Docket: 2013-3994(IT)I

BETWEEN:

CLAUDE GAUMOND,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on September 24, 2014, at Montréal, Quebec.

Before: The Honourable Justice Lucie Lamarre

Appearances:

For the appellant:	The appellant himself
Counsel for the respondent:	Emmanuel Jilwan

JUDGMENT

The appeal from the reassessment made by the Minister of National Revenue under the *Income Tax Act* for the 2011 taxation year is dismissed, in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 14th day of November 2014.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 16th day of January 2015
Janine Anderson, Translator

Citation: 2014 TCC 339
Date: 20141114
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REASONS FOR JUDGMENT

Lamarre J.

[1] The appellant is appealing a reassessment made by the Minister of National Revenue (**Minister**) whereby the Minister refused to consider the loss of $368,341, which the appellant claims to have incurred in the 2011 taxation year, as a business investment loss (**BIL**). The loss was, however, recognized as a capital loss.

[2] The appellant is the principal shareholder and president of the corporation called Groupe médical Gaumond inc. (**GMG**), which was incorporated in 2003.

[3] GMG is a Canadian-controlled private corporation and a small business corporation.

[4] GMG is a business that carries out research and development and that is funded, in part, by government subsidies.

[5] The appellant also helped fund GMG by advancing a total of $368,341 to it over the last ten years.

[6] Interest at the rate of 3% was paid by GMG to the appellant, who reinvested it in GMG.

[7] GMG also obtained a loan from the Community Futures Development Corporation – Investment Fund (C.F.D.C.), which required that the full amount of the loan be repaid.

[8] In May 2011, GMG, which could no longer meet its financial obligations, made a proposal in bankruptcy under the *Bankruptcy and Insolvency Act*.

[9] At the time of that proposal, the applicant's claim amounted to $368,341, that is, 40% of the total unsecured claims (Exhibit A-1).

[10] The appellant had to forgive all of his debt at the request of the other creditors, who then voted in favour of the proposal, thus allowing GMG to stay active. The proposal was executed on August 30, 2011 (Exhibit A-1).

Statutory provisions

[11] A business investment loss is a capital loss (defined at paragraph 39(1)(*b*) of the *Income Tax Act* (ITA)) that meets the prerequisites at paragraph 39(1)(*c*) of the ITA. The relevant passages of paragraphs 39(1)(*b*) and (*c*) read as follows:

> **39. (1) Meaning of capital gain and capital loss** — For the purposes of this Act:
>
> . . .
>
> (*b*) a taxpayer's capital loss for a taxation year from the disposition of any property is the taxpayer's loss for the year determined under this subdivision (to the extent of the amount thereof that would not, if section 3were read in the manner described in paragraph (*a*) of this subsection and without reference to the expression "or the taxpayer's allowable business investment loss for the year" in paragraph 3(*d*), be deductible in computing the taxpayer's income for the year or any other taxation year) from the disposition of any property of the taxpayer other than:
>
> (i) depreciable property, or
>
> (ii) property described in any of subparagraphs 39(1)(*a*)(i), (ii) to (iii) and (v); and
>
> (*c*) a taxpayer's business investment loss for a taxation year from the disposition of any property is the amount, if any, by which the taxpayer's capital loss for the year from a disposition after 1977:
>
> (i) to which subsection 50(1) applies, or
>
> (ii) to a person with whom the taxpayer was dealing at arm's length
>
> of any property that is

(iii) a share of the capital stock of a small business corporation, or

(iv) a debt owing to the taxpayer by a Canadian-controlled private corporation (other than, where the taxpayer is a corporation, a debt owing to it by a corporation with which it does not deal at arm's length) that is

(A) a small business corporation,

(B) a bankrupt (within the meaning assigned by subsection 128(3)) that was a small business corporation at the time it last became a bankrupt, or

(C) a corporation referred to in section 6 of the Winding-up Act that was insolvent (within the meaning of that Act) and was a small business corporation at the time a winding-up order under that Act was made in respect of the corporation,

. . .

[Emphasis added.]

[12] Subsection 50(1) of the ITA reads as follows:

50. (1) Debts established to be bad debts and shares of bankrupt corporation — For the purposes of this subdivision, where:

(*a*) a debt owing to a taxpayer at the end of a taxation year (other than a debt owing to the taxpayer in respect of the disposition of personal-use property) is established by the taxpayer to have become a bad debt in the year, or

(*b*) a share (other than a share received by a taxpayer as consideration in respect of the disposition of personal-use property) of the capital stock of a corporation is owned by the taxpayer at the end of a taxation year and:

(i) the corporation has during the year become a bankrupt,

(ii) the corporation is a corporation referred to in section 6 of the Winding-up Act that is insolvent (within the meaning of that Act) and in respect of which a winding-up order under that Act has been made in the year, or

(iii) at the end of the year,

(A) the corporation is insolvent,

(B) neither the corporation nor a corporation controlled by it carries on business,

(C) the fair market value of the share is nil, and

(D) it is reasonable to expect that the corporation will be dissolved or wound up and will not commence to carry on business

and the taxpayer elects in the taxpayer's return of income for the year to have this subsection apply in respect of the debt or the share, as the case may be, the

> taxpayer shall be deemed to have disposed of the debt or the share, as the case may be, at the end of the year for proceeds equal to nil and to have reacquired it immediately after the end of the year at a cost equal to nil.
>
> [Emphasis added.]

[13] The term "disposition" is defined in subsection 248(1) of the ITA. The relevant passages read as follows:

> **PART XVII — INTERPRETATION**
>
> **248. (1) Definitions** — In this Act,
>
> . . .
>
> **"disposition"** of any property, except as expressly otherwise provided, includes
>
> (*a*) any transaction or event entitling a taxpayer to proceeds of disposition of the property;
>
> (*b*) any transaction or event by which,
>
> (i) where the property is a share, bond, debenture, note, certificate, mortgage, hypothecary claim, agreement of sale or similar property, or interest, or for civil law a right, in it, the property is in whole or in part redeemed, acquired or cancelled,
>
> (ii) where the property is a debt or any other right to receive an amount, the debt or other right is settled or cancelled, ...
>
> [Emphasis added.]

Arguments of the parties

[14] The two parties agree that there was a disposition of the appellant's debt when he agreed to forgive it at the time the proposal in bankruptcy was accepted by the creditors.

[15] In this case, the respondent relies on subparagraph 39(1)(*c*)(ii) of the ITA to argue that the capital loss realized by the appellant cannot be considered a BIL. According to the respondent, upon forgiving GMG's debt to him, the appellant disposed of his debt in favour of a person (GMG) with whom he was not dealing at arm's length, thus rendering him ineligible to claim a BIL.

[16] The appellant argues that he did not favour GMG in any way. He simply allowed it to stay active at the request of the creditors who signed the proposal. Moreover, he adds that if he had chosen to establish that his debt was a bad debt on December 31, 2010, he would have been entitled to a BIL through the application of paragraph 50(1)(*a*) of the ITA. He therefore finds it illogical that the loss incurred on the actual disposition of his debt as part of the proposal does not receive the same treatment. According to him, the law cannot produce such an inconsistent result (Exhibit I-1).

[17] Furthermore, he maintains that there is no provision in the ITA that stipulates that, when a person forgives the payment of a debt, that person is deemed to have disposed of that debt "in favour" of the debtor. He draws a parallel with subsection 84(9) of the ITA, which establishes such a presumption for the cancellation of a share of the capital stock of a corporation.

[18] Finally, the appellant relies on subparagraph 39(1)(*c*)(iv) of the ITA to argue, *a contrario*, that an individual may claim a BIL on a loss that he or she incurred on a debt owed by a corporation with which the individual is not dealing at arm's length.

Analysis

[19] For the following reasons, I am of the opinion that the appellant is not entitled to a BIL, but for different reasons than those raised by the respondent.

[20] To be entitled to treat a capital loss as a BIL, the taxpayer must meet one of the two prerequisites that I will analyze below.

1st prerequisite: Application of subsection 50(1) of the ITA.

[21] It is clear that subsection 50(1) does not apply here because one of the requirements is that the debt is still owing to the taxpayer at the end of the taxation year. However, because the appellant waived his debt, GMG no longer owed the debt at the end of 2011. To be able to avail himself of that provision in the 2010 taxation year, the appellant would have first had to make that election in his income tax return for the same year, which he did not do, and, secondly, prove that his debt had become a bad debt at the end of 2010.

2nd prerequisite: Because subsection 50(1) does not apply, the disposition of the debt must be in favour of a person with whom the taxpayer was dealing at arm's length.

[22] Here, the fact that there was a disposition is not in dispute, and I need not determine that issue. The issue is whether that disposition was made in favour of a person with whom the taxpayer was dealing at arm's length.

[23] Even though, according to the definition of "disposition" in subsection 248(1) of the ITA, the settlement or cancellation of a debt is equivalent to a disposition, that definition does not specify that the disposition must be made in favour of any person.

[24] It seems clear that the definition making the settlement or cancellation of a debt a disposition of that same debt has the effect of allowing the taxpayer to claim a capital loss, as defined in paragraph 39(1)(*b*). That paragraph does not require the disposition to be made in favour of any person.

[25] However, I do not think that it can be claimed here that there was a disposition in favour of any person in particular. To claim the contrary, it would have been preferable for Parliament to express itself clearly, as it did for the redemption, acquisition or cancellation of a share, three transactions that fall under the definition of "disposition" in subparagraph 248(1)(*b*)(i) of the ITA. In those three specific cases, Parliament set out in subsection 84(9) of the ITA that the shareholder is deemed to have disposed of the share to the corporation.

> **84(9) Shares disposed of on redemptions, etc.** — For greater certainty it is declared that where a shareholder of a corporation has disposed of a share of the capital stock of the corporation as a result of the redemption, acquisition or cancellation of the share by the corporation, the shareholder shall, for the purposes of this Act, be deemed to have disposed of the share to the corporation.

[26] Information Bulletin IT-484R2—Business Investment Losses, November 28, 1996, specifies the following at paragraph 13:

> 13. If a shareholder is dealing at arm's length with a small business corporation, a business investment loss may arise when the shares of that corporation are redeemed or purchased for cancellation. Subsection 84(9) provides that shares are disposed of by the shareholder to the corporation at the time they are redeemed, acquired or cancelled by the corporation. . . .

[27] Thus, without the existence of subsection 84(9) of the ITA, it can be assumed that a shareholder who is dealing at arm's length with a small business corporation and whose shares are redeemed or cancelled cannot benefit from a BIL.

[28] According to my reading of paragraph 39(1)(*c*) of the ITA, the only way for a taxpayer to claim a BIL on a debt is through the application of subsection 50(1) when the debt has become a bad debt (under subparagraph 39(1)(*c*)(i) of the ITA) or to demonstrate that he or she has disposed of the debt at a loss, in favour of a person at arm's length. If the disposition is realized through the settlement or cancellation of the debt, the taxpayer must demonstrate that he or she has settled or cancelled the debt in favour of a person at arm's length (in accordance with a combined reading of subparagraph 39(1)(*c*)(ii) and the definition of the term "disposition" in subsection 248(1) of the ITA).

[29] Furthermore, in the case of a corporation, if it is able to demonstrate that its debt has become a bad debt under subsection 50(1) of the ITA, it will not be entitled to a BIL if its debt is owed by a corporation with which it is not at arm's length (by virtue of subparagraph 39(1)(*c*)(iv) of the ITA), whereas individuals are not subject to such a restriction (to the extent the individual first demonstrates that he or she has met the conditions of subsection 50(1) of the ITA).

[30] Furthermore, subparagraph 39(1)(*c*)(iv) of the ITA applies only if the prerequisites in subparagraph 39(1)(*c*)(i) and (ii) of the ITA are met.

[31] In this case, I do not believe that it can be said that the appellant meets the second prerequisite to be entitled to claim a BIL. Indeed, in the absence of a provision analogous to subsection 84(9) that would apply in the event of the settlement or cancellation of a debt, I find that, by purely and simply waiving his debt, the appellant did not dispose of it in favour of a person in particular; therefore, *a fortiori*, he did not dispose of it in favour of a person with whom he was dealing at arm's length, or at least did not demonstrate that he did.

Decision

[32] In light of the foregoing, the appellant unfortunately cannot benefit from a BIL based on waiving his debt in 2011.

[33] The appeal is dismissed.

Signed at Ottawa, Canada, this 14th day of November 2014.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 16th day of January 2015
Janine Anderson, Translator

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APPEARANCES:

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COUNSEL OF RECORD:

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