Docket: 2012-793(IT)G

BETWEEN:

LEONARD ROSZKO,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on February 7, 2014, at Edmonton, Alberta

By: The Honourable Justice Campbell J. Miller

Appearances:

Counsel for the Appellant:	S. Dane ZoBell
Counsel for the Respondent:	Donna Tomljanovic

JUDGMENT

The Appeal from the reassessment made under the *Income Tax Act* for the 2008 taxation year is allowed and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant did not earn interest income of $156,000 in 2008.

Signed at Ottawa, Canada, this 21st day of February 2014.

"Campbell J. Miller"

C. Miller J.

Citation: 2014 TCC 59
Date: 20140221
Docket: 2012-793(IT)G

BETWEEN:

LEONARD ROSZKO,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

C. Miller J.

[1] In 2008 Mr. Roszko received $156,000 from TransCap Corporation ("TransCap"). Unbeknownst to Mr. Roszko, TransCap ran a well-orchestrated Ponzi scheme. The issue before me is whether the $156,000 was interest received by Mr. Roszko duly taxable as income from a source, or whether the $156,000 was a return of part of the $800,000 Mr. Roszko believed he had loaned to TransCap.

[2] The Parties provided me with an Agreed Statement of Facts as follows:

1. At all material times, the Appellant was an individual resident in Canada and Alberta for the purposes of the *Income Tax Act*.

2. From February 2006 to December 2007 the Appellant provided TransCap Corporation with a series of four amounts which totalled $800,000.

3. With each amount provided to TransCap Corporation, the Appellant received documents as follows:

   (a) Exhibit 1 – Copies of TransCap Corporation Schedule A – Lenders Document, Schedule B – Promissory Note and Wire Payment Services confirmation report respecting the $100,000 February/March 2006 funds;

(b) Exhibit 2 – Copies of TransCap Corporation Schedule A – Lenders Document, Schedule B – Promissory Note and Wire Payment Services confirmation report respecting the $100,000 May/June 2006 funds;

(c) Exhibit 3 – Copies of TransCap Corporation Schedule A – Lenders Document, Schedule B – Promissory Note and Wire Payment Services confirmation report respecting the $300,000 January 2007 funds; and

(d) Exhibit 4 – Copies of TransCap Corporation Schedule A – Lenders Document, Schedule B – Promissory Note and Wire Payment Services confirmation report respecting the $300,000 October 2007 funds;

4. Each of the Schedule A – Lenders Documents and Schedule B – Promissory Notes found at Exhibits 1 through 4 were issued according to the T.C.C. Master Loan Agreement. A copy of the T.C.C. Master Loan Agreement is attached as Exhibit 5.

5. In 2008, the Appellant received a total of $156,000 from TransCap Corporation, broken down as follows:

(i) $7,500 monthly, by way of cheque or direct deposit; and

(ii) A $66,000 annual sum by way of cheque.

Copies of the cheques for the period May 2008 through December 2008 are attached as Exhibit 6.

6. The Appellant reported the $156,000 received from TransCap Corporation in his 2008 T1 personal income tax return as interest income and paid both federal and provincial income taxes on this amount.

7. TransCap Corporation did not ever issue the Appellant any T5 Statement of Investment Income slips for any funds received from TransCap Corporation.

8. TransCap Corporation perpetrated a fraud on Alberta investors, including the Appellant, contrary to the *Securities Act* (Alberta), RSA 2000 c. S-4. A copy of the Alberta Securities Commission decisions *Re TransCap Corporation*, 2013 ABASC 201, and *Re TransCap Corporation*, 2013 ABASC 326 are attached as collectively at Exhibit 7.

9. In total, TransCap Corporation provided $408,000 to the Appellant between 2006 and 2009, inclusive, as follows:

2006: $22,500

2007: $81,000

2008: $156,000

2009: $148,500

The annual amounts were received by the Appellant by way of monthly cheques or direct deposits and, in 2008 and 2009, one larger lump sum in the amount of $66,000. The Appellant has not received any additional funds from TransCap Corporation.

10. On December 6, 2012, the Appellant sent correspondence to TransCap Corporation declaring all funds received from TransCap Corporation to be a return of capital. A copy of the December 6, 2012 correspondence is attached as Exhibit 8.

[3] Rather than attach all the exhibits referred to in the Agreed Statement of Facts, I have attached the following:

Appendix A	Promissory Note for $100,000 dated the 1st day of March, 2006; (the second Promissory Note for $100,000 is similar)
Appendix B	Promissory Note for $300,000 dated January 18, 2007; (the second Promissory Note for $300,000 is similar)
Appendix C	Excerpts from Master Loan Agreement.

[4] Mr. Roszko testified, flushing out in greater detail some of the above facts. He had sold the family farm in 2006 and invested his portion of the proceeds with a reputable Alberta financial enterprise. However, as he was concerned about taxes arising from the sale of the farm, he attended a presentation by TransCap in Edmonton, hoping that he may receive some advice to assist with his tax position. Instead, with promises from Blair Carmichael of TransCap that he could achieve significant returns on his investments in the range of 18% to 22%, and following a subsequent meeting with Mr. Carmichael, Mr. Roszko decided to try an initial $100,000 investment. As is clear from the schedules attached this was set up in the form of a loan. Mr. Roszko was led to believe TransCap bought and sold commodities at considerable profit to achieve the high returns.

[5] Having received the monthly payments promised on the first $100,000, he proceeded to make an additional $100,000 investment and again received the promised monthly payments. He then made the two additional $300,000 investments, receiving payments from TransCap as set out in paragraph 9 of the Agreed Statement of Facts.

[6] In December 2009, after the accidental death of his son, Mr. Roszko approached TransCap for a return of some funds to cover funeral expenses. His request was denied in a manner which caused Mr. Roszko some suspicion. He made enquiries which eventually led to an Alberta Securities Commission investigation, and a finding by the Alberta Securities Commission that TransCap perpetrated a fraud on investors. The Alberta Securities Commission[1] indicated in their decision of May 9, 2013 that:

> 143 The "prohibited act" asserted by Staff was, essentially, the misrepresentations to Alberta investors that their money would be applied in bond trading and bridge financing that would fund interest payments and principal payments on TCC and STC securities, whereas in fact payments to investors in this Ponzi scheme were funded from their own and their fellow investors subscription money – something sustainable only for so long as investment subscriptions covered the payments out.

Issue

[7] Is the $156,000 received by Mr. Roszko in 2008 from TransCap interest income within the meaning of paragraph 12(1)(*c*) of the *Income Tax Act* (the "*Act*") or does it represent the return of capital?

Analysis

[8] The Appellant's position is that the sum of $156,000 received by the Appellant is a return of the principal loan to TransCap and is not includable in his income, for the following two reasons:

a) First, the Appellant entered into the lending arrangement having relied on fraudulent misrepresentations. As the innocent party, the Appellant has rescinded the lending arrangement, rendering the contract void

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[1] TransCap Corporation, Re, 2013 ABASC 201.

ab initio and of no effect with respect to any payment of interest. In the alternative, the Appellant argues that the transfer of funds by him to TransCap in circumstances where there is no enforceable agreement, and no consideration payable by TransCap, creates a resulting trust. The beneficial ownership of the funds advanced by Mr. Roszko therefore always remained with him. The only possible characterization of the payment to the Appellant is the transfer to him of legal title to funds that were beneficially already owned by him.

b) Second, the lending arrangement itself provides that any misrepresentation or breach of the agreement would result in all principal and interest becoming due and payable, without demand. As such, it is reasonable for the Appellant to characterize the amount received as return of principal.

[9] The Respondent relies on the four contracts along with the Master Loan Agreement to argue that the $156,000 clearly falls into interest within the meaning of paragraph 12(1)(*c*) of the *Act*, and the fact of fraud does not negate a finding of interest from a source. The Respondent considered the factors cited in the case of *R v Cranswick*[2] and also relied on the Federal Court of Appeal's decision in *Johnson v R*[3] to reach this conclusion. The Respondent also identified three requirements, based on the Federal Court of Appeal decisions of *Perini v R.*[4] and *Sherway Centre Ltd. v R*,[5] that, if met, would render an amount interest:

a) the amount was compensation for the borrower's use of the money;

b) the amount was ascertainable on a daily basis;

c) the amount was related to the outstanding principal sum.

[10] The basic distinction between the Respondent's approach and the Appellant's first reason is that the Appellant maintains that, legally, Mr. Roszko could rescind the

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2 [1982]1 FC 813, 82 DTC 6073.

3 2012 FCA 254.

4 82 DTC 6080.

5 (1998) 98 DTC 6121.

contract and render it void *ab initio* (which he did by letter of December 6, 2012), whereas the Respondent maintains one has to look to the terms of the contract, which are enforceable, and they evidence Mr. Roszko's right to interest income. In effect, the Respondent relies on the contract and the Appellant does not.

[11] The Parties raise these rather technical arguments addressing contract law, creditor-debtor law and tax law. I am not convinced the situation needs to be as technically dissected. In the *Johnson* case, which also involved a Ponzi scheme, the Federal Court of Appeal concluded there can indeed be a source of income in a Ponzi scheme. It confirmed that, where, as in that case, the investor ultimately receives back more than she invested, applying the factors in the *Cranswick* case, there is indeed income from a source.

[12] However, in *Johnson*, the situation was quite different from the situation before me. In *Johnson*, the Federal Court of Appeal found that the contract was simply Ms. Johnson agreeing to invest money on the basis she would receive the money she invested "with a return in instalments in the amounts and on the dates indicated by the post-dated cheques he gave her in exchange". The Federal Court of Appeal went on to say:

> 39. Ms. Johnson may well have believed that Mr. Lech was going to use the money to earn profits by option trading, because that is what he told her he would do. However, the record discloses no evidence upon which the judge could reasonably conclude that Mr. Lech was under a contractual obligation to Ms. Johnson to generate profits in that manner, or in any particular manner.
>
> …
>
> 43. … Hypothetically, if Ms. Johnson had made her payments to Mr. Lech knowing that he would use the money to operate a Ponzi scheme, she would have profited exactly as she did in the years in issue in this case …
>
> …
>
> 49. However, the principle on which Mr. Hammill was precluded from claiming tax relief for his losses is not applicable to Ms. Johnson. Their circumstances are entirely different, not because she profited from her transactions with Mr. Lech, but because her contractual rights were respected. As a matter of law, the fact that Mr. Lech used the proceeds of his unlawful Ponzi scheme to fund the profits he was contractually obliged to pay to Ms. Johnson is not relevant in determining the income tax consequences to Ms. Johnson of her transactions with Mr. Lech.

[emphasis added]

[13] There are significant differences between Ms. Johnson's situation and Mr. Roszko's:

a) Mr. Roszko's agreement with TransCap stipulated how the funds were to be invested;

b) Mr. Roszko was led to believe the funds would be so invested;

c) the funds were not so invested: Mr. Roszko's contractual rights were not respected; although he got a $156,000 payment, it was not derived as contracted;

d) it was agreed as a fact TransCap perpetrated a fraud;

e) the fraud was as described by the Alberta Securities Commission in paragraph 143 of their decision quoted earlier.

[14] The Respondent argued that I could not rely on facts raised in the Alberta Securities Commission decision, not proven in the trial before me. While I accept such a general proposition, I am of the view that the description of the fraud as set out in the above quote from paragraph 143 is the Alberta Securities Commission's finding of law. It is unnecessary for Mr. Roszko to have to subpoena the individuals who perpetrated the fraud on behalf of TransCap to describe the fraud. The Alberta Securities Commission has done so, and I am prepared to rely on that finding.

[15] Mr. Roszko was misled to believe interest would be funded by TransCap. It was not. The funding of those payments, described as interest, was from Mr. Roszko and other investors' own money. That is not what was contracted for: it is not interest.

[16] Putting this analysis in terms of the Respondent's argument, I find that of the requirements to find interest, there is one missing element; that is, that TransCap did not use Mr. Roszko's money as it had contracted to do so – the payment of $156,000 cannot be seen as a payment for the use of the money. Indeed, it is even questionable that TransCap could be considered a "borrower" if it simply took from Peter to pay Paul: that is not interest, that is a return of capital, and only if, as in Ms. Johnson's

case, the investor receives more than a return of capital can we ask whether such profit is business income from a source.

[17] Further, in the *Johnson* decision, the Federal Court of Appeal went on to distinguish the case before it from the *Hammill v R*[6] case. The Federal Court of Appeal in addressing the *Hammill* decision stated:

> 48. … It was determined at trial, however, that Mr. Hammill was the victim of a fraud that commenced when he was contacted about the profits to be made from buying and selling gems, and continued with the purported efforts of the perpetrators to sell the gems. This Court confirmed that his expenditures were not deductible because they were not connected to any source of income – or in other words, there was in fact no business even though Mr. Hammill honestly believed that there was. Justice Noël, writing for the Court, summarized this conclusion as follows at paragraph 28 of the reasons:
>
> > A fraudulent scheme from beginning to end or a sting operation, if that be the case, cannot give rise to a source of income from the victim's point of view and hence cannot be considered as a business under any definition.

[18] Mr. Roszko's situation of having a fraud perpetrated upon him from the outset is more similar to the situation Mr. Hammill found himself in, and, as Justice Noël confirmed, this cannot give rise to a source of business income. Granted, in the case before me, the Respondent is not suggesting there is a source of business income, but a source of property income in the form of interest. The principle I would suggest is the same: the purported interest is a fraud from the outset. It cannot be considered income from property, but rather a return of capital to the extent of the original amounts invested: only excess returns might be considered income. This is quite different from Ms. Johnson's situation where there were excess returns, and the court found she entered into a contract and her rights under that contract were respected. No fraud, as such, was found: she got exactly what she contracted for.

[19] Having reached this conclusion, I find it unnecessary to tackle the thorny issues raised by the Appellant of the effect of rescission on a contract, the concept of a resulting trust, or the impact of an ongoing breach of a contract. I see the matter in simpler terms. Mr. Roszko was defrauded – that has been agreed. He trusted TransCap to wisely invest his $800,000 to yield a significant return. TransCap did not do that. In effect, TransCap just gave Mr. Roszko his own money back or that of

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6 [2005] 4 C.T.C. 29.

other duped investors. There is a distinction, I would suggest, between earning income based on a fraudulent act or illegal activity versus a finding that the contract itself is a fraud. In the former situation there can be a source of income which can be taxable. In the latter situation there cannot.

[20] I allow the Appeal and refer the matter back for reconsideration and reassessment on the basis that Mr. Roszko did not earn interest income of $156,000 in 2008.

Signed at Ottawa, Canada, this 21st day of February 2014.

"Campbell J. Miller"

C. Miller J.

Appendix A

TRANSCAP CORPORATION

SCHEDULE B – PROMISSORY NOTE

LENDER:	Len Roszko Box 1386 Mayerthorpe, AB T0E 1N0	BORROWER: TransCap Corporation 10 Discovery Ridge Heath S.W. Calgary, AB T3H 4Y2

Transaction Code: BJP0306-LR100-000C

This certifies that the Borrower is indebted to the Lender in the amount of $100,000.00 Canadian dollars (the "Principal"). This Promissory Note is issued according to the T.C.C. Master Loan Agreement and is further subject to the following terms and conditions:

1. PRINCIPAL AND INTEREST: Incorporated under the laws of Alberta, Canada, the Borrower, for value received, hereby acknowledges itself indebted and promises to pay the Lender on or about February 28th 2011, the Principal plus interest at the rate of one-point-five (1.5%) percent per month, paid monthly in arrears, all amounts received to be applied firstly against interest and then principal.

2. WAIVER: No consent or waiver by the Lender shall be effective unless made in writing and signed by an authorized officer of the Lender.

3. NOTICE: Any notice to the Borrower may be given by prepaid registered mail to the Borrower at its address set forth herein and any notice so given shall be deemed to have been duly given on the date following the day on which the envelope containing the notice was deposited prepaid and registered in a post office. Notwithstanding the above notice to the Borrower which designates a place or a person to which payment is to be given which is different from that contained above, shall be deemed to have been received by the Corporation six (6) days after the date such notice is sent by registered mail.

4. APPLICABLE LAW: This agreement shall be interpreted in accordance with the laws of Province of Alberta of the country of Canada and the parties hereto do hereby irrevocably submit to the jurisdiction of these courts for all matters related to this agreement, its validity or interpretation.

5. SUCCESSION: This agreement shall enure to the benefit of and be binding upon the parties and their respective successors and assigns.

6. NON-NEGOTIABLE AND NON-TRANSFERABLE: This Promissory Note is non-negotiable and non-transferable.

Dated this 1st day of March 2006.

Signed for and on behalf of TransCap Corporation

Per: _____
Dale E. St. Jean (President)

Appendix B

TRANSCAP CORPORATION

SCHEDULE B – PROMISSORY NOTE

LENDER: Len Roszko
Box 1386
Mayerthorpe, AB T0E 1N0

BORROWER: TransCap Corporation
10 Discovery Ridge Heath S.W.
Calgary, AB T3H 4Y2

Transaction Code: SJB0207-LR300-000C

This certifies that the Borrower is indebted to the Lender in the amount of $300,000.00 Canadian dollars (the "Principal"). This Promissory Note is issued according to the T.C.C. Master Loan Agreement and is further subject to the following terms and conditions:

1. PRINCIPAL AND INTEREST: Incorporated under the laws of Alberta, Canada, the Borrower, for value received, hereby acknowledges itself indebted and promises to pay the Lender on or January 31st 2012, the Principal plus interest at the rate of one-point-five (1.5%) percent per month, paid monthly in arrears, all amounts received to be applied firstly against interest and then principal.

2. WAIVER: No consent or waiver by the Lender shall be effective unless made in writing and signed by an authorized officer of the Lender.

3. NOTICE: Any notice to the Borrower may be given by prepaid registered mail to the Borrower at its address set forth herein and any notice so given shall be deemed to have been duly given on the date following the day on which the envelope containing the notice was deposited prepaid and registered in a post office. Notwithstanding the above notice to the Borrower which designates a place or a person to which payment is to be given which is different from that contained above, shall be deemed to have been received by the Corporation six (6) days after the date such notice is sent by registered mail.

4. APPLICABLE LAW: This agreement shall be interpreted in accordance with the laws of Province of Alberta of the country of Canada and the parties hereto do hereby irrevocably submit to the jurisdiction of these courts for all matters related to this agreement, its validity or interpretation.

5. SUCCESSION: This agreement shall enure to the benefit of and be binding upon the parties and their respective successors and assigns.

6. NON-NEGOTIABLE AND NON-TRANSFERABLE: This Promissory Note is non-negotiable and non-transferable.

Dated this 1st day of February 2007.

Signed for and on behalf of TransCap Corporation

Per: _____
Dale E. St. Jean (President)

APPENDIX C

1.1 The Lender shall be those parties who from time to time lend funds to the Borrower.

1.2 The Indebtedness of the Borrower to the Lender shall, from time time, be equal to the aggregate amount outstanding at any time of all loans and advances made or which mat be made by the Lender to the Borrower pursuant to this Agreement and any interest/capital gain thereon (the "Indebtedness").

…

2.2 The Loan(s) amount plus all accrued and unpaid interest/capital gain, and such other amounts which may be due and payable to the Lender from the Borrower, shall become due and payable in any event on the various Loan Maturity Date(s) as agreed between the particular Lender and the Borrower. Notwithstanding anything herein contained, and in addition to any payment deadlines or accelerated provisions herein contained, all Indebtedness shall become due and payable, without demand, in the event an interest/capital gain payment is not made in a timely manner or upon a Default occurring.

…

3.3 Under Irrevocable Representation and Warranty made with various organizations and institutions and under specific arrangements the loaned funds can only be utilized for "Qualified Transactions" which are defined as the acquisitions of assets only where TransCap has first acquired "Forward Commitment Contracts" with organizations or institutions with the financial strength to provide guaranteed purchases of those assets at a predetermined price and date, which will allow TransCap to make a profit in the transaction. Further conditions of the TransCap Corporation ESCROW is that the original loaned funds can only be returned to the Lender and the original co-ordinates unless notification of change is received from the Lender.

…

5.1.2 Keep the loaned funds in "TransCap Corporation ESCROW" and be managed according to the conditions as stated in Article 3.3. herein.

5.1.3 Continue to be liable for any Indebtedness remaining outstanding should the funds for any reason not be recovered from the "TransCap Corporation ESCROW", and in the event of Default, to satisfy all the Indebtedness, and the Lender shall be entitled to pursue full payment thereof.

…

7.1.2 If the Borrower neglects to carry out or observe any covenant or condition under this Agreement;

…

CITATION:	2014 TCC 59
COURT FILE NO.:	2012-793(IT)G
STYLE OF CAUSE:	LEONARD ROSZKO AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Edmonton, Alberta
DATE OF HEARING:	February 7, 2014
REASONS FOR JUDGMENT BY:	The Honourable Justice Campbell J. Miller
DATE OF JUDGMENT:	February 21, 2014

APPEARANCES:

Counsel for the Appellant:	S. Dane ZoBell
Counsel for the Respondent:	Donna Tomljanovic

COUNSEL OF RECORD:

For the Appellant:

Name:	S. Dane ZoBell
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