Docket: 2004-2257(IT)G

BETWEEN:

ROBERT SCRAGG,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on May 30 and June 1, 2007,
at Vancouver, British Columbia

By: The Honourable Justice E.A. Bowie

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Victor Caux

JUDGMENT

The appeals from reassessments made under the *Income Tax Act* for the 1999, 2000 and 2001 taxation years are dismissed, with costs.

Signed at Ottawa, Canada, this 7th day of August, 2008.

"E.A. Bowie"

Bowie J.

Citation: 2008 TCC 455
Date: 20080807
Docket: 2004-2257(IT)G

BETWEEN:

ROBERT SCRAGG,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Bowie J.

[1] Mr Scragg appeals from assessments under the *Income Tax Act*[1] (the *Act*) for the 1999, 2000 and 2001 taxation years. His appeals for 1999 and 2000 are from the disallowance by the Minister of National Revenue of his claim to deduct interest paid by him during those years on borrowed money in the computation of his income. His claim for 2001 is for a loss carry-forward, and it will be governed by the result of the other two appeals.

[2] The deduction that the appellant claims to be entitled to is governed by subparagraph 20(1)(*c*)(i) of the *Act*, the relevant part of which reads:

> 20(1) Notwithstanding paragraphs 18(1)(*a*), 18(1)(*b*) and 18(1)(*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
>
> (*a*) …
>
> (*c*) an amount paid in the year or payable in respect of the year (depending on the method regularly followed by the taxpayer in

[1] R.S. 1985 c.1 (5th supp.), as amended.

> computing the taxpayer's income), pursuant to a legal obligation to pay interest on
>
> (i) **borrowed money used for the purpose of earning income from a business or property** (other than borrowed money used to acquire property the income from which would be exempt or to acquire a life insurance policy),
>
> …
>
> or a reasonable amount in respect thereof, whichever is the lesser;

I have emphasized the words that are the subject of controversy in this case.

[3] The appellant is a management consultant, and he has engaged in a number of businesses over the years, many of them through corporations owned by him, or possibly in one case by a family trust. His evidence was that in 1996 he was under considerable financial pressure, and needed funds to support certain of his business activities. The respondent does not dispute that Mr. Scragg borrowed $150,000.00 from a business associate on August 6, 1996. Nor is it disputed that he repaid the loan by way of transfer of 30,000 shares in a corporation called Sonic Systems Corporation. The repayment took place in April 2000, and it is not disputed that the interest was paid, in the years and in the amounts claimed. The respondent's position is simply that Mr. Scragg has not been able to show how the $150,000.00 was used by him for the purpose of gaining or producing income during the years under appeal.

[4] When he assessed Mr. Scragg, the Minister assumed the following facts:[2]

> a) the appellant has insufficient documentation to support his claims of interest deductions in the 1999 and 2000 taxation years;
>
> b) the appellant borrowed $150,000 in August 1996 (the "Loan");
>
> c) the appellant did not use the proceeds of the Loan to make loans to the corporations that he wholly owned;
>
> d) the appellant did not use the Loan for a particular shareholder use;
>
> e) the appellant cannot trace the proceeds of the Loan to a particular use;

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[2] Reply, paragraph 9.

f) the appellant did not use the Loan to earn income;

g) the appellant received no interest, income or dividend in respect to any loans made to his wholly owned corporations; and

h) the appellant did not use the loan for the purposes of earning income from a business or property.

[5] The appellant's position is that he used the borrowed funds to provide working capital for various of his corporations, that those corporations produced income for him in the form of both profits and management consulting fees, and so the interest must be deductible under paragraph 20(1)(*c*)(i) of the *Act*. The problem that Mr. Scragg faces in this case, and that he has not been able to overcome, is the requirement that he discharge the onus of showing that he put the borrowed funds to an eligible use. The applicable principle was put this way by Chief Justice Dickson in *Bronfman Trust v. The Queen*:[3]

> The statutory deduction thus requires a characterization of the use of borrowed money as between the eligible use of earning non-exempt income from a business or property and a variety of possible ineligible uses. **The onus is on the taxpayer to trace the borrowed funds to an identifiable use which triggers the deduction.** Therefore, if the taxpayer commingles funds used for a variety of purposes only some of which are eligible he or she may be unable to claim the deduction:
>
> (emphasis added)

[6] Mr. Scragg was not able to produce the books and records of his various companies to which he testified that he had lent the borrowed money. His evidence was that these were in the possession of his accountant, and that his accountant had dissolved his practice without giving Mr. Scragg the records that he requires to prove his claim. He did, however, have yearend unaudited financial statements for Scragg Development Corporation (SDC) and 286603 B.C. Ltd. (286603), and a bank statement of SDC for the month of August 1996. That bank statement shows a deposit to the bank account of SDC on August 7, 1996 in the amount of $73,403.41. Mr. Scragg testified that this amount was part of the loan proceeds, and that it was credited to his shareholder loan account. The balance sheets of the corporations show the following yearend balances in the shareholder loan accounts:

	SDC	286603

[3] [1987] 1 S.C.R. 32 @ 45-6.

1995	$192,936	$121,824
1996	205,632	139,469
1997	217,877	104,020
1998	200,591	
1999	176,730	
2000	270,617	

[7] Mr. Scragg's testimony was both confused and confusing. He referred repeatedly to SDC and 286603, as well as three other companies that were at one time involved in the entertainment industry, as being his companies, without ever making clear how the shares were actually held, or whether he held shares carrying a right to receive dividend income. He identified the August 7, 1996 deposit as part of the loan proceeds, but was unable to say exactly what he had done with the remaining $76,596.59, other than to aver that some $32,970 of it was applied to pay his obligation as guarantor of a bank loan for one of his screen production companies. Here, as elsewhere, he was vague as to the exact amount of the obligation that he paid.

[8] The following excerpts from the appellant's evidence illustrate the lack of precision that characterized virtually everything he had to say about his business dealings in general, and his use of the borrowed funds in particular.

> The point I'm trying to make here now is that I in fact was trying to earn income, and that I was putting this money into general-purpose use for the capital requirements of my companies, either to pay me back some of the capital – I had paid-up equity in the companies – pay off loans which I had incurred because of the business, or to put capital directly into the companies, which the companies subsequently used as working capital.[4]
>
> …
>
> Now I am under the impression, rightly or wrongly, if I have paid-up capital in the company and I am not a large corporation who's able to have significant capital beyond my immediate needs, where I can't have several buckets of money that I can keep separate from one another, that the CRA recognizes this as being a situation where money can be and is usually commingled. In this particular case I was the commingling of that money. If a company needed money, I had to put it in. All of

[4] Transcript, p. 53 l.l. 16-24.

> the companies had paid-up capital and owed money to me. At no time during the period of that loan did that capital owed to me by Scragg Development, by the numbered company, by City Centres, reduce below the amount of money of this loan. In fact it was always significantly higher.[5]

He said a number of times in one way or another that his companies required the borrowed funds for their continued existence, and that he had borrowed the money at a very high rate of interest, and on other unfavourable terms, only in order to keep his businesses afloat. He also argued at some length that an examination of the yearend balances of his loan accounts in the various corporations somehow demonstrated that he had injected the loan proceeds into these corporations, and that it remained there throughout the period that the loan was outstanding. His submission was that he needed to say no more than that to be entitled to deduct the interest that he paid on the loan.

[9] All this evidence falls far short of discharging the onus that Chief Justice Dickson spoke of in *Bronfman Trust.*[6] The only information concerning the appellant's shareholder loan accounts is the yearend balances shown on the balance sheets of the corporations. It is impossible to tell from these to what extent, if any, the appellant advanced the loan proceeds to any of these corporations. The increase of about $12,000.00 in the SDC loan account between 1996 and 1997 certainly does not corroborate Mr. Scragg's account of the $73,403.41 deposit as being a credit to his loan account in that company. Nor is there any useful evidence from which I could conclude that the borrowed funds, even if they were initially put to an eligible use, continued in the same use. It was quite apparent from Mr. Scragg's evidence that he simply did not know either how he applied the proceeds initially, or their use in later years, other than in the most general terms.

[10] I do not wish to leave the impression that Mr. Scragg was not an honest witness. I have no doubt that he believed quite sincerely that he had put these loan proceeds to an eligible use in one or more of his corporations. It was clear throughout his evidence, however, that he did not have any clear recollection of the specific application of the funds in question, either initially or throughout the period of almost four years between the initial borrowing and the repayment. The quality of the evidence before me as to the use of the borrowed funds is simply not sufficient to support a claim to deduct the interest that was paid. Although it was said in a

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5 Transcript, p. 53 l.22 to p. 54 l. 11.

6 *Supra*, para. 5 .

somewhat different context, the following passage from the unanimous judgment of the Federal Court of Appeal in *Njenga v. The Queen*[7] is equally apposite here:

> The Income tax system is based on self monitoring. As a public policy matter the burden of proof of deductions and claims properly rests with the taxpayer. The Tax Court Judge held that persons such as the Appellant must maintain and have available detailed information and documentation in support of the claims they make. We agree with that finding. Ms. Njenga as the Taxpayer is responsible for documenting her own personal affairs in a reasonable manner. Self written receipts and assertion without proof are not sufficient.

Mr. Scragg's evidence can only be characterized as "assertion without proof", and as such it is insufficient to discharge the burden of proof that was on him.

[11] The appeals are dismissed. The respondent is entitled to costs.

Signed at Ottawa, Canada, this 7th day of August, 2008.

"E.A. Bowie"

Bowie J.

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7 96 DTC 6593, @ 6594.

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STYLE OF CAUSE:	ROBERT SCRAGG and HER MAJESTY THE QUEEN
PLACE OF HEARING:	Vancouver, British Columbia
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DATE OF JUDGMENT:	August 7, 2008

APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Victor Caux

COUNSEL OF RECORD:

For the Appellant:

Name:	N/A
Firm:	N/A
For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada