Docket: 2012-1517(IT)G

BETWEEN:

M. BERNARD LOATES,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Before: The Honourable Mr. Justice Randall S. Bocock

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Jack Warren

AMENDMENT TO REASONS FOR JUDGMENT

Upon the Court finding typographical errors in certain paragraphs of the Reasons for Judgment issued February 6, 2015, the following paragraphs are amended as follows:

In the first line of paragraph [5], the word "the" is deleted;

In the second line of paragraph [6], the word "the" is deleted;

In the fifth line of paragraph [12], the period after " … March 2 …" is deleted and replaced with a comma;

In the first line of subparagraph (b) of paragraph [22], the word "the" is deleted; and

In paragraph [39], the word "Respondents" is replaced with "Respondent".

These Amended Reasons for Judgment are issued in substitution to the Reasons for Judgment issued on February 6, 2015.

Signed at Ottawa, Canada, this 12th day of February 2015.

"R. S. Bocock"

Bocock J.

Citation: 2015 TCC 30
Date: 20150212
Docket: 2012-1517(IT)G

BETWEEN:

M. BERNARD LOATES,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

AMENDED REASONS FOR JUDGMENT

Bocock J.

I. Introduction

[1] This appeal concerns a section 160 assessment under the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) (the "*Act*"). The Appellant's wife, Karen Somerville, owed the Minister $158,058.27 for tax (the "Tax Debt") relating to taxation years of 1998, 1999, 2000, and 2001. In 2008, the Minister became aware of the Appellant's ownership of a property located at Howe Island, Gananoque, Ontario (the "Howe Island Property"). The Howe Island Property had been transferred by Ms. Somerville to the Appellant, Bernard Loates, on March 15, 2005 (the "Transfer Date"). The Minister issued a Notice of Assessment on September 30, 2010 against Mr. Loates for the Tax Debt.

II. Facts

[2] Two witnesses provided testimony: Mr. Loates gave evidence on his own behalf and Peter Neeteson, a collections officer with the Canada Revenue Agency (the "CRA"), gave evidence for the Respondent. Ms. Somerville was present at trial, but the Appellant did not call her as a witness.

A. Testimony of Mr. Loates

[3] Mr. Loates and Ms. Somerville were married in the year 2000. Beginning in 1998 and until January 2006, he and Ms. Somerville lived together at 3050 Cochrane Street, Whitby, Ontario, (the "Cochrane Property"), title to which was held solely by Ms. Somerville.

[4] On July 25, 2002, Ms. Somerville purchased the Howe Island Property, again solely in her name, with the intention that the Howe Island Property would be a retirement property.

[5] From 2004 to 2006, Mr. Loates asserts he made three loans to Ms. Somerville totalling approximately $294,600.00 (the "Loans"). In early 2005, Ms. Somerville wished to take out a second mortgage on the Cochrane Property, in order to obtain capital for her business. Mr. Loates disagreed. The Cochrane Property was valued at $1,000,000.00, and had an existing mortgage of $448,054.89 registered on title.

[6] Mr. Loates testified that on March 2, 2005 he and Ms. Somerville came to an understanding. A "division of property" agreement was executed by Mr. Loates and Ms. Somerville, in their own handwriting (the "Division Agreement"). The agreement provided that:

(a) Mr. Loates would consent to the second mortgage on the Cochrane Property, in return for Ms. Somerville transferring title to the Howe Island Property to Mr. Loates;

(b) Mr. Loates would have "no claim" on the Cochrane Property;

(c) Ms. Somerville would have "no claim" on the Howe Island property; and,

(d) Ms. Somerville was to sell the Cochrane Property and pay her taxes and other debts.

[7] On March 3, 2005, Ms. Somerville gave a second mortgage against the Cochrane Property in the amount of $315,000.00 (the "Cochrane Second Mortgage").

[8] As further collateral security for the Cochrane Second Mortgage, a collateral mortgage was registered against title to the Howe Island Property on the same date in the amount of $311,850.00 (the "Howe Island Collateral Mortgage").

[9] On March 15, 2005, the Transfer Date, Ms. Somerville transferred ownership of the Howe Island Property to Mr. Loates.

[10] At trial, the parties agreed that at the Transfer Date the fair market value of the Howe Island Property was $700,000.00, coincidentally the assumed value of the Minister. The parties further agreed that the balance of the first mortgage remaining on the Howe Island Property at the Transfer Date was $414,735.11.

[11] In January of 2006, the Cochrane Property was sold for $800,000.00 by Ms. Somerville. After satisfying the mortgages, approximately $20,228.14 remained and was remitted to the CRA in respect of Ms. Somerville's tax debt.

[12] Mr. Loates stated he did not believe the investment in Ms. Somerville's consulting business was a good idea. He did not want to additionally encumber the matrimonial home, the Cochrane Property at the time, with a second mortgage. To mitigate putting his interest in the Cochrane Property at risk, he stated that Ms. Somerville and he executed the Division Agreement on March 2, 2015 based upon Mr. Loates' understanding of family law. In return for Ms. Somerville transferring title to Howe Island Property to Mr. Loates, Mr. Loates would relinquish 'his share' of the Cochrane Property, the matrimonial home at the time. Mr. Loates' then current 'share' in the Cochrane Property was valued by them at approximately $276,000.00.

[13] Mr. Loates testified that he borrowed money for the Loans to Ms. Somerville from one Mr. Burke, a business associate. Mr. Loates obtained additional funds for the Loans by selling $46,600.00 worth of artwork. Mr. Loates was uncertain how Ms. Somerville would and did use the Loans. There were no terms and conditions to the Loans; they were made in 'good faith'. To date, neither Ms. Somerville, nor Mr. Loates, has paid back any amount owed to Mr. Burke.

[14] Mr. Burke did not testify. Mr. Loates could provide no documentation regarding the Loans. Mr. Loates stated he relied on his accountant, David Fluss, to properly reflect the Loans. Mr. Fluss suddenly passed away in or around 2011 or 2012. Despite multiple attempts, Mr. Loates testified that he was unable to get any of his financial records from Mr. Fluss' office. In contrast, Mr. Neeteson stated the

Loans were never brought to his attention at any point by Mr. Loates during their audit communications.

B. Testimony of Mr. Neeteson

[15] In 2008, Mr. Neeteson was assigned the file relating to Ms. Somerville.

[16] In 2010, after a title search, Mr. Neeteson became aware of the transfer of the Howe Island Property to the Appellant.

[17] Mr. Neeteson determined that there was equity in the property at the Transfer Date. He based that calculation on the value of the property ($700,000.00) and subtracted from that amount the balance of the first mortgage registered on title at the Transfer Date. In his calculation, Mr. Neeteson did not consider the Howe Island Collateral Mortgage as an encumbrance when determining the equity, value or consideration tendered for the Howe Island Property.

[18] In a letter dated October 26, 2009, Mr. Loates' lawyer wrote to Mr. Neeteson providing an explanation regarding the sale of the two properties. The description roughly coincides with Mr. Loates' testimony regarding the arrangement between he and Ms. Somerville arising from the Division Agreement. Mr. Neeteson did not consider that explanation satisfactory. Mr. Neeteson did not follow up with the lawyer.

III. Law

[19] The leading case with respect to section 160 of the *Act* is *Livingston v. Canada*, 2008 FCA 89, 2008 DTC 6233 ("*Livingston*"). Specifically, at paragraph 17 the Court stated:

> In light of the clear meaning of the words of subsection 160(1), the criteria to apply when considering subsection 160(1) are self-evident:
>
> 1) The transferor must be liable to pay tax under the Act at the time of transfer;
>
> 2) There must be a transfer of property, either directly or indirectly, by means of a trust or by any other means whatever;
>
> 3) The transferee must either be:

i. The transferor's spouse or common-law partner at the time of transfer or a person who has since become the person's spouse or common-law partner;

ii. A person who was under 18 years of age at the time of transfer; or

iii. A person with whom the transferor was not dealing at arm's length.

4) The fair market value of the property transferred must exceed the fair market value of the consideration given by the transferee.

[20] In *Yates v. Canada*, 2009 FCA 50, 2009 DTC 5062 ("*Yates*"), the language of section 160 was considered by the Federal Court of Appeal, in relation to family law. Justice Desjardins at paragraphs 12 and 16 called section 160 of the *Act* "unquestionably a draconian measure", but, nonetheless, a correct reading of section 160 makes it clear the only exception to subsection 160(1) of the *Act* is provided for in subsection 4. Justice Blais, concurring, stated at paragraph 67 that "A plain language interpretation of subsection 160(1) does not allow for a family law exception …". Justice Nadon, also concurring, stated at paragraph 39 that the nature of the transfer is not relevant in determining whether an individual is subject to subsection 160(1) of the *Act*.

[21] The case of *Allen v. Canada*, 2009 TCC 426, 2009 DTC 1292 ("*Allen*") at paragraph 39, stands for the proposition that the relevant time to determine when consideration is made, with respect to the fourth requirement of section 160, is at the Transfer Date, not before or after.

IV. Issues

[22] Mr. Loates does not challenge the Tax Debt, the transfer of the property, nor the non-arm's length relationship. He challenges the Minister's assumption that consideration paid by him was less than the fair market value of the Howe Island Property, the transferred property. There are three issues raised by him and to be decided by the Court:

(a) Was Ms. Somerville indebted to Mr. Loates at the Transfer Date and, if so, for what amount (the "Offset Loans")?;

(b) Did Mr. Loates provide consideration in the form of a valuable exchange of property with Ms. Somerville at the Transfer Date (the "Exchanged Property")?; and,

(c) Was there any value in the Howe Island Property at the Transfer Date ("Nil Value of Transferred Property")?

V. Analysis

[23] The criteria from *Livingston* disputed are whether Mr. Loates provided consideration equal to the fair market value of the property and whether the Howe Island Property had any value at the Transfer Date. Each of the three arguments advanced by Mr. Loates suggest either a set-off of a debt owed, other property transferred as consideration, or the non-existence of the value of the property transferred.

A. The Offset Loans

[24] Mr. Loates, as noted from the facts above, firstly asserts that he received no benefit with respect to the transferred property because there existed loans advanced by him to Ms. Somerville in the aggregate of $294,600.00. These funds were, in turn, obtained by Mr. Loates who borrowed $248,000.00 from a business associate, one Mr. Burke, and his sale of works of art totalling $46,600.00.

[25] With respect to the Offset Loans made to Ms. Somerville and with respect to Mr. Loates' source of the loaned amounts, there is simply no evidence. Neither Ms. Somerville nor Mr. Burke testified and no bank records, cancelled cheques nor promissory notes were produced at trial. Mr. Neeteson testified that Mr. Loates had never raised the Offset Loans during their audit dealings. Perhaps as telling is the handwritten Division Agreement, which according to Mr. Loates settled the outstanding credits, debits, and transfer of property between the parties, but it made no mention of the deemed repayment of the Offset Loans.

[26] Quite apart from this last point, Mr. Loates' assertion of the existence of the Offset Loans is devoid of any supportive third-party documentary or *viva voce* evidence. On this basis, it must fail: *Nandakumar v. R*, 2012 TCC 338 at paragraphs 5 and 16(2).

B. Exchanged Property at Transfer

[27] Secondly, Mr. Loates asserts the Division Agreement is sufficient evidence of his tendering consideration through the concurrent release of his spousal interest and division of property rights under the *Family Law Act*, R.S.O 1990, chapter F.3 (the "*Family Law Act*"). He states he released the more valuable Cochrane

Property (the matrimonial home) in exchange for his receipt of sole title in the lesser valued Howe Island Property (a recreational property). This is based upon the theory that his forbearance had consideration valued at the sum of approximately $276,000.00.

[28] This argument also fails for several reasons, the most compelling of which is the Federal Court of Appeal's decision in *Yates*, *supra*. The surrender of spousal rights under contract, even if properly valued, evidenced, and arithmetically accurate, does not override the joint liability of a transferee for the transferor's tax debt where the other requirements are met (*Yates* at paragraphs 16 and 67).

[29] In addition, and although moot, there is simple logic. Ms. Somerville was the titled owner of both properties. Together they both formed family property and any division would have to account for Ms. Somerville's release of her interest in the unencumbered portion of the Howe Island Property, prior to the Division Agreement. Further, Mr. Loates provided no supportable evidence of the relative values of the properties. As a guide to just how anecdotal Mr. Loates' values likely were, the Cochrane Property was ultimately sold for $800,000 in January 2006. Only 8 months after Mr. Loates' hopeful assessment of value ($1,000,000.00) that property was worth some $200,000.00 less than his estimate.

[30] Lastly, the Division Agreement itself does not reference values, specific release of rights, or outline the underlying purpose, even briefly, of the transfers. As well, the statutory requirement under subsection 55(1) of the *Family Law Act* that any domestic contract be witnessed was not fulfilled. While this requirement is not essential for the Division Agreement's admission as evidence at this tax appeal, the absence of same goes to the timeliness, weight, and purpose to be given to such a document. Moreover, there was no evidence that such a lump sum transfer was reflective of a recurring, vital, subsisting legal obligation or payment pursuant to a court order or a matrimonial division case: *Yates*, *supra* at paragraph 30. As such, there is no exemption from the application of section 160 to the transfer on the basis of the Exchanged Property consideration, even if the inconsistencies of a genuine contractual agreement contained then present releases and identifiable consideration tendered: *Allen*, *supra* at paragraph 35.

C. Nil Value of Transferred Property

[31] The Nil Value of Transferred Property argument depends upon the determination of whether and to what extent the Howe Island Collateral Mortgage affected the value for the purposes of section 160. If the Howe Island Collateral

Mortgage is fully accounted for as an encumbrance, then the Howe Island Property arguably has no value at the Transfer Date; Mr. Loates would have received no benefit since the fair market value was zero and no consideration need be paid for it. Counsel for the Respondent acknowledged this reasoning put to him from the Bench. However, if the Howe Island Collateral Mortgage need not to be taken into account, then there was value in the Howe Island Property at the Transfer Date and section 160 would apply, at least to the extent of the Tax Debt.

[32] A review of the relative values of the Howe Island Property and encumbrances assists. The Minister assumes a Transfer Date value of $700,000.00 for the Howe Island Property. On title at the Transfer Date, there was a pre-existing first mortgage having an unpaid balance of $414,735.11. The Howe Island Collateral Mortgage had been registered several days before the date of transfer in the amount of $311,850.00.

[33] The *prima facie* debt represented by the two mortgages, if fully counted, exceeds the assumed fair market value of $700,000.00. At the Transfer Date, the registered transfer of land on page 1 of the document indicated consideration as $730,083.00 by way of interlineated handwriting in box 4, the space reserved for such information. Page 2 of the transfer, being the sworn Land Transfer Tax Affidavit, contained similar interlineations reflecting assumed mortgages of $730,083.00 and total consideration for the same amount. In addition, the page 2 affidavit also indicated that the consideration was nominal and explained same as a conveyance between "a husband and wife for natural love and affection".

[34] It was clear during testimony that Mr. Loates did not fully appreciate the distinction and implications of these conflicting statements. Surprisingly, neither did Mr. Neeteson who failed to examine page 2 of the transfer during his sub-search of title even though the parcel register he obtained for the Howe Island Property reflected consideration of $730,083.00. Perhaps more surprisingly, Mr. Neeteson failed to examine the Howe Island Collateral Mortgage registered March 3, 2005 (prior to the Transfer Date) because it had been discharged on February 13, 2006, namely after the Transfer Date, but before his search of title. Counsel for the Respondent, after grasping the impact of this point during questions from the Bench, stated that the Howe Island Collateral Mortgage was not primary security and should not be deducted from the Minister's $700,000.00 assumed value of the Howe Island Property.

[35] Prior to considering and assigning no value to an encumbrance like the Howe Island Collateral Mortgage, it is important for the Minister to maintain an

even-handed approach to the timing of valuations of property and registered encumbrances. Respondent's counsel stated accurately such values are to be determined and assigned at the transfer date: *Livingston*, *supra* at paragraph 24. The CRA cannot ignore encumbrances on title at the Transfer Date simply because they were discharged (and referenced on the parcel register as such) subsequently. The Minister must consider these impediments to title and assess their potential diminishment to the value of the transferred property at the transfer date.

[36] Notwithstanding this methodological error on the Respondent's part, it is of no consequence in the present case. At the Transfer Date, Mr. Loates submitted the Cochrane Property was worth $1,000,000.00. It sold 10 months later for $800,000.00, at which time the full mortgage indebtedness was repaid and all security, primarily secured by the mortgage on the Cochrane Property and collaterally secured by the Howe Island Property, was discharged. The word "security" is decidedly singular both grammatically and logically. One debt was secured by encumbrances on two properties. The Howe Island Collateral Mortgage was a contingent liability and the collateral mortgage stated so on its face. The Howe Island Collateral Mortgage stated that the Cochrane Property comprised the primary security for the loan and its repayment and discharge constituted full evidence of a discharge of the Howe Island Collateral Mortgage.

[37] To understand the extent of the diminishment of value of the Howe Island Collateral Mortgage on the Howe Island Property, one must look to the value of the Cochrane Property at the Transfer Date. Insufficient equity in the Cochrane Property at the Transfer Date available to satisfy the indebtedness represented by the Cochrane Second Mortgage would require that the Howe Island Property be marshalled as security by the lender.

[38] As stated, the value of the Cochrane Property at the Transfer Date was, based upon Mr. Loates' admission and the subsequent sale price, at least $800,000.00. Such a value was greater than all registered encumbrances including the full extent of the Cochrane Second Mortgage (to which the Howe Island Collateral Mortgage was collateral). On this basis, at the Transfer Date, any diminishment to the Howe Island Property value by registration of the Howe Island Collateral Mortgage was notional at best. As such, the Minister's assumption that Mr. Loates received a benefit, for which consideration was not paid, of not less than the amount of the Tax Debt ($158,058.27) remains intact. The Howe Island Property had an assumed fair market value of $700,000.00 and registered, quantifiable, and realizable debt of some $414,000.00. Consistent with *Livingston*, it is the value of the benefit at the time of transfer which matters and not the value

of a possible realizable security at a future date should related property values change and inchoate rights of enforcement become choate. In short, the Howe Island Collateral Mortgage did not diminish the value of the Howe Island Property because the Cochrane Property had more than sufficient equity at the Transfer Date to satisfy all security registered against it.

[39] For these reasons, the appeal is dismissed and costs are awarded to the Respondent on a party and party basis in accordance with the Tariff.

Signed at Ottawa, Canada, this 12th day of February 2015.

"R. S. Bocock"

Bocock J.

CITATION:	2015 TCC 30
COURT FILE NO.:	2012-1517(IT)G
STYLE OF CAUSE:	M. BERNARD LOATES AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Ottawa, Ontario
DATE OF HEARING:	December 8, 2014
AMENDED REASONS FOR JUDGMENT BY:	The Honourable Mr. Justice Randall S. Bocock
DATE OF JUDGMENT:	February 6, 2015
DATE OF AMENDED REASONS FOR JUDGMENT:	February 12, 2015

APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Jack Warren

COUNSEL OF RECORD:

For the Appellant:

Name:	N/A
Firm:	

For the Respondent:	William F. Pentney Deputy Attorney General of Canada Ottawa, Canada