

Docket: 2008-3021(IT)G

BETWEEN:

9136-6872 QUÉBEC INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

---

Appeal heard on December 14, 2009, at Quebec City, Quebec.

Before: The Honourable Justice François Angers

Appearances:

Agent for the Appellant: Maurice Dussault

Counsel for the Respondent: Vlad Zolia

---

**JUDGMENT**

The appeal from the determination made under the *Income Tax Act* for the taxation year ended November 30, 2004, is dismissed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 5th day of March 2010.

"François Angers"

---

Angers J.

Translation certified true  
on this 31st day of May 2010.

Erich Klein, Revisor

Citation: 2010 TCC 91  
Date: 20100305  
Docket: 2008-3021(IT)G

BETWEEN:

9136-6872 QUÉBEC INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

### **REASONS FOR JUDGMENT**

Angers J.

[1] This is an appeal from a notice of determination of a loss dated May 18, 2007, for the Appellant's taxation year ended November 30, 2004.

[2] In its income tax return for its fiscal year ended November 30, 2004, the Appellant claimed \$1,477,154 as a terminal loss. On or about February 21, 2007, the Appellant received a reassessment in which the Respondent disallowed the terminal loss in question, adjusting it to half the amount claimed, that is, \$738,577. Following the notice of reassessment, the Appellant made a request for determination of a loss on March 2, 2007, for the taxation year in question.

[3] In her notice of determination of a loss, which is the subject of this appeal, the Respondent established the "non-capital" loss as \$1,092,981 for the taxation year in question, and the Appellant's objection to that notice of determination is based on the Respondent's tax treatment of the Appellant with regard to the demolition of a building (classes 1 and 3) belonging to the Appellant. What is objected to in particular is the application of paragraph 13(21.1)(b) of the *Income Tax Act* ("the Act"), the consequence of which was to reduce the terminal loss by half.

[4] The Appellant operated the Hôtel Rond-Point in Lévis, Quebec, for several years. In May 2004, it decided to demolish the building in order to build a commercial building on the site. Construction of the new building was completed in November of that same year. The building in question was leased for a period of 20 years with an option to renew the lease for five-year periods. The lessee (an IGA supermarket) also has a right of first refusal in the event that the Appellant should decide to sell the building. However, there was never any question of selling the land either when the hotel was demolished or thereafter.

[5] Through its accounting advisors, the Appellant asked the Canada Revenue Agency what amount of terminal loss it was entitled to deduct, and, according to the information it received, it was entitled to claim \$1,477,154 as a terminal loss for its fiscal year ended November 30, 2004. On December 8, 2004, the Canada Customs and Revenue Agency, as it then was, authorized the Appellant, effective November 30, 2004, to use November 30 instead of January 31 as its fiscal year-end. That explains why the Appellant filed two income tax returns in 2004.

[6] The terminal loss claimed was disallowed following the audit and also following the determination request. The Respondent is of the opinion that paragraph 13(21.1)(b) of the Act applies here. The cost amount of the demolished building was \$1,477,154 and the Appellant reported zero proceeds of disposition for the building in its amortization table. The Appellant, for its part, submits that the aforesaid paragraph does not apply because at the time the building was demolished, the Appellant had no intention of selling the land on which the building was situated. It was already planning to build a new commercial building on the site after the demolition and to lease the new building for 20 years, and it was therefore entitled to claim the full amount of the loss.

[7] The terminal loss that the Appellant claimed arose from the disposition of all its property in Class 1 and Class 3 of Schedule II of the *Income Tax Regulations* and was established in accordance with subsection 20(16) of the Act, which reads as follows:

**Terminal loss.** Notwithstanding paragraphs 18(1)(a), (b) and (h), where at the end of a taxation year,

(a) the total of all amounts used to determine A to D in the definition “undepreciated capital cost” in subsection 13(21) in respect of a taxpayer’s depreciable property of a particular class exceeds the total of all amounts used to determine E to J in that definition in respect of that property, and

(b) the taxpayer no longer owns any property of that class,

in computing the taxpayer’s income for the year

(c) there shall be deducted the amount of the excess determined under paragraph (a), and

(d) no amount shall be deducted for the year under paragraph (1)(a) in respect of property of that class.

[8] That subsection provides that, where a taxpayer has disposed of all property of a particular class and there remains a balance in respect of the "undepreciated capital cost" (UCC) of the property of that class, the balance must be deducted in full, in computing income, as a final deduction or terminal loss.

[9] However, there are restrictions as to the terminal loss in respect of buildings. These restrictions are set out in subsection 13(21.1) of the Act and the application of that subsection is ultimately the issue here. According to subsection 13(21.1), the rules laid down therein apply where the proceeds of disposition are less than the cost amount of the building, which is the case here, in my opinion, since the proceeds of disposition are nil and the cost amount of the building is greater than the proceeds of disposition.

[10] Subsection 13(21.1) of the Act reads as follows:

Disposition of building

**13(21.1)** Notwithstanding subsection (7) and the definition “proceeds of disposition” in section 54, where at any particular time in a taxation year a taxpayer disposes of a building of a prescribed class and the proceeds of disposition of the building determined without reference to this subsection and subsection (21.2) are less than the lesser of the cost amount and the capital cost to the taxpayer of the building immediately before the disposition, for the purposes of paragraph (a) of the description of F in the definition “undepreciated capital cost” in subsection (21) and subdivision c,

(a) where in the year the taxpayer or a person with whom the taxpayer does not deal at arm's length disposes of land subjacent to, or immediately contiguous to and necessary for the use of, the building, the proceeds of disposition of the building are deemed to be the lesser of

...

(b) where paragraph (a) does not apply with respect to the disposition and, at any time before the disposition, the taxpayer or a person with whom the taxpayer did not deal at arm's length owned the land subjacent to, or immediately contiguous to and necessary for the use of, the building, the proceeds of disposition of the building are deemed to be an amount equal to the total of

(i) the proceeds of disposition of the building determined without reference to this subsection and subsection (21.2), and

(ii) 1/2 of the amount by which the greater of

(A) the cost amount to the taxpayer of the building, and

(B) the fair market value of the building

immediately before its disposition exceeds the proceeds of disposition referred to in subparagraph (i).

[11] There is no question that, from a taxation standpoint, the Appellant's demolition of the building constitutes a disposition. For paragraph 13(21.1)(a) to apply, the Appellant, or a person with whom the Appellant does not deal at arm's length, must dispose of the subjacent land during the year, which is not the case here. The facts of the instant case do not allow this paragraph to be applied because neither the Appellant, nor a person with whom it was not dealing at arm's length, disposed of the subjacent land during the year. That being the case, the proceeds of disposition must be adjusted pursuant to paragraph 13(21.1)(b) so as to reduce the loss that can be claimed. That loss, which would normally be fully deductible, will be treated as a capital loss of which only half will be deductible.

[12] The technical notes to subsection 13(21.1) of the Act, which date from 1982, refer to the particular time of the disposition of the land and indicate that paragraph (b) applies where paragraph (a) does not apply to the disposition. Several excerpts from articles and other writings were quoted at the hearing. In an article entitled "Sale of a Business – Purchaser and Vendor Issues", 1999 British

Columbia Tax Conference, Leonard Glass expresses the opinion that it is not necessary for the land to be sold in a subsequent year for paragraph (b) to apply:

Where a land is not sold or is not sold until a subsequent year, paragraph 13(21.1)(b) effectively treats any terminal loss on the building as a capital loss.

[13] Lorne Shillinger, in an article entitled "Developments in the Taxation of Real Estate Investments" (Report of Proceedings of the Fifty-ninth Tax Conference, Canadian Tax Foundation, 2008), pp. 13-50, is of the same opinion. If the taxpayer does not dispose of the subjacent land, the proceeds of disposition will be adjusted by operation of paragraph 13(21.1)(b) of the Act.

[14] In another article, entitled "Règles spéciales concernant la déduction pour amortissement" (1995), 17 *Revue de planification fiscale et successorale* 163, Michelle Desrosiers expresses the same opinion as the Appellant. She writes as follows at page 224:

[TRANSLATION]

Of course, if the building is demolished and the seller does not intend to sell the subjacent land, the rules of subsection 13(21.1) *I.T.A.* will not apply so as to deem proceeds of disposition to have been received.

Rather, the usual rules of sections 54 *I.T.A.* and 251 *T.A.* and subsections 13(21) *I.T.A.* and 93(f) *T.A.* will apply to consider a disposition to have taken place, a viewpoint which is supported by the Supreme Court of Canada's decision in *Compagnie Immobilière BCN Ltée*.

Therefore, to avoid the seller's demolishing the building before the sale and being able to claim a terminal loss, certain rules apply whereby new proceeds of disposition are deemed to have been received for the building and the land.

[15] Further on, at page 229, Ms. Desrosiers explains the operation of paragraph 13(21.1)(b) of the Act as follows:

[TRANSLATION]

Disposition of the land during a subsequent year

Paragraph 13(21.1)(b) *I.T.A.* sets out a second rule where the disposition of the associated land does not occur during the same taxation year as the disposition of the building but where the associated land belonged, at any time before the disposition of the building, to the taxpayer or to a person with whom the taxpayer was not dealing at arm's length.

[16] In my opinion, it would be incorrect to argue that paragraph (b) does not apply if the land is never sold or if an appellant has no intention of selling it, because no taxpayer knows at what particular time he or she will dispose of land. Yet a terminal loss may be claimed only in the year during which it was incurred. In *The Queen v. Compagnie Immobilière BCN Ltée*, [1979] 1 S.C.R. 865, at page 880, the Supreme Court of Canada held that the right to claim a terminal loss "exists in respect to the year in which it was incurred; the right is forfeited if it is not exercised for that year and it is not available to be used in respect of a subsequent tax year." In my opinion, therefore, it would be unreasonable and inefficient to allow a taxpayer to claim a terminal loss in the year a building is disposed of if the taxpayer does not sell the subjacent land, and then to assess the taxpayer again subsequently if he or she does sell it. This would make paragraph 13(21.1)(b) utterly superfluous.

[17] As certain authors have pointed out, the purpose of subsection 13(21.1) is to prevent taxpayers from benefiting unduly from the possibility of claiming a terminal loss in certain circumstances. In the 3rd edition of their work *L'impôt sur le revenu au Canada*, Pierre Dussault and Normand Ratti had this to say about paragraphs 13(21.1)(a) and (b):

[TRANSLATION]

9. Subsection 13(21.1) *I.T.A.* sets out a restriction concerning the terminal loss with regard to buildings. According to the preceding rules, the disposition of a building may give rise to a terminal loss where the lesser of the cost and the proceeds of disposition is less than the "undepreciated capital cost" of property of the particular class. This terminal loss is normally fully deductible under subsection 20(16) *I.T.A.* The land adjacent or subjacent to the building is moreover a non-depreciable capital asset; its disposition can only give rise to a



capital gain or loss of which only part is taxable or deductible. If, following the acquisition of land and a building, the building is disposed of for an amount less than the undepreciated capital cost of the class to which the building belongs (in the case, for example, of demolition) but a capital gain is realized on the land, that gain, which is taxable only in part, may be completely offset or even exceeded by the fully deductible terminal loss with respect to the building.

In order to prevent taxpayers from deriving undue benefit from these rules, restrictions have been made to the possibility of claiming a terminal loss in certain circumstances. The *practical result* of these rules is to treat a loss on the sale of a building that would normally be fully deductible as a capital loss that is only partly deductible. This result is obtained by reducing the capital gain on the land by an amount equal to the disallowed terminal loss.

[18] Paragraph 13(21.1)(b) merely provides that the land must not be disposed of in the same taxation year as the building. In such a case, the proceeds of disposition must be adjusted to reduce the loss that may be claimed. No other interpretation would be functional or efficient.

[19] Sophie Rousseau, of the Canada Revenue Agency, gave testimony explaining certain corrections to the calculations made with reference to classes 1, 3 and 8. These corrections ultimately had no impact on the amount of the terminal loss nor did they have any other tax consequence. The Appellant did not object to the corrections and it is not necessary to reproduce them here, in my opinion, since they do not affect the application of subsection 13(21.1) of the Act in this case.

[20] The appeal is dismissed, with costs.

Signed at Ottawa, Canada, this 5th day of March 2010.

"François Angers"

---

Angers J.

Translation certified true  
on this 31st day of May 2010.

Erich Klein, Revisor

CITATION: 2010 TCC 91

COURT FILE NO.: 2008-3021(IT)G

STYLE OF CAUSE: 9136-6872 Québec Inc. v. Her Majesty the Queen

PLACE OF HEARING: Quebec City, Quebec

DATE OF HEARING: December 14, 2009

REASONS FOR JUDGMENT BY: The Honourable Justice François Angers

DATE OF JUDGMENT: March 5, 2010

APPEARANCES:

Agent for the Appellant: Maurice Dussault  
Counsel for the Respondent: Vlad Zolia

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

For the Respondent:

John H. Sims, Q.C.  
Deputy Attorney General of Canada  
Ottawa, Canada