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ALLOWABLE BUSINESS INVESTMENT LOSSES – PART 2

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on allowable business investment losses ("ABILs"). Alpert Law Firm is experienced in providing legal services to its clients in tax dispute resolution and tax litigation, tax and estate planning matters, corporate-commercial transactions and estate administration. Howard Alpert has been certified by the Law Society as a Specialist in Estates and Trusts Law, and also as a Specialist in Corporate and Commercial Law.

A. BUSINESS MUST QUALIFY AS A SMALL BUSINESS CORPORATION

Pursuant to subsection 38(c) of the Act, an ABIL is defined as one-half of a "business investment loss". Only a capital loss will qualify as a business investment loss. Therefore, if a transaction does not result in a capital loss or if the capital loss is deemed to be nil, no business investment loss arises.

A business investment loss may arise from the following dispositions by a taxpayer:

(a) a share of a corporation that is, or was at any time in the twelve months preceding the disposition, a small business corporation. A small business corporation is a Canadian controlled private corporation ("CCPC") that uses all or substantially all of the fair market value of its assets principally in an active business carried on primarily in Canada by the corporation or a related corporation; or

(b) a debt owing to the taxpayer by a small business corporation as defined above (other than, where the taxpayer is a corporation, a debt owed to it by a non-arm's length small business corporation). Therefore, a capital loss incurred by a corporation on a disposition of a debt owing to it by another corporation with which it does not deal at arm's length will not be regarded as a business investment loss.

1. *Gill v. M.N.R.*, 98 DTC 2048

In this Tax Court of Canada decision, the taxpayers advanced funds to a corporation, which purchased land in 1988. The corporation then acted as the main contractor in the construction of a 17-unit strip plaza on the land. A receiver was appointed on October 22, 1993, for this plaza, and the taxpayers' advances were never repaid, having become bad debts during 1993. The Minister denied the taxpayers' ABIL deductions for 1993, claiming that the corporation was not a "small business corporation" carrying on an "active business", as defined in subsection 248(1), but was, in fact, a corporation carrying on a "specified investment business." Pursuant to paragraph 125(7)(e) of the Act, a "specified investment business" is carried on by a corporation: (i) who employs less than five full-time employees throughout the year; and (ii) whose principal purpose is to derive income from property.

The Tax Court of Canada dismissed the taxpayers' appeals since there was no evidence that the corporation had more than five full-time employees. In addition, the corporation's "principal purpose" was to earn income from property in the form of (i) rental income from this plaza, (ii) interest on the rental deposits, and (iii) a management fee. As a result, the Tax Court found that the corporation was involved in a "specified investment business," and did not qualify as a "small business corporation." Therefore, the losses sustained by the taxpayers were not ABILs, but were held to be net capital losses available for carryover to be applied against capital gains earned by the taxpayers in the carryover years.

2. *Belzile v. The Queen*, 2006 DTC 2540

In this Tax Court of Canada case, the taxpayer and a business associate incorporated a numbered company, which during 1995 to 1996 constructed an 8-unit residential building. The numbered company was in the construction business, and its activities consisted of constructing and selling buildings. The taxpayer loaned the numbered company $65,405. However, the company was unsuccessful in selling the units for several years. By 2000, despite (i) renting out the residential units, (ii) the loan by the taxpayer, and (iii) their efforts to sell the building, the company continued to lose money. The taxpayer, in computing his 2000 income, deducted the amount of his loans as an ABIL. The Minister disallowed the deduction, claiming that the numbered company which the taxpayer gave funds to was a "specified investment business," and as such, did not meet the criteria in the definition of a "small business corporation" in subsection 248(1) of the Act. The taxpayer appealed to the Tax Court of Canada.

The Tax Court of Canada allowed the ABIL deduction in regards to the funds advanced by the taxpayer. The Tax Court found that, at all times, the numbered company was in the construction business and its activities consisted of constructing and selling buildings. The company had only rented the building in this case because it was unable to sell it, and at no time did the company ever deviate from its primary objection of building and selling buildings. As such, the company was not operating a

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"specified investment business," and met the criteria for qualifying as a "small business corporation." As such, the Tax Court found that the taxpayer was entitled to the ABIL deduction he claimed.

3. *Fillion et al. v. The Queen*, 2004 DTC 6579

In this Federal Court of Appeal decision, the Minister assessed the taxpayer for three consecutive taxation years, and disallowed an ABIL deduction the taxpayer claimed. The claim had arisen from a $30,000 investment the taxpayer had made in a corporation situated, and carrying on business, in Mali. The taxpayer appealed to the Tax Court of Canada.

The Tax Court of Canada found that the corporation in Mali was not a small business corporation as its assets were situated outside of Canada. Accordingly, it did not meet the ABIL deductibility rules of paragraph 39(1)(c) of the Act. As such, the taxpayer was not entitled to the ABIL deduction. The Federal Court of Appeal upheld the Tax Court's decision. Thus, assets of an SBC must be used principally in an active business carried on primarily in Canada.

4. *Mackay v. The Queen*, 2006 DTC 3653

In this Tax Court of Canada case, the Minister disallowed the ABIL deduction claimed by the taxpayer for a loan made to another individual to acquire shares of a corporation. The sole issue was whether the amounts loaned by the taxpayer had been loaned to an individual or to a CCPC.

The Tax Court of Canada dismissed the taxpayer's appeal and affirmed the Minister's decision. According to the documentary evidence submitted, the loans in question had not been made by the taxpayer to a CCPC. The loans were, in fact, made to an individual to enable him to acquire shares in a CCPC. In addition, the loans were not given to the individual as a trustee for the taxpayer to invest in the CCPC. The Tax Court further held that the taxpayer never became a shareholder in the CCPC. Consequently, the taxpayer's appeal was dismissed and she was not entitled to the ABIL deduction claimed.

5. *Benjamin v. The Queen*, 2006 DTC 2265

In this Tax Court of Canada decision, the Minister disallowed an ABIL deduction because there was no evidence that proved that the taxpayer invested in a CCPC.

The Tax Court of Canada allowed the taxpayer's appeal. Although the taxpayer did not have sufficient documentary evidence to prove that he actually made any investment in the CCPC, the Tax Court allowed his ABIL deduction based on the credibility of his testimony and the testimony of his witnesses. The Tax Court held that the policy of the CRA to require documentation to support an expense, a payment or a deduction is not the policy of the Tax Court of Canada, unless the taxing statute specifically requires it. If a taxpayer can demonstrate through credible oral testimony that a payment was made or an expense incurred, the Tax Court will make a finding based on that evidence and give effect to it. Although the taxpayer's documentary evidence was deficient, the Tax Court held that his testimony and that of his witnesses, that he had, in fact, made the investment in the CCPC, was credible. Accordingly, the taxpayer's appeal was allowed, and he was entitled to the ABIL deduction claimed.

6. *Abrametz v. The Queen*, 2009 DTC 5083

This Federal Court of Appeal case involved an ABIL claim concerning a loan guarantee. The taxpayer and an unrelated party (P) were shareholders and sole directors of two corporations: Regent and Placid. The taxpayer and P were jointly and severally liable as guarantors of Regent's debts to an arm's length mortgagee (the Bank). When Regent defaulted on those debts, the Bank sought to enforce the guarantee. Consequently, P paid a sum of money to the Bank in order to discharge the guarantee. To repay P his half of the amount, the taxpayer transferred his shares in Placid to P. As a result, the taxpayer reported a capital gain in respect of the Placid share transfer. To offset some of the gain, the taxpayer sought to deduct an ABIL, claiming that, because of the law of subrogation, he now acquired half of the Regent debt and was entitled to the ABIL.

The Minister disallowed the ABIL claim, pursuant to subsection 39(12) of the Act, on the basis that (i) Regent was not a small business corporation and (ii) no evidence was presented to demonstrate that the taxpayer paid the debts on behalf of Regent. The Tax Court of Canada dismissed the taxpayer's appeal holding that the taxpayer failed to disprove the assumptions on which the Minister's determination was based and failed to present the necessary evidence to support his claim.

The Federal Court of Appeal set aside the Tax Court decision and allowed the taxpayer's appeal in part. The Federal Court of Appeal held that, even if the taxpayer had not realized a business investment loss, the taxpayer may have realized a capital loss. The Federal Court of Appeal further found that the approach taken by the Tax Court of Canada was incorrect and constituted an error of law. The Federal Court of Appeal followed an earlier Tax Court of Canada decision in ***Dietrich v. Canada*, 2005**

DTC 990, holding that the correct approach to determine whether a loss is a business investment loss is an analysis based on paragraph 39(1)(c), not subsection 39(12) of the Act as adopted by the Tax Court, which was found to be irrelevant in the circumstances.

Pursuant to paragraph 39(1)(c) of the Act, the requirements that a taxpayer must establish to sustain an ABIL claim are as follows: (i) the taxpayer must acquire a portion of the indebtedness as a consequence of having made the guarantee payment, in respect of the indebtedness of the corporation; (ii) the taxpayer must have realized a capital loss as a result of the deemed or actual disposition of the acquired debt; and (iii) the corporation that owes the debt must qualify as a small business corporation, at the time of the deemed or actual disposition of the acquired debt.

The Federal Court of Appeal held that the taxpayer had not realized an ABIL because Regent did not meet the definition of a small business corporation at the relevant time. The Federal Court of Appeal agreed with the Tax Court's conclusion that the taxpayer failed to adduce evidence that established that Regent ever engaged in an active business, as required by the definition of small business corporation. Thus, the case was referred back to the Minister for reconsideration and reassessment to determine whether the taxpayer realized a capital loss as a consequence of having made that payment.

7. <u>Ollenberger v. R., 2013 FCA 74</u>

In this Federal Court of Appeal case, the taxpayer advanced funds to a new corporation engaged in acquiring distressed oil and gas properties. The taxpayer did not own any shares in the corporation. The taxpayer loaned the corporation $600,000 in order to purchase one such property. In exchange the taxpayer was to receive a $100,000 commission. The transaction fell apart as a result of a defect in title, and the corporation was unable to repay the loan made to it by the taxpayer. The taxpayer claimed an ABIL in respect of the loan. The Minister reassessed the taxpayer, finding that no loss had taken place, and that the corporation was not an "active business corporation" for the purposes of the *Income Tax Act*. The taxpayer appealed the assessment to the Tax Court of Canada, where the Minister agreed at the discovery stage that a loss had occurred. The Tax Court held that the corporation was not "active" under the ordinary and harmonious meaning of the terms.

The Federal Court of Appeal allowed the taxpayer's appeal, holding that that the definition of "active business" is an inclusive one that applies to almost all businesses. The Federal Court of Appeal held that the definition given in subsection 248(1) of the

Income Tax Act must be read simply to apply to all businesses with a minor degree of activity that are not specified investment businesses or personal service businesses. The taxpayer was, therefore, allowed to deduct the loss as an ABIL.

8. McDowell v. R., 2012 TCC 244

In this Tax Court of Canada case, at the request of Laurentian Bank the taxpayer advanced $1,115,000 to a corporation which was wholly owned by her spouse. Within a few months of the loan, a receiver was appointed by the chief creditor of the corporation, and almost all of the assets of the corporation were disposed of. The taxpayer claimed an ABIL for the loan amount, claiming the debt had become bad under subsection 50(1) of the *Income Tax Act*. The Minister reassessed the taxpayer, denying the ABIL deductions. The Minister found that the company had not been carrying on active business within the 12 months preceding the loan by the taxpayer, and thereby did not constitute a small business corporation for the purposes of the Act. The Taxpayer appealed to the Tax Court of Canada, claiming that while the Minister was correct in their finding, there was some authority that a corporation can be taken to be a small business corporation in instances of temporary dormancy.

The Tax Court of Canada dismissed the taxpayer's appeal, holding that the inactivity of the corporation was in no way temporary, as of the time that the debt was declared bad under subsection 50(1) of the *Income Tax Act*. As a result, the Court held that the corporation was not a small business corporation for the purposes of the *Income Tax Act*, and that the ABIL was correctly disallowed.

B. INCOME EARNING PURPOSE

1. *Blanco v. The Queen*, 98 DTC 1678

In this Tax Court of Canada decision, the taxpayer's husband was a mentally incompetent person. In 1989, the taxpayer, on behalf of her husband, utilized a Power of Attorney granted to her in September 1986, and loaned $100,000 to a corporation owned by her daughter and son-in-law. No supporting documentation, promissory note or other security was taken back by the taxpayer. The purpose of the loan was to allow the corporation to purchase a restaurant business. In 1991, the business failed, and the corporation became insolvent. As a result, the $100,000 loan was uncollectible. The husband died on January 10, 1995. In computing the income of the husband's estate for 1991, the taxpayer, in her capacity as executrix of her husband's estate, attempted to deduct the loss arising from the uncollectible loan as an ABIL. The Minister disallowed such deduction.

The Tax Court of Canada dismissed the appeal and held that the taxpayer had made the $100,000 loan for the purpose of assisting her daughter and family, finding that her primary reason for making this loan was for her family. Therefore, the taxpayer was unable to discharge the onus of proving that the loan had been granted for the purpose of earning income as required by subparagraph 40(2)(g)(ii) of the Act. Thus, the taxpayer was not entitled to the ABIL deduction which she had claimed.

2. *Poirier v. The Queen*, 2000 DTC 2463

In this Tax Court of Canada decision, the taxpayer was a shareholder and the sole director of a corporation, which went insolvent in May 1995. At that time, the corporation owed provincial sales tax and workers' compensation remittances. The taxpayer personally guaranteed the payment of these amounts, and the various government bodies registered liens against a property owned by the taxpayer to secure such guarantee. On May 10, 1995, the taxpayer's property was sold in order to satisfy these liens, and as a result, the taxpayer was required to pay these amounts personally. The taxpayer claimed these payments as deductible ABILs in his 1995 tax return. The Minister disallowed these deductions.

The taxpayer's appeal was dismissed by the Tax Court of Canada. The Minister's counsel accepted that the taxpayer had a legal obligation to pay these amounts, which resulted in a debt owing by the corporation to the taxpayer. While the Tax Court was prepared to accept the counsel's view on this point, the Tax Court was not prepared to independently endorse it. The Tax Court held that, where a payment is made pursuant to a guarantee by a shareholder of a debt of a corporation, the debt that arises by subrogation is acquired for the purpose of gaining or producing income. However, this was held to only apply to situations where the corporation is still in operation and not insolvent, with a view to enhancing its income earning potential. The Tax Court found that the corporation was insolvent and had closed down when the taxpayer made the payments, therefore, the payments were not made for the purpose of gaining income. The taxpayer was merely paying off an obligation imposed by law after no further possibility of earning income from the corporation existed.

3. *Mackay v. The Queen*, 2003 DTC 748

This Tax Court of Canada case dealt with an ABIL deduction claim of a taxpayer whose claim arose from a series of loans he had given to a numbered company of which he was a shareholder. During the years 1994, 1995, and 1996, the taxpayer had given this numbered company loans which totalled $121,138, $120,839, and $127,614 respectively. In computing his income for those taxation years, the taxpayer reported the loans as an ABIL deduction. The Minister disallowed the taxpayer's ABIL claim stating that: (i) the loans were non-interest bearing, and as such the loans had not been made with a goal of earning income (as required by subparagraph 40(2)(g)(ii) of the Act); and (ii) the loans made to the company had not become bad debts. The taxpayer appealed.

The Tax Court of Canada allowed the ABIL deduction regarding the loans made by the taxpayer. The Tax Court found that although the loans were non-interest bearing, it could not be said that they had not been made for the purposes of gaining or producing income from a business or property, as required by subparagraph 40(2)(g)(ii) of the Act. The fact that a loan is interest free is irrelevant in deciding whether the loan was given for the purpose of earning income, as it is common for a shareholder to lend money, without interest and without security in the corporation, in anticipation that the loans will assist the corporation to earn income and to pay him by way of dividends. The Tax Court concluded that the loans were made for that precise purpose: to produce income. The Tax Court also concluded that the loans had become bad debts by the last day in each of the respective years, as the evidence indicated that the corporation had no real ability to pay back the taxpayer the amounts it owed by the end of the year each of the loans were given.

4. *Joncas v. The Queen*, 2004 DTC 2315

This Tax Court of Canada case dealt with an ABIL deduction claim of a taxpayer whose claim arose from a $222,325 advance he had made to a Co-operative of which he was a member. The Co-operative then ceased its operations, and the amounts advanced by the taxpayer became a bad debt for him. As such, the taxpayer claimed the amounts advanced as an ABIL. The Minister disallowed the taxpayer's ABIL claim, stating that the advance to the Co-operative that gave rise to his claim had not been made with a goal of earning income (as required by subparagraph 40(2)(g)(ii) of the Act), but rather the advance was made for philanthropic purposes. The taxpayer appealed.

The Tax Court of Canada allowed the ABIL deduction in regards to the advance to the Co-operative. The Tax Court found that the taxpayer had not made the advance to the Co-operative for philanthropic purposes, but to promote his own commercial business interest and derive income. The documentary evidence and verbal testimony indicated that the taxpayer was engaged in the Co-operative for economic purposes and made loans to the Co-operative to enable it to start up and get through its growth period. The Tax Court concluded that the advance met the requirements of subparagraph 40(2)(g)(ii) of the Act and entitled the taxpayer to the ABIL claimed.

5. *Russell Scott v. The Queen*, 2010 TCC 401

In this Tax Court of Canada case, the taxpayer made interest-bearing loans to a corporation, which was owned by his son and daughter-in-law. The taxpayer and the corporation entered into a financing agreement, setting out that the interest and repayment terms were to be the same as those of the taxpayer's borrowings from his lenders. In addition, the agreement contained a financing fee payable by the corporation to the taxpayer at the end of the term. This additional financing fee was the equivalent of an additional 5 percent return to the taxpayer over his cost of funds. This was the equivalent of a 1 percent spread over his cost of funds annually over the five-year term.

The following relevant facts were not in dispute: (i) that the amounts advanced were considered loans; (ii) that the loans went bad; and (iii) the corporation was a small business corporation. The only issue was whether the taxpayer loaned the money for the purpose of earning income.

The Tax Court cited *Rich v. The Queen*, 2003 DTC 5115 in stating that one of the purposes of the loan needed to be to earn income, however it need not be the primary purpose. One factor that the Tax Court focused on was whether a reasonable return in the form of interest was legally payable on the loan. In a related party loan, a rate of return is considered reasonable if the total return exceeds the lender's cost of funds. Accordingly, because of this additional financing fee, the Court found that "the cost to [the corporation] of the loan materially exceeded [the taxpayer]'s cost of funds". If the taxpayer only wanted to lend the money to help his son and daughter-in-law, without having an income earning purpose, he needed only to have charged interest at the rate that he was charged. Therefore, the taxpayer's appeal was allowed and the matter was sent back to the Minister for reassessment.

6. *Gilbert v. The Queen*, 2009 DTC 1205

In this recent Tax Court of Canada case, the taxpayers were the sole shareholders and directors of a corporation that was experiencing financial difficulties. In May 2001, the taxpayers made voluntary payments amounting to $34,386 to some of the creditors of the corporation. On May 31, 2001, the corporation made an assignment into bankruptcy. The taxpayers each claimed an ABIL in respect of the payments to the creditors.

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The Minister denied the taxpayers' ABIL deduction claim and reassessed the taxpayers' 2001 returns. The taxpayers appealed to the Tax Court of Canada on various grounds, including that the amounts claimed by the taxpayers were valid ABIL deduction claims.

The Tax Court reaffirmed the Minister's decision and held that the payments were not made for income earning purposes because the payments could not have been recovered from the corporation in light of the imminent bankruptcy. Since the taxpayers were not legally required to make the payments to the creditors, the Tax Court found it obvious that these payments were made specifically for a tax benefit, as the taxpayers were aware that the amounts would be lost definitively without a possibility of return. The taxpayers had elected to pay the creditors without duress or coercion and without any hope of any profit or income; therefore the payments could not have been paid to earn income. The Tax Court concluded that this was merely a payment of convenience and did not satisfy the requirements for an ABIL deduction.

7. *Daniels v. The Queen,* 2007 DTC 883

In this Tax Court of Canada case, the taxpayer and his brother each owned a $4,000,000 debenture of Shoppers Trust Co. ("Shoppers"), which was a Canadian controlled private corporation and small business corporation. The taxpayer held a 25% share interest of Shoppers through a holding company controlled by him, while his brother held 75% of the shares of Shoppers. They had taken out a bank loan on a joint and several basis, which was used to acquire a further debenture from Shoppers.

When Shoppers went into receivership, the taxpayer and his brother, on the determination that the Shoppers' debenture had become worthless, were each allowed an ABIL deduction of $3,000,000. The taxpayer had repaid his full amount, however, his brother was unable to do so. Therefore, the taxpayer accepted his brother's debenture, and claimed an additional ABIL deduction of $3,000,000 for the $4,000,000 debenture acquired from his brother. The Minister disallowed this deduction on the basis that the $4,000,000 debenture was not acquired by the taxpayer from his brother in order to earn income from business or property.

The taxpayer appealed to the Tax Court. The issue before the Tax Court was whether the taxpayer acquired his brother's debenture for the purpose of gaining or producing income from a business or property within the meaning of subparagraph 40(20(g)(ii) of the Act.

The taxpayer's principal argument was that his brother's debenture might one day have value. Alternatively, the taxpayer argued that the time to consider the purpose of acquiring the debenture should be determined by looking to the event that eventually gave rise to the acquisition. In this case, the taxpayer acquired the debenture as a direct result of the income earning purpose that motivated him to guarantee his brother's debt and invest in Shoppers originally.

The Tax Court allowed the taxpayer's appeal on the basis of the taxpayer's alternative argument. However, note that the Tax Court also spoke to the taxpayer's principal argument and took the position that if the taxpayer acquired the debenture, it was because he believed it could have value in the future. Thus, a "faint hope" of future value is enough to meet the income-earning purpose requirement.

8. ***Woloshyn v. The Queen*, 2011 DTC 1260**

In this Tax Court of Canada case, the taxpayer and his spouse were shareholders of a corporation, which was sold in 2002. Afterwards, the taxpayer personally paid the amounts required to settle two creditor debt claims against the corporation which he had personally guaranteed. The taxpayer also personally incurred legal fees in settling these claims. The taxpayer was reassessed by the Minister for his 2007 taxation year as a result of a T1 Adjustment Request, and was allowed an ABIL in respect of the payment of the two creditors claims. However, the taxpayer appealed to the Tax Court of Canada, and argued that the ABIL should have also included the legal fees incurred from the settlement of business debts.

The Tax Court dismissed the taxpayer's appeal, and held that the legal fees incurred in settling the two debts did not form part of the taxpayer's ABIL. The Court in ***Thiele Drywall Inc. v. R.*, 1996 UDTC 337** observed that the deduction of legal expenses are permitted when such costs are incurred in order to preserve the taxpayer's ability to earn income in the normal course of the taxpayer's business. However, the settlement of the two debts mentioned above occurred long after the business had been sold, and the payment of the debts was not for the purpose of producing profits for the business. Since the legal fees incurred were of a personal nature, they were not deductible under subsection 18(1)(h) of the Act.

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C. BUSINESS LOSSES

1. *Giasson v. The Queen*, 2010 DTC 1115

In this Tax Court of Canada case, the issue was whether the taxpayer's losses on his loan guarantees were considered to be ABIL or business losses. The taxpayer owned 99% of the shares of a corporation (HCI). HCI had bank loans owing, which were guaranteed by the taxpayer. The taxpayer sought to deduct as business expenses, losses he incurred in paying out the guarantees. However, the Minister took the position that the amounts paid under the guarantees were ABILs.

The Tax Court turned to *Easton v. The Queen* (97 DTC 464) for the general principle concerning personal guarantees of the shareholder that allow a corporation to obtain loans from financial institutions. The general principle was stated to be that guarantees by shareholders of corporate loans are generally presumed to be capital in nature. However, there are two exceptions to rebut that presumption: (i) guarantees given in normal course of the shareholder's business activities, and (ii) when corporate shares are held as a commercial asset rather than as an investment.

The taxpayer argued that he fell within these exceptions (i.e. the guarantee was *not* capital in nature), and attempted to show that he granted the guarantees in the ordinary course of his business. Alternatively, the taxpayer noted that he did not seek to show that his shareholdings in HCI were a trading asset. If it were a trading asset, the gains or losses would be on account of income, and not capital.

The Tax Court held that the taxpayer did not meet the conditions for the exceptions set out in *Easton*. The Tax Court stated that the loans of HCI guaranteed by the taxpayer were incurred to provide HCI with operating funds, and that the taxpayer failed to show that he operated any business at all. Thus, there was no connection between the granting of the guarantees and the operation of a business by the taxpayer. Furthermore, the fact that the taxpayer held the shares for 10 years suggested that he held the shares as an investment. Thus, the Court concluded that the losses were correctly treated as ABILs by the Minister.

D. CURRENT STATUS OF DEBT

The Tax Court of Canada has ruled on two cases that interpret the effect that changes in the status of a debt can have on the ability of a taxpayer to deduct ABILs.

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1. ***Litowitz v. R*****, 2005 TCC 557**

In this Tax Court of Canada case, the issue was whether the taxpayer's debt could be considered to have been bad at the time he declared a business investment loss. The taxpayer invested in a corporation the sole asset of which was shares in another company, whose sole asset was a co-tenancy project. When the co-tenancy ran into financial troubles, the financial prospects for the taxpayer's investment looked dim and he elected to declare the debt bad, pursuant to subsection 50(1) of the Act. The Minister disagreed with this assessment and disallowed the ABIL. The taxpayer appealed this decision to the Tax Court of Canada.

The Tax Court determined that the taxpayer was entitled to a degree of deference for their bona fide business decision making. This imports part of the business judgement rule of corporate law, and imparts a degree of deference for the business decision making of a taxpayer. The Tax Court also ruled on an interesting quirk that was specific to this particular situation. The corporation later recovered, and was able to pay the debt that it owed to the taxpayer, but the Tax Court determined that this did not affect the ability of the taxpayer to claim the ABIL.

This decision indicates that the Tax court of Canada will focus on the decision making at play at the time of the election, and in doing so will give deference to the business decision making of the investor. This case also underscored that the Court will not take later situations into account in determining whether it was reasonable to consider that a debt had become bad.

3. ***Delisle c. R.*****, 2015 TCC 281**

In this Tax Court of Canada case, the taxpayer was one of a number of creditors who possessed a debt from a company that had undergone financial troubles. The debtor company was forced into bankruptcy, and made a proposal to their creditors. This proposal was accepted by a majority of the creditors of the debtor company. The taxpayer declared the debt to have become bad in his next taxation year, and was reassessed by the Minister. The central issue was whether the acceptance of the bankruptcy proposal removed the debt underlying the ABIL claim.

The tax Court of Canada held that the acceptance of the bankruptcy proposal had discharged all of the remaining debts held by the debtor corporation. As a result,

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the Tax Court of Canada held that the taxpayer was not entitled to an ABIl deduction because the underlying debt no longer existed.

This holding indicates that the Tax Court will take subsequent events that affect the underlying debt into account, even where the loss is clear and unquestioned. This indicates that, while circumstances related to the ultimate satisfaction of a debt will not necessarily affect the ability of a taxpayer to claim an ABIL, but events that affect the existence of the debt will affect the ability of a taxpayer to claim an ABIL.

These two cases underscore the importance of timing with regards to events that affect the status of a debt. In *Litowitz,* the ABIL was claimed before the debt was ultimately satisfied, while in *Delisle,* the proposal in bankruptcy was agreed upon before the taxpayer made his ABIL claim. This shows the importance of considering the timing of events that take place after the creation of the underlying obligation.

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Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.