

Docket: 2006-2798(IT)G

BETWEEN:

JONES DEVELOPMENT CORPORTION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on November 6, 2008, at Vancouver, British Columbia

Before: The Honourable Justice Valerie Miller

Appearances:

Counsel for the Appellant: Terry S. Gill  
Counsel for the Respondent: Michael Taylor

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**JUDGMENT**

The appeals from the assessments made under the *Income Tax Act* for the 2001 and 2003 taxation years are dismissed in accordance with the attached Reasons for Judgment.

The appeal from the Notice of Loss Determination made under the *Income Tax Act* for the 2001 taxation year is dismissed by consent of the parties.

The Respondent is granted its costs with respect to the appeal of the 2003 taxation year.

Signed at Halifax, Nova Scotia, this 10<sup>th</sup> day of August 2009.

“V.A. Miller”

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V.A. Miller, J.

Citation: 2009TCC397  
Date: 20090810  
Docket: 2006-2798(IT)G

BETWEEN:

JONES DEVELOPMENT CORPORTION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

### **REASONS FOR JUDGMENT**

V.A. Miller, J.

[1] This appeal was from reassessments in respect of the Appellant's 2001 and 2003 taxation years and a Notice of Loss Determination issued in respect of the Appellant's 2001 taxation year. Prior to the hearing, the Appellant consented, on a without cost basis, to the dismissal of its appeal for the 2001 taxation year. It agreed that the Notice of Loss Determination issued in respect of its 2001 taxation year was correct in reducing its non-capital loss to nil pursuant to subsection 80(12) of the *Income Tax Act* (the "Act").

[2] The question that remains in this appeal is whether the Minister of National Revenue (the "Minister") correctly calculated the adjusted cost base (the "ACB") of the Appellant's interest in Harbourside Partnership (the "Partnership") in 2003 when the Partnership dissolved. If the Minister's calculation is incorrect, then the character of the parcels of land, at the time that they were transferred into the Partnership, becomes a second question which must be determined.

[3] The answer to the first question depends on an interpretation of the Partnership Agreement that was entered into by the Appellant, Pocket Bay Marina Ltd. ("Pocket Bay"), Maureen Franks ("Maureen") and Stephen Franks ("Stephen").

## **Background**

[4] The parties submitted a Partial Agreed Statement of Facts which is attached to these reasons as Appendix A. The material facts are as follows.

[5] Norman Jones, an architect, is the president, sole shareholder and director of the Appellant. The business of the Appellant is real estate development.

[6] Mr. Jones described how the Partnership was formed. He stated that Nova Pacific Developments Ltd. (“Nova Pacific”), a corporation related to the Appellant, had purchased a parcel of land contiguous to properties owned by Pocket Bay, Maureen and Stephen. Pocket Bay was owned by Maureen and Stephen who were married to each other. In the summer of 1993, Mr. Jones was introduced to the Franks by a real estate agent who was a mutual acquaintance. The purpose of the introduction was to ascertain if the Franks wanted to participate in developing their properties.

[7] Mr. Jones stated that he and the Franks met every few weeks in their garden, to have tea and discuss the possibilities of a project. In early 1994, they discussed making a joint approach to city council to have all of the parcels of land rezoned for a multi-residential development (the “Development”). As a result of discussions with the city officials, various sketches of the proposed Development were produced. The final sketch was dated June 5, 1996.

[8] The Appellant did all of the work and paid all expenses with respect to the rezoning of the parcels of land. Mr. Jones stated that he was acting on behalf of the Franks but that they were waiting to see the form of development that would be approved before they decided whether to sell their land or to partner with him in the Development.

[9] The parcels of land were rezoned from single family residential lots to W2-Marine-Commercial/Residential Retail and development permits authorizing the Development were issued on September 3, 1996. It was Mr. Jones’ evidence that the application for rezoning the properties would have been made in 1994 and the rezoning would have been approved on September 3, 1996 when the development permits were issued.

[10] On November 1, 1996, the Appellant, Pocket Bay, Maureen and Stephen agreed in writing to form the Partnership. The Appellant dealt at arm’s length with

the other partners. Pocket Bay, Maureen and Stephen each transferred one parcel of land to the Partnership and the Appellant agreed to cause Nova Pacific to transfer its parcel of land to the Partnership. The business of the Partnership was limited to the acquisition, development, construction, promotion and marketing of a condominium project on the Development Property.

[11] Pursuant to the Partnership Agreement (the “Agreement”), the Appellant assigned to the Partnership, all services which it had performed with respect to the Development.

[12] Pocket Bay, Maureen and Stephen originally purchased their parcels of land for the purpose of earning income and historically held their land as capital property.

[13] On April 28, 1997, Pocket Bay and Stephen, jointly with the Partnership, elected pursuant to subsection 97(2) of the Act to transfer their parcels of land to the Partnership for proceeds of disposition equal to their ACB. Maureen filed an amended subsection 97(2) election on May 29, 1998. They thus avoided realizing total gains of \$514,792 at the time of transfer.

[14] Neither the Appellant nor Nova Pacific made an election under subsection 97(2). The parcel of land transferred into the Partnership by the Appellant was transferred at fair market value in accordance with subsection 97(1) of the Act.

[15] At the time of transfer to the Partnership, the four parcels of land had the following attributes for tax purposes:

<b>Parcel #</b>	<b>FMV</b>	<b>ACB/Elected Amount</b>	<b>Difference</b>
<b>1</b> (Appellant)	\$200,000	\$200,000	0
<b>2</b> (Pocket Bay)	407,375	95,000	\$312,375
<b>3</b> (Maureen)	194,550	23,848	170,702
<b>4</b> (Stephen)	158,075	126,360	31,715
<b>Total</b>	\$960,000	\$445,208	\$514,792

[16] The Partnership constructed the condominiums and sold the developed properties from 1998 to 2003. The last condominiums were sold in 2003 and the Partnership was dissolved in the same year. Upon dissolution, the Partnership reported that the Appellant had a negative partnership equity balance of \$210,674.

[17] From 1998 to 2003, the Partnership failed to account for the effect of the subsection 97(2) election and it based its cost of goods sold on the FMV of the land

transferred into it by the partners. As a result, the Partnership overstated its cost of goods sold by \$514,792 (the “Partnership Error”).

[18] This Partnership Error caused the Partnership to report aggregate losses of \$685,468 through 1998 to 2003. In accordance with paragraph 21 of the Agreement, the Appellant was allocated 60%, or \$410,694, of those losses.

[19] Mr. Peter Clark, a certified general accountant, testified on behalf of the Respondent. He stated that he has been Maureen’s accountant since 1977. He was also the accountant for Stephen and Pocket Bay until 1994 when Stephen decided to go to another accounting firm. He again became the accountant for Stephen and Pocket Bay in 2001 when Stephen became ill and Maureen brought all of the work back to him. Stephen died in 2005.

[20] Mr. Clark described Stephen and Maureen as intelligent, successful small business people.

[21] It was Mr. Clark’s evidence that he became aware of the Partnership Error in 1998. He read the Agreement and it was his opinion that the gains were the responsibility of the Franks and Pocket Bay. On his recommendation, Maureen reported capital gains which totalled \$170,653 in the 1997 to 2003 taxation years. When he again became the accountant for Stephen and Pocket Bay, Mr. Clark advised Maureen that the deferred gains should be reported by them. He completed their tax returns so that Pocket Bay reported capital gains which totalled \$291,447 and Stephen reported capital gains which totalled \$31,715. As a result, the total capital gain reported was \$493,815. He stated that the difference of \$20,977 (\$514,792 - \$493,815) was the result of a mistake that he made in Pocket Bay’s tax return.

[22] The Minister corrected the Partnership Error by allocating \$514,792 as capital gains to Maureen, Stephen and Pocket Bay. This resulted in an increase to the adjusted cost base (“ACB”) of their interest in the Partnership. The Minister did not allocate any of the capital gains to the Appellant.

[23] It is the Appellant’s position that a portion of the gains should have been allocated to the Appellant. This would result in an increase to the ACB of the Appellant’s partnership interest on the deemed disposition in 2003. The ACB would not be (\$210,674) as assumed by the Minister, but would be \$97,614 which would give rise to an allowable capital loss of \$48,807.50.

## Analysis

[24] The general rule that governs the transfer of property to partnerships is given in subsection 97(1) of the Act. According to this subsection, a taxpayer who transfers property to a partnership of which he is a partner is deemed to have disposed of the property for its fair market value and the partnership is deemed to have acquired it at the same amount.<sup>1</sup> The result of the deemed disposition in subsection 97(1) is that any gain or loss which has accrued on the property will be realized by the partner at the time of transfer.

[25] If certain conditions are met, the partner who is transferring property to a partnership and the partnership may elect, pursuant to subsection 97(2) of the Act, to defer recognizing those gains or losses. The use of an election may mean that an unrealized capital gain and the associated tax liability on this capital gain are transferred to the partnership and the other partners unless the partnership agreement indicates a contrary intention<sup>2</sup>.

[26] The question is whether the Agreement allocates the deferred gains of \$514,792 to Pocket Bay, Maureen and Stephen as the partners who transferred the properties into the Partnership; or, whether the Agreement permitted those partners to transfer their gains and associated tax liabilities to the Appellant.

[27] The relevant paragraphs of the Agreement are as follows:

### TRANSFER OF INTERESTS TO PARTNERSHIP

11. The Partners agree to transfer to the Partnership to following:
  - (a) Maureen shall transfer Lot 1, Plan 10658, to the Partnership, free and clear of any financial encumbrances;
  - (b) Stephen shall transfer Lot 3, Plan 9678 to the Partnership, free and clear of any financial encumbrances;
  - (c) Pocket Bay shall transfer Lot 1, Plan 6394 to the Partnership, free and clear of any financial encumbrances;
  - (d) Jones Development shall cause Nova Pacific Business Park Ltd. to transfer Lot 2, Plan 10658 to the Partnership, in consideration of the sum of \$1.00, and the Partnership shall assume all liability for the mortgages registered against the said lot in favour of Scotia Mortgage Corporation and Lawrence Mayles, provided such liability shall not exceed \$289,000.00;

- (e) Jones Development shall assign to the Partnership all services performed by it to the date hereof with respect to the Project, including the rezoning of the Development Property.

The Partners shall not be entitled to any consideration for the transfer of the aforescribed lands and services, save and except for the Contributory Interests, as hereinafter defined.

**All tax consequences of the transfer of any asset to the Partnership by a Partner pursuant to this paragraph 11 shall be the sole responsibility of the Partner transferring the asset to the Partnership and shall not be a responsibility of the Partnership.** It is further agreed that the value at which the said assets are transferred to the Partnership shall be as agreed between the Partners, or, failing agreement, at the value specified by the Partner transferring such asset to the Partnership. **(emphasis added)**

#### LIMITATION OF PARTNERSHIP LIABILITY

12. It is the intention of the Partners that the liability of the Stephen, Maureen and Pocket Bay shall be limited to the extent of their respective Contributory Interests. It is therefore hereby mutually agreed that, notwithstanding anything to the contrary in this agreement herein contained:

- (a) Neither Stephen, Maureen or Pocket Bay shall be required to grant any guarantee or other security to any party with respect to the business of the Partnership, including, without limitation, guarantees to any institutional lender providing construction financing;
- (b) Neither Stephen, Maureen or Pocket Bay shall be required to make any capital contribution or loan to the partnership or to contribute to any losses incurred by Jones Development or its principals as the result of the business of the Partnership;
- (c) Jones Development shall render and save harmless Stephen, Maureen and Pocket Bay from any demand or claim arising against them as the result of the business of the Partnership;
- (d) Neither Stephen, Maureen or Pocket Bay shall be required to compensate Jones Development for any loss incurred by Jones Development as the result of the business of this Partnership and no Party shall be required to contribute to or compensate any of the other Party for the loss of the whole or portion of that Party's Contributory Interest, provided that Jones Development shall be responsible for its Proportionate Share of any loss of any loan made to the Partnership made by Stephen, Maureen or Pocket Bay.

...

#### PARTNERS CONTRIBUTORY INTERESTS

18. The Partners agree that they shall have the following Contributory Interests in the Partnership (herein called the "Contributory Interests"):

Jones Development	\$200,000.00
Maureen	\$194,550.00
Stephen	\$158,075.00
Pocket Bay	\$407,375.00

Interest shall accrue on the Contributory Interests at the rate of five (5.0%) per annum, commencing and calculated monthly from May 1, 1997. No Partner shall demand or be entitled to payment of such Partner's Contributory Interest except as provided in this agreement.

...

#### PARTNERS PROPORTIONATE INTERESTS

21. The Partners agree that they shall have the following Proportionate Interests in the Partnership (herein called the "Proportionate Interests"):

Jones Development	sixty (60.0%) per cent
Maureen	ten and two tenths (10.2%) per cent
Stephen	eight and three tenths (8.3%) per cent
Pocket Bay	twenty one and five tenths (21.5%) per cent

#### ACCOUNTING, CONTRIBUTIONS AND DISTRIBUTIONS

22. The Partners agree that profits and losses of the Partnership computed in accordance with generally accepted accounting principles applied consistently from year to year shall be shared between the Partners according to their Proportionate Interests.

...

24. It is acknowledged and agreed by the Partners that the proceeds from the disposition of the Project, after payment of all costs related to the construction and development of the project, shall be disbursed as follows:

- (a) firstly, to the payment of any expenses directly related to the sale of the Development Property, including, without limitation, real estate commissions, adjustments, and legal costs;



- (b) secondly, in repayment of the principal and accrued interest under any financing obtained to facilitate the construction and development of the Project;
- (c) thirdly, to pro rata payment of any loan contributions (included interest accrued thereon) to the Partnership made by the Partners; and
- (d) fourthly, to pro rata payment of the Contributory Interests, including interest thereon;
- (e) finally, the balance, if any, shall be distributed to the Partners in accordance with their Proportionate Interest.

[28] The principles that are to be used in interpreting a contract were recently summarized by the Federal Court of Appeal in *General Motors of Canada Ltd. v. R.*<sup>3</sup> as follows:

36 A number of propositions emerge from the above authorities. First, failing a finding of ambiguity in the document under consideration, it is not open to the Court to consider extrinsic evidence. Second, where extrinsic evidence may be considered, that evidence must pertain to the "surrounding circumstances which were prevalent at the time". Third, even where there is ambiguity, evidence only of a party's subjective intention is not admissible.

[29] With these principles in mind, I have not considered Mr. Jones' testimony with respect to his interpretation of various paragraphs of the Agreement. As well, I have not considered any extrinsic evidence as it is my opinion that the Agreement is not ambiguous.

[30] Paragraph 11 of the Agreement provides that the tax consequences of the transfer of any asset to the Partnership by a partner pursuant to paragraph 11 shall be the sole responsibility of the partner transferring the asset and shall not be a responsibility of the Partnership. I note that the parcels of land transferred by the partners are the major assets dealt with in paragraph 11 of the Agreement.

[31] This is a clear and unambiguous intention of the partners not to permit the transfer of the deferred gains and the associated tax liability to the Partnership.

[32] Paragraph 18 of the Agreement specifies that the partners' contributory interest is the fair market value of the property transferred into the Partnership and not the lower elected amount. This, as well, reflects an intention of the partners to allocate the deferred gains to Pocket Bay, Maureen and Stephen.

[33] Finally, the Agreement indicates that each partner is to receive the benefit of the gains that had accrued on the parcel of land that it transferred into the Partnership. Paragraph 24 specifies how the proceeds from the disposition of the Development shall be disbursed. It entitles the partners to recover their contributory interest, including interest thereon, in preference to receiving any proceeds according to their proportionate interest.

[34] Counsel for the Appellant argued that paragraph 22 of the Agreement provided that the profits and losses of the Partnership were to be shared between the Partners according to their proportionate interests and this provision should govern to allocate 60% of any correction for the Partnership Error to the Appellant.

[35] The correction that the Appellant refers to is the Partnership Error which is the deferred gains of \$514,792.

[36] The Appellant's argument begs the question. This argument implicitly assumes that the deferred gains were transferred to the Partnership to be shared by the partners according to their proportionate interests.

[37] Counsel for the Appellant also argued that the Appellant was granted a 60% proportionate interest in the Partnership as compensation for the fact that it would bear a portion of the tax burden from the deferred gains on the properties transferred by Pocket Bay, Maureen and Stephen.

[38] Neither the evidence presented at the hearing nor the Agreement supports counsel's submission. It was Mr. Jones' evidence that he received a 60% proportionate interest because he assumed all of the liability for the Development. His evidence is supported by paragraph 12 of the Agreement wherein the liability of Pocket Bay, Maureen and Stephen was limited to the extent of their respective contributory interests.

[39] In conclusion, the Appellant has not shown that the Minister's reassessment was in error.

[40] The appeal is dismissed. The Respondent is granted its costs with respect to the appeal of the 2003 taxation year.

Signed at Halifax, Nova Scotia, this 10<sup>th</sup> day of August 2009.

“V.A. Miller”

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V.A. Miller, J.

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<sup>1</sup> Subsection 97(1) reads:

**97. (1) Contribution of property to partnership** -- Where at any time after 1971 a partnership has acquired property from a taxpayer who was, immediately after that time, a member of the partnership, the partnership shall be deemed to have acquired the property at an amount equal to its fair market value at that time and the taxpayer shall be deemed to have disposed of the property for proceeds equal to that fair market value.

<sup>2</sup> Eddy, L.A. *Capital Gains and Rollovers*. Toronto: Richard de Boo Limited, 1979, p. 306

<sup>3</sup> 2008 FCA 142

## Appendix A

### **PARTIAL AGREED STATEMENT OF FACTS AND ISSUES**

#### **AGREEMENT AS TO 2001 TAXATION YEAR**

1. The Appellant agrees that the Notice of Loss Determination issued in respect of its 2001 taxation year does not understate the Appellant's non-capital loss. The Appellant consents to the dismissal of its appeal for the 2001 taxation year, and the Respondent consents to that dismissal without costs.

#### **FACTS RELATING TO 2003 TAXATION YEAR**

##### **Formation of the Harbourside Partnership**

2. The Appellant is a corporation incorporated under the laws of British Columbia.
3. The Appellant's business includes the provision of architectural services relating to land development ventures.
4. On November 1, 1996, the Appellant, another corporation known as Pocket Bay Marina Ltd. ("Pocket Bay"), and two individuals known as Pansy Maureen Franks ("Maureen") and Stephen Oliver Franks ("Stephen"), agreed in writing to form a partnership known as the Harbourside Partnership (the "Partnership").
5. Pocket Bay was owned by Maureen and Stephen.
6. The Appellant dealt at arm's length with the other partners.
7. A copy of the written Partnership Agreement is attached at Tab B1.
8. The purpose and business of the Partnership was to acquire, develop, construct, promote and market a residential condominium project in the town of Sidney, B.C.
9. The land to be developed was originally in four contiguous parcels, one each owned by Pocket Bay, Maureen and Stephen, and one owned by Nova Pacific Development Ltd. ("Nova Pacific"), a corporation related to the Appellant.
10. In the Partnership Agreement, Pocket Bay, Maureen and Stephen agreed to transfer their parcels to the Partnership and the Appellant agreed to cause Nova Pacific to transfer its parcel to the Partnership. The Appellant also agreed to assign to the Partnership all services performed by it with respect to the development project to the date of the Agreement.
11. The four parcels were transferred to the Partnership in accordance with the Partnership Agreement on November 1, 1996.

12. Pocket Bay, Maureen and Stephen originally purchased their parcels for the purpose of earning income and historically held the parcels as capital property. At the time of transfer to the Partnership, the four parcels had the following tax attributes:

Parcel #	FMV	ACB/Elected Amount	Difference
1	\$200,000	\$200,000	\$0
2	\$407,375	\$95,000	\$312,375
3	\$194,550	\$23,848	\$170,702
4	\$158,075	\$126,360	\$31,715
TOTAL	\$960,000	\$445,208	\$514,792

13. Pocket Bay, Maureen and Stephen, jointly with the Partnership, elected under subsection 97(2) of the *Income Tax Act* (the “Act”) to transfer their parcels to the Partnership for proceeds of disposition equal to their adjusted cost bases in those parcels. By doing so, Pocket Bay, Maureen and Stephen avoided realizing aggregate gains of \$514,792 on the disposition to the Partnership. Copies of the elections filed by under subsection 97(2) by Pocket Bay, Maureen and Stephen are attached at Tabs B2, B3 and B4, respectively.

14. Neither the Appellant nor Nova Pacific made any election under subsection 97(2) of the Act in respect of the transfer of Nova Pacific’s parcel to the Partnership and thus transferred it at fair market value.

15. With respect to the transfer of the parcels to the Partnership, the Partnership Agreement provided that:

All tax consequences of the transfer of any asset to the Partnership by a Partner...shall be the sole responsibility of the Partner transferring the asset to the Partnership and shall not be a responsibility of the Partnership. It is further agreed that the fair market value at which the said assets are transferred to the Partnership shall be as agreed between the Partners, or failing agreement, at the value specified by the Partner transferring such asset to the Partnership.

### **Creation of Partners’ Contributory and Proportionate Interests**

16. Under the Partnership Agreement, the partners were credited with the following “Contributory Interests” with a combined value of \$960,000 upon transfer of the four parcels to the Partnership:

Partner	Contributory Interest
Appellant	\$200,000
Pocket Bay	\$407,375
Maureen	\$194,550
Stephen	\$158,075
TOTAL	\$960,000

17. The Partnership Agreement provided that the partners were entitled to interest on their Contributory Interests at the rate of 5% per year, calculated monthly commencing May 1, 1997.

18. The Partnership Agreement also assigned each partner a “Proportionate Interest” as follows:

Partner	Proportionate Interest
Appellant	60.0%
Pocket Bay	21.5%
Maureen	10.2%
Stephen	8.3%
TOTAL	100%

19. The Partnership Agreement provided that profits and losses of the Partnership, computed in accordance with generally accepted accounting principles applied consistently from year to year, would be shared between the Partners according to their Proportionate Interests.

20. The Partnership Agreement also provided that the proceeds from the disposition of the development project, after payment of all costs related to the construction and development of the project, would be disbursed as follows:

- a. first, to the payment of any expenses directly related to the sale of the property, including, without limitation, real estate commissions, adjustments and legal costs;
- b. second, in repayment of the principal and accrued interest under any financing obtained to facilitate the construction and development of the project;
- c. third, to pro rata repayments of any loan contributions, including accrued interest thereon, made by the partners to the Partnership;
- d. fourth, to pro rata repayment of the partners’ Contributory Interests, including interest on those Interests; and
- e. lastly, the balance would be distributed to the partners in accordance with their Proportionate Interests.

21. The Partnership constructed the condominium development and sold the developed properties from 1998 to 2003. The last condominium was sold in 2003 and the Partnership dissolved.

**Partnership Accounting and ACB of the Appellant’s Partnership Interest**

22. For its fiscal periods ending from May 31, 1998 to May 31, 2003, the Partnership reported the following partnership income and losses, of which it allocated 60% to the Appellant in accordance with the Appellant's Proportionate Interest:<sup>1</sup>

<u>Fiscal Period End</u>	<u>Partnership Income/Loss</u>	<u>60% Allocated to the Appellant</u>
May 31, 1998	(\$51,523.15)	(\$30,914.00)
May 31, 1999	(\$88,397.81)	(\$53,039.00)
May 31, 2000	(\$183,313.00)	(\$109,988.00)
May 31, 2001	(\$131,549.54)	(\$78,930.00)
May 31, 2002	(\$187,151.95)	(\$112,291.00)
May 31, 2003	(\$43,533.02)	(\$25,532.00)
TOTALS	(\$685,468.47)	(\$410,694.00)

23. Over the life of the partnership, the Appellant contributed and withdrew the following amounts of capital in addition to the parcel originally owned by Nova Pacific:

<u>Fiscal Period End</u>	<u>Contribution/(Withdrawal)</u>
May 31, 1997	\$50,500
May 31, 1998	\$16,356
May 31, 1999	(\$40,806)
May 31, 2000	(\$5,690)
May 31, 2001	(\$5,000)
May 31, 2002	(\$15,350)
May 31, 2003	\$10

24. Upon the dissolution of the Partnership, the Partnership reported that the Appellant's partnership equity was (\$210,674), as follows:

<u>Fiscal Period May 31, 1997</u>	
Opening contribution	\$200,000
Additional contribution	\$50,500
Ending balance	<u>\$250,500</u>

<u>Fiscal Period May 31, 1998</u>	
Opening balance	\$250,500
Additional contributions	\$16,356
Allocated losses	(\$30,914)
Ending balance	<u>\$235,942</u>

Fiscal Period May 31, 1999

<sup>1</sup> The Partnership reported nominal net income of \$233.00 for the fiscal period ending May 31, 1997, which did not factor into the calculation of the ACB of the Appellant's partnership interest.

Opening balance	\$235,942
Withdrawals	(\$40,806)
Allocated losses	(\$53,039)
Ending balance	\$142,097

Fiscal Period May 31, 2000

Opening balance	\$142,097
Withdrawals	(\$5,690)
Allocated losses	(\$109,988)
Ending balance	\$26,419

Fiscal Period May 31, 2001

Opening balance	\$26,419
Withdrawals	(\$5,000)
Allocated losses	(\$78,930)
Ending balance	(\$57,511)

Fiscal Period May 31, 2002

Opening balance	(\$57,511)
Withdrawals	(\$15,350)
Allocated losses	(\$112,291)
Ending balance	(\$185,152)

Fiscal Period May 31, 2003

Opening balance	(\$185,152)
Additional contributions	\$10
Allocated losses	(\$25,532)
Ending balance	(\$210,674)

25. Copies of the Partnership's Balance Sheets and Income Statements for the fiscal periods ending May 31, 1997 to May 31, 2003 are attached at Tab B5.

**Errors in Partnership Accounting and Financial Statements**

26. In computing its income for tax purposes between 1998 and 2003, the Partnership based its cost of goods sold on the fair market value of the parcels transferred to it by the partners, which was \$960,000.
27. The Partnership erroneously failed to account for the effect of the elections made by Pocket Bay, Maureen and Stephen pursuant to subsection 97(2) of the Act, wherein the elected amount was \$514,792 less than the fair market value of those parcels (the "Partnership Error").
28. Maureen's accountant, Peter Clark, certified general accountant, became aware of the Partnership Error. On his recommendation, Maureen reported capital gains totalling



\$170,653 in the 1997 through 2003 taxation years in an attempt to compensate for the Partnership Error.

29. In 2001, Peter Clark became the accountant for Pocket Bay. On his recommendation, Pocket Bay reported capital gains totalling \$291,447 in the 2001 and 2002 taxation years in an attempt to compensate for the Partnership Error. Prior to Peter Clark becoming its accountant, Pocket Bay had not reported any capital gains in respect of the Partnership Error.
30. In 2002, Peter Clark became the account for Stephen. On his recommendation, Stephen reported capital gains totalling \$31,715 in the 2003 taxation year in an attempt to compensate for the Partnership Error. Prior to Peter Clark becoming his accountant, Stephen did not report any capital gains in respect of the Partnership Error.
31. In total, Maureen, Pocket Bay, and Stephen reported \$493,815 of capital gains in respect of the Partnership Error.
32. Peter Clark's recommendation to Maureen, Pocket Bay and Stephen to report the capital gains referred to in paragraphs 27 through 30 above was based on his interpretation of the Partnership Agreement. He did not base his recommendation based on any agreement between the partners outside of the Partnership Agreement itself.

#### **Reassessment by the Minister**

33. In reassessing the Appellant's 2003 taxation year, the Minister concluded that the Appellant was deemed to dispose of its interest in the Partnership when the Partnership dissolved. The Minister concluded that the adjusted cost base of the Appellant's partnership interest was (\$210,674), the amount of the Appellant's partnership equity as reported by the Partnership in its financial statements.
34. The Minister therefore included a taxable capital gain of \$105,337, being 50% of a deemed capital gain of \$210,674, resulting from the deemed disposition of the Appellant's interest in the Partnership when the Partnership dissolved.
35. The Minister corrected the Partnership Error by allocating \$514,792 as a capital gain to Maureen, Stephen and Pocket Bay. The result was an increase to the ACB of those three partners' interests in the Partnership. The Minister did not allocate any of the \$514,792 to the Appellant, and therefore declined to increase the Appellant's Partnership equity and the ACB of the Appellant's Partnership interest.
36. A copy of the auditor's working papers showing the Minister's calculations is attached at Tab B6. A copy of the auditor's prior proposal letter, along with supporting working papers, are attached at Tab B7.

#### **ISSUES**

37. The issue is whether the Minister correctly computed the ACB of the Appellant's interest in the Partnership at the time the Partnership dissolved in 2003.
38. Specifically:
  - a. In correcting the Partnership Error, did the Minister properly allocate \$514,792 as a capital gain only to Maureen, Stephen and Pocket Bay, or should a portion of that amount have been allocated to the Appellant by reducing the aggregate Partnership business losses allocated to the Appellant in the Partnership's 1997 through 2003 fiscal periods?
  - b. If an amount in respect of the Partnership Error should be allocated to the Appellant:
    - i. What portion should have been allocated to the Appellant?
    - ii. What was the adjusted cost base of the Appellant's partnership interest at the time the Partnership dissolved in 2003?

CITATION: 2009TCC397  
COURT FILE NO.: 2006-2798(IT)G  
STYLE OF CAUSE: JONES DEVELOPMENT CORPORTION  
AND HER MAJESTY THE QUEEN  
PLACE OF HEARING: Vancouver, British Columbia  
DATE OF HEARING: November 6, 2008  
REASONS FOR JUDGMENT BY: The Honourable Justice Valerie Miller  
DATE OF JUDGMENT: August 10, 2009

APPEARANCES:

Counsel for the Appellant: Terry S. Gill  
Counsel for the Respondent: Michael Taylor

COUNSEL OF RECORD:

For the Appellant:

Name: Terry S. Gill  
Firm: Thorsteinssons LLP

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