Docket: 2007-3940(IT)G

BETWEEN:

ELIAHU SWIRSKY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on June 1st and 2nd, 2011 and May 7, 8 and 10, 2012,
at Toronto, Ontario.
Before: The Honourable Justice B. Paris

Appearances:

Counsel for the Appellant:	David Chodikoff Patrick Deziel Brahm Taveroff
Counsel for the Respondent on June 1st and 2nd, 2011	Peter A. Vita Justin Kutyan
Counsel for the Respondent on May 7, 8 and 10, 2012	Bobby Sood Thang Trieu Iris Kingston

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JUDGMENT

The appeals from the assessments made under the *Income Tax Act* in respect of the 1996, 1997, 1998, 1999, 2000, 2001, 2002 and 2003 taxation years are dismissed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Toronto, Ontario, this 28th day of February 2013.

"B.Paris"

Paris J.

Citation: 2013 TCC 73
Date: 20130228
Docket: 2007-3940(IT)G

BETWEEN:

ELIAHU SWIRSKY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Paris J.

[1] In three transactions, in 1991, 1993 and 1995, the appellant, Mr. Swirsky, transferred shares in a family-owned corporation to his spouse, Joanne Swirsky. On each occasion, Ms. Swirsky borrowed the money to purchase the shares. The interest and certain carrying costs incurred in relation to the loans resulted in losses from the shares. Mr. Swirsky claimed those losses pursuant to subsection 74.1(1) of the *Income Tax Act*, (the "*Act*") which attributes income and losses on property transferred from one spouse to the other back to the transferor spouse.

[2] The Minister of National Revenue (the "Minister") reassessed Mr. Swirsky for his 1996 to 2003 taxation years to disallow his claim for those losses. The Minister determined that the interest and carrying costs on the loans were not deductible to Ms. Swirsky because she did not borrow the money for the purpose of earning income and therefore that there were no losses on the shares that could be attributed back to Mr. Swirsky.

[3] In confirming the reassessments, the Minister also relied on the General Anti-Avoidance Rule (the "GAAR") in section 245 of the *Act* to disallow the losses.

[4] Mr. Swirsky is appealing those reassessments in these proceedings.

[5] In the Reply to Notice of Appeal, the respondent has raised the further argument that the losses should be denied pursuant to subsection 74.5(11) of the *Act*. That provision applies where one of the main reasons for the transfer of the property (in this case the shares) is to reduce taxes payable on the income from the property.

Facts

[6] Mr. Swirsky's father immigrated to Canada in 1970 and began carrying on business as a real estate developer. Mr. Swirsky himself came to Canada in 1974 and attended university for a few years before dropping out to work with his father. In 1978 he incorporated a company with capital advanced by his father. The company later became Torgan Construction Limited ("Torgan"). Mr. Swirsky was the sole shareholder of the company and both he and his father were directors.

[7] In 1981 Mr. Swirsky married Joanne Rumack. In about 1985, she became an equal shareholder in Torgan with Mr. Swirsky. Mr. Swirsky also held approximately 12% of the shares in Torgan in trust for his sister who lived in Israel. When Ms. Swirsky acquired her interest in Torgan, she and Mr. Swirsky entered into an agreement whereby they pledged their Torgan shares as security for certain management fees that Torgan was obligated to pay Mr. Swirsky's father each year.

[8] Despite certain early setbacks, Torgan was successful in the real estate development business and from the mid 1980's it supported Mr. and Ms. Swirsky and their children, Mr. Swirsky's parents and his disabled brother.

[9] In the mid 1980s, Mr. Swirsky's mother became ill and his father spent a large part of his time caring for her. Mr. Swirsky then entered into a partnership with Sam "Shlomo" Cohen to carry out various development projects. Mr. Swirsky testified that he and Mr. Cohen each set up a separate corporation for each project. Mr. Swirsky's corporations held their interests in the properties that were developed in trust for Torgan.

[10] By the late 1980's Torgan held a half interest in approximately 20 properties, mostly medical office buildings that it, along with Mr. Cohen's corporations, leased

and managed. The average cost of these developments was between $5 million and $10 million.

[11] In 1989, Mr. Swirsky and Mr. Cohen undertook the development of a two acre parcel of land on Yonge Street near Eglinton Street in Toronto. The scope of this project far exceeded anything they had done before. The cost of the land was $20 million and the anticipated cost of construction of the luxury condominium and retail project they planned was and additional $30 million. In order to secure the financing from the Royal Bank to purchase the land and construct the project, Mr. Swirsky and Mr. Cohen provided joint and several personal guarantees.

[12] Pre-sales were started in the fall of 1989, just as the real estate market in Toronto slowed sharply. Mr. Swirsky and Mr. Cohen were not able to pre-sell enough units to proceed and they had to cancel the project. As a result of the financial difficulties created by the project, Mr. Cohen sought to have Mr. Swirsky buy him out. Mr. Swirsky testified that Mr. Cohen told him that if the Royal Bank sought to enforce their personal guarantees, it would not be able to collect anything from him because of the way in which he had arranged his holdings, and therefore that Mr. Swirsky would be required to pay back the entire amount of the guarantees.

[13] Faced with this possibility, Mr. Swirsky asked his accountants to devise a plan that would allow him to buy out Mr. Cohen and pay off the Royal Bank by selling off properties. Mr. Swirsky testified that he also became concerned about losing his shares in Torgan to creditors if he were required to declare bankruptcy. Since Torgan was the primary source of financial support for his family, the loss of his shares would have serious consequences not just for him but for all of his family.

[14] By January 1991 it became apparent that Mr. Swirsky could not come to an arrangement with Mr. Cohen. Mr. Swirsky's accountant, David Steinberg, then proposed a plan under which Mr. Swirsky would sell his shares in Torgan to Ms. Swirsky, thereby protecting them from seizure by creditors. Mr. Swirsky would use the proceeds to repay his outstanding shareholder loans from Torgan so that the proceeds from the sale of the shares would not be available to creditors. By repaying those loans before Torgan's June 30, 1991 year end, he would avoid having to include them in his income in that year, pursuant to subsection 15(2) of the *Act*.

[15] Mr. Swirsky and Mr. Steinberg testified that since the main goal of the plan was to creditor-proof Mr. Swirsky, it was preferable that he sell only enough of his shares at one time to enable him to repay his outstanding shareholder loans. They explained that if he sold all of his shares and ended up holding cash after repaying the

shareholder loans, the cash could be easily seized by creditors in the event of bankruptcy.

[16] Pursuant to this plan, the following transactions were carried out:

(i) in March 1991, a loan from Mutual Trust Company (Mutual Trust) to Ms. Swirsky for $2.5 million was arranged. The loan was to be for a term of five years at 11% interest. It was to be guaranteed by Torgan, and supported by the purchase and assignment by Torgan of a Mutual Trust guaranteed investment certificate (GIC) for $2.5 million. Torgan was to receive 10% interest on the GIC. In return for the loan guarantee, Ms. Swirsky would pay Torgan an annual fee of 0.5% of the loan balance.

(ii) on or about April 19, 1991, Ms. Swirsky accepted the offer of financing from Mutual Trust and paid a commitment fee of $18,750 to Mutual Trust from her personal account. Mr. Swirsky testified that he later reimbursed her for the commitment fee.

(iii) on June 25, 1991:

- Mutual Trust advanced $2.5 million to Ms. Swirsky, who used it to purchase 122 Class C shares of Torgan and 441 shares of another corporation (689799 Ontario Limited) [1] from Mr. Swirsky at their fair market value. The purchase agreement provided that the number of Torgan shares purchased would be subject to adjustment based on a valuation report to be prepared after the transfer so that the total value of the shares of both Torgan and 689799 Ontario Limited that were transferred would match the amount of the outstanding shareholder loans.

- Mr. Swirsky used the proceeds of the sale to repay his shareholder loans from Torgan.

[1] Prior to the sale, Mr. and Ms. Swirsky each owned 441 shares in 689799 Ontario Limited, which owned a strip mall that it did not hold in trust for Torgan. For the purposes of this appeal the parties did not distinguish between the shares of Torgan and 689799, and so I have not done so either in these reasons.

- Torgan used the repayment proceeds to purchase a GIC for $2.5 million from Mutual Trust and assigned it to Mutual Trust.

[17] The interest payable to Torgan on the GIC was applied by Mutual Trust to the interest owing by Ms. Swirsky on the loan. The balance of the interest owing was paid by Torgan and charged to Mr. Swirsky's Torgon shareholder loan account each month. The guarantee fee payable by Ms. Swirsky to Torgan for the loan was also charged to Mr. Swirsky's Torgan shareholder loan account each year.

[18] In accordance with a valuation report dated January 18, 1993, the number of Torgan shares purchased by Ms. Swirsky was adjusted to 202.71.

[19] Simultaneously with the June 30, 1991 share sale, Torgan issued Mr. Swirsky additional Class A voting shares to maintain his voting control over the company.

[20] The second sale of Torgan shares by Mr. Swirsky to Ms. Swirsky took place on June 30, 1993. The value of the Torgan shares sold in this transaction was $1.7 million dollars, which was equal to the outstanding balance of Mr. Swirsky's shareholder loans from Torgan on that date. Ms. Swirsky financed the purchase with a loan from Mutual Trust on similar terms to the 1991 loan and Torgan guaranteed the loan on the same terms as in 1991.

[21] The third sale of Torgan shares by Mr. Swirsky to Ms. Swirsky took place on January 31, 1995 (Torgan's new fiscal year end, due to an amalgamation.) Mr. Swirsky sold $700,000 worth of Torgan shares to Ms. Swirsky, which was again equal to his shareholder loan account balance. Ms. Swirsky obtained a loan from Mutual Trust for the full purchase price and Torgan guaranteed the loan. The terms of the loan and guarantee were similar to the previous transactions.

[22] The number of shares sold to Ms. Swirsky in the second and third transactions was adjusted upon the completion of valuation reports, as with the first transaction.

[23] From 1991 to 2002 Mr. Swirsky claimed the losses arising from the Torgan shares that he transferred to Ms. Swirsky in 1991, 1993 and 1995. The amount of the losses was equal to the interest and carrying charges paid on the loans. In 2003, Torgan paid a dividend of $1,572,748.22[2] on Ms. Swirsky's shares and the grossed-up amount of the dividend ($1,965,935.28) less the interest on the Mutual Trust loans

[2] Exhibit A-75, 2003 Statement of Investment Income (T5).

still outstanding was included by Mr. Swirsky in his income for that year[3]. Torgan also paid a capital dividend of $2,500,000[4] in 1999. Because it was a capital dividend it was non-taxable and was not included in the computation of the income arising from the transferred shares that was included by Mr. Swirsky in his income for that year. Mr. Swirsky testified that he has continued to claim the interest and carrying charges on the loans that are still outstanding up to the present, but the amounts claimed were not put into evidence.

[24] The amounts of interest and carrying costs deducted by Mr. Swirsky in computing his income in the years in issue were as follows:

YEAR	Interest	Guarantee Fees	Commitment Fees	Discharge Fee	Loan Fee	Total
1996	297,035	24,500	3,500			**325,034**
1997	231,187	24,500				**255,687**
1998	212,871	24,500				**237,371**
1999	197,005	18,125		3,125		**218,255**
2000	139,121	12,000			15,000	**166,121**
2001	149,488	12,000				**161,488**
2002	116,961	12,000				**128,961**
2003	101,616	0				**101,616**
Total	**1,445,284**	**127,625**	**3,500**	**3,125**	**15,000**	**1,594,534**

[25] The Minister reassessed Mr. Swirsky for his 1996 to 2003 taxation years to disallow the deduction of the interest expenses and carrying costs paid on the Mutual Trust loans. As indicated at the outset of these reasons, the Minister assumed that the loans were not used for the purpose of earning income from a business or property and therefore that the interest and carrying costs claimed were not deductible.

[26] The issues before the Court are:

1. Whether Ms. Swirsky used the funds borrowed from Mutual Trust in 1991, 1993 and 1995 for the purpose of earning income from the shares? If not, the interest and carrying charges on those loans would not be deductible to her under subparagraph

[3] It appears from the Notice of Appeal that loan guarantee fees of $12,000 were paid to Torgan in 2003. However, these fees were not attributed back to Mr. Swirsky and do not appear on the Statement of Investment Income filed with his 2003 tax return.

[4] Exhibit A-52, Financial Statements.

20(1)(*c*)(i) and paragraph 20(1)(*e*.1) of the *Act* and there would be no losses that would be attributed back to Mr. Swirsky.

2. If Ms. Swirsky did use the borrowed funds to earn income, whether the attribution of her losses on the Torgan shares she acquired from Mr. Swirsky is prohibited by subsection 74.5(11) of the *Act*?

3. If subsection 74.5(11) does not prohibit the attribution of the losses to Mr. Swirsky, does the General Anti-Avoidance Rule in section 245 of the *Act* apply to deny the losses?

Legislation

[27] The relevant provisions of the *Act* read as follows:

Subparagraph 20(1)(*c*)(i)

(*c*) interest —an amount paid in the year or payable in respect of the year (depending upon the method regularly followed by the taxpayer in computing the taxpayer's income), pursuant to a legal obligation to pay interest on

> (i) borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt or to acquire a life insurance policy),

Subparagraph 20(1)(e.1)

(e.1) annual fees, etc. [re borrowings] – an amount payable by the taxpayer (other than a payment that is contingent or dependent on the use of, or production from, property or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders of any class of shares of the capital stock of a corporation) as a standby charge, guarantee fee, registrar fee, transfer agent fee, filing fee, service fee or any similar fee, that can reasonably be considered to relate solely to the year and that is incurred by the taxpayer

> (i) for the purpose of borrowing money to be used by the taxpayer for the purpose of earning from a business or property (other than borrowed money used by the taxpayer for the purpose of acquiring property the income from which would be exempt income)…

Subsection 74.1(1)

Transfers and loans to spouse [or common-law partner]—Where an individual has transferred or lent property (otherwise than by an assignment of any portion of a retirement pension pursuant to section 65.1 of the Canada Pension Plan or a comparable provision of a provincial pension plan as defined in section 3 of that Act or of a prescribed provincial pension plan), either directly or indirectly by means of a trust or by any other means whatever, to or for the benefit of a person who is the individual as spouse or common-law partner or who has since become the individual's spouse or common-law partner, any income or loss, as the case may be, of that person for a taxation year from the property or from property substituted therefore, that relates to the period in the year throughout which the individual is resident in Canada and that person is the individual's spouse or common-law partner, shall be deemed to be income or a loss, as the case may be, of the individual for the year and not of that person.

Subsection 74.5(11)

Artificial transactions —Notwithstanding any other provision of this act, section 74.1 to 74.4 do not apply to a transfer or loan of property where it may reasonably be concluded that one of the main reasons for the transfer or loan was to reduce the amount of tax that would, but for this subsection, be payable under this Part on the income and gains derived from the property or from property substituted therefore.

Section 245

(1)"tax benefit" means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty;

"tax consequences" to a person means the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by or refundable to the person under this Act, or any other amount that is relevant for the purposes of computing that amount;

"transaction" includes an arrangement or event.

(2) Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

(3) An avoidance transaction means any transaction

> (*a*) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; or
>
> (*b*) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

(4) Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

> (*a*) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
>
> > (i) this Act,
> >
> > (ii) the *Income Tax Regulations*,
> >
> > (iii) the *Income Tax Application Rules*,
> >
> > (iv) a tax treaty, or
> >
> > (v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or
>
> (*b*) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.
>
> …

Did Ms. Swirsky use the proceeds of the Mutual Trust loans for the purpose of earning income?

[28] The matter of deductibility of interest under subparagraph 20(1)(*c*)(i) of the *Act* was considered by the Supreme Court in *Shell Canada Ltd. v. Canada*,[5] and

[5] [1999] 3 S.C.R. 622.

Ludco Enterprises Ltd. v. Canada.[6] In *Shell*, the Court stated that there are four requirements that must be met in order to obtain a deduction:

> 28 …(1) the amount must be paid in the year or be payable in the year in which it is sought to be deducted; (2) the amount must be paid pursuant to a legal obligation to pay interest on borrowed money; (3) the borrowed money must be used for the purpose of earning non-exempt income from a business or property; and (4) the amount must be reasonable, as assessed by reference to the first three requirements.

[29] In this case, we are only concerned with whether the third requirement has been met: whether the borrowed money was used for the purpose of earning non-exempt income from the Torgan shares. This is a question of fact.

[30] In *Ludco*, the Supreme Court held that the test for determining the purpose for interest deductibility was "whether, considering all of the circumstances, the taxpayer had a reasonable expectation of income at the time the investment was made."[7] The Court noted that a taxpayer's subjective intention, while relevant, is not conclusive of the question of purpose.[8]

[31] The appellant's position is that Ms. Swirsky had a reasonable expectation of income from the Torgan shares at the time she purchased them in 1991, 1993 and 1995, and that this expectation was borne out by the payment of dividends on the shares in 1999, 2003, 2004 and 2005. Counsel also referred to the evidence of Mr. and Ms. Swirsky that Torgan constituted the primary source of income for the entire Swirsky family. Finally counsel submitted that the creditor proofing purpose of the transactions was, in itself, evidence of the Swirskys' belief in the future income earning potential of the shares.

[32] The first difficulty with the appellant's position, however, is that there is no evidence that Torgan, prior to 1999, had any history of paying dividends. Instead, it appears that Mr. Swirsky took money out of the company in the form of bonuses or as loans that were subsequently included in income. These were the funds used to support the family.

[33] Mr. Swirsky testified that Torgan paid family expenses and treated those payments as shareholder advances. Those shareholder advances would then either be

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[6] 2001 SCC 62.
[7] Ibid, at paragraph 54.
[8] Ibid, at paragraph 55.

cleared out by the payment of bonuses, or the advances would be included in income pursuant to subsection 15(2) of the *Act*. Prior to the first sale of shares to Ms. Swirsky, Mr. Swirsky said that all of the advances to family members or for family expenses were treated as "a global sum" and that, generally speaking, the advances would be recorded in his shareholder loan account, and would be cleared off by Torgan declaring a bonus to him, or by his including all of the advances in income at the end of the year following the year they were received. Later, he said that the usual practice of Torgan was to declare a bonus or management fee to him sufficient to pay down the loan balance to zero. He also said that Torgan would pay him bonuses rather than dividends because bonuses were deductible to Torgan whereas dividends were not.

[34] It appears to me that, prior to the first transaction, the family was supported by shareholder loans from Torgan and that those loans were transformed into bonuses to Mr. Swirsky. Those bonuses were not income derived from the Torgan shares. This is confirmed by Mr. Swirsky's own admission in cross-examination in the following exchange:

> Q. That was your only income producing asset, wasn't it?
> A. What was?
> Q. Your shares in Torgan.
> A. I had shares in Torgan, but the income didn't come from the shares. It came from the company.[9]

[35] I therefore find that the income that the Swirskys claim the share transfer was intended to protect was not income from the Torgan shares.

[36] This conclusion is supported by what took place in the years immediately after the transactions as well, when the family expenses continued to be paid by Torgan and treated as advances. There is some evidence that after July 1, 1993 separate loan accounts were maintained for each family member, but it was not established whether the loans were repaid, included in income or dealt with in some other way. More importantly, all withdrawals from Torgan continued to be treated as loans which were advanced to family members regardless of whether they held shares in the company. For example, amounts paid to or on behalf of Mr. Swirsky's father and brother were recorded as loans to them.

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[9] Transcript, page 473, lines 14-20

[37] Between the first and the third share sale transactions it was not necessary for Torgan to declare any bonuses to Mr. Swirsky because he repaid his shareholder loans with proceeds from the sale of his shares to Ms. Swirsky.

[38] In addition, there is no evidence that the income producing potential of the Torgan shares was ever considered before the transactions took place. The plan to sell the shares to Ms. Swirsky and all of the steps in the transaction were devised by the accountant, Mr. Steinberg. Those steps were set out in a letter dated February 18, 1991 addressed to Mr. Swirsky. Nowhere in the letter is there any discussion or consideration of an income earning purpose to the proposed acquisition of the shares by Ms. Swirsky.

[39] In cross-examination, Mr. Swirsky testified that he made no representations or promises to Ms. Swirsky that dividends would be paid on the Torgan shares he was selling her. In fact, there was no evidence that dividends were discussed at all. He also confirmed that Ms. Swirsky was not expecting to realize any gains by selling the shares to a third party.

[40] Ms. Swirsky stated that her purpose in entering into the transactions was to assist her husband whom she believed was about to go bankrupt and to "salvage some income for the family." However, it is clear that Ms. Swirsky was unaware how the income to support her family was derived from Torgan and that she had little knowledge of Torgan's finances. The following passage from her cross-examination illustrates these points:

> Q. For instance, when I mean by negotiate, you didn't come up with the 2.5 million figure?
>
> A. No. The only thing I was happy about was that they looked to see where there was a gap, like a debt in the company. I was happy that it would be more money. They wouldn't give me more money than that, because I didn't want floating extra money around. That's all.
>
> Q. What debt are you talking about?
>
> A. I guess in order to see what would bring everything to zero in the company, they looked up and saw what -- I don't know what the debt was for, but I know that missing money was about that amount. Then if I got a loan and paid it to my company, it would bring things to a zero. That's how I understood it.
>
> Q. Was it the debt into the shareholder loan account?
>
> A. Is the question like -- at that time, I just knew of it as owing money. The company owed money. I didn't know where it was placed exactly.

> Q. You really didn't know any of the financial situation of the company first hand?
> A. Not from the stand point of book keeping details. I would go to the office and constantly keep apprised of how many properties I had and what the names were. But in terms of the intricacies, financial book keeping, no, I was not. I entrusted that to him.
> Q. Him being?
> A. Eli. [10]

[41] In any event, there was no evidence that Ms. Swirsky believed or expected at the time she entered into the three transactions that there would be dividends paid on the shares. Nor was there any evidence that she intended to sell the shares at a profit.

[42] The evidence also shows that Ms. Swirsky expected to return the shares to Mr. Swirsky at some point after the financial problems relating to the Yonge Street project passed. The following passage from Ms. Swirsky's testimony illustrates this point:

> Q. Who suggested to you to buy the shares?
> A. Eli.
> Q. Why did he make that suggestion to you?
> A. Because our family used to live off the company, the existing properties. I understood that if he held his 43 percent, if he kept his shares, the bank would take it all away. On top of even that, I used to think they would have to take all the properties away. There would be nothing for my family to live on. We were accustomed to a comfortable lifestyle. He thought he could try to solution with the bank, buy some time a little bit. In the meantime, I would hold his interest, his shares.[11]

[43] In fact, Ms. Swirsky did transfer the shares back to Mr. Swirsky in 2008 as part of their divorce settlement. Mr. Swirsky assumed the remaining outstanding Mutual Trust debt of about $2.4 million but did not pay any other consideration for them. Ms. Swirsky said she transferred them back out of a moral obligation.

[44] I am also satisfied that it was arranged at the outset of the transactions that Ms. Swirsky would not have to pay the interest and carrying costs on the Mutual Trust loans out of her own pocket and therefore it is more likely than not that she was not concerned with the income earning potential of the shares. Mr. Swirsky testified that it was arranged that the interest would be paid by Torgan and charged to his

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[10] Transcript, page 133 line 15 to page 134 line 23
[11] Transcript, page 26, lines 4-13

shareholder loan account. Although counsel for Mr. Swirsky submitted that it was only through a bookkeeping error that these payments were charged to Mr. Swirsky's shareholder loan account rather than Ms. Swirsky's, the evidence of Mr. Swirsky satisfies me that he intended to pay these amounts. In this regard, Mr. Swirsky testified as follows[12]:

> Q. That was understood from the start, that your wife would not be paying interest out of her own pocket. Correct?
> A. Yes -- not from her own salary.
> Q. When you told your wife that you would take care of the interest, describe how you intended to take care of the interest on the $4.9 million loan.
> A. The way it works, like everything else in the company, all the money required to pay the expenses came out of the company as a shareholder's advance. That was to me, and then I paid all the expenses relating to whatever was required. She knew that I would make sure that there was sufficient money to pay for the loan from the way our company was operated.
> Q. Let's take it one at a time. The actual interest payments and other costs related to the loan were, in fact, paid each year by Torgan. Is that correct?
> A. Yes.
> Q. When Torgan made the payment each year, it had to charge that amount to a shareholder loan account. Right?
>
> A. Yes.
> Q. In fact, Torgan charged the interest that it paid to your shareholder loan account. Correct?
> A. Yes.
> Q. As opposed to your wife's shareholder loan account.
> A. Yes.
> Q. So that was charged to you.
> A. Yes.

[45] Counsel's submission that there was a bookkeeping error was based on evidence from Torgan's bookkeeper from 1993 to 2000. She testified that she posted the Mutual Trust loan payments to Mr. Swirsky's shareholder loan account during those years because there was no instruction on the debit memos for those payments to charge them to Ms. Swirsky's shareholder loan account. She also explained that where there was a specific direction on an invoice or bill or debit memo to charge the amount to a specific person's loan account, it would be charged to that account. If there was no specific instruction, the practice was to post the amount to Mr. Swirsky's shareholder loan account. However, this evidence alone does not prove

[12]Transcript, page 516 line 9 to page 517 line 18

that the payments were misposted. I note that Mr. Swirsky was not asked about this alleged error, and his evidence indicates that he intended these amounts to be charged to his account. Furthermore, it seems implausible that those payments, which totaled almost $1.6 million for the period in issue, could have been posted to the wrong account without anyone noticing.

[46] On the basis of the evidence before me, I am unable to conclude that the appellant has met the onus on him to show that Ms. Swirsky had a reasonable expectation of income from the Torgan shares at the time she acquired them in each of the three transactions. The appellant has not shown that there was any history of dividend payments on the Torgan shares or that there was any policy or plan in place to pay dividends on those shares after the acquisitions.

[47] While dividends were eventually paid on the shares, this was after a substantial amount of time had passed since Ms. Swirsky's purchased the shares. Furthermore, the first dividend, paid in 1999, was a capital dividend which was paid out of the non-taxable portion of capital gains realized by Torgan. No evidence was led to show what the balance in Torgan's capital dividend account was at the time of the three transactions in issue such that Ms. Swirsky could be said to have a reasonable expectation of receiving a capital dividend from Torgan. The next dividend was not paid until 2003.

[48] According to the test laid down by the Supreme Court in *Ludco*, there must be a reasonable expectation of income at the time the investment was made. The appellant has not shown that this test was met in this case. After considering all of the circumstances surrounding the transactions, including Ms. Swirsky's subjective intention in acquiring the shares, I find that she did not have a reasonable expectation of income when she acquired them. Therefore, she was not entitled to deduct the interest and carrying charges in computing her income from the shares, and the losses and income reported by Mr. Swirsky in respect of those shares were properly determined by the Minister.

[49] My conclusion that the interest and carrying charges are not deductible to Ms. Swirsky is sufficient to dispose of Mr. Swirsky's appeal. The entire amount of the losses claimed by Mr. Swirsky for the 1996 to 2002 taxation years consisted of the interest and carrying charges and therefore there are no losses remaining to be attributed to him for those years. In 2003, however, Ms. Swirsky received a dividend on the Torgan shares, and Mr. Swirsky included that dividend, minus the interest paid on the Mutual Trust loans, in his income. The Minister reassessed the 2003 taxation year to increase the amount of income attributed to Mr. Swirsky by denying the

deduction of the interest. Since Mr. Swirsky agrees that subsection 74.1(1) applies to attribute the losses and gains on the shares to him, the full amount the dividend has been properly included in Mr. Swirsky's income for his 2003 taxation year.

[50] Although it is not necessary for me to consider the alternative arguments presented by the parties, it may be of assistance to the parties for me to do so.

First alternative argument: Does subsection 74.5(11) preclude the attribution of income and losses on the shares to Mr. Swirsky?

[51] The respondent's first alternative argument is that subsection 74.5(11) precludes the attribution of the net income or loss on the shares to Mr. Swirsky because one of the main reasons for the transfer of the Torgan shares was to reduce the amount of tax that would be payable, but for that section, on the income and gains derived from the shares.

[52] For the purposes of subsection 74.5(11), the inquiry into the main reasons for the transfer is a factual one, and in this respect would be similar to the one that is undertaken under subsection 245(3) of the *Act* in a GAAR analysis concerning the existence of an avoidance transaction. In relation to the latter section, the Supreme Court stated in *Canada Trustco v. Canada*,[13] that :

> 28 While the inquiry proceeds on the premise that both tax and non-tax purposes can be identified, these can be intertwined in the particular circumstances of the transaction at issue. It is not helpful to speak of the threshold imposed by s. 245(3) as high or low. The words of the section simply contemplate an objective assessment of the relative importance of the driving forces of the transaction.
>
> 29 Again, this is a factual inquiry. The taxpayer cannot avoid the application of the GAAR by merely stating that the transaction was undertaken or arranged primarily for a non-tax purpose. The Tax Court judge must weigh the evidence to determine whether it is reasonable to conclude that the transaction was not undertaken or arranged primarily for a non-tax purpose. The determination invokes reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered.

While subsection 74.5(11) does not require that the *primary* purpose of the transfer be the reduction of tax payable on the income or gains derived from the property, only that it be one of the main reasons, it would nonetheless require "an objective assessment of the relative importance of the driving forces of the transaction."

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[13] 2005 SCC 54.

[53] The respondent did not rely on subsection 74.5(11) in reassessing Mr. Swirsky or in confirming the reassessments. This argument was raised for the first time in the Reply to Notice of Appeal. While it is possible to raise a new argument at that stage of the proceedings, the onus of proving any of the facts required to support that argument will be on the respondent: *Canada v. Anchor Pointe Energy Ltd*.[14] Therefore the respondent is required to show on the balance of probabilities that one of the main reasons for the transfer of the Torgan shares was to reduce tax. For the following reasons, I find that the respondent has not met that onus.

[54] Mr. Swirsky testified that he had two reasons for transferring the shares: to protect them from seizure by creditors and to enable him to pay off his shareholder loans that he would otherwise have been required to include in his income. I accept his testimony, firstly because it is consistent with the circumstances in which he found himself at the time the transactions were entered into, and secondly because Mr. Swirsky struck me as a credible witness.

[55] It was not disputed that the Yonge Street project which Mr. Swirsky and Mr. Cohen began in late 1989 was a financial disaster for them. The value of the property dropped from $20 million to $8 million within a year of purchase and the luxury condo collapsed just as they were beginning presales. Both Mr. Swirsky and Mr. Cohen had given personal guarantees to the Royal Bank for the loans advanced for the purchase of the property and I find it was reasonable for Mr. Swirsky to assume that their was a substantial risk that the bank would try to collect from him. He said that the Royal Bank loan was being handled by the "Special Loans" division throughout the period from 1990 to 1995 and was subject to being called at any time. Mr. Swirsky also testified that two of their other projects were in financial difficulties and letters from the CIBC backed those statements up. It is well known that the Toronto real estate market went through a severe downturn in the early 1990's and that property values were slow to recover. All of these factors lead me to conclude that Mr. Swirsky had ample grounds to want to protect his major asset.

[56] The respondent argued that there was no evidence that the transactions were effective to creditor-proof the Torgan shares or that there was even a need to do so. However, the respondent presented no evidence to show that the transactions were not effective for that purpose or any evidence to show that Mr. Swirsky was not at risk of going bankrupt. In the absence of such evidence, I am satisfied that to the extent that Mr. Swirsky was able to transfer shares to his spouse for fair market

[14] 2007 FCA 188

value, he removed them from the reach of creditors. Both Mr. and Ms. Swirsky's evidence was that Mr. Swirsky was extremely concerned at the time about going bankrupt, and this was confirmed by Mr. Steinberg.

[57] The respondent also submitted that the transfers to Ms. Swirsky did not protect the shares because they were still subject to seizure by her creditor, Mutual Trust, after the transfer. I am satisfied, though, that the shares were not seriously at risk after they were transferred. In light of the fact that Mutual Trust held GICs for the full amount of the loans, the possibility that Mutual Trust would have tried to collect first from Ms. Swirsky seems remote at best.

[58] In addition, it was submitted that, if Mr. Swirsky truly intended to protect his shares in Torgan, he would have sold all of his shares immediately to Ms. Swirsky. However, this ignores the evidence that if he had done so, he would have been left with a substantial amount of cash that would have been more easily accessible to creditors. It would have made little sense to proceed in the manner suggested by the respondent. On the other hand, I believe that the staggering of the share sales supports the appellant's position that it did not undertake the transactions in order to reduce tax payable on the income from the shares. If it had so intended, it would have achieved even greater tax savings by transferring all the shares as soon as possible, rather than over a four year period.

[59] The respondent also suggested that Mr. Swirsky could have increased his shareholder loan in Torgan up to an amount that would have equaled the fair market value of all of his Torgan shares and then sold all of the shares at once to Ms. Swirsky. He also suggested that the extra funds withdrawn as shareholder loans from Torgan could have been given to Ms. Swirsky. However, it seems that the obvious flaw in this plan would be that there would be no consideration given by Ms. Swirsky for the funds withdrawn from Torgan, and therefore the transfer would be subject to attack as a preferential transaction.

[60] The respondent contended that the fact that Mr. Steinberg did not consult with a bankruptcy lawyer about the plan showed that creditor-proofing was not the goal of the transactions. I do not believe, though, that it would be necessary to get such advice on a transaction that involved a transfer of property at fair market value.

[61] Another argument was that the Royal Bank was unlikely to try to seize the shares because it would get more by working with Mr. Swirsky or because the shares were a minority interest in a private company or because the shares were subject to a lien in favour of Torgan for the unpaid shareholder loans. The respondent did not

present any evidence from the Royal Bank to support the contention that it would not have tried to seize the shares in the event of a bankruptcy and it is, at best, only speculation.

[62] The respondent also queried whether the transfers constituted a material adverse change in Mr. Swirsky's financial condition that would have triggered a default under the financing agreement for the Yonge Street project (as provided for in the agreement) and exposed his Torgan shares to immediate collection action. It is not obvious to me, though, that the sale of an asset to repay a debt would constitute a material change in Mr. Swirsky's financial condition. Again, no evidence was led to show that it would have been treated that way by the Royal Bank.

[63] Finally, the respondent submitted that there was no documentation contemporaneous with the transactions that referred to a creditor-proofing purpose. It would not seem unusual to me that references to creditor-proofing would be omitted from planning documents, given the potential problems that could arise should they come to the attention of creditors.

[64] Having regard to the evidence that was presented at the hearing, and considering the relationships between the parties and the actual transactions that took place, I am not satisfied that one of the main reasons for those transactions was to reduce the tax payable on the income derived from the Torgan shares. For this reason, section 74.5(11) would not preclude the attribution of the losses on the shares to Mr. Swirsky.

Second alternative argument: Does the GAAR apply?

[65] Mr. Swirsky's counsel argued that it was not open to the respondent to argue that the GAAR applied, in light of the respondent's reliance on the anti-avoidance rule in subsection 74.5(11). He referred to the following passage from the dissenting reasons of Rothstein J. in *Lipson v. Canada*[15] in support of his position that subsection 74.5(11) pre-empted the application of the GAAR:

> [102] With respect to the views of my colleague, LeBel J., I do not believe it was appropriate for the Minister to rely on the general anti-avoidance rule ("GAAR") in this case. In my opinion, the GAAR does not apply here because there is a specific anti-avoidance rule that pre-empted its application. Had the Minister reassessed Mr. Earl Lipson using the relevant specific anti-avoidance provision, s. 74.5(11), the tax

[15] 2009 SCC 1.

> benefit that resulted from Mr. Lipson's use of the attribution rules would have been precluded.

[66] This view, however, was rejected by the majority in *Lipson*. Lebel J. wrote at that the court should not refuse to apply the GAAR "on the ground that a more specific provision …might also apply to the transaction."[16] I am, of course, bound by the majority decision of the Supreme Court.

[67] In *Canada Trustco*, the Supreme Court summarized the approach to be taken to the application of the GAAR. It stated that the following three requirements must be established in order to apply the GAAR:

> (1) A *tax benefit resulting from a transaction* or part of a series of transactions (s. 245(1) and (2));
>
> (2) that the transaction is an *avoidance transaction* in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit; and
>
> (3) that there was *abusive tax avoidance* in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer.

[68] Mr. Swirsky's counsel conceded the existence of a tax benefit from the transactions in issue.

[69] The next step is to determine whether any of the impugned transactions was an avoidance transaction, which is defined in subsection 245(3) of the *Act* as:

> (*a*) any transaction that , but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit, or
>
> (*b*) is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.

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[16] Ibid, at paragraph 45

[70] The purpose test in subsection 245(3) is broader than the test in subsection 74.5(11) in that it looks to whether the primary purpose of the transaction was to obtain *any* of the tax benefits arising from the transaction whereas the latter is concerned specifically with the purpose of reducing tax payable on the income and gains from the transferred property.

[71] The purpose of a transaction is a question of fact and the ordinary rules of onus apply. Since the GAAR was first used by the Minister at the confirmation stage in this case, the respondent is required to show that the primary purpose of the three share dispositions was to obtain a tax benefit.

[72] I have already concluded that the respondent has not shown that the reduction of tax on the income or gains from the shares was one of the main purposes of the transactions. However, it is also necessary to evaluate the transactions in light of the two additional tax benefits identified by the respondent that accrued to Mr. Swirsky from the transactions: the deferral of the capital gains on the disposition of the shares as a result of the rollover provided by subsection 73(1) of the *Act*, and the avoidance of tax on the income inclusion that would have arisen under subsection 15(2) of the *Act* if Mr. Swirsky had not repaid his shareholder loans. Both of these results appear to fall within the broad definition of "tax benefit" in subsection 245(1) of the *Act*:

> "tax benefit" means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty;

[73] In my view, the respondent has not shown that the primary purpose of the transactions in issue was to obtain either of these two additional tax benefits. I find that the deferral of the capital gains was incidental in this case, because there was no evidence to show that Mr. Swirsky was contemplating the disposition of his shares prior to being presented with the plan by his accountant. Since Mr. Swirsky was not already planning to dispose of his shares, it cannot be said that the plan was devised and executed in order to defer the gain on the dispositions.

[74] I also find that while the repayment of the shareholder loans was one of the main purposes of the transactions, it has not been shown to be the primary purpose. There was no evidence to show that Mr. Swirsky was concerned about the repayment of the loans before the plan to sell them was devised. In prior years, it had been his practice to be paid a bonus by Torgan to enable him to repay the loans and to pay the

tax associated with the loans. In the absence of any evidence to show that it would not have been possible to follow this practice with respect to the loans outstanding at the end of Torgan's 1991, 1993 and 1995 taxation years, I infer that the loans would have been treated in the same manner as in earlier years. Mr. Swirsky admitted that he was aware of the tax advantage to repaying the loans from the proceeds of the sales of his shares and that this was one of the reasons he undertook the transactions, but I accept his evidence that this was not his main reason for entering into the transactions.

[75] Since I have found that the respondent has not demonstrated that the transactions in issue were avoidance transactions, it is not necessary for me to consider the question of whether there was abusive tax avoidance. If I were to decide that question, I would have great difficulty in distinguishing the transactions in this case from those in *Lipson*. Counsel for Mr. Swirsky suggested that I should follow the decision of this Court in *Overs v. The Queen*,[17] given that the facts in that case were almost identical to those in the case at bar. In *Overs*, Little J. accepted that the disposition of the shares by Mr. Overs to his spouse did not constitute abusive tax avoidance and that the GAAR did not apply. However, in my view, that case has been implicitly overruled by the *Lipson* decision.

[76] For all of these reasons, the appeals are dismissed, with costs to the respondent on a party and party basis.

Signed at Toronto, Ontario, this 28th day of February 2013.

"B.Paris"

Paris J.

[17] 2006 TCC 26.

CITATION:	2013 TCC 73
COURT FILE NO.:	2007-3940(IT)G
STYLE OF CAUSE:	ELIAHU SWIRSKY AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	June 1st, 2nd, 2011, May 7, 8 and 10, 2012
REASONS FOR JUDGMENT BY:	The Honourable Justice B. Paris
DATE OF JUDGMENT:	February 28, 2013

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