Docket: 2005-1828(IT)G

BETWEEN:

GESTION RAYNALD LAVOIE INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on May 28 and May 29, 2007, at Rimouski, Quebec

Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant: Pierre Lévesque

Counsel for the Respondent: Vlad Zolia

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the 2003 taxation year is allowed, with costs, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 21st day of May 2008.

"François Angers"

Angers J.

Translation certified true
on this 21st day of October 2008.

Brian McCordick, Translator

Citation: 2008TCC204
Date: 20080521
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REASONS FOR JUDGMENT

Angers J.

[1] In an amended income tax return that it filed with respect to its 2003 taxation year, the Appellant claimed a $52,000 non-capital loss. The Minister of National Revenue ("the Minister"), by notice of reassessment dated January 7, 2005, disallowed the claimed loss, and, upon an objection filed by the Appellant, confirmed the reassessment dated January 7, 2005, in relation to the 2003 taxation year.

[2] The parties raised several issues at the hearing of this matter. The Respondent questions whether the debt alleged by the Appellant really existed, and, if it did exist, the amount of that debt. The Appellant wonders whether it is entitled to use the non-capital losses that it incurred in prior years during the years 2000, 2001, 2002 and 2003, and whether it properly did not write off work in progress on the production of a television series prior to its 1997 fiscal period.

[3] Other issues were raised as well – specifically, whether the Court, as part of the instant appeal, has jurisdiction to determine the precise moment at which the non-capital loss was realized, whether it was appropriate under the circumstances to include the project in the Appellant's subsidiary's inventory, and, if so, what value should be ascribed to this inventory property in the accounting for the years in issue.

[4] The Appellant is a company duly incorporated under Quebec's *Companies Act* by articles of incorporation issued on September 8, 1986. Since January 1988, its sole shareholder has been Raynald Lavoie.

[5] 2841-0777 Québec Inc. ("the subsidiary") was duly incorporated on October 16, 1990 under Part 1A of the *Companies Act* (Quebec) and was a wholly-owned subsidiary of the Appellant until its dissolution on November 2, 1999. On October 31, 1997, the subsidiary went into liquidation, and all its assets were distributed to its sole shareholder, the Appellant. The Appellant's fiscal periods end on October 31 each year, and those of its subsidiary ended on the last day of February each year, except for the last period, which ended on October 31, 1997. The subsidiary was operating as "Groupe Contact" or "Groupe de communication Contact".

[6] The subsidiary's activities began in 1991. It was a marketing and communications company. Raynald Lavoie looked after the administrative aspects of management and injected funds. The first contracts were in graphic design. This was followed by contracts with Parks Canada for signage and other work, and, finally, by the contract in issue.

[7] According to Mr. Lavoie, it was common practice for Parks Canada to receive work orders after work was done. The actual mandate, then, was given before the work order was issued. Jean Bernier, the subsidiary's director of operations, confirmed that this was how things were done. In fact, he was the one who headed the marketing and communications field work for the subsidiary. The subsidiary got several contracts from Parks Canada, and Mr. Bernier had become friends with Jean-Paul Desjardins, the marketing director of the Environment Canada Parks Service ("the Parks Service"). The projects started before the contracts were signed, because the contracts had to go through Supply and Services Canada. Mr. Bernier said that he relied on Mr. Desjardins, whom he described as a man of his word, and that a handshake was sufficient to start a project. He met with Mr. Desjardins two or three times a week. He emphasized that it was commonplace for work to be finished before a contract was received.

[8] The project in issue began in early 1991. It was a television series that was initially to be called *Jardinier du monde* but was later re-titled *Curieux de nature*. According to Mr. Lavoie, the impetus for the series, and the investment therein, was a letter dated March 13, 1991, in which Jean-Paul Desjardins confirmed to the subsidiary's Jean Bernier that the Parks Service would be going ahead with the series, to be produced by Parks Canada with partial funding from the private sector. Mr. Desjardins added that, even though the broadcaster had not yet been decided upon, the research and pre-scripting stage needed to begin; the costs associated with that stage were to be defrayed in the course of the following fiscal year (1991-92). Mr. Desjardins ended the letter by stating: [TRANSLATION] "Let the great adventure begin."

[9] The subsidiary invested in scripting, and a draft script (tab 28 of Exhibit A-1) was submitted to the Parks Service. In the wake of this, the Parks Service notified the subsidiary that there was no money in the short term, but it made employees and other resources, such as equipment and guides from various parks, available to the subsidiary. On June 6, 1991, Société de radio-télévision du Québec (Radio-Québec) confirmed to the Parks Service that it would provide nearly $200,000 for the project, and, in a letter to the broadcaster dated June 19, 1991, the Parks Service confirmed its own $200,000 financial commitment to the project. The next day, June 20, 1991, the Parks Service promised that it would repay Radio-Québec the $100,000 that it had advanced to the subsidiary if the project did not go ahead within the coming months.

[10] The funds from Radio-Québec enabled Raynald Lavoie to authorize shooting to begin, and the shooting took place from June 21 to September 1, 1991. On December 11, 1991, the subsidiary signed a broadcasting and exploitation rights pre-purchase contract with Radio-Québec for the project. The contract acknowledged its $100,000 investment of June 21, 1991, and its commitment to invest an additional $100,000 in two instalments of $50,000 each. The financial structure of the project, set out in Appendix B of the contract, states a total of $700,395, including Radio-Québec's contribution. According to a letter dated February 19, 1992, Radio-Québec clearly still wanted to broadcast the 13-episode series.

[11] On October 20, 1992, Parks Canada, through Laurent Tremblay, its associate director general for the Quebec region, sent a letter to Jean Bernier underlining the efforts that the subsidiary had devoted to the project and informing Mr. Bernier that, in response to his call for partners, and in a spirit of partnership, Jean-Paul Desjardins would be supporting his efforts to secure financing and would offer his cooperation.

[12] On February 3, 1993, Raynald Lavoie wrote to Jean-Paul Desjardins of the Parks Service to tell him that the subsidiary still had not received a contract number based on which an invoice could be issued. He therefore notified him that his letter dated March 13, 1991, would be considered a contract, and, in that regard, he enclosed an invoice for $53,470, plus tax, covering professional fees, research and pre-scripting. The reply was swift. In a letter dated February 9, 1993, Laurent Tremblay set out the facts and the circumstances, noting that no contract had been signed, that no instructions for work had been issued, and that, ultimately, Parks Canada would merely be a partner, along with the other sponsors, subject to the availability of the funds applied for.

[13] According to Mr. Bernier, and based on Exhibit A-3, the project budget was $727,981. A total of $444,360 was actually paid. Although the budget is dated October 30, 2002, the figures are from an earlier pre-budget proposal. In addition, the contract provided for a 15% profit margin, so that the actual expense for the subsidiary was approximately $377,400, less Radio-Québec's contribution, for a total of $277,400.

[14] Mr. Bernier left his job with the subsidiary in the spring of 1993. In 1994 and 1995, he continued his efforts to sell the project to Parks Canada. He screened excerpts, and met with Suzanne Hogan, a Parks Canada marketing consultant from 1990 through 1995, though Ms. Hogan was absent from July 18, 1994, to August 24, 1995. Ms. Hogan recalls seeing a project script and remembers having contacts with Mr. Bernier. Mr. Bernier's efforts with Parks Canada were unsuccessful, because it was clear that it did not have the budget for the project.

[15] As for Mr. Lavoie, he also took steps to find out why Parks Canada had changed its mind. He tried to retain the services of a Montreal lawyer, but the lawyer asked him for a rather substantial retainer, which he did not provide. Mr. Lavoie also met with his MP and a government minister in order to move things forward, but he was unsuccessful. He says that he does not have the resources to sue.

[16] Laurent Tremblay and Jean-Paul Desjardins also testified. They stressed that private-sector partners were crucial for the project. Mr. Desjardins testified that even though Parks Canada made a $200,000 financial commitment to Radio-Québec in its letter of June 19, 1991, the commitment was subject to finding such partners. He discussed Parks Canada's efforts to find sponsors in a letter to Mr. Bernier dated October 20, 1992.

[17] As for Mr. Tremblay, he stressed that the project was proposed to Parks Canada by the subsidiary, and he repeated that private-sector partners were a must for the project. His interpretation of the letter of March 13, 1991, is that it merely expressed Parks Canada's intent to be involved, and did not constitute a work request or a contract.

[18] In the subsidiary's financials for the period ended February 29, 1992, the assets column includes the asset class [TRANSLATION] "work in progress" (WIP). According to Mr. Lavoie, its value, $260,000, represents the subsidiary's total expenditures on the project. The amount is entered under this item because he was still hoping to recover it. Following discussions with his accountant, the amount continued to be characterized in this manner until February 1997, at which point, given the financial situation of the subsidiary (which had been inactive since 1995) and Mr. Lavoie's physical exhaustion, he decided to abandon his efforts to recover the project expenditures.

[19] According to the accountant responsible for preparing the subsidiary's financial statements, the project remained on the books as WIP because of discussions with Mr. Lavoie, who said that the amount might later be converted into real dollars. This explains why it was only in 1997 that the decision was made to sacrifice the amount and take it off the books upon issuing the subsidiary's closing financial statements as at October 31, 1997. According to the accountant, the subsidiary now had to be liquidated because its *raison d'être* had ceased to exist. This did not happen earlier because the subsidiary was thought to have an asset (namely WIP) that had value.

[20] The accountant says that, in a notice to readers, an accountant must ascertain whether the numbers are truthful, and that one must ensure that everything makes sense. In the subsidiary's financial profit and loss statement for the period ended February 29, 1996, the accountant took care to note, under [TRANSLATION] "Contingency", that the valuation of the WIP had not changed, and he explained the position of the subsidiary's management. References to contingencies in a financial statement denote an uncertain situation. In the instant case, in order to valuate the WIP as nil, one would need to show that the amount was unlikely to be realized. Section 3290, paragraph 6(2) of the *CICA Handbook* explains the conditions that must be met in order for a contingency to be entered in financial statements.

[21] The accountant was questioned as to why the WIP was not written off earlier. In response, he explained that a write-off has repercussions on the financial situation of the subsidiary, and that if his only consideration had been the tax consequences of the write-off, he would have done it much earlier. In 1997, he felt that the limit had been reached, and that all was lost for the subsidiary from a financial standpoint. Thus, the subsidiary was liquidated on October 31, 1997.

[22] Éric Beauséjour is an appeals officer with the Canada Revenue Agency. He was the person who changed the year of the loss from 1997 to 1993 on behalf of the Respondent. In his submission, the letter from Parks Canada to the subsidiary, dated February 9, 1993, clearly states that there was no contract and that Parks Canada did not owe the subsidiary anything. When he received the file in 2002, he asked the subsidiary to provide him with documents showing what measures it had taken to recover the loss, and he was not given any such documents. He says that the CRA prefers to see documents rather than believe taxpayers. He therefore maintained his decision that the loss should have been claimed at the close of the fiscal period that ended on February 28, 1993. In fact, the notice of confirmation dated May 19, 2005, reflects this.

[23] It is interesting to note that the notice of confirmation refers to a non-capital loss of $347,014, whereas the amount in the financial statements is $260,000.

[24] On another note, the evidence suggests that, on March 29, 2004, the Appellant, through its accounting firm, made a loss determination request in connection with its taxation year ended October 31, 1997. Having been told that the request had not been received, the Appellant faxed it on October 24, 2004. However, the evidence does not disclose that the Agency issued a notice of determination. Although the Appellant, in its written submissions, alleged that a notice of determination was issued prior to the reassessment, I believe that the evidence does not support such an allegation, and I dare say that if the Appellant had not been satisfied with the determinations set out in such a notice, it would have filed an appeal from it in this Court.

[25] Since I have found that the Minister did not issue a notice of determination prior to the issuance of the reassessment that gave rise to the instant appeal, I will first address the question of whether this Court has jurisdiction to determine the precise moment at which the non-capital loss was incurred.

[26] The Tax Court of Canada's jurisdiction over these questions has been the subject of decisions in which it has been held that the Court has jurisdiction to consider all constituent elements of an assessment under appeal. In *Horvath v. The Queen*, 1999 CarswellNat 7, No. 97-373(IT)I, January 7, 1999, Judge Bell of this Court held that the non-capital losses realized in 1991 and 1992, and carried forward to 1994, were constituent elements of the assessment made in respect of the latter year. Judge Bell relied on the principles set out in *Aallcann Wood Suppliers v. The Queen*, 94 D.T.C. 1475, and *Samson & Frères Ltée v. The Queen*, 97 DTC 642. In *Aalcann*, Judge Bowman (as he then was) made the following remarks concerning this Court's jurisdiction with respect to this question:

> . . . it is open to a taxpayer to challenge the Minister's calculation of a loss for a particular year in an appeal for another year where the amount of the taxpayer's taxable income is affected by the size of the loss that is available for carry-forward under section 111. In challenging the assessment for a year in which tax is payable on the basis that the Minister has incorrectly ascertained the amount of a loss for a prior or subsequent year that is available for deduction under section 111 in the computation of the taxpayer's taxable income for the year under appeal, the taxpayer is requesting the court to do precisely what the appeal procedures of the *Income Tax Act* contemplate: to determine the correctness of an assessment of tax by reviewing the correctness of one or more of the constituent elements thereof, in this case the size of a loss available from another year. This does not involve the court's making a determination of loss under subsection 152(1.1) or entertaining an appeal from a nil assessment. It involves merely the determination of the correctness of the assessment for the year before it.

[27] In *Samson et Frères Ltée.*, Judge Dussault clearly showed that, in determining whether an assessment is valid, this Court may look at each constituent element of that assessment. The relevant excerpt reads:

> As the Minister was entitled to make a reassessment in respect of that year, it seems clear that he could assess every relevant element for the purposes of computing the tax for the year, including the amount of a non-capital loss in respect of which a taxpayer claimed a carry-back in order to reduce his taxable income. To the extent that there was no request by the taxpayer for determination of the loss under subsection 152(1.1) of the Act and that, therefore, no determination was made that would be binding on the Minister and the taxpayer under subsection 152(1.3) of the Act, it is clear that, for the purposes of the assessment in respect of a taxation year, the Minister may determine the amount of the non-capital loss that a taxpayer is entitled to deduct for the purposes of computing his taxable income. Similarly, in his appeal from such an assessment, the taxpayer may dispute the amount thus assessed, even if the year in which the loss was incurred is time-barred and may have been the subject of a 'nil' assessment.

[28] In my opinion, then, the initial moment at which the loss was realized becomes a constituent element of the instant dispute because it dictates both the expiry of the loss and the actual amount of the loss, there being nothing in the nature of a determination by the Minister that is binding on the parties. Thus, it is this Court's duty to verify the accuracy of this constituent element of the assessment in order to ensure that it is valid, even though the year in which the losses were incurred is otherwise time-barred.

[29] Before analysing these issues, we must clarify the circumstances of the case at bar and the confusion regarding the method that needed to be used in order to account for the expenses, and, ultimately, the revenue, associated with the television series project. This must include, among other things, certain clarifications regarding the term "work in progress". A distinction must be drawn between the accounting definition of WIP and the tax definition of WIP. From an accounting standpoint, the project was still in progress when it was abandoned. From the perspective of the financial standing of the subsidiary, it was important to continue to characterize the amount in this manner, and not to write it off, because it was an asset. From a tax standpoint, the term "work in progress" is generally used for work done by certain professionals. Such professionals can elect to exclude their year-end WIP in computing their income for a taxation year, so that it will not be part of their inventory. But they are nonetheless entitled to deduct the expenses associated with the work, even though no income therefrom will be taxable until the client is billed. This tax treatment is provided for in subsection 10(4) of the *Income Tax Act* ("the Act"). As for other unfinished work, it is normally part of inventory, in accordance with section 10 of the Act.

[30] We must also determine whether the unfinished work in the case at bar can constitute an inventory asset. Subsection 248(1) of the Act provides the following very broad definition of inventory:

> "inventory" means a description of property the cost or value of which is relevant in computing a taxpayer's income from a business for a taxation year or would have been so relevant if the income from the business had not been computed in accordance with the cash method and, with respect to a farming business, includes all of the livestock held in the course of carrying on the business;

[31] Thus, an inventory consists of property. Is the television series project truly property? The term "property" is also defined in subsection 248(1) of the Act:

> "property" means property of any kind whatever whether real or personal or corporeal or incorporeal and, without restricting the generality of the foregoing, includes
>
> (*a*) a right of any kind whatever, a share or a chose in action;
>
> (*b*) unless a contrary intention is evident, money;
>
> (*c*) a timber resource property; and
>
> (*d*) the work in progress of a business that is a profession.

[32] In my opinion, even though the project was not completed, the fact remains that some work was done, and thus it can be concluded that the project constitutes property. The production of a 13-episode television series, including scripting and shooting, is incorporeal personal property that undoubtedly gives the producer intellectual property rights. In my opinion, the television series project constituted property, and the fact that it was unfinished does not alter the situation in any way. The Act does not say that the property in a taxpayer's inventory has to be finished product.

[33] It must be recalled that this type of project was normally carried out by the subsidiary of the Appellant, which operated a communications business. It seems reasonable to me that the inventory of this type of business would include these types of projects, which are in the course of production.

[34] This being said, we must, as counsel for the Appellant has suggested, valuate the inventory. For the purpose of computing its income from a business that is not an adventure or concern in the nature of trade, a taxpayer must use the method set out in subsection 10(1) of the Act to valuate the property described in its inventory. The property must be stated at the lesser of cost or fair market value. Subsections 10(4) and 10(6) do not apply, and the Appellant cannot avail itself of them.

[35] Thus, under the circumstances, it is difficult for the Appellant to state a project in the midst of production at fair market value. The project's development spanned several subsequent fiscal periods, so it is difficult to obtain a market value that faithfully reflects the reality at each different stage of production. In the instant case, it is more realistic to state an inventory value equal to the expenditures made for the purpose of completing the project.

[36] Under the circumstances, I believe that the amount truly incurred by the Appellant's subsidiary in 1991, 1992 and 1993 to produce the 13 episodes is $260,000. That is the amount that I consider fair under the circumstances, and it is the amount that the Respondent accepted at the time of the assessment, as shown, in fact, by her position in paragraph 38 of the Amended Reply to the Notice of Appeal, where she submits that the Appellant's subsidiary's $260,000 loss was sustained no later than its fiscal year ended February 28, 1993. Moreover, in the notice of confirmation issued by the Minister on May 19, 2005, the loss was valuated at $347,014.

[37] Consequently, there was indeed a $260,000 claim. At what moment was the loss realized on that claim? As we have seen, on February 9, 1993, the Appellant received a letter from Laurent Tremblay, informing it that no contract had been signed, that no work order had been issued, and that Parks Canada was merely one partner among several, subject to the availability of funds. The Appellant's 1993 fiscal period ended on February 28, and, according to the appeals officer, the Appellant should have stated the loss on its 1993 balance sheet.

[38] In my opinion, the appeals officer's conclusion that the letter from Parks Canada clearly states that there was no contract, and that the Appellant was therefore not a creditor of a debt, reflects a defeatist and much too categorical attitude. It would amount to saying that, immediately upon receiving the letter stating that there was a potential problem with Parks Canada's financial involvement, the Appellant should have thrown in the towel, forgotten about the project, and taken its losses on the spot. Given the circumstances of the instant case, I do not believe that it would have been wise or even prudent to think that such a claim could be written off without making some efforts to collect on it, and in fact the Appellant made such efforts in subsequent years.

[39] At the same time, one would have had to be very optimistic to believe that the project could keep its $260,000 market value until 1997, before the decision to abandon the television series. Thus, perhaps the loss should not have been completely written off in 1993 or 1997.

[40] In view of this situation, it would have been logical, in my view, for the subsidiary to state a reduction of the permanent value of the project over more than one fiscal period. Thus, the market value of the property described in the inventory would have been reduced in 1993 upon receiving the letter from Laurent Tremblay. The fact that the subsidiary was continuing to make efforts to keep the project on track shows that it was still worth something. Thus, it would also be logical to conclude that the property's market value decreased over the subsequent fiscal years each time the efforts were unsuccessful, up until 1997, when the project was abandoned.

[41] Such logic offers a solution to the problem, albeit a purely arbitrary one, under which the project's market value is reduced by 20% for each of the five fiscal periods in issue. The following table shows how this works out.

Year	Amount of loss	Year that loss expires
1993	$52,000	2000
1994	$52,000	2001
1995	$52,000	2002
1996	$52,000	2003
1997	$52,000	2004
Total	$260,000	

[42] In my opinion, this approach is much more faithful to reality than claiming that the total value of the inventory should have been written off in 1993 or 1997. The market value of the property underwent a significant reduction, but that reduction results from the circumstances as a whole, not one single event.

[43] Consequently, the Appellant was entitled to carry forward a $52,000 loss to its 2003 taxation year. The appeal is allowed, with costs.

Signed at Ottawa, Canada, this 21st day of May 2008.

"François Angers"

Angers J.

Translation certified true
on this 21st day of October 2008.

Brian McCordick, Translator

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