the point of onus. If, on an appeal to the judge of the Court of Revision, it appears that, on the true facts, the application of the pertinent enactment is doubtful, it would, on principle, seem that the Crown must fail. That seems to be necessarily involved in the principle according to which statutes imposing a burden upon the subject have, by inveterate practice, been interpreted and administered. But, as concerns the inquiry into the facts, the appellant is in the same position as any other appellant. He must shew that the impeached assessment is an assessment which ought not to have been made; that is to say, he must establish facts upon which it can be affirmatively asserted that the assessment was not authorized by the taxing statute, or which bring the matter into such a state of doubt that, on the principles alluded to, the liability of the appellant must be negatived. The true facts may be established, of course, by direct evidence or by probable inference. The appellant may adduce facts constituting a *prima facie* case which remains unanswered; but in considering whether this has been done it is important not to forget, if it be so, that the facts are, in a special degree if not exclusively, within the appellant's cognizance; although this last is a consideration which, for obvious reasons, must not be pressed too far.
>
> [Emphasis added]

[23] In *Johnston v Minister of National Revenue*, [1948] SCR 486 at 489–90, [1948] 4 DLR 321, Justice Rand developed that doctrine in stating that:

> Notwithstanding that it is spoken of in section 63 (2) as an action ready for trial or hearing, the proceeding is an appeal from the taxation; and since the taxation is on the basis of certain facts and certain provisions of law either those facts or the application of the law is challenged. Every such fact found or assumed by the assessor or the Minister must then be accepted as it was dealt with by these persons unless questioned by the appellant. If the taxpayer here intended to contest the fact that he supported his wife within the meaning of the Rules mentioned he should have raised that issue in his pleading, and the burden would have rested on him as on any appellant to show that the conclusion below was not

> warranted. For that purpose he might bring evidence before the Court notwithstanding that it had not been placed before the assessor or the Minister, but the onus was his to demolish the basic fact on which the taxation rested.
>
> . . .
>
> I am consequently unable to accede to the view that the proceeding takes on a basic change where pleadings are directed. The allegations necessary to the appeal depend upon the construction of the statute and its application to the facts and the pleadings are to facilitate the determination of the issues. It must, of course, be assumed that the Crown, as is its duty, has fully disclosed to the taxpayer the precise findings of fact and rulings of law which have given rise to the controversy. But unless the Crown is to be placed in the position of a plaintiff or appellant, I cannot see how pleadings shift the burden from what it would be without them. Since the taxpayer in this case must establish something, it seems to me that that something is the existence of facts or law showing an error in relation to the taxation imposed on him.

[Emphasis added]

[24] It is also very important to keep in mind that the shifting of the burden of proof to the Minister cannot be lightly, capriciously or casually done, since the taxpayer typically has the information within his reach and under his control. Absent exceptional circumstances where facts are peculiarly within the Minister's knowledge, the onus on an assessment of tax owing should be the result of demolishing the Minister's assumptions (see *Canada v. Anchor Pointe Energy Ltd*, 2007 FCA 188 at paras 35–36, 283 DLR (4th) 434).

[25] Furthermore, the burden of proof applicable to an assessment under the *ITA* also applies to a notice of determination of losses (See, for instance, *Canada Trust Co v Canada (Minister of National Revenue – MNR)*, [1985] TCJ No 3 (QL) at paras 4, 34 (TCC)).

[26] A *prima facie* case is one "supported by evidence which raises such a degree of probability in its favour that it must be accepted if believed by the Court unless it is rebutted or the contrary is proved. It may be contrasted with conclusive evidence which excludes the possibility of the truth of any other conclusion than the one established by that evidence" (*Stewart v Canada (Minister of National Revenue – MNR)*, [2000] TCJ No 53 (QL) at para 23 (TCC). Cited with approval by Trudel JA in *Amiante Spec Inc v Canada*, 2009 FCA 139 at para 23, [2010] G.S.T.C. 26).

[27] Keeping in mind these principles, I will now examine the issues raised in this appeal.

(2) Deduction for bad debt expenses in the amount of $14,919 for the 2008 taxation year under paragraph 20(1)(p) of the ITA

[28] Paragraph 20(1)(*p*) of the *ITA* reads as follows:

20(1) Deductions permitted in computing income from business or property — Notwithstanding paragraphs 18(1)(*a*), 18(1)(*b*) and 18(1)(*h*), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto:	**20(1) Déductions admises dans le calcul du revenu tiré d'une entreprise ou d'un bien** — Malgré les alinéas 18(1)*a*), *b*) et *h*), sont déductibles dans le calcul du revenu tiré par un contribuable d'une entreprise ou d'un bien pour une année d'imposition celles des sommes suivantes qui se rapportent entièrement à cette source de revenus ou la partie des sommes suivantes qu'il est raisonnable de considérer comme s'y rapportant :
. . .	[…]
(*p*) bad debts — the total of	***p*) Créances irrécouvrables** — le total des montants suivants :
(i) all debts owing to the taxpayer that are established by the taxpayer to have become bad debts in the year and that have been included in computing the taxpayer's income for the year or a preceding taxation year, and	(i) les créances du contribuable qu'il a établies comme étant devenues irrécouvrables au cours de l'année et qui sont incluses dans le calcul de son revenu pour l'année ou pour une année d'imposition antérieure,
. . .	[…]
[Emphasis added]	[Notre soulignement]

[29] In order for a taxpayer to be entitled to a deduction under paragraph 20(1)(*p*) of the *ITA*, two requirements have to be met: (i) the taxpayer must establish that the debts have become a bad debt in the year and (ii) the debts have to have been

included in computing the taxpayer's income for the year or a preceding taxation year.

[30] Various factors need to be taken into account as to the determination of a bad debt.

[31] In *Rich v Canada*, 2003 FCA 38, [2003] 3 FC 493 [*Rich*], Rothstein JA (as he then was) summarized factors to be taken into account in the determination of a bad debt:

> 12 The assessment of whether a debt is bad is one based upon the facts at a particular point in time, i.e. December 31, 1995. The *Income Tax Act* does not prescribe factors to be considered in assessing the collectibility of a debt. However, Tax Appeal Board judgments in *Hogan v. The Minister of National Revenue*, 56 D.T.C. 183 and *No. 81 v. The Minister of National Revenue*, 53 D.T.C. 98, suggest some of the factors to be taken into account. After the creditor personally considers the relevant factors, the question is whether the creditor honestly and reasonably determined the debt to be bad.
>
> 13 I would summarize factors that I think usually should be taken into account in determining whether a debt has become bad as:
>
> 1. the history and age of the debt;
>
> 2. the financial position of the debtor, its revenues and expenses, whether it is earning income or incurring losses, its cash flow and its assets, liabilities and liquidity;
>
> 3. changes in total sales as compared with prior years;
>
> 4. the debtor's cash, accounts receivable and other current assets at the relevant time and as compared with prior years;
>
> 5. the debtor's accounts payable and other current liabilities at the relevant time and as compared with prior years;
>
> 6. the general business conditions in the country, the community of the debtor, and in the debtor's line of business; and
>
> 7. the past experience of the taxpayer with writing off bad debts.
>
> This list is not exhaustive and, in different circumstances, one factor or another may be more important.

> 14 While future prospects of the debtor company may be relevant in some cases, the predominant considerations would normally be past and present. If there is some evidence of an event that will probably occur in the future that would suggest that the debt is collectible on the happening of the event, the future event should be considered. If future considerations are only speculative, they would not be material in an assessment of whether a past due debt is collectible.
>
> 15 Nor is it necessary for a creditor to exhaust all possible recourses of collection. All that is required is an honest and reasonable assessment. Indeed, should a bad debt subsequently be collected in whole or in part, the amount collected is taken into income in the year it is received.

[32] In the case at bar, Mr. Backman, who is the director and principal shareholder of the Appellant, did not testify and was not present at the hearing. Furthermore, Mr. Rudolph was not the bookkeeper-accountant of the Appellant during the taxation year in issue. In addition, according to Mr. Rudolph, it was Mr. Backman who decided which debts had become bad debts and thereby always acted in good faith and as a reasonable person.

[33] No evidence was presented to me at the hearing pertaining to the method followed by Mr. Backman as to the determination of a bad debt. The Appellant presented insufficient evidence for me to apply the factors described in *Rich*. All I was told by Mr. Rudolph is that Mr. Backman, in making that determination, acted in good faith and as a reasonable person.

[34] Because of this lack of evidence, it is clear that the Appellant did not discharge its initial burden of proof to make out a *prima facie* case showing the inaccuracy of the assumption made by the Minister in that respect. The initial burden was on the Appellant to demolish the assumption made by the Minister that the debts in the amount of $14,919 were not bad debts within the meaning of paragraph 20(1)(*p*) of the *ITA*. Consequently, the burden of proof did not shift onto the Minister.

[35] It is not, therefore, necessary for me to consider the second requirement pertaining to a deduction under paragraph 20(1)(*p*) of the *ITA*, namely that the amount had to have been included in the computation of the Appellant's income in the year or a preceding taxation year.

[36] I therefore conclude that the Appellant has not discharged its burden of proof to show that it is entitled to a deduction for bad debt expenses in the amount of $14,919 for the 2008 taxation year under paragraph 20(1)(*p*) of the *ITA*.

(3) Deduction for cumulative eligible capital in the amount of $4,996 in the 2010 taxation year under paragraph 20(1)(b) of the ITA

a) Is the Respondent's challenge pertaining to the 2010 taxation year statute-barred?

[37] The Appellant is of the view that the Respondent's challenge of the value of the goodwill in issue is statute-barred since the value was determined on January 1, 2005.

[38] In my view, there is no basis to oppose either the Minister or any other party making factual allegations as to a state of affairs in a previous taxation year if such allegations, if true, would impact the correctness of the assessment (or in the case at bar, a notice of determination of losses) in dispute before this Court.

[39] I note the principle, referred to in certain cases as the "New St. James principle" (See, for instance, *Sherway Centre Limited v The Queen*, 2001 DTC 1021, [2001] TCJ No 751 (QL) (TCC)): the Minister is not prevented from challenging certain factual determinations with respect to a prior year in coming to a conclusion as to a taxpayer's position in a given taxation year. As held by Chief Justice Bowman (as he then was) in discussing the New St. James principle (*Coastal Construction & Excavating Ltd v R*, [1996] 3 CTC 2845 at para 23, 97 DTC 26 (TCC), citing *New St. James Ltd v MNR*, [1966] CTC 305, 66 DTC 5241 (Ex. Ct.):

> Finally, the appellant contends that because the Minister, in prior years, had treated the operation as a "facility" as defined in the RDIA he was not entitled to change the investment tax credit carry-forward from those admittedly statute-barred years to affect the taxable income of a year that was not statute-barred to conform to his view that the property was qualified and not certified. This interpretation would involve a conclusion that a determination of the balance of a carry-forward of investment tax credits for a statute-barred year was tantamount to an assessment. I do not read section 152 of the *Income Tax Act* as supporting such a conclusion. The Minister is obliged to assess in accordance with the law. If he assesses a prior year incorrectly and that year becomes statute-barred this will prevent his reassessing tax for that year, but it does not prevent his correcting the error in a year that is not statute-barred, even though it involves adjusting carry-forward balances from previous years, whether they be loss carry-forwards or balances of investment tax credits. *New St. James Limited. v. M.N.R.*, 66 D.T.C. 5241; *Allcann Wood Suppliers Inc. v. The Queen*, 94 D.T.C. 1475. No question of estoppel arises: *Goldstein v. The Queen*, 96 D.T.C. 1029.

[Emphasis added]

Those comments were later cited with approval by Létourneau JA in *Canada v Papiers Cascades Cabano Inc*, 2006 FCA 419 at para 23, 2008 DTC 6264).

[40] In my view, the New St. James principle makes it clear that in the case at bar, the Minister has the power to challenge the computation of the cumulative eligible capital balance of the Appellant for the 2010 taxation year based on the value of the goodwill at the time of transfer of the goodwill by Mr. Backman to the Appellant on September 30, 2006; that challenge is not statute-barred.

[41] Moreover, the Court has to review the validity of the notice of determination of losses dated November 14, 2014, which disallowed a cumulative eligible capital deduction in the amount of $4,996 for the 2010 taxation year. The notice of determination of losses was issued by the Minister further to the request of the Appellant made on May 27, 2014 (see Exhibit A-1). Under subsection 152(1.2) of the *ITA*, the provisions of the *ITA* dealing with the objection and appeal process apply to a notice of determination of loss. The Appellant has not pointed to any procedural irregularity regarding the issuance of that notice of determination or any other issue tending to invalidate it. Throughout the process whereby the Appellant requested the determination of loss, the Minister determined such loss, and the Appellant objected to, and then appealed from, that determination, the requirements of the *ITA* were respected.

[42] I therefore conclude that the 2010 taxation year is not statute-barred; the factual allegations with respect to the value of the goodwill are not statute-barred.

b) Evidence provided to the value of the goodwill

[43] Paragraph 20(1)(*b*) of the *ITA* provides that a taxpayer is entitled to a 7% deduction in respect of the cumulative eligible capital in respect of a business of such taxpayer and it reads as follows:

20(1) Deductions permitted in computing income from business or property — Notwithstanding paragraphs 18(1)(*a*), 18(1)(*b*) and 18(1)(*h*), in computing a taxpayer's income for a taxation year from a business or property, there may be	**20(1) Déductions admises dans le calcul du revenu tiré d'une entreprise ou d'un bien** — Malgré les alinéas 18(1)*a*), *b*) et *h*), sont déductibles dans le calcul du revenu tiré par un contribuable d'une entreprise ou d'un bien pour une

deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto:	année d'imposition celles des sommes suivantes qui se rapportent entièrement à cette source de revenus ou la partie des sommes suivantes qu'il est raisonnable de considérer comme s'y rapportant :
. . .	[…]
(*b*) cumulative eligible capital amount — such amount as the taxpayer claims in respect of a business, not exceeding 7% of the taxpayer's cumulative eligible capital in respect of the business at the end of the year. . .	***b*) Montant cumulatif des immobilisations admissibles** — la somme qu'un contribuable déduit au titre d'une entreprise, ne dépassant pas 7 % du montant cumulatif des immobilisations admissibles relatives à l'entreprise à la fin de l'année; […]
[Emphasis added]	[Notre soulignement]

[44] Subsection 14(5) of the *ITA* defines the phrase "cumulative eligible capital" of a taxpayer and that amount includes, *inter alia*, a portion of the eligible capital expenditures (also defined in subsection 14(5) of the *ITA*) incurred by a taxpayer. Very briefly, the latter phrase will include outlays and expenses incurred by the taxpayer to acquire goodwill. That is the reason why the fair market value of the goodwill as of September 30, 2006 is the key element to consider in respect of the deduction claimed by the Appellant under paragraph 20(1)(*b*) of the *ITA*.

[45] As stated above, the Minister has made an assumption of fact: the value of the goodwill transferred from Mr. Backman to the Appellant as of September 30, 2006 was nil. Accordingly, if the Appellant has made out a *prima facie* case that the value of the goodwill as of September 30, 2006 was equal to an amount other than a nil amount as assumed by the Minister, then the burden of proof will shift to the Minister, who must then prove said assumption.

[46] In this regard, the Appellant filed Exhibit A–7 (the "Deloitte Letter"). The Deloitte letter states the method of calculation of the amount of the goodwill followed at the time Mr. Backman acquired his partner's interest in the partnership; that determination was made on January 1, 2005, and Deloitte concluded that the amount of the goodwill was $105,864 at that time. The Deloitte Letter also contains the following paragraph: "On September 30, 2006, Mr. Backman transferred the

business to a newly incorporated company on a tax-deferred basis pursuant to section 85 of the Income Tax Act. With respect to the goodwill, an amount equal to 4/3 of the CEC (cumulative eligible capital) balance of $77,398 was elected as the proceeds of disposition". Furthermore, as stated above, no one from Deloitte testified at the hearing as to the fair market value of the goodwill as of September 30, 2006.

[47] I am of the view that the Appellant has not made out a *prima facie* case with the Deloitte Letter as to the value of the goodwill as of September 30, 2006 being something other than nil; the Appellant has not demolished the Minister's assumption in this regard.

[48] As stated above, the case law defines a *prima facie* case as one "supported by evidence which raises such a degree of probability in its favour that it must be accepted if believed by the Court unless it is rebutted or the contrary is proved".

[49] The Deloitte Letter does establish the fair market value of the goodwill as of January 1, 2005; it does not establish the fair market value of the goodwill as of September 30, 2006, namely 21 months after the January 1, 2005 valuation. No evidence was offered to the effect that the fair market value of the goodwill should be of the same value at the beginning of 2005 and in September 30, 2006, namely 21 months after. That is a long period of time in business and many events may have altered the initial valuation being made. Furthermore, the Appellant did not claim that Deloitte had provided an evaluation of the fair market value of the goodwill as of September 30, 2006. Even if I had received sufficient evidence before me to ascertain with a degree of confidence the method used by Deloitte to determine the value of the goodwill as of January 1, 2005, the Appellant simply asks me to infer that the value of the goodwill had not declined to nil in the 21 months after the valuation made in the Deloitte Letter. I conclude that the probative value of the Deloitte Letter is minimal as to the determination of the actual value of the goodwill at the relevant moment in September 2006. Consequently, the burden of proof did not shift to the Minister to establish the fair market value of the goodwill.

[50] Moreover, I would be compelled to dismiss the appeal even if I had concluded that with the Deloitte Letter the Appellant has made out a *prima facie* case that the value of the goodwill as of September 30, 2006 was other than a nil amount as assumed by the Minister.

[51] I note the limited scope of, and caveats contained in, Exhibit R–1 (for instance, that it had been prepared without the contribution of the Appellant's

management), but the fact does remain that it is the most comprehensive evaluation of the fair market value of the goodwill at the relevant time. The testimony of Ms. Caryi grappled with these issues raised by Exhibit R–1, but provided sufficient credible evidence for me to conclude on whether it was more likely than not that the goodwill had a fair market value of nil as of September 30, 2006. I am of the view that the Respondent, on the basis of Exhibit R–1 and of the testimony of Ms. Caryi, has proven, on a balance of probabilities, that the fair market value of the goodwill as of September 30, 2006 was nil. This would be true even if the Appellant had managed to shift the burden of proof to the Respondent.

[52] For these reasons, the Appellant is not entitled to a deduction for cumulative eligible capital in the amount of $4,996 in the 2010 taxation year under paragraph 20(1)(*b*) of the *ITA*.

c) Costs under subsection 11.2(1) of the *Rules*

[53] Mr. Rudolph requests that costs be awarded to the Appellant in accordance with subsection 11.2(1) of the *Rules* for the delays occasioned by the CRA in completing its audit, the incompetency of CRA auditors, the difficult process of dealing with the CRA, the stress and deterioration of Mr. Backman's health caused by this whole process, and for the CRA failing to respect the rights guaranteed to the Appellant by the *Taxpayer Bill of Rights*.

[54] The Respondent argues that since no evidence of the disbursement incurred has been adduced, I cannot award costs to the Appellant.

[55] As noted in *Munro v R*, [1998] 4 CTC 89 at paras 12–14, 163 DLR (4th) 541 (FCA), the discretion to award costs is governed by section 18.26 of the *Tax Court of Canada Act*, R.S.C., 1985, c. T-2, (the "*TCC Act*") and the applicable *Rules*.

[56] Subsection 18.26(1) of the *TCC Act* reads as follows:

18.26(1) Costs — The Court may, subject to the rules, award costs. In particular, the Court may award costs to the appellant if the judgment reduces the aggregate of all amounts in issue or the amount of interest in issue, or increases the amount of loss in issue, as the case may be, by more	**18.26(1) Frais et dépens** — La Cour peut, sous réserve de ses règles, ordonner le paiement des frais et dépens. Elle peut notamment en allouer à l'appelant si le jugement réduit de plus de la moitié le total de tous les montants en cause ou des intérêts en cause, ou augmente de

than one half.

plus de la moitié le montant de la perte en cause.

[57] The relevant portions of the *Rules* read as follows:

10(1) Costs — The Court may determine the amount of the costs of all parties involved in any proceeding, the allocation of those costs and the persons required to pay them.

. . .

11.2(1) Such other disbursements may be allowed as were essential for the conduct of the appeal if it is established that the disbursements were made or that the party is liable for them.

(2) There may be allowed all services, sales, use or consumption taxes and other like taxes paid or payable on any counsel fees and disbursements allowed if it is established that such taxes have been paid or are payable and are not otherwise reimbursed or reimbursable in any manner whatever, including, without restriction, by means of claims for input tax credits in respect of such taxes.

10(1) Frais et dépens — La Cour peut fixer les frais et dépens, les répartir et désigner les personnes qui doivent les supporter.

[…]

11.2(1) Les autres débours essentiels à la tenue de l'appel peuvent être adjugés s'il est établi qu'ils ont été versés ou que la partie est tenue de les verser.

(2) Peuvent être adjugées les taxes sur les services, les taxes de vente, les taxes d'utilisation, les taxes de consommation et autres taxes semblables payées ou payables sur les honoraires d'avocat et les débours adjugés, s'il est établi que ces taxes ont été payées ou sont payables et qu'elles ne peuvent faire l'objet d'aucune autre forme de remboursement, notamment sur présentation, à l'égard de ces taxes, d'une demande de crédits de taxe sur les intrants.

[58] In an appeal pursuant to the Informal Procedure, a judge still has discretion to decide whether to award costs in certain circumstances.

[59] The general rule is well-settled: costs are not awarded under the Informal Procedure (For instance, see *Cavanagh c R*, [2000] 3 CTC 2354 at para 45, [1999] TCJ No 465 (QL) (TCC)).

[60] Furthermore, Justice Dawson in *Canada v Martin*, 2015 FCA 95, 2015 DTC 5048, wrote:

> 18 It is well-settled law that in exceptional circumstances conduct that occurs prior to a proceeding may be taken into account if that conduct unduly and unnecessarily prolongs the proceeding. See, for example: *Merchant v. Canada*, 2001 FCA 19, 267 N.R. 186, at paragraph 7; *Canada v. Landry*, 2010 FCA 135, 404 N.R. 255, at paragraph 25.
>
> 19 Thus, in *Merchant* conduct at the audit and objection stages was relevant to the assessment of costs in the Tax Court because it impacted on the manner in which the trial proceeded. In the trial Judge's view, a trial that should have lasted no more than one day took seven days: *Merchant v. Canada*, [1998] T.C.J No. 278, 98 DTC 1734, at paragraph 59.

[61] This was a General Procedure case; however, those comments are relevant as to the exercise of my discretion.

[62] I do not see any factors in this appeal that would convince me to exercise my discretion so as to award costs to the Appellant. Furthermore, I can see no exceptional circumstances in the conduct of CRA officials prior to the filing of the Notice of Appeal. No evidence was provided by the Appellant as to any disbursements incurred, the state of Mr. Backman's health or any exceptional stress that was occasioned by the conduct of the CRA. This may be in part because Mr. Backman did not appear at the hearing.

[63] Therefore, regardless of the result of the appeal in this case, I would not have been inclined to award costs to the Appellant.

F. CONCLUSION

[64] For all these reasons, the appeal is dismissed, without costs.

Signed at Ottawa, Canada, this 31st day of May 2016.

"Dominique Lafleur"

Lafleur J.

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REASONS FOR JUDGMENT BY:	The Honourable Justice Dominique Lafleur
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APPEARANCES:

Agent for the Appellant:	Doug Rudolph
Counsel for the Respondent:	Stan W. McDonald
	Heidi Cullicutt

COUNSEL OF RECORD:

For the Appellant:

Name:	
Firm:	

For the Respondent:	William F. Pentney
	Deputy Attorney General of Canada
	Ottawa, Canada