Federal Court of Appeal | Cour d'appel fédérale

Date: 20090609

Docket: A-272-08

Citation: 2009 FCA 193

CORAM: **SHARLOW J.A.**
RYER J.A.
TRUDEL J.A.

BETWEEN:

GARRET MADELL

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Edmonton, Alberta, on June 9, 2009.

Judgment delivered from the Bench at Edmonton, Alberta, on June 9, 2009.

REASONS FOR JUDGMENT OF THE COURT BY: RYER J.A.

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REASONS FOR JUDGMENT OF THE COURT
(Delivered from the Bench at Edmonton, Alberta, on June 9, 2009)

RYER J.A.

[1] This is an appeal from a decision of Little J. of the Tax Court of Canada (2008 TCC 264) dated May 2, 2008, dismissing the appeals of Mr. Garret Madell (the "appellant") from assessments of his 1997 and 1998 taxation years that were made by the Minister of National Revenue (the "Minister"), pursuant to the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA"). Unless otherwise indicated, all statutory references in these reasons shall be to the corresponding provisions of the ITA for the taxation years under consideration.

[2] In the taxation years under appeal, the appellant and Stellar Dynamic Limited Partnership (the "Partnership"), in which the appellant was a limited partner, participated in tax shelter arrangements promoted by Stellar Financial Services Inc. Under these arrangements, they entered into licence agreements (the "Licence Agreements") with Rockhaven International Inc., a British Virgin Islands incorporated corporation. Under those agreements, the appellant and the Partnership obtained licences ("Licences") to publish, reproduce, market and distribute, within specific geographic areas, the Quest Prestige Card, a customer loyalty card entitling its holder to discounts at hotels, restaurants and other commercial establishments.

[3] The Licence Agreements required the appellant and the Partnership to pay $350 as a licence fee and a royalty of $5.00 for each Quest Prestige Card that was sold in the licensed territory. Licencees were required to pay an advance royalty (the "Advance Royalty") of $20,000 per Licence at the time of execution of the Licence Agreements but in fact only $5,000 of that amount was paid by the appellant and the Partnership when they executed their Licence Agreements.

[4] As part of the tax shelter arrangements, the appellant and the Partnership entered into operating agreements (the "Operating Agreements") with Crusader Marketing Corporation Inc. ("Crusader") at the same time they signed their Licence Agreements. Under the Operating Agreements, Crusader agreed to market and distribute the Quest Prestige Card in the territories that were specified in their Licences.

[5] Under agreements (the “Performance Bond Conditions”) entered into at the same time as the Operating Agreements, Crusader agreed to provide cash performance bonds (“Performance Bonds”) of $15,000 per licensed territory to the appellant and the Partnership, for the purpose of ensuring that it achieved minimum levels of performance in respect of its marketing and distribution obligations under the Operating Agreements. The Performance Bond Conditions provided that the fees that Crusader was to receive for its marketing efforts under the Operating Agreements would be offset against the amount of the Performance Bonds. If those fees had not fully offset the amount of the Performance Bonds by the expiration of the related Operating Agreements, the remaining amount of those Performance Bonds were required to be paid to the appellant and the Partnership as damages for the lack of performance by Crusader under the Operating Agreements.

[6] A tax shelter identification number was obtained from the Canada Revenue Agency in respect of the marketing of the Licences. Accordingly, the Licences that were acquired by the appellant and the Partnership in 1997 and 1998 were tax shelter investments, within the meaning of subsection 143.2(1).

[7] In computing his income for 1997 and 1998, the appellant deducted the full amount of the Advance Royalties payable by him ($20,000 per Licence) under the Licence Agreements he entered into in respect of those years. In addition, he deducted his allocated share of the losses of the Partnership for those years that were derived from similar deductions claimed by the Partnership in respect of Advance Royalties payable by it under the Licence Agreements it entered into in those years.

[8] The Tax Court Judge dismissed the appellant's appeal for a number of reasons, namely,

a) that the activities of the appellant and the Partnership in respect of the marketing and distribution of the Quest Prestige Card did not constitute a source of income for the purposes of section 9;

b) that the expenditures of the appellant and the Partnership in respect of Advance Royalties payable by them pursuant to their Licence Agreements were required to be reduced to zero by virtue of the tax shelter investment rules in section 143.2, and in particular subparagraphs 143.2(6)(*b*)(i) and (ii) thereof; and

c) that the licence fees of $350 per Licence were capital expenditures, the deduction of which was precluded by paragraph 18(1)(*b*).

The appellant's memorandum of fact and law takes issue with only the first two of the Tax Court Judge's reasons for dismissing his appeal. In our view, this appeal can be disposed of by reference to the tax shelter investment provisions in section 143.2.

[9] Applying those provisions, the Tax Court Judge found that the $20,000 amount of the Advance Royalty expenditure in respect of each of the Licences acquired by the appellant and the Partnership was reduced to zero by virtue of two reductions to that expenditure that are required by subsection 143.2(6). The relevant portions of that provision read as follows:

143.2(6) Notwithstanding any other provision of this Act, the amount of any expenditure that is, or is the cost or capital cost of, a taxpayer's tax shelter investment, and the amount of any expenditure of a taxpayer an interest in which is a tax shelter investment, shall be reduced to the amount, if any, by which	143.2 6) Malgré les autres dispositions de la présente loi, le montant d'une dépense qui représente un abri fiscal déterminé d'un contribuable, ou le coût ou le coût en capital d'un tel abri fiscal, et le montant d'une dépense d'un contribuable dans lequel une participation est un abri fiscal déterminé sont ramenés au montant égal à l'excédent éventuel du montant visé à l'alinéa *a*) sur le total visé à l'alinéa *b*):
(*a*) the amount of the taxpayer's expenditure otherwise determined	

exceeds

(*b*) the total of

(i) the limited-recourse amounts of

(A) the taxpayer, and

(B) all other taxpayers not dealing at arm's length with the taxpayer

that can reasonably be considered to relate to the expenditure,

(ii) the taxpayer's at-risk adjustment in respect of the expenditure, and

a) le montant de la dépense du contribuable, déterminé par ailleurs;

b) le total des montants suivants :

(i) les montants à recours limité du contribuable et des autres contribuables qui ont un lien de dépendance avec lui, qu'il est raisonnable de considérer comme se rapportant à la dépense,

(ii) le montant de rajustement à risque du contribuable relatif à la dépense,

[10] The first reduction of the Advance Royalty expenditure in respect of each Licence was determined by the Tax Court Judge to be $15,000 per Licence. He found that such amount, which related to the unpaid balance of the Advance Royalty payable under each Licence Agreement, was a limited recourse amount, within the meaning of subparagraph 143.2(6)(*b*)(i).

[11] The second reduction of the Advance Royalty expenditure in respect of each Licence was also determined by the Tax Court Judge to be $15,000. He found that such amount, which related to the $15,000 Performance Bond that was required to be provided under the Performance Bond Conditions applicable in respect of each Licence, was an at-risk adjustment, within the meaning of subparagraph 143.2(6)(*b*)(ii).

[12] The appellant concedes that the Tax Court Judge was correct in finding that the $15,000 unpaid balance of the Advance Royalty in respect of each Licence is a limited recourse amount as contemplated by subparagraph 143.2(6)(*b*)(i). However, the appellant argues that the Tax Court Judge erred by concluding that the $15,000 Performance Bond amount in respect of each Licence is an at-risk adjustment, as contemplated by subparagraph 143.2(6)(*b*)(ii). According to the appellant, this finding was not open to the Tax Court Judge because he made a factual finding that the evidence before him did not establish that the Performance Bonds were actually provided by Crusader, even though the Performance Bond Conditions obligated Crusader to provide them. Thus, the appellant argues that if the Performance Bonds were not provided to the appellant and the Partnership, there was no amount or benefit that could fall within the definition of an at-risk adjustment in subsection 143.2(2). That subsection reads as follows:

143.2(2) For the purpose of this section, an at-risk adjustment in respect of an expenditure of a particular taxpayer, other than the cost of a partnership interest to which subsection 96(2.2) applies, means any amount or benefit that the particular taxpayer, or another taxpayer not dealing at arm's length with the particular taxpayer, is entitled, either immediately or in the future and either absolutely or contingently, to receive or to obtain, whether by way of reimbursement, compensation, revenue guarantee, proceeds of disposition, loan or any other form of indebtedness, or in any other form or manner whatever, granted or to be granted for the purpose of reducing the impact, in whole or in part, of any loss that the particular taxpayer may sustain in respect of the expenditure or, where the expenditure is the cost or capital cost of a property, any loss from the holding or disposition of the property. [Emphasis added]	143.2(2) Pour l'application du présent article, le montant ou l'avantage qu'un contribuable, ou un autre contribuable avec qui il a un lien de dépendance, a le droit, immédiat ou futur et absolu ou conditionnel, de recevoir — sous forme de remboursement, de compensation, de garantie de recettes, de produit de disposition, de prêt ou d'autre forme de dette ou sous toute autre forme — et qui est accordé en vue de supprimer ou de réduire l'effet d'une perte que le contribuable peut subir relativement à la dépense ou, dans le cas où la dépense représente le coût ou le coût en capital d'un bien, d'une perte résultant du fait que le bien est détenu ou fait l'objet d'une disposition constitue un montant de rajustement à risque relatif à une dépense du contribuable. Le présent paragraphe ne s'applique pas au coût d'une participation dans une société de personnes à laquelle s'applique le paragraphe 96(2.2). [Je souligne]

[13] We are of the view that the appellant's argument cannot be accepted. It is clear that the Operating Agreements required Crusader to perform marketing functions on behalf of the appellant and the Partnership in the territories covered by their Licences. It is equally clear that the Performance Bond Conditions obligated Crusader to post (i.e. deliver) a $15,000 Performance Bond in respect of each licensed territory for the purpose of ensuring that Crusader achieved a minimum level of marketing and distribution performance under the Operating Agreement in respect of that territory.

[14] In our view, the provisions of the Performance Bond Conditions contain revenue guarantees that constitute amounts or benefits to which the appellant and the Partnership were entitled, within the meaning of subsection 143.2(2). To fall within that provision, a particular amount or benefit need not be received: entitlement thereto is sufficient. These revenue guarantees were, in the entirety of the tax shelter arrangements in which the appellant and the Partnership acquired Licences, granted or agreed to be granted for the purpose of reducing the loss that the appellant and the Partnership might sustain as a consequence of having acquired their Licences and having agreed to incur Advance Royalty expenditures in respect of those Licences.

[15] Our conclusion on this issue springs from our interpretations of the Performance Bond Conditions and the provisions of subsection 143.2(2), which are matters of legal interpretation. While the Tax Court Judge made a factual finding that the Performance Bonds contemplated by the Performance Bond Conditions applicable in respect of each of the Licences acquired by the

appellant and the Partnership may not have been physically delivered to them, this finding is irrelevant to our conclusion. The appellant and the Partnership became entitled to receive the Performance Bonds at the time of execution of the Performance Bond Conditions and the at-risk adjustment, within the meaning of subsection 143.2(2), arose at that time. A subsequent failure of Crusader to physically deliver the Performance Bonds, if indeed such a failure did occur, does not negate the entitlement of the appellant and the Partnership to receive them that arose upon the execution of the Performance Bond Conditions.

[16] Accordingly, we are of the view that the Tax Court Judge was correct in finding that the revenue guaranty provisions of the Performance Bond Conditions in respect of each Licence acquired by the appellant and the Partnership in 1997 and 1998 constituted an at-risk adjustment, within the meaning of subsection 143.2(2), in respect of the Advance Royalty expenditure applicable to each of those Licences, in the amount of $15,000 per Licence, and that each such Advance Royalty expenditure was required, pursuant to subparagraph 143.2(6)(b)(ii), to be reduced by that amount.

[17] This reduction, along with the $15,000 reduction that has been conceded by the appellant, is sufficient to reduce to zero the Advance Royalty expenditure in respect of each Licence acquired by the appellant and the Partnership in the taxation years under consideration in this appeal.

[18] Having reached this conclusion, we find it unnecessary to consider any of the additional arguments raised by the appellant. As well, we express no opinion on any of the other bases for

decision of the Tax Court Judge. However, we note that one aspect of the issue raised by the appellant with respect to the interpretation of *Stewart v. R.*, [2002] 2 S.C.R. 645 was addressed by this Court in *Massé v. Minister of National Revenue*, 2003 FCA 351.

[19] For the foregoing reasons, the appeal will be dismissed with costs.

"C. Michael Ryer"
J.A.

FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

(APPEAL FROM A DECISION OF LITTLE J. OF THE TAX COURT OF CANADA (2008 TCC 264) DATED MAY 2, 2008)

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