Docket: 2013-1651(IT)G

BETWEEN:

DOMENIC DELLE DONNE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on March 16, 2015, at Hamilton, Ontario,

Before: The Honourable Justice John R. Owen

Appearances:

Counsel for the Appellant:	John H. Loukidelis
Counsel for the Respondent:	Marcel Prevost

JUDGMENT

In accordance with the attached Reasons for Judgment the appeal from the reassessment made under the *Income Tax Act* for the 2009 taxation year, notice of which is dated May 19, 2011, is allowed, with costs to the Appellant, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to deduct the amount of $137,500.00 under subparagraph 20(1)(*p*)(i) of the *Income Tax Act* (Canada) in computing his income.

Signed at Ottawa, Canada, this 16th day of June 2015.

"J.R. Owen"

Owen J.

Citation: 2015 TCC 150
Date: 20150616
Docket: 2013-1651(IT)G

BETWEEN:

DOMENIC DELLE DONNE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Owen J.

I. Introduction

[1] This is an appeal by Dr. Domenic Delle Donne of a reassessment of his 2009 taxation year; the notice of reassessment was dated May 19, 2011. The reassessment included in the Appellant's income interest in the amount of $138,633.67. This amount included $137,500 of interest payable to the Appellant by S.A. Capital Growth Corporation (hereinafter, "SA"). Only the amount of $137,500 payable to the Appellant by SA is in issue in this appeal (I will refer to this amount as the "Interest").

II. Facts

[2] The Appellant, Mr. Davide Amato and Mr. Kevin Yee Loong, CPA testified for the Appellant. The Respondent did not call any witnesses.

[3] The Appellant is a dentist who practises as a root canal specialist. Mr. Amato is a retired dentist and the brother-in-law of the Appellant. Mr. Yee Loong is the chartered professional accountant who prepared the Appellant's 2009 T1 tax return. Mr. Yee Loong obtained the designation of chartered accountant

(now chartered professional accountant) in Ontario in 1984 and is a partner with Sautner Austin Chartered Accountants.

[4] SA is a Canadian-resident corporation owned by Mr. Amato. Mr. Amato practised dentistry for 18 years before he sold his practice in 2008 to concentrate full-time on his investments. Mr. Amato incorporated SA in the latter part of 2007 for that purpose.

[5] SA borrowed money from Mr. Amato and his wife and from 40 individuals who were family and friends of Mr. Amato (the "outside investors"), including the Appellant. SA then lent that money to a second, unrelated corporation at a higher rate of interest. It was anticipated that the second corporation would invest the borrowed money in the market.

[6] At first, SA made the loans to C.O. Capital Growth Inc., which was owned by Mr. Peter Sbaraglia, another retired dentist. Mr. Sbaraglia was a long-time friend of Mr. Amato.

[7] In May 2008, SA stopped lending money to C.O. Capital Growth and from that point forward instead lent money exclusively to E.M.B. Asset Group Inc. ("EMB"), a Canadian-resident corporation solely owned by Mr. Mander. Mr. Mander was not related to Mr. Amato or the Appellant.

[8] Mr. Mander held himself out as a super trader with a specialized trading strategy. Mr. Amato described the strategy as follows:

> . . . a systematic approach using defensive mechanisms that would minimize potential losses and would result in small incremental growth or small percentage growths on a weekly basis. It ended up being substantial for the year, but small incremental growth every week.[1]

[9] On December 11, 2008, January 26, 2009 and February 27, 2009, the Appellant lent SA a total of $900,000 pursuant to the terms of three loan agreements entered into on those dates (Exhibits A-1, R-1 and A-5). The first agreement was for a loan of $400,000 and the other two agreements were for loans of $250,000 each.

[10] Each loan by the Appellant to SA was for a term of three years at a simple interest rate of 25% per annum. The interest was to be paid on the first and second

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[1] Lines 13 to 18 of page 11 of the transcript of the proceedings held on March 16, 2015 (the "Transcript").

anniversary dates of the agreements only if the lender requested payment in writing at least 45 days prior to the anniversary date.[2] Otherwise, the interest would be added to the principal owed under the agreement and simple interest at 25% per annum would accrue on the additional principal. A written request to pay interest had to be made in the form of Schedule "G" to the agreements.

[11] Mr. Amato testified that he would not have enforced the requirement to submit a written request to pay interest and would have had SA pay the interest owed to the Appellant if asked by the Appellant. The Appellant testified that he understood that he only had to ask for payment of the interest.[3] No written request to pay interest was tendered by the Appellant to SA or to Mr. Amato.

[12] The Appellant's understanding of the strategy was that investments would be made by SA and then would be returned to cash on a daily basis. The Appellant was aware that Mr. Mander implemented this strategy, but he was not aware of the loan arrangement between SA and EMB. He believed that the money he had lent to SA was controlled by SA (or Mr. Amato) and he did not know that the money was in fact controlled by EMB. He felt that Mr. Amato had misled him in that regard.

[13] Around August 2009, the Appellant invested funds that were in his RRSP with an entity called Crystal Wealth, which was another company controlled by Mr. Mander. The monthly RRSP statements for August 2009 and thereafter showed significant losses and this raised doubts with the Appellant regarding the returns promised on the loans he had made to SA. He testified that he questioned how such a high rate of interest could be earned using the same strategy as that which lost money in his RRSP.

[14] In the fall of 2009, Mr. Amato considered terminating the arrangements with EMB mainly because of Mr. Mander's difficult personality. However, he did not take any steps to that end.

[15] During 2009, a few amounts owed by EMB to SA came due, some of which were left with EMB. Prior to early December 2009, EMB did pay to SA the amounts that were not left with EMB. Mr. Amato did not recall the total of the amounts that were paid. He did recall that SA made a payment of $60,500 to his mother-in-law on December 7, 2009.

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[2] If a request was made in respect of the second anniversary date, the interest paid on the second anniversary date was to be the total interest accrued to that date (Exhibit A-1, paragraph 1).

[3] Lines 3 to 7 of page 76 of the Transcript.

[16] The payments from EMB to SA ceased in mid-December 2009. A payment by EMB to SA in the amount of $208,000 was due on December 14, 2009 and Mr. Mander had agreed to make the payment at a meeting scheduled for 2 p.m. on December 11, 2009. Mr. Mander did not show up at the meeting and EMB did not pay SA the $208,000 either on December 11, 2009 or on December 14, 2009. Mr. Amato was asked about his reaction to this development:

> Multiple calls to several people that were involved in his office, at which point there was some discussion as to they hadn't heard from him, and some feedback was that he had a heart attack and some people in his own office went to his house to see if he was okay. One person made contact with him and everybody claimed he had had a heart attack.[4]

[17] Mr. Amato received an e-mail on December 15, 2009 which stated that Mr. Mander had had a heart attack six weeks earlier.[5] Mr. Amato immediately took steps to demand payment from EMB:

> Q. What did you attempt to do to collect amounts from E.M.B. or Mr. Mander in 2009?
>
> A. He had an automatic renewal notice on the loan agreement with a specified date of 45 days where he was to be notified as to whether money would be returned. So step one was to submit that. And then step two was repeated notifications by me or somebody else that worked with us that - - so these were the required payments that were coming due.[6]

[18] Mr. Mander did not admit that EMB could not pay the amounts due to SA but instead resisted payment on the grounds that it would disrupt his trading strategy. He asked for meetings with various people to discuss the strategy. In hindsight, it appears that this was merely a stalling tactic.

[19] Because of the back-to-back loan arrangements, the $208,000 due from EMB on December 14, 2009 was payable by SA to an outside investor. Mr. Amato paid the amount owed to the investor from his own funds.[7] When again asked his reaction to EMB's refusal or failure to pay, Mr. Amato said:

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4 Lines 5 to 11 of page 19 of the Transcript.

5 Mr. Amato later came to the conclusion that Mr. Mander did not have a heart attack because of inconsistent statements in a second e-mail he received in February 2010 (lines 24 to 28 of page 16 and lines 1 to 17 of page 17 of the Transcript).

6 Lines 18 to 26 of page 17 of the Transcript.

7 Mr. Amato paid a further $88,000 to another investor, whom he described as a friend. He did not make any further payments to the investors in SA.

> Probably couldn't categorize it in one word, but it was probably panic, anger, a whole - - powerlessness.[8]

[20] Mr. Amato met with the Appellant and his wife at the Appellant's home on December 16, 2009 and advised them of the developments with Mr. Mander.[9] The Appellant testified that he knew something was seriously wrong because his brother-in-law had always been very successful financially. When asked what Mr. Amato had told him at the meeting, the Appellant stated:

> He said that Robert had a heart attack and he's having trouble getting in touch with him and getting to his money. But he didn't want us to hear anything from somebody else, and he didn't want us to panic and tell anybody else because he wasn't quite sure. But for Dave to not be sure, that is not - - something is terribly wrong because he is always sure about money. As long as I have known him, he has been part of our family, he has been very good with money. So that was very upsetting to my wife and I that day. I kind of knew but I didn't want to say anything to my wife, "It's gone."[10]

[21] The Appellant stated that he did not make any further inquiries of Mr. Amato in December 2009 as it was very hard to reach him after their December meeting. The Appellant also explained that he did not hire a lawyer because "He is my family. It would have killed my mother."[11]

[22] In January 2010, Mr. Amato retained legal counsel, who advised him not to have any contact with Mr. Mander so as to allow time to work up a case and gather information. Subsequently, to obtain access to all of Mr. Mander's assets, SA made a receivership application, and a hearing was scheduled for March 17, 2010. Mr. Mander did not attend the meeting and the parties received notice at the meeting that Mr. Mander had been found dead in his home.[12] When asked what this meant for SA, Mr. Amato stated:

> A. It was devastating.
>
> Q. Why is that?

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8 Lines 2 to 6 of page 20 of the Transcript.

9 The date of the meeting was provided by Mr. Amato. The Appellant did not recall the exact date of the meeting but did recall that it was before his father's birthday, which was on December 18.

10 Lines 26 to 28 of page 52 and lines 1 to 8 of page 53 of the Transcript.

11 Lines 27 and 28 of page 53 of the Transcript.

12 It was subsequently determined that he had committed suicide.

> A. Well, I felt a certain responsibility to take care of the people there, and that they weren't going to get their money.[13]

[23] The Appellant identified a letter from SA's counsel dated March 23, 2010 (Exhibit A-7) in which it is stated on page 2:

> We believe it is becoming quite clear through, amongst other things, the Receiver's investigations that S.A. Capital and the investors it represents are but one part of a large scheme (which we believe to be a 'ponzi' scheme) orchestrated by Robert Mander.

[24] The Appellant was asked about his reaction to this letter:

> Q. After reading this, what did you conclude at the time?
>
> A. It just confirmed. I knew that there was nothing left. Again, if you know Dave - - when I saw him in December and he's devastated and he can't really get to his money, I knew that things were wrong. And we were probably, I think, somewhat misled.
>
> Q. Misled by whom?
>
> A. By Dave.
>
> Q. About what?
>
> A. Well, we thought we were giving him the money and he had control and Robert's telling him what to do but he had control. He had no control. He couldn't even - - if he can't get to his money in December when things are due, that is not Dave, so something - - if Dave can't get to his money, then I knew we had lost it. If you know him, if you had been a family member, you would have seen it too.[14]

[25] The Appellant recalled seeing news reports in the newspapers, online and elsewhere about the death of Mr. Mander. Four such reports, published during the period from March 24 to March 31, 2010, were entered into evidence as Exhibits A-8, A-9, A-10 and A-11 not for the truth of their contents but to provide an

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13 Lines 9 to 15 of page 26 of the Transcript.

14 Line 28 of page 55 and lines 1 to 17 of page 56 of the Transcript.

understanding of the circumstances that the Appellant was facing in late March 2010.[15]

[26] Each report speculated about the nefarious activities of Mr. Mander. The March 31, 2010 report by CBC News (Exhibit A-11) stated: "Mander committed suicide March 17 in his Freelton, Ont. home north of Hamilton, leaving behind little evidence of the $50 million or so in loans he had taken from investors in southern Ontario."

[27] The Appellant was asked about his reaction to Exhibit A-8, which was a report by CBC News dated March 24, 2010:

> Q. So you read the document at the time. What did you conclude from having read it?
>
> A. There is nothing. It is gone. If there was anything, maybe there are some assets in these properties or his personal thing. I think they were trying to, from what I understood at the time, Dave's lawyers or his counsel was going to try and have things seized or a receiver was appointed. I am not sure how it works. I am not a lawyer. But I think they did seize about $4 or $5 million of assets. And some of us were a little optimistic that we would get something back, but apparently, the receiver went through the whole thing for their costs. I don't think there was anything left for not one investor. 4 or 5 million is used up by the lawyers. That is my understanding. I couldn't believe it. [Lines 10 to 24 of page 58 of the Transcript.]

[28] With respect to the news reports collectively, the Appellant testified:

> Q. Again, what conclusions did you draw from reading these?
>
> A. Not only did I lose everything, that everybody I knew that was close to me lost whatever they had invested. I think I was probably one of the larger investors because I had means, but I trusted my family. It didn't work out the way we wanted it to. I would have loved to have made that income. [Lines 9 to 16 of page 60 of the Transcript.]

[29] Mr. Amato identified a document titled "Statement of Affairs (Business Proposal)" dated April 23, 2010 and signed by Mr. Amato (Exhibit A-2). On the first page of the Statement of Affairs, the total liabilities of SA are stated to be

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[15] Exhibits A-8 and A-9 were dated March 24, 2010, Exhibit A-10 was dated March 30, 2010, and Exhibit A-11 was dated March 31, 2010. The news reports in Exhibits A-8, A-10 and A-11 were issued by CBC News and the news report in Exhibit A-9 was issued by *The Globe and Mail*.

$17,318,303.35 and the total assets are stated to be $288,200, for a shortfall of $17,030,103.35.

[30] List "A" attached to the Statement of Affairs identifies the unsecured creditors of SA and the amounts owed to those creditors. The List indicates that Mr. and Mrs. Amato were owed $7,019,434.47 of a total of $17,290,103.35. With the exception of a small amount owed to few trade creditors of SA, the balance was owed to the outside investors.

[31] List "H" is titled "Full Statement of Property". In row (i) titled "Securities" are listed an amount of $8,542,000 and an amount of $8,000,000, each of which is described in the column titled "Details of property" as "Other". Mr. Amato testified that these were the amounts owed to SA by EMB. They are not included as assets of SA on the first page of the Statement of Affairs.

[32] Mr. Amato stated that he believed the Statement of Affairs to be a fair representation of the assets and liabilities of SA on April 23, 2010 and, in retrospect, as at December 31, 2009. He also stated that SA has paid none of its liabilities listed in the Statement of Affairs. The Appellant confirmed that to the date of the hearing he had received no payments of principal or interest from SA.

[33] SA filed a notice of intention to make a proposal under the *Bankruptcy and Insolvency Act* on April 6, 2010. This proposal was accepted by the creditors of SA on May 10, 2010 and by the Superior Court of Ontario on July 29, 2010. Mr. Amato also filed a proposal to creditors under the *Bankruptcy and Insolvency Act*.

[34] SA issued to the Appellant a T5 slip for his 2009 taxation year on which the Interest was included in Box 13 as interest from a Canadian source. The issuance of the T5's was followed by a letter from SA's counsel dated March 29, 2010 (Exhibit R-3) that stated, in part:

> Some clients have asked whether the amounts reported in the T5s will be paid out in cash. S.A. Capital is currently unable to respond to that query but will be in a better position to do so once the court-appointed receiver's investigation concludes. That investigation could take a number of months.

[35] The letter also stated that SA could not reissue the T5s as "they are currently correct as a matter of tax law".

[36] The Appellant's 2009 T1 income tax return was prepared by Mr. Yee Loong. The Appellant's wife delivered all of the Appellant's information slips to Mr. Yee Loong and told him that the interest from SA shown on the T5 was not earned.

[37] Mr. Yee Loong testified that initially he was not quite sure how to deal with the Interest and that he did some research on the point. Ultimately, Mr. Yee Loong did not include the Interest on the T1 and provided a letter on his firm's letterhead, addressed to the Canada Revenue Agency ("CRA") and dated April 21, 2010, to explain the omission. The letter was accompanied by an extract from the Receiver's first report to the Superior Court and by a March 25, 2010 article in the *Oakville Beaver*, a local newspaper.[16] Mr. Yee Loong's letter stated that the Interest was "never earned, payable nor collectible". A copy of each of the attachments to the return was entered into evidence by the Appellant (Exhibit A-17).

[38] To accommodate the filing of the attachments to the T1 return, Mr. Yee Loong prepared a paper copy of the return, which was delivered to the Appellant with instructions on how to file the return with the CRA. The Appellant filed the T1 return with the letter, the two attachments to the letter and the T5 issued by SA. An unsigned copy of the T1 tax return was entered into evidence (Exhibit A-16).

[39] In cross-examination, Mr. Yee Loong acknowledged that he stated in the letter he had prepared that "[a]t the present time, it is not known whether the principal amounts are recoverable" and agreed that at the time he did not know whether SA could pay the principal and interest owed to the Appellant.

[40] The CRA assessed the Appellant as filed by notice dated June 7, 2010, but subsequently, by notice dated May 19, 2011, reassessed the Appellant to include the Interest in income for 2009. The Appellant objected to the reassessment and the CRA confirmed the reassessment by letter dated December 12, 2012.

III. The Position of the Appellant

[41] Counsel for the Appellant concedes that the Interest is income of the Appellant earned during his 2009 taxation year but argues that he is entitled to

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[16] The Appellant and Mr. Yee Loong rejected an alternative filing position that had been presented to the outside investors because it required the Appellant to claim an interest deduction equal to the Interest even though he had not borrowed any money to make the loans to SA.

claim an offsetting deduction under either subparagraph 20(1)(*l*)(i) or 20(1)(*p*)(i) of the *Income Tax Act* (Canada) (the "ITA"). Counsel observes that the tests in these two provisions are fairly simple and straightforward.

[42] Under subparagraph 20(1)(*l*)(i), the taxpayer must demonstrate that the amount claimed is reasonable, that the debt is doubtful and that the debt has been included in the income of the taxpayer for the year or for a previous year.

[43] Under subparagraph 20(1)(*p*)(i), the taxpayer must demonstrate that the debt has become a bad debt in the year and that the debt has been included in the income of the taxpayer for the year or a previous year.

[44] Counsel observed that how the amount is to be claimed under these provisions is not specified in the provisions. As well, he stated that he could find no authority establishing that specific formal reporting was required in order to claim the deduction. This may be contrasted with other provisions in the ITA that require specific formal reporting, such as the designation required under paragraph 55(5)(*f*) of the ITA.

[45] Counsel submits that there is no requirement that the claim under either subparagraph 20(i)(*l*)(i) or subparagraph 20(i)(*p*)(i) be made in respect of trading accounts and cites *Falaise Steamship Co. Ltd. (No. 3) v. M.N.R.*, 63 DTC 663, 33 Tax A.B.C. 1 in support of that proposition.

[46] Counsel observes that the taxpayer is required to make a determination as to whether the debt is doubtful or bad, depending on the provision relied upon. This raises two questions. First, at what point in time must that determination be made. That is to say, must the determination be made (i) by the end of the relevant taxation year, (ii) by the taxpayer's filing-due date for the relevant taxation year, or (iii) by a date after the taxpayer's filing–due date for the relevant taxation year? Second, at which of these three points in time must the debt actually be doubtful or bad?

[47] The Appellant submits that the cases addressing doubtful and bad debts seem to agree that the debt must be doubtful or bad as at the end of the relevant taxation year. However, they also seem to assume that the determination of that status not only can but should be made after the end of the relevant taxation year. Otherwise the creditor is left in the position of assessing the debt on the last day of the year, which would not work in the real world.

[48] The question that remains is what information may be used by the taxpayer to assess the status of the debt as at the end of the relevant taxation year? Is the taxpayer limited to information that exists at the end of the relevant taxation year or can the taxpayer take into account information that comes to light after the end of that year?

[49] The Appellant submits that the taxpayer may take into account information that becomes available after the end of the relevant taxation year and cites *Gibraltar Mines Ltd. v. The Queen*, 83 DTC 5294, 48 N.R. 188, *MacDonald Engineering Projects Ltd. v. M.N.R.*, 87 DTC 545 and *Coppley Noyes & Randall Limited v. The Queen*, 91 DTC 5291 in support of that proposition.

[50] With respect to the facts, counsel submits that by April 30, 2010 it was absolutely clear that a fraud had been perpetrated and that at best only a fraction of the principal lent by SA to EMB would be recovered. In fact, given the information available by April 30, 2010, it would have been fanciful to conclude that the debt owed by SA to the Appellant was not at least doubtful by the end of 2009. Events subsequent to April 30, 2010 only served to reinforce the conclusion that the debt was at least doubtful at the end of 2009.

[51] Finally, counsel submitted that, while the letter accompanying the Appellant's 2009 T1 income tax return does not mention a doubtful or bad debt claim, it does generally describe a series of positions, including the contention that the Interest was not income and was not collectible. The reference to the Interest not being collectible identified the concern of the Appellant that the Interest was a doubtful or bad debt at the end of 2009.

IV. The Position of the Respondent

[52] Counsel for the Respondent submits that under the terms of the three loan agreements the Appellant was required to formally demand payment of the Interest using the form in Schedule "G" to the agreement and that, since the Appellant did not demand payment of the Interest in 2009, there could be no bad debt at the end of 2009.

[53] Counsel argues that the Appellant was aware in December 2009 that Mr. Mander had had a heart attack. However, at that time the Interest was not owed by Mr. Mander or by his corporation, EMB. The debt was owed to the Appellant by SA. The ability of SA to pay the Interest was not clear, as reflected in

the letters from SA's lawyers in March and April 2010 regarding the prospects for recovery.

[54] Counsel further submits that the Interest was not included in the Appellant's income in 2009 because it was not reported on his T1 income tax return. As the Interest was not included in income, no amount could be claimed under subparagraph 20(1)(*l*)(i) or 20(1)(*p*)(i) of the ITA. The proper approach would have been to include the amount as income on the return and then claim an offsetting deduction under one of those two provisions.

V. Statutory Provisions

[55] The statutory provisions in issue are paragraphs 20(1)(*l*) and (*p*) of the ITA. The portions of those provisions relevant to this appeal are as follows:

> 20.(1) Deductions permitted in computing income from business or property - Notwithstanding paragraphs 18(1)(*a*), (*b*) and (*h*), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto
>
> . . .
>
> (*l*) Doubtful or impaired debts - a reserve determined as the total of
>
> (i) a reasonable amount in respect of doubtful debts (other than a debt to which subparagraph (ii) applies) that have been included in computing the taxpayer's income for the year or a preceding taxation year, and
>
> . . .
>
> (*p*) Bad debts - the total of
>
> (i) all debts owing to the taxpayer that are established by the taxpayer to have become bad debts in the year and that have been included in computing the taxpayer's income for the year or a preceding taxation year, and
>
> . . .

[56] Paragraph 12(1)(*d*) of the ITA requires a taxpayer to include in computing income from a business or property any amount deducted under paragraph 20(1)(*l*)

of the ITA in computing income for the immediately preceding taxation year. Paragraph 12(1)(i) of the ITA requires a taxpayer to include in computing income from a business or property any amount received in the year on account of a debt for which a deduction for bad debts has been made in computing the taxpayer's income for a preceding taxation year.

VI. Analysis

[57] A useful overview of the provisions in issue is provided by Professor Tim Edgar in a 1994 paper delivered at the National Tax Conference (footnotes omitted):

> The statutory basis for the deduction of loan losses is relatively straightforward. As indicated above, one of the fundamental judicial principles governing the deduction of business expenses is the non-recognition of a reserve or allowance for expected losses. Any deduction for losses is generally deferred until the loss is realized, which normally occurs with an outstanding loan on a disposition by the lender arising on either a sale or a settlement. This judicial principle is now codified, to some extent, in paragraph 18(1)(e) and its prohibition on the deduction of an amount as a reserve or contingent liability. In addition, paragraph 18(1)(b) prohibits the deduction of a loss or replacement of capital, or an allowance in respect of depreciation. Paragraph 18(1)(s), added in 1988, also specifically prohibits the deduction of any loss, depreciation, or reduction in the value of a loan or lending asset made or acquired in the ordinary course of business of an insurer or moneylender where the loan or lending asset is not disposed of in the year. In allowing a deduction for the amount of a reasonable reserve in respect of doubtful loans, paragraph 20(1)(l) operates as an exception to the judicial principle of realization applicable to loan losses as well as the statutory prohibition on the deductibility of a loss or depreciation allowance in respect of loans held as capital property. The companion provision in paragraph 20(1)(p) permits a comparable deduction for loans that have become bad.
>
> Paragraph 20(1)(l) was originally included in the 1948 Act as part of a gradual movement toward the recognition of business revenue and expenses on an accrual basis. Before that time, taxpayers could only deduct an amount for bad debts, subject to the discretion of the minister of national revenue. For taxpayers other than moneylenders, subparagraph 20(1)(l)(i) permits the deduction of a reasonable amount as a reserve in respect of doubtful debts, the amount of which has been included in computing business income. The provision thus permits the recognition of anticipated losses on accounts receivable that have been recognized as business revenue. For moneylenders, this general provision applies with respect

> to interest on a loan to the extent that the interest has been included in income and its collection is doubtful.[17]

[58] Although Professor Edgar refers to income in a business context, it is uncontroversial that the provisions also apply to provide a deduction against income from property.

[59] The Respondent suggests that, because no written demand to pay the Interest was made by the Appellant, there can be no doubtful or bad debt. The terms of the loan agreements entered into by SA and the Appellant stated that SA agreed to pay to the Appellant simple interest on the principal amount of the loan at the rate of 25% per annum. The amount of interest owed by SA to the Appellant could be determined from day to day as the simple interest accrued on the outstanding principal.

[60] The interest may not have been payable until a written demand was made in the form of Schedule "G", or the loan matured, but it was nevertheless owed by SA to the Appellant as it accrued. This is reinforced by the fact that, if a written demand for payment of the interest was not made 45 days before the anniversary date of the loan, the interest that had accrued to the first or second anniversary date was added to the principal amount of the loan, which was clearly a debt owed by SA to the Appellant.[18] Although the precise meaning of the word "debt" may be the subject of some debate, it certainly encompasses a contractual obligation to pay an ascertainable sum such as the Interest, regardless of whether or not a demand for payment had been made by the Appellant.[19]

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[17] Tim Edgar, "Deduction of Loan Losses and Financing Expenses by Moneylenders," Report of Proceedings of Forty-Sixth Tax Conference, 1994 Conference Report (Toronto: Canadian Tax Foundation, 1995), 16:1-52 at pages 16:8 and 16:9.

[18] This is provided for in section 1 of the loan agreements.

[19] See C.R.B. Dunlop, *Creditor-Debtor Law in Canada*, 2nd ed. (Scarborough, Ont.: Carswell, 1995) at page 16.

A. Subparagraph 20(1)(*l*)(i)

[61] The potential application of subparagraph 20(1)(*l*)(i) to interest on a loan was confirmed in the Department of Finance technical notes that accompanied amendments to paragraphs 20(1)(*l*) and 20(1)(*p*) in 1988:

> Paragraph 20(1)(*l*) allows a taxpayer to deduct a reasonable amount as a reserve for doubtful debts. Subparagraph 20(1)(*l*)(i) provides a reserve in respect of debts that have been included in computing the income of a taxpayer. In the case of a loan, this subparagraph would provide a reserve in respect of interest that has been included in a taxpayer's income but the collection of which is doubtful.

[62] The clear and plain words of subparagraph 20(1)(*l*)(i) require the taxpayer to establish three things: (1) that the deduction is being claimed in respect of a debt that has been included in income, (2) that the debt is doubtful, and (3) that the amount being claimed as a deduction from income is reasonable.

[63] With respect to the first requirement, whether an amount is included in a taxpayer's income is a determination made by applying the provisions of the ITA to the facts. The Appellant concedes that the Interest was income to him in 2009 and the Respondent does not say that the Interest was not taxable as such. In fact, I would not be hearing this appeal if the Interest had not been included in the Appellant's income for 2009. The Respondent argues, however, that because the Appellant did not record the Interest as income on his T1 income tax return, he cannot claim the benefit of the deduction in subparagraph 20(1)(*l*) or (*p*) of the ITA.

[64] The fact that the Appellant reported the Interest in a manner that did not record it as income on a line of his 2009 T1 income tax return does not alter the fact that the interest was included in his income for 2009 by virtue of the application of the provisions of the ITA to the facts. This general principle was identified by Noël A.C.J. in *The Queen* v. *Simard-Beaudry Inc.*, [1971] F.C. 396, as follows (at page 403):

> As to his second argument, namely that the debt arising from re-assessment of the taxpayer dates only from the time that the taxpayer is assessed, and that it did not, accordingly, exist at the time the agreement was made, it seems to me that the answer to this is that the general scheme of the *Income Tax Act* indicates that the taxpayer's debt is created by his taxable income, not by an assessment or re-assessment. In fact, the taxpayer's liability results from the Act and not from the assessment. In principle, the debt comes into existence the moment the income is

> earned, and even if the assessment is made one or more years after the taxable income is earned, the debt is supposed to originate at that point. . . .

[65] As the Interest was included in the Appellant's income for 2009 pursuant to the terms of the ITA applicable to interest income, the first requirement of subparagraph 20(1)(*l*)(i) is satisfied.

[66] The second requirement in subparagraph 20(1)(*l*)(i) is that the debt must be doubtful. The Appellant concedes that the debt must be doubtful as of the end of the relevant taxation year (in this case, December 31, 2009), which accords with the jurisprudence and with the fact that a taxpayer's liability under the ITA is determined on a taxation-year-by-taxation-year basis. It would simply make no sense if a deduction for a taxation year were to be dependent on a state of affairs that came into existence after the end of that taxation year, unless the ITA expressly so provided as is the case, for example, with loss carry-backs.

[67] The more pertinent question is whether the taxpayer may rely on information that comes into existence after the end of the taxation year to make a determination of fact as at the end of that taxation year. In my view, that is precisely how the scheme of the ITA works, within specified time limits. Let me explain.

[68] A taxpayer who is required to file an income tax return for a taxation year is required to file that return by the filing-due date for the year.[20] In the case of an individual, the filing-due date is either April 30 or June 15 of the immediately following year.[21] By signing the return, the taxpayer certifies that the return is correct and complete and that it fully discloses all of the taxpayer's income for the year.

[69] A taxpayer must, therefore, determine his, her or its income for the year by the filing-due date. If, in making this determination, the taxpayer was limited to the information available at the end of the taxation year, it would prove to be a very difficult, if not impossible, task. Instead, the taxpayer may rely on information that comes into existence after the end of the year, but before the filing-due date, to fulfill his, her or its obligation to report all income earned in the year. This

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[20] The term "filing-due date" is defined in subsection 248(1) of the ITA.

[21] Paragraph 150(1)(*d*) of the ITA. The June 15 deadline applies when the taxpayer carries on a business in the year, or is the cohabiting spouse or common law partner of such a taxpayer.

information includes the amounts reported on information slips such as T3s, T4s and T5s, which are expressly not due until after the end of the taxation year.[22]

[70] In practical terms, the determination of whether a debt is doubtful for the purposes of paragraph 20(1)(*l*) must also be made, in respect of a taxation year, by the filing-due date for that year so that the deduction can be reflected in the net income reported for the year in the taxpayer's income tax return. I can see no valid reason why, in making that determination, a taxpayer should be precluded from relying on all information available up to the filing-due date. That is not to say that the debt need only be doubtful by the filing-due date. Rather, the taxpayer must determine whether or not the debt was doubtful at the end of the taxation year, taking into account all information available up to the filing-due date for that year. Similarly, any assessment of the taxpayer's determination regarding the debt should be based on all information available up to the filing-due date. The review of the taxpayer's decision should not be an exercise in second-guessing the taxpayer's judgment as of the filing-due date, using hindsight rather than the facts available up to that date.

[71] In this case, the filing-due date for the Appellant's 2009 taxation year was April 30, 2010. The Appellant was entitled to take into account all information available up to April 30, 2010 in filing his 2009 T1 income tax return, so that he could certify that his return for the year was correct and complete and that it fully disclosed all of his income for the 2009 taxation year.

[72] This leads to the question of what is a doubtful debt. In *Coppley Noyes & Randall*, *supra*, the Federal Court-Trial Division described the requirements for finding a doubtful debt as follows (at page 5297):

> It is conceded that in order for an amount to be included as a reserve for doubtful debts there has to be more than just some doubt that the account might not be paid: *Picadilly Hotels Ltd. v. The Queen*, 78 DTC 6444 (F.C.T.D.). The decision in *No. 81 v. M.N.R., (supra)* rejected the assertion that every debt which is overdue is a doubtful one against which a reserve must be set up; see also *Brignall v. M.N.R.*, 61 DTC 488 (T.A.B.). There must be good and substantial reason to question the likelihood that the account will be paid. The Interpretation Bulletin issued by the Minister of National Revenue (No. IT-442, paragraph 22) describes the test as follows:
>
> > . . . For a debt to be classed as a bad debt there must be evidence that it has in fact become uncollectible. For a debt to be included in a reserve for

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[22] See, generally, Part II of the *Income Tax Regulations*.

> doubtful debts it is sufficient that there be reasonable doubt about the collectibility of it. . . .
>
> In *Highfield Corporation Ltd. v. M.N.R.*, 82 DTC 1835 (T.A.B.) at 1847, it was said:
>
> > . . . A "Reserve for doubtful debts" established under section 20(1)(*l*) of the Act would seem to leave with the taxpayer a much greater degree of flexibility in using business judgment with regard to the inclusion of amounts in such a reserve that [*sic*] is permitted to a taxpayer in claiming a deduction under section 20(1)(*p*) of the Act for a "bad debt". The term "doubtful debt" in itself can mean only what it says — the debt is owing and possible of collection, but that possibility is not sufficiently certain in the mind of the taxpayer that he wishes to be placed in the disadvantageous position of having to pay income tax thereon before that possibility has become more of a certainty.

[73] The information available to the Appellant by April 30, 2010, including the suggestion by SA's lawyers in late March 2010 that a Ponzi scheme was involved (Exhibit A-7) and newspaper and other media reports suggesting the same (Exhibits A-8 to A-11), casts serious doubt on the collectibility at the end of 2009 not just of the Interest but also of the principal owed by SA to the Appellant. In my view, any reasonable person would have reached the conclusion that at the end of 2009 the payment of the Interest was at the very least doubtful given the strong indication that SA had been the victim of fraud and had no independent means of paying the amounts owed to the Appellant.

[74] The tenuous financial position of SA at the end of 2009 was further confirmed by the fact that SA had filed on April 6, 2010 a notice of intention to make a proposal under the *Bankruptcy and Insolvency Act*. The "Statement of Affairs (Business Proposal)" dated April 23, 2010 made clear the fact that SA had no financial resources other than the amounts owed to it by EMB, which, because of the circumstances, were not recorded as an asset of the corporation. Mr. Amato testified that the Statement also fairly reflected the financial position of SA at the end of 2009, which simply recognizes that SA's financial condition resulted from the fraud perpetrated by Mr. Mander from the outset, and not from circumstances that arose after 2009.

[75] To be clear, the circumstances of SA that were revealed by April 30, 2010 also existed at the end of 2009. This is not a case where the financial condition of SA deteriorated after 2009. This is a case where the true circumstances of SA at the end of 2009 were revealed by facts that came to light both in December 2009

and after 2009 but before the Appellant's filing-due date for the year. As already stated, the Appellant was entitled to rely on all these facts in assessing the status of the debt owed by SA at the end of 2009.

[76] Although not relevant to the analysis of the Appellant's judgment on the filing-due date, events subsequent to April 30, 2010 only serve to confirm that the money lent by SA to EMB was fraudulently appropriated by Mr. Mander and that SA could not have paid any of its debts at the end of 2009 as the money it had lent to EMB had been stolen.

[77] The final requirement that must be satisfied is that the amount claimed must be reasonable. Given that it was apparent by April 30, 2010 that SA and the Appellant were very likely the victims of a Ponzi scheme that held out the illusory promise of high interest rates, that the whereabouts of the principal lent to EMB was unknown and that the prospects for recovery of the principal invested were uncertain, it was reasonable for the Appellant to claim a deduction under subparagraph 20(1)(*l*)(i) equal to the full amount of the Interest. As stated in *Coppley Noyes & Randall*, *supra* (at page 5297):

> If there is a reasonable doubt that an account is not collectible, the degree of doubt is expressed as a proportion of the total debt taken as a reserve. In that sense the amount included in a reserve with respect to any given account is an estimate of the *risk* that the account will not ultimately be paid.

[78] Here, the Appellant had reasonably concluded that there was little, if any, prospect of recovering the principal lent to SA and no prospect of recovering the Interest. Accordingly, a deduction under subparagraph 20(1)(*l*)(i) of the ITA equal to the full amount of the Interest was reasonable.

B. Subparagraph 20(1)(*p*)(i)

[79] Subparagraph 20(1)(*p*)(i) has only two requirements. First, the debt in issue must have been included in the taxpayer's income for the year the deduction is claimed or for a previous year. For the reasons given above in the context of the analysis of subparagraph 20(1)(*l*)(i) of the ITA, this requirement has been satisfied by the Appellant.

[80] Second, the taxpayer must establish that the debt has become a bad debt in the year. The generally accepted approach to determining whether a debt is bad is identified by the Federal Court of Appeal in *Flexi-Coil Ltd. v. The Queen*, 96 DTC 6350, 199 N.R. 120 as follows (at page 6351 DTC, 122 N.R.):

> The parties are also agreed as to the learned Tax Court Judge's statement of the case law interpreting this provision (*Appeal Book V*, 942):
>
> > The question of when a debt becomes bad is a question of fact to be determined according to the circumstances of each case. Primarily, a debt is recognized to be bad when it has been proved uncollectible in the year. In *Roy v. M.N.R.*, 58 DTC 676, Mr. Boisvert of the Tax Appeal Board stated at page 680:
> >
> > > As the Act does not define a bad debt, it is necessary to turn to recognized accounting principles of business practice. A debt is recognized to be bad when it has been proved uncollectible in the year.
> >
> > The question of when a debt is to be considered uncollectible is a matter of the taxpayer's own judgment as a prudent businessman. In *Hogan v. M.N.R.*, 56 DTC 183 at page 193, Mr. Fisher described how this determination should be made:
> >
> > > For the purposes of the *Income Tax Act*, therefore, a bad debt may be designated as the whole or a portion of a debt which the creditor, after having personally considered the relevant factors mentioned above in so far as they are applicable to each particular debt, honestly *and reasonably determines to be uncollectable at the end* of the fiscal year when the determination is required to be made, notwithstanding that subsequent events may transpire under which the debt, or any portion of it, may in fact, be collected. The person making the determination should be the creditor himself (or his or its employee), who is personally thoroughly conversant with the facts and circumstances surrounding not only each particular debt but also, where possibly, [*sic*] each individual debtor . . . (Emphasis is mine)
> >
> > This approach has been followed in numerous judgments, including *Anjalie Enterprises Ltd. v. The Queen*, 95 DTC 216 (TCC), and *Berretti v. M.N.R.*, 86 DTC 1719 (TCC). In summary, to decide whether a taxpayer is entitled to a deduction for bad debts, the Court must be satisfied that the taxpayer itself made the determination that the debts had become uncollectible and that in making such determination, it acted reasonably and in a pragmatic business-like manner, applying the proper factors.

[81] The decision in *Flexi-Coil* indicates that a debt is a bad debt when the taxpayer determines that the debt is uncollectible and, in making this determination, has acted reasonably and in a pragmatic, business-like manner, applying the proper factors. The excerpt from the decision of the Income Tax Appeal Board decision in *Hogan* also confirms that subsequent events do not alter

a properly made determination. To this I would add that there is a difference between events that transpire by the filing-due date that reveal the true state of affairs as of the end of the relevant taxation year and events that transpire after the end of that taxation year that alter the circumstances of the debt in the subsequent taxation year. Only the former are relevant to the status of the debt as at the end of the relevant taxation year.

[82] As for the proper factors, the Federal Court of Appeal in *Rich v. Canada*, 2003 FCA 38, [2003] 3 F.C. 493 provided the following guidelines for determining when a debt is a bad debt (at paragraph 13):

> I would summarize factors that I think usually should be taken into account in determining whether a debt has become bad as:
>
> 1. the history and age of the debt;
>
> 2. the financial position of the debtor, its revenues and expenses, whether it is earning income or incurring losses, its cash flow and its assets, liabilities and liquidity;
>
> 3. changes in total sales as compared with prior years;
>
> 4. the debtor's cash, accounts receivable and other current assets at the relevant time and as compared with prior years;
>
> 5. the debtor's accounts payable and other current liabilities at the relevant time and as compared with prior years;
>
> 6. the general business conditions in the country, the community of the debtor, and in the debtor's line of business; and
>
> 7. the past experience of the taxpayer with writing off bad debts.
>
> This list is not exhaustive and, in different circumstances, one factor or another may be more important.

[83] The circumstances in this case are unusual in that the inability of SA to pay its debt to the Appellant arises because SA was the victim of fraud. The CRA states in Income Tax Folio S3-F9-C1: Lottery Winnings, Miscellaneous Receipts, and Income (and Losses) from Crime, under the heading "Fraudulent investment schemes":

> 1.43 A taxpayer may claim a deduction for a bad debt pursuant to paragraph 20(1)(*p*) in the year the fraud is discovered to the extent that investment income

> purportedly earned from a scheme, that was not considered to have been received or withdrawn by the taxpayer, was previously included in the taxpayer's income. Generally, the year the fraud is discovered is considered to be the year during which the Crown lays charges against the perpetrator of the fraud. Any amounts received by the taxpayer or paid to a third party for the benefit of the taxpayer cannot be claimed as a bad debt deduction.

[84] The CRA position does not address a circumstance such as that existing here where the perpetrator of the fraud has committed suicide and therefore will never be subject to charges. In my view, the proper question to ask here is whether, in the circumstances as they were known by April 30, 2010, a person acting reasonably and in a pragmatic, business-like manner would have concluded that the Interest was uncollectible at the end of 2009 because the existence and the result of the fraud perpetrated against SA had been sufficiently well established to draw that conclusion.

[85] The information available to the Appellant as at April 30, 2010 indicated that as of December 31, 2009 SA had no resources to pay its debts other than what it might collect from EMB under the receivership. Although the amount that might be recovered by SA was not known (as suggested in some of the correspondence highlighted by the Respondent), it would have been perfectly reasonable for the Appellant to conclude that only a portion of the principal owed was likely to be recovered and that the Interest was illusory and would not be recovered.

[86] After all, it was apparent by April 30, 2010 that the whole investment scheme was very likely a fabrication by Mr. Mander (a Ponzi scheme, as it was described by SA's lawyers in March 2010). As well, by all indications, the whereabouts of the money that had been loaned to EMB was unknown, even though lawyers had been retained by Mr. Amato to investigate as early as January 2010. Although it was still possible that the receiver would recover some of the debt owed to SA so that SA could pass that money on to the outside investors, a reasonable person may well have concluded that the probability that the Interest would be recovered was zero.

[87] As stated above in the context of the analysis of subparagraph 20(1)(*l*)(i) of the ITA, SA's financial condition did not deteriorate after 2009. The facts that came to light after 2009 and before the Appellant's filing-due date revealed that SA did not have the ability to pay the Interest at the end of 2009 because Mr. Mander had stolen the funds EMB had borrowed from SA using the promise of a 25% annual return.

[88] In the unusual circumstances of this case, I am of the view that the only reasonable conclusion for the Appellant to reach on April 30, 2010 was that the Interest, which was owed by SA to the Appellant at the end of 2009, was a bad debt at the end of 2009. Consequently, the Appellant was entitled to claim under subparagraph 20(1)(*p*)(i) of the ITA a deduction in the amount of the Interest in computing his income for the 2009 taxation year.

C. Other Issues

[89] The Respondent suggested that in order to claim a deduction under either subparagraph 20(1)(*l*)(i) or subparagraph 20(1)(*p*)(i) of the ITA, the Appellant should have recorded the Interest as income and then claimed the deduction. However, the Respondent was not able to identify exactly how the deduction under either of these subparagraphs is claimed on the return. One possibility, not identified by either party, is that the amount would have to be entered on line 232 of the return under "Other deductions", with a description of what was being claimed.

[90] The Appellant sought expert advice on how to file his 2009 T1 income tax return from a chartered professional accountant and followed that advice. The letter attached to the return amply described and explained the Appellant's filing position. Although the letter did not make specific reference to paragraph 20(1)(*l*) or 20(1)(*p*), it did state that the Interest was not included on the return because, among other things, it was not collectible. The jurisprudence makes clear that the essential characteristic of a bad debt is that it is uncollectible.

[91] In any event, even if the Appellant did not specify that he was claiming a deduction under subparagraph 20(1)(*l*)(i) or (20(1)(*p*)(i) of the ITA, it is well established that it is open to a taxpayer to amend his return through the appeal process. In *The Queen v. Imperial Oil Limited et al.*, 2003 FCA 289, 2003 DTC 5485, the Court stated (at paragraph 10):

> The administrative difficulties arising from the complex affairs of two large corporations have driven the Crown to propose statutory interpretations that are not only incorrect, but that have the potential to cause inordinate difficulties for taxpayers whose affairs are not complex. For example, it is reasonably common for taxpayers to file objections to assessments based on their own returns. **This is routinely done, for example, if a taxpayer wishes to preserve the potential right of appeal while the Minister deals with a request to allow a deduction that the taxpayer simply forgot to claim.** Alternatively, a taxpayer might choose to assert a controversial claim for the first time in a notice of objection because a

> negative outcome at that stage will not result in tax liability. Many such claims could be considered fairly without a complete audit.
>
> [Emphasis added.]

[92] Here, the Appellant is using the appeal process to claim a deduction under subparagraph 20(1)(*l*)(i) or 20(1)(*p*)(i) of the ITA that was implicitly reflected in his filing position as explained in the letter accompanying his 2009 T1 income tax return. If, as stated in *Imperial Oil Limited*, a taxpayer can use the appeal process to claim a deduction not initially claimed, then it must be that the Appellant can use the appeal process to clarify a filing position that was identified in general terms when he filed the return.

[93] For the foregoing reasons, the Appeal is allowed with costs to the Appellant and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to deduct $137,500.00 under subparagraph 20(1)(*p*)(i) of the ITA in computing his income for the 2009 taxation year.

Signed at Ottawa, Canada, this 16th day of June 2015.

"J.R. Owen"

Owen J.

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