Docket: 2016-2904(IT)G

BETWEEN:

KEYBRAND FOODS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 19, 20 and 21, 2018, at Hamilton, Ontario.
Additional submissions received on March 11 and 12, 2019.

Before: The Honourable Gaston Jorré, Deputy Judge

Appearances:

Counsel for the Appellant:	Keith M. Trussler Sean C. Flaherty
Counsel for the Respondent:	Tokunbo Omisade

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeal from the reassessments made under the *Income Tax Act* for the 2011 and 2012 taxation years, is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessments on the basis that the Appellant is entitled to the capital loss claimed in the 2011 taxation year in relation to the $500,000 loan and that any consequential adjustments arising therefrom should be made to the 2012 taxation year. No changes shall be made in respect of the other issues in dispute.

Costs are awarded to the Respondent. If the parties are unable to agree on costs, they shall advise the Registry no later than 21 September 2019 and

arrangements will be made for submissions in writing or by teleconference on the question of costs.

Signed at Ottawa, Canada, this 2nd day of August 2019.

"Gaston Jorré"

Jorré D.J.

Citation: 2019 TCC 161
Date: 20190802
Docket: 2016-2904(IT)G

BETWEEN:

KEYBRAND FOODS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Jorré D.J.

Introduction

[1] This appeal relates to three deductions claimed by the Appellant with respect to its 2011 and 2012 taxation years.[1]

[2] First, the Appellant claimed an allowable business investment loss ("ABIL") of close to $10 million in relation to shares in Vidabode Group Inc. ("Vidabode"). This loss has been denied by the Minister of National Revenue (the "Minister") on the basis that at the time of acquisition the fair market value ("FMV") of the shares was nil and that the two companies were not dealing at arm's length. As a consequence, the Minister takes the position that there is no loss to deduct because paragraph 69(1)(a) of the *Income Tax Act* (the "*Act*") applies.

[3] In its opening statement the Appellant stated that it was not contesting the Minister's FMV but was contesting the conclusion that the two companies were not dealing at arm's length.[2]

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[1] Those taxation years ended on 24 April 2011 and 29 April 2012, respectively. There are three issues. They all affect the 2011 taxation year. As for 2012, the reassessment simply reflected the flow-through into 2012 of the 2011 reassessment.

[2] See page 8 of the Transcript of the first day of hearing. I was somewhat surprised by this because the Notice of Appeal, filed by a different law firm, raised the FMV issue but did not appear to raise the arm's length issue. Assuming without deciding that the arm's length issue was not raised, given that the Respondent did not raise an

[4] The key question to be determined with respect to the ABIL is whether or not, factually, the Appellant was dealing at arm's length with Vidabode, a Nova Scotia company, when it acquired shares of Vidabode in December 2010.

[5] Second, the Appellant borrowed funds to acquire the shares in December 2010. In its returns for the 2010 and 2011 taxation years the Appellant deducted, and the Minister disallowed, interest paid by the Appellant on those borrowed funds on the basis that the funds were not used for the purpose of earning income.

[6] Third, in October 2010 the Appellant made a loan to Vidabode of $500,000 and, in 2011 it claimed a capital loss in relation to the loan. The Minister denied the loss on the grounds that it was not made for the purpose of earning income.[3]

[7] The key portions of the relevant provisions of the *Income Tax Act* read as follows:

With respect to the ABIL:[4]

> **69(1) Inadequate considerations** — Except as expressly otherwise provided in this Act,
>
> > (a) where a taxpayer has acquired anything from a person with whom the taxpayer was not dealing at arm's length at an amount in excess of the fair market value thereof at the time the taxpayer so acquired it, the taxpayer shall be deemed to have acquired it at that fair market value;
> >
> > . . .
>
> **251(1) Arm's length** — For the purposes of this Act,
>
> > (a) related persons shall be deemed not to deal with each other at arm's length;

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objection and did not appear to be surprised, I assume that the Respondent became aware of this change early enough in the course of the pre-trial proceedings that it had no impact on the trial for the Respondent. While a notice of appeal should clearly set out what is in issue, given that pre-trial procedures are there to enable discovery of the facts, insure a fair trial and more generally serve the interests of justice and given that in this case no unfairness appears to have arisen, in the circumstances, I can, like the parties, safely ignore the issue of whether the Notice of Appeal raised the non-arm's length issue.

[3] At the beginning of the hearing, the Appellant abandoned certain other secondary issues.

[4] Subsection 251(2) is also relevant.

. . .

(c) in any other case, it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length.

With respect to the interest expense:

20(1) Deductions permitted in computing income from business or property — 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:

. . .

(c) **interest** — an amount paid in the year or payable in respect of the year . . . , pursuant to a legal obligation to pay interest on

(i) borrowed money used for the purpose of earning income from a business or property . . .

(ii) an amount payable for property acquired for the purpose of gaining or producing income from the property or for the purpose of gaining or producing income from a business . . .

. . .

or a reasonable amount in respect thereof, whichever is the lesser;

With respect to the capital loss claimed:

40(2) Limitations — Notwithstanding subsection 40(1),

. . .

(g) **[various losses deemed nil]** — a taxpayer's loss, if any, from the disposition of a property . . . , to the extent that it is

. . .

(ii) a loss from the disposition of a debt or other right to receive an amount, unless the debt or right, as the case may be, was acquired by the taxpayer for the purpose of gaining or producing income from a business or property . . .

. . .

is nil;

The Facts[5]

[8] B.W. Strassburger Ltd. ("BWS") is the sole owner of the Appellant. The shareholders and directors of BWS are Mr. Bernhardt Strassburger and his three siblings.

[9] BWS was started by Mr. Strassburger's father and is active in the restaurant and food service industry.[6]

[10] The Appellant, Keybrand Foods Inc., was created originally to provide certain prepared food to BWS's restaurants and later became a supplier to a wide variety of other customers.

[11] The Appellant is wholly owned by BWS.

[12] Mr. Strassburger was president, secretary-treasurer and sole director of BWS as well as president and sole director of the Appellant.

[13] One of Mr. Strassburger's siblings first brought to his attention a company operating in Nova Scotia and incorporated in Nova Scotia called Vidabode Group Inc.[7] Vidabode held the patents in a new concrete product called Vidacrete as well as a production system for Vidacrete.

[14] Vidacrete had a number of very positive characteristics which appeared to give it great potential.[8] Broadly, the basic business model of Vidabode was this. It would build a production plant in Nova Scotia and produce some of the product. The plant and product could be shown to clients. This plant was subsequently

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[5] There were two witnesses, Mr. Bernhardt Strassburger and Ms. Emma Plant, the auditor who worked on the file.

[6] When Mr. Strassburger was a child, his father had a roadside restaurant and met Col. Sanders at a food-service conference. Soon thereafter Col. Sanders came to the family home for two days and Col. Sanders and Mr. Strassburger's father cooked chicken resulting in Mr. Strassburger's father becoming the first Kentucky Fried Chicken franchisee in Canada. Mr. Strassburger remembers that the Colonel wore a dark suit and not a white suit.

[7] See note 13 of the financial statements for the year ending 31 December 2009 at Tab 5 of Exhibit A-1. I would note that the parties' books of documents, A-1, A-2 and R-1, were initially marked for identification and the documents at individual tabs were entered into evidence one by one in the course of the hearing. Only some tabs were entered into evidence. There is a summary of the tabs entered into evidence starting at page 293 of the third day of hearing. In addition, there are also Exhibits R-2 and R-3 in evidence.

[8] See page 49 of the Transcript of the first days of hearing.

completed. Vidabode also built in a 1800 ft.² home using Vidacrete next to the completed plant to demonstrate what could be done with Vidacrete.

[15] Vidabode planned to sell master licensing agreements for the production plant technology for $7.5 million dollars and collect royalties per cubic metre of cement produced. In addition, the licensee would have to pay something like $12 million for the manufacturing equipment and setting it up. The licensee would also have to acquire the land and the buildings for the plant themselves.[9] Vidabode also wanted to sell the Nova Scotia plant but intended to keep the Vidabode head office at the Nova Scotia site.

[16] Notwithstanding a recommendation by Mr. Strassburger not to invest, the other siblings voted to go ahead and the family invested in Vidabode in various ways.

[17] Regrettably things did not go well resulting in financial losses and the dispute before this Court.

[18] The family's involvement in Vidabode started in 2006 when Twincorp Inc., a company 100% owned by Mr. Strassburger, made two loans totaling $500,000; Vidabode issued promissory notes for $500,000 to Twincorp. In 2007, BWS loaned $4 million to Vidabode.[10] In 2007, BWS also bought non-voting Vidabode class C preferred shares from treasury; those shares cost $1,025,000. In 2007, Dorothy Strassburger, Mr. Strassburger's mother, bought non-voting Vidabode class B preferred shares from treasury; her shares cost $300,000.[11]

[19] Subsequently, BWS bought 2,500,000 shares of Vidabode from treasury at the beginning of June 2008. As we shall see below, in 2008 the Appellant, as well as other related family companies, became a guarantor of certain loans made by GE Capital to Vidabode. The Appellant did not become a shareholder of Vidabode until late 2010 when it acquired the shares in respect of which it is claiming the allowable business investment loss that is in issue in this appeal.

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[9] See pages 37 and 38 of the Transcript of the first day of hearing as well as the Master Licensing Agreement draft at Tab 34 of Exhibit A-1, especially Article 4.2(d).

[10] See notes 8 and 9 of the financial statements for 2007 at Tab 3 of Exhibit A-1.

[11] See pages 165 to 167 of the Transcript of the first day of hearing and Tab 3 of Exhibit R-2 at pages 380 and 381 as well as note 17 to the 2007 financial statements at Tab 3 of Exhibit A-1.

[20] As of June 2008, BWS owned about 25% of the voting shares of Vidabode, and about 25% of the votes.[12]

[21] In early 2008, Vidabode obtained financing of up to $23,450,000 from GE Capital under three different agreements.[13] Vidabode and the other investors had not lined up any financing to pay for the equipment for the plant in Nova Scotia and they asked Mr. Strassburger to do it. He had previously worked with GE Capital to obtain financing and over a period of six months he obtained the financing package.

[22] 2090810 Ontario Ltd. is a wholly-owned subsidiary of BWS; Mr. Strassburger was the president of 2090810 Ontario.

[23] The Appellant became involved in the financing of Vidabode when the loan agreements were made with GE Capital. In the agreement for $2.2 million in mortgage financing, the Appellant was the guarantor. The mortgage was on the Nova Scotia real estate where the cement plant was located. In the other two agreements Vidabode, BWS and 2090810 Ontario were the guarantors of the two loans. These two loans were secured by real estate in four locations in Ontario, one of which was owned by the Appellant, two of which were owned by BWS and one of which was owned by 2090810 Ontario.[14]

[24] The Appellant did not receive any fee for providing its guarantees.[15] BWS soon started making further loans to Vidabode.

[25] The GE Capital loans were used to pay off a mortgage on the Nova Scotia property, to buy equipment, to pay off $4 million loaned by BWS, to pay off some loans by Twincorp and as operating capital. The financial statements for 2008 and

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[12] See the shareholder register of common shares at Tab 9 of Exhibit A-1. There were also a small number of preferred shares that were non-voting. See the notes to the financial statements at Tabs 1 to 5 of Exhibit A-1 and, particularly, note 12 to the financial statements at Tab 5 where it is indicated that those preferred shares are non-voting. The $2,500,000 shares cost $0.0004 per share for a total of $1,000.

[13] These agreements are found at Tabs 16, 17 and 18 of Exhibit A-1. Looking at note 9 of Vidabode's financial statements for 2009, it would appear that the year end balances of these three loans at the end of 2008 and 2009 were just under $18 million and just under $15.7 million, respectively.

[14] One of the loans was secured by three of the four properties; the other was secured by two of the properties. See pages 112 and 113 of the Transcript of the first day of hearing. While I refer to three loans and there are only three loan agreements in evidence, I note that when one looks at the financial statements, it appears that there was a fourth loan agreement with GE Capital—see note 9 to the financial statements of 2009 at Tab 5 of Exhibit A-1. In his testimony, Mr. Strassburger also referred to four agreements. Whether there were three agreements or four agreements does not affect one way or the other the issues in this appeal.

[15] See pages 110 to 114 of the Transcript of the first day of hearing.

2009 show the balance owed by Vidabode on Promissory Notes held by BWS as $2,150,000 on 31 December 2008 and $6,441,394 on 31 December 2009.[16]

[26] Subsequently, BWS acquired 1,600,000 shares in September 2009 that were transferred to it by one of the other shareholders, Atlantic Aboriginal Capital Inc. ("AACI") This was in return for BWS guaranteeing a loan to Vidabode by Banc Developments Limited ("Banc") .[17]

[27] As a result of the acquisition of the additional 1,600,000 shares, BWS had about 41% of the common shares and about 41% of the votes with the consequence that it was now the largest shareholder of Vidabode. The second largest shareholder was AACI. which had about 34% of the votes.

[28] In September 2009, there was also an amendment to the shareholders' agreement between all the shareholders of Vidabode. Clauses 2 and 3 of the amending agreement provide i) that BWS shall nominate two of the four directors of Vidabode, ii) that BWS shall have the right to nominate one of its directors as chairman of the board and iii) that the chairman nominated by BWS will have a casting vote.[18] AACI had the power to name the two other directors.

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[16] See pages 43 and 44 of the Transcript of the first day of hearing as well as Tabs 15, 16 and 17 of Exhibit A-1 and note 8 of the 2009 financial statements at Tab 5 of Exhibit A-1.

[17] See Tab 13 of Exhibit A-1.

[18] See Tab 11 of Exhibit A-1.Although the agreement is simply called the Shareholders' Agreement it states clearly at the bottom of the first page that the signatories own all the shares of the corporation. Later it appears that Banc Developments Limited became a shareholder but there is no evidence of a new shareholders agreement with the consequence that all the signatories to the shareholders agreement, who collectively held about 85% of the shares, continued to be bound by the agreement. Since Banc only owned about 15% of the common shares it could not have any influence on the election of Directors and change the fact that BWS was entitled to two directors plus the casting vote. Banc became a shareholder because it had lent money to Vidabode and under the agreement if Vidabode failed to pay on the due date then Banc was entitled to 1.5 million common shares in addition to repayment of the loan. Vidabode failed to pay on time.

This is a good place to mention a factual issue which came up at trial. Although the Minister assumed that BWS owned 40% of the shares of Vidabode, at the hearing it was suggested to Mr. Strassburger that by December 2010 BWS owned about 56% of the common shares. If that were the case, BWS and Vidabode would for that reason alone not be at arm's length.

There is a certain amount of evidence that supports that contention. Specifically, under Banc's loan agreement with Vidabode there was provision that if Vidabode defaulted Banc could keep the 1,500,000 common shares that AACI had pledged in guarantee; the agreement further stated that if BWS remedied the default within 10 business days of receiving notice of the default then Banc would transfer the 1,500,000 common shares to BWS - see tab 13 of Exhibit A-1. We know that Banc is not listed as a creditor in the receivership documents so someone must have paid off the debt owing to Banc.

In addition, we see references in the minutes of the December 22, 2010 board meeting that seem to suggest BWS had more than 50% of the shares - notably a statement by Wanda Arnold at page 8 and a statement by Mr. Strassburger at page 30 saying "… it's not an issue because we already have more than 50% of the shares in our combined companies …". Finally, in billings to BWS sent to the attention of Mr. Strassburger a law firm reports as a

[29] Throughout its history, Vidabode was only able to generate modest revenues. The company had considerable losses particularly in the years ending 31 December 2008 and 2009. In those years, the company lost some $7 million and some $8.6 million, respectively.[19]

[30] In late 2009, Vidabode provided a projection of $51 million in profits over 5 years. Mr. Strassburger had some concerns and sent his own Chief Financial Officer, Mr. Bunty, to Nova Scotia for 10 days to look over the company and make his own evaluation. Mr. Bunty came back having concluded that it was possible for Vidabode to have an operating income of around $40 million over five years. This was based on four plant sales which appeared to have a good chance of closing at the time.[20]

[31] As a result of certain problems with the previous President of Vidabode, Mr. Strassburger became President and Secretary Treasurer of Vidabode at the end of August 2010.

[32] The directors of Vidabode were Ms. Wanda Arnold, Mr. Robin Googoo, Mr. Strassburger and Mr. David MacDonald. Ms. Arnold and Mr. Googoo were

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work item in mid-October " … drafting report letter for Banc transaction and drafting amendments to report book index …"

On the other hand, in cross-examination Mr. Strassburger was quite clear that BWS did not get those shares and the share register page at tab 9 of Exhibit A-1 shows Banc as the owner of the shares - although there is admittedly an oddity in the share register insofar as the year but not the month of Banc's acquisition is shown, unlike all the other entries.

It is also important to consider that parts of the discussion at the December 22, 2010 board meeting are confusing to follow and the reference to " combined companies " by Mr. Strassburger does not appear to be a reference to BWS and other related family companies because we know that only BWS and none of the companies related to it were shareholders prior to the acquisition by the Appellant of the share in issue.

Considering Mr. Strassburger's evidence and the share register, I am satisfied that BWS did not own a majority of the shares prior to the share acquisition in issue in this case.

Interestingly, the default regulations in Annex A of the *Companies Act* of Nova Scotia also provide that the Chairperson shall have a casting vote. Under section 21 of that Act, the statutory provision applies if the company does not register articles or, if articles are registered, where the registered articles ". . . do not exclude or modify the regulations in Table A in the First Schedule to this Act. . .". The First Schedule of Table A provides that "[q]uestions arising at any meeting of Directors shall be decided by a majority of votes, and in case of an equality of votes the Chairman shall have a second or casting vote." See chapter 81 of the revised statutes of Nova Scotia, 1989, section 21 and section 129 of Table A of the First Schedule to the *Companies Act*. Section 129 of Table A later became section 132 of that Table.

[19] See the financial statements at Tabs 1 to 6 of Exhibit A-1.

[20] See pages 46, 47 and 51 to 53 of the Transcript of the first day of hearing and Tab 74 of Exhibit A-1. Earlier in 2009, Vidabode was close to a sale but, ultimately, the customer could not get financing.

the directors named by AACI. The Board had monthly meetings except in summer.[21]

[33] Mr. MacDonald first brought Vidabode to the attention of Mr. Strassburger's brother. That eventually led to Mr. Strassburger and his family investing in Vidabode. In return for bringing in the Strassburger family Mr. MacDonald acquired 1 million shares, about 10% of the voting share, at the same time as BWS.[22] Mr. MacDonald and Mr. Strassburger also became partners in an unincorporated entity called Davenport Industries that was one of the sales agents for Vidabode.[23]

[34] In 2010, the financial situation of Vidabode was clearly problematic. Prior to the 2008 fiscal year, its annual revenue had never exceeded $5,060. In 2008, it recorded revenues of $848,845 and in 2009, $108,932. By the end of 2009, the accumulated deficit shown on the balance sheet was some $17,700,000.[24]

[35] Because one of the loans had a final balloon payment of about $3 million at the end of September 2010 and because another of the loans would be due in mid-2011, Mr. Strassburger had started speaking to GE Capital in the late spring of 2010. He was informed by GE Capital that they would be calling all the other loans in the middle of 2011.

[36] This was of great concern to Mr. Strassburger. Members of his family instructed him that neither BWS nor the Appellant were to pay the $3 million balloon payment.[25] He tried to see if the other shareholders would fund the payment. While the AACI representatives said they would look into that at the August board meeting AACI did not come up with funding.

[37] GE Capital would not postpone the payment deadline and Vidabode defaulted on the balloon payment. That resulted in GE Capital calling in all the loans.

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[21] See page 45 of the Transcript of the first day of hearing. These four individuals constituted the Board from June 2008 and throughout the period relevant to this appeal. See Exhibit R-2, Tab 3, at pages 227 to 229 as well as the first page of Tabs 36 and 37 of Exhibit A-1.

[22] See Tab 9 of Exhibit A-1. Mr. MacDonald paid $0.0004 per share for a total of $400.

[23] See pages 41 and 105 of the Transcript of the first day of hearing. Mr. Strassburger had 50% interest and Mr. MacDonald and his wife each had 25%.

[24] It is worth bearing in mind that Vidabode was trying to launch a new business in the period that included the financial crisis of 2007 – 2008 and, subsequently, what has come to be known as the "great recession".

[25] See pages 62, 63 and 66 of the Transcript of the first day of hearing.

[38] Mr. Strassburger started working with TD Bank to get funding to cover repayment of GE Capital. He obtained an extension to the end of November provided that GE Capital received a $500,000 payment at the end of October. The Appellant made the payment of the $500,000 on behalf of Vidabode and received the $500,000 promissory note, the loss on which is the third issue in this appeal.[26] The note was issued 29 October 2010 and bore interest at 10% per year, calculated monthly.[27]

[39] Around this time, in order to cut the rate at which the company was burning cash, Vidabode decided to lay off most of the staff and keep the plant in shutdown mode. The plant would still be available to show potential customers and employees could be recalled if needed to reopen the plant.[28]

[40] Mr. Strassburger kept working with TD Bank and, eventually, in December 2010, the Appellant obtained the financing that would be necessary to repay GE Capital.

[41] Once the TD financing was complete Mr. Strassburger started looking at what was the best way to pay off GE Capital. Based on advice from legal, accounting and tax professionals, he was told that the Appellant should take shares.[29] The Appellant subscribed, on or about 22 December 2002, to 19,343,493 common shares of Vidabode at a par value of one dollar each. On or about 29 December 2010, the Appellant borrowed $14,452,515 that were used to buy 14,452,515 of the shares.[30]

[42] With this purchase the Appellant and BWS become the owners of about 80% of the shares.[31]

[43] Given that the Minister assumed that the fair market value of those 19,343,493 common shares was nil and that the Appellant chose not to contest that

[26] See pages 70 to 74 of the Transcript of the first day of hearing.
[27] See Tab 25 of Exhibit A-1.
[28] See pages 72 and 73 of the Transcript of the first day of hearing.
[29] See pages 74 and 75 of the Transcript of the first day of hearing.
[30] The total number of shares acquired and the amount borrowed are in subparagraphs 11q) and dd) of the Reply to Notice of Appeal; both subparagraphs were admitted.
[31] Mathematically, after this last acquisition of shares acquisition, BWS and the Appellant owned about 80% of the shares based on Tab 9 of Exhibit A-1. The December 22, 2010 board meeting transcript seems to suggest about 75%. Whichever percentage is correct, it would not change the outcome.

finding I must proceed on the basis that the fair market value of those shares was nil.[32]

[44] The Minister also assumed and the Appellant admitted at the start of the hearing that, at the time the Appellant subscribed to the Vidabode shares, Vidabode was unable to meet its financial obligations and Vidabode's liabilities far exceeded its assets.

[45] As of the end of 2010 Vidabode had not yet made a sale. The closest that it had come to a sale was receiving some non-refundable deposits in 2008.[33]

[46] While the Appellant's injection of an additional $14 million in cash into Vidabode through its acquisition of treasury shares solved the problem of paying off the debts owed to GE Capital, it did not solve the problem of paying an amount of $1 million to $2 million in outstanding payables to other creditors as of the end of December 2010. The amount was probably closer to $2 million based on the claims listed when Vidabode went into receivership.[34]

[47] At the December 22, 2010 board meeting Mr. Strassburger made it quite clear that neither BWS, nor the Appellant, nor TD Bank, were going to put in any additional funding to cover payables or any other future costs. The other owners would have to put in money or there would have to be sales of cement plants.[35]

[48] Mr. Strassburger estimated that Vidabode needed around $20,000 a month to keep going.[36]

[49] It is very clear that the injection of an additional amount of about $14 million in cash by the Appellant was driven by the need to repay GE Capital. While everyone had been aware of the balloon payment coming up in September the rest of the loans should normally have continued for longer. However, as previously stated, once the balloon payment was missed, GE Capital called in all the loans precipitating a crisis.

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[32] Paragraph 11bb) of the Reply to Notice of Appeal. The assumption of the nil fair market value and the failure to contest that assumption is not binding on me if there were evidence to the contrary. There is no evidence before me leading to a different conclusion—see paragraph 9 of *Fiducie Alex Trust v. The Queen*, 2014 FCA 123.

[33] The 2008 financial statements show revenues of about $850,000 and note 15 to those financial statements states that these are non-refundable deposits for the purchase of licenses for cement plants.

[34] See pages 23 to 26 at Tab 36 of Exhibit A-1. Based on Form 78 dated April 29, 2011 Vidabode owed unsecured creditors about $1.8 million if one excludes debts owing to BWS. See pages 12 to 21 of Tab 20 of Exhibit R-1.

[35] See page 24 of Tab 36 of Exhibit A-1.

[36] See page 91 of the Transcript of the first day of hearing.

[50] The Appellant, BWS and 2090810 Ontario were all guarantors of the loans and had no choice but to come up with the money to honour the guarantees given that no one else was coming up with cash for Vidabode to repay the loans.

[51] Even when the problem was only the $3 million balloon payment in September 2010 no one had come up with the money. As we have seen prior to the late August 2010 board meeting Mr. Strassburger's family had instructed him that BWS and the Appellant were not to pay the $3 million. At the August board meeting the AACI representatives said they would see if they could come up with anything but nothing came of that.

[52] It is clear that Keybrand's advisors were considering and preparing for the possibility of the insolvency of Vidabode prior to the December 22, 2010 board meeting. A letter from BWS to BDO Canada Limited ("BDO") appointing BDO as receiver was signed by Mr. Strassburger on the 5th day of January 2011, a Wednesday and exactly one week after the Appellant paid the $14 million to Vidabode. Based on the fact that it was dated on the 15th day of December 2010 on the first page it is reasonable to conclude that it was prepared on or about 15 December 2010.[37] An email dated January 5, 2011 asked that a $25,000 cheque for BDO's retainer be prepared.

[53] Presumably there was some delay in BDO accepting the appointment because it was on or about 14 April 2011, that BDO became the receiver of Vidabode. On or about 6 May 2011, Vidabode filed for bankruptcy.

Analysis

[54] It is useful to again set out part of subsection 251(1) of the *Act*:

> For the purposes of this Act,
>
> > (a) related persons shall be deemed not to deal with each other at arm's length;

[37] See pages 3 and 4 of Exhibit R-3 as well as pages 11 to 15 of Tab 13 of Exhibit R-1 where the date on the first page is December 15, 2010 although the letter was only signed by Mr. Strassburger on the fifth day of January 2011. When it was suggested to Mr. Strassburger that he had concerns about the insolvency of Vidabode prior to the December 22, 2010 board meeting his response was that they would not have been putting millions of dollars into Vidabode if they were planning to put the company into bankruptcy. He also said that always has concerns with company losing money.

> . . .
>
> (c) in any other case, it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length.

[55] The Appellant and 2090810 Ontario are both wholly owned by BWS. Mr. Strassburger is the President of all three corporations and is the sole Director of BWS and the Appellant.[38] BWS can elect all the Directors of the Appellant and 2090810 Ontario with the result that they are controlled by BWS.

[56] Without reviewing the definition of "related persons" in subsection 251(2) of the *Act*, I would simply note that the definition includes persons who are related by blood relationship, marriage and adoption as well as corporations where one corporation controls the other.[39]

[57] The Appellant, BWS and 2090810 Ontario are related within the meaning of subsection 251(2) and, accordingly, do not deal at arm's length with each other.[40]

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[38] There is no evidence regarding the Director(s) of 2090810 Ontario.

[39] In the case of a corporation, see subparagraph 251(2)(b)(i).

[40] Although this was not raised by either party as such, one should consider the question whether Vidabode is related to BWS because it is controlled by BWS.

It is well settled that "controlled" by itself means *de jure* control although in a number of provisions of the *Act* control has been extended to include *de facto* control.

The general test for *de jure* control is whether the majority shareholder enjoys "effective control" over the "affairs and fortunes" of the corporation, as manifested in "ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors". This is however subject to a number of additional considerations such as, for example, whether any provisions in a unanimous shareholder agreement have the effect of changing what would otherwise be a person's effective control: *Duha Printers (Western) Ltd. v. Canada*, [1998] 1 SCR 795 (*Duha*).

Paragraphs 36 and 37 of *Duha*, *supra*, says in part:

> 36 Thus, *de jure* control has emerged as the Canadian standard, with the test for such control generally accepted to be whether the controlling party enjoys, by virtue of its shareholdings, the ability to elect the majority of the board of directors. However, it must be recognized at the outset that this test is really an attempt to ascertain who is in effective control of the affairs and fortunes of the corporation. That is, although the directors generally have, by operation of the corporate law statute governing the corporation, the formal right to direct the management of the corporation, the majority shareholder enjoys the indirect exercise of this control through his or her ability to elect the board of directors. Thus, it is in reality the majority shareholder, not the directors *per se*, who is in effective control of the corporation. . . .
>
> 37 Viewed in this light, it becomes apparent that to apply formalistically a test like that set out in *Buckerfield's*, without paying appropriate heed to the reason for the test, can lead to an unfortunately artificial result. The task before this Court, then, is to determine whether, just prior to the amalgamation, Marr's was <u>in effective control</u> of the affairs and fortunes of Duha No. 2 by virtue of its majority shareholdings.

[58] As we saw earlier, paragraph 251(1)(c) says:

> (c) in any other case, it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length.

[59] In the Canadian Oxford Dictionary,[41] the relevant meaning is:

> 2 far enough to avoid to avoid undue familiarity or influence

[60] In the Oxford English Dictionary,[42] the relevant meanings are:

> **d.**
> **(a)** ***at arm's length***.
>
> **(i)** . . .
>
> . . .
>
> **(ii)** *Law*. Of two parties: without legal obligations to each other, esp. fiduciary obligations; (also more generally) in an independent or impartial position; conducted by independent or impartial parties.
>
> . . .
>
> **(b)** . . .

Duha, *supra*, then continues to decide that the constating documents of a corporation including a unanimous shareholder agreement, a USA, can be considered in deciding who has effective control.
That raises the following question: Does BWS have *de jure* control of Vidabode by virtue of its 40% shareholding and the USA which gives it the right i) to name two directors, ii) to name one of those directors as Chairman and iii) to have the Chairman cast a second, or casting, vote in the event of a tie? The logic of *Duha* suggests that the answer is yes.
Such an argument was not raised or debated and I shall not deal with it given that, in the end, I have concluded that it would not affect the outcome and, as a result, I decided not to invite argument on the question.
However, given *Duha*, *supra*, and given the following statement by the Supreme Court of Canada in *Minister of National Revenue v. Dworkin Furs (Pembroke) Ltd. et al.*, [1967] SCR 223, 1967 CanLII 112 (SCC):

> . . . Thurlow J. held that the existence of the right to exercise a second or casting vote did not give Aaron control. He said:
>
> > the casting vote, unlike the votes arising from shareholding, which are exercisable without responsibility to the company or to other shareholders is in my opinion not the property of the holder, but is an adjunct of an office.
>
> and with this I agree.

If the question arose, it would also be necessary to reconcile the two decisions on the question of whether the casting vote could be considered for the purposes of *de jure* control.
[41] Second edition 2004.
[42] Online edition, under phrases.

> **arm's-length** *adj*. Conducted or agreed by independent parties not able to coerce or control each other; characterized by distance, independence, or impartiality.

[61] The Supreme Court of Canada in *Canada v. McLarty*,[43] states:

> [62] The Canada Revenue Agency Income Tax Interpretation Bulletin IT-419R2 "Meaning of Arm's Length" (June 8, 2004) sets out an approach to determine whether the parties are dealing at arm's length. Each case will depend on its own facts. However, there are some useful criteria that have been developed and accepted by the courts: see for example *Peter Cundill & Associates Ltd. v. Canada*, [1991] 1 C.T.C. 197 (F.C.T.D.), aff'd [1991] 2 C.T.C. 221 (F.C.A.). The Bulletin provides:
>
> > **22.** . . . By providing general criteria to determine whether there is an arm's length relationship between unrelated persons for a given transaction, it must be recognized that all-encompassing guidelines to cover every situation cannot be supplied. Each particular transaction or series of transactions must be examined on its own merits. The following paragraphs set forth the CRA's general guidelines with some specific comments about certain relationships.
> >
> > **23.** The following criteria have generally been used by the courts in determining whether parties to a transaction are not dealing at "arm's length":
> >
> > · was there a common mind which directs the bargaining for both parties to a transaction;
> >
> > · were the parties to a transaction acting in concert without separate interests; and
> >
> > · was there "de facto" control.

[62] These last three considerations: common mind, acting in concert and "*de facto*" control have been widely used in the case law. However, it is clear from the opening of paragraph 62 of the Supreme Court's decision when it says that "Each case will depend on its own facts. However, there are some useful criteria that have been developed and accepted by the courts: ..." that the three considerations are not exclusive and that any relevant consideration can be taken into account.

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[43] [2008] 2 SCR 79.

[63] The Supreme Court also sets out in the decision the purpose of non-arm's length provisions in the following passage:

> [43] It has long been established that when parties are not dealing at arm's length, there is no assurance that the transaction "will reflect ordinary commercial dealing between parties acting in their separate interests" . . . The provisions of the *Income tax Act* pertaining to parties not dealing at arm's length are intended to preclude artificial transactions from conferring tax benefits on one or more of the parties. Where the parties are found not to be dealing at arm's length, the taxpayer who has made an acquisition is deemed to have made the acquisition at fair market value regardless of whether the amount paid was in excess of fair market value . . .

[64] In *McGillivray Restaurant Ltd. v. Canada*,[44] the Federal Court of Appeal reviews the law regarding control starting with the Supreme Court of Canada decision in *Duha Printers (Western) Ltd. v. Canada*.[45]

[65] It is useful to bear in mind that the Supreme Court of Canada said at paragraph 70 of *Duha*:

> As I have said, the essential purpose of the *Buckerfield's* test is to determine the locus of effective control of the corporation. …

[66] The Federal Court of Appeal in *McGillivray* notes at paragraph 35:

> In *Silicon Graphics*, Justice Sexton formulated the test as follows:
>
> > [67] It is therefore my view that in order for there to be a finding of *de facto* control, a person or group of persons must have the clear right and ability to effect a significant change in the board of directors or the powers of the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors.
> >
> > (Emphasis added.)

[67] *McGillivray* reaffirms that test from *Silicon Graphics* and then continues to explain that subsequent cases in the Federal Court of Appeal have not overturned

[44] [2017] 1 FCR 209, 2016 FCA 99.
[45] 1998 CanLII 827 (SCC), [1998] 1 SCR 795.

that narrow test in *Silicon Graphics*. Specifically, the Court rejected "…any assertion that the test for control in fact is based on "operational control."[46]

[68] Here, we have a situation where BWS has the power to elect two directors one of which shall be the chairman and the chairman has a casting vote. This power arises as a result of the shareholder agreement.

[69] As a consequence BWS is in a position to control decisions of the Board of Directors as that is understood for the purpose of determining whether someone has control of the corporation. The practical effect of the casting vote is the same as if BWS has the power to name three out of five directors.[47]

[70] Given this, it seems to me unavoidable that I must conclude that the S*ilicon Graphics* test is met. BWS had *de facto* control of Vidabode.[48] It follows that BWS and Vidabode do not deal at arm's length and, in turn, because BWS and the Appellant do not deal at arm's length, the Appellant and Vidabode do not deal at arm's length.

[71] That is sufficient to determine the first issue.[49]

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[46] See paragraphs 45 to 48 of the decision.

[47] While it is true, as the Respondent pointed out, that Atlantic Aboriginal Capital Inc. named the two other directors and that Mr. MacDonald was also a shareholder of Vidabode with his own interest in the success of that company, that does not change the fact that Mr. MacDonald could not have been a director if BWS had no wanted him to be.

[48] It had *de facto* control apart from any question of operational control.

[49] Other factors, when combined with the ability to control the decisions of the board, just discussed, also demonstrate that the Appellant and Vidabode are not at arm's length: Mr. Strassburger was Chairman and President of the Appellant, BWS and Vidabode; Mr. MacDonald and Mr. Strassburger were partners in the unincorporated entity called Davenport industries that was a sales agency for Vidabode; the Appellant was planning to acquire shares with no value; not only was BWS the largest shareholder but by late 2010 it held a majority of Vidabode's debt after excluding the debt owed to GE Capital – see the financial statements at Tab 5 and 6 of Exhibit A-1; the realities of the situation by December 2010 were that economically - but not juridically- one might view Vidabode as a joint venture between BWS and its related family companies, on the one hand, and the other investors, on the other, a joint venture where BWS and its related family companies had gradually become the dominant partner.

In considering that the shares in issue had no value, I am not suggesting it is determinative; however, I am satisfied that when a party borrows over $14 million and converts almost $5 million in pre-existing debt to acquire shares with a fair market value of nil that is certainly an indicia that a transaction is not at arms length.

I am not unmindful that, as the Appellant pointed out, at the December 2010 board meeting Ms. Arnold did have concerns regarding the position of Atlantic Aboriginal Capital Inc. with respect to the dilution of its shareholding after the proposed issue of new shares to the Appellant and that as a result she sought to keep open for a time the possibility for AACI to also put in money through the acquisition of shares. That seems like a relatively minor consideration. When one reads the minutes, one sees that Mr. Strassburger was in no way opposed and, it is clear from the overall evidence, Mr. Strassburger and as a consequence BWS and the Appellant would have been pleased if AACI had brought some of the needed capital and bought new shares.

[72] Accordingly the Appellant is not entitled to the ABIL claimed.[50]

[73] I now turn to the second issue; the deductibility of the interest borrowed on the amount of approximately $14 million. The key question here is whether the Appellant borrowed the money *for the purpose of earning income* as required by paragraph 20(1)(c) of the *Income Tax Act*.

[74] I am satisfied that the Appellant would not have borrowed the $14 million were it not for its obligation and the obligation of BWS and of 2090810 Ontario, to honour the guarantee. The basic motivation for the payment was that the Appellant and/or the two related companies would have to had to honour the guarantee to GE Capital in any event.

[75] The decision to buy shares as opposed to any other way of dealing with the guarantee and the debt to GE Capital was the result of professional advice received by BWS and the Appellant that this was the best way to do this.[51]

[76] There may, however, be more than one purpose behind the transaction and, for the purpose of the test in paragraph 20(1)(c) of the *Income Tax Act* it is sufficient if there is an ancillary income earning purpose.

[77] I am satisfied that the Appellant wanted to earn income from the shares.

Mr. Strassburger readily agreed AACI could have a period within which it could buy treasury shares so as to maintain its share of the ownership. At that meeting Mr. MacDonald did not appear to have any disagreement with the proposal on the table.
This issue of dilution of AACI's holdings does not reflect any divergence as between the Appellant/BWS and Vidabode. It reflects a discussion within Vidabode, the outcome of which reflected how much capital each owner was willing or was able to put in.
I would also note another aspect of this. The Appellant is funding Vidabode through the share purchase; in so doing, because the share purchase funds would pay off the loans from GE Capital, it is benefiting not only Vidabode but also itself, BWS and 2090810 Ontario, given that the latter three companies were all guarantors of the loans.

[50] I should briefly deal with the following. The Appellant made certain arguments regarding the assumptions, the basis of the assessment, the resulting onus of proof and the consequences that should flow therefrom.
As a practical matter the onus of proof matters only where, at the end of the hearing on the evidence before the Court, the Court is unable to make a finding in respect of one or more material facts. When such a situation occurs, and only when such a situation occurs, must the Court ask itself who had the onus on the particular fact or facts and then draw the appropriate conclusion.
In this case, I am able to draw the necessary findings of fact based on the evidence.

[51] See for example pages 3 and 4 of the Transcript of the December 22, 2010 board meeting at Tab 36 of Exhibit A-1.

[78] However, the test is "…whether, considering all the circumstances, the taxpayer had a reasonable expectation of income at the time the investment was made." [52]

[79] For the following reason, unfortunately, I do not see how I could conclude that there was a reasonable expectation of income in December 2010.

[80] While it is true that a single sale of a cement plant license could have been the start of a turnaround for Vidabode, cumulatively by December 2010, there are enormous difficulties that make a turnaround very unlikely. Let us consider those difficulties.

[81] As of the end of December 2010 Vidabode had significant payables and little cash. It needed an injection of funds beyond the $14 million quickly or it would necessarily collapse equally quickly.[53]

[82] Vidabode would have had to obtain at least two $1 million deposits from two sales before it would cover the payables and its modest running costs to stay open for a short period.

[83] However, in December 2010, even though Vidabode has been pursuing sales for some time, it had still not made a sale and there was no prospect in the pipeline which had paid a deposit. Also, as Mr. Strassburger says at the beginning of the December 22 board meeting, it was difficult for businesses to obtain credit.[54]

[84] There was no reason to expect that a sale or a deposit would happen quickly enough given that cash needs were truly urgent.

[85] In August 2010 at the board meeting the representatives of the AACI had said they would look and see if they could do anything to fund the balloon payment; they had come back with nothing even though they had been told by Mr. Strassburger that his family had instructed him that the family companies were not putting in the $3 million due for the balloon payment.

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[52] See *Ludco Enterprises Ltd. v. Canada*, [2001] 2 SCR 1082, 2001 SCC 62, paragraphs 54 to 56.
[53] The unaudited Financial Statement at 31 December 2010 shows current liabilities of about ten times current assets of about $255,000. Somewhat more than half of the current assets are inventory. See Tab 6 of Exhibit A-1.
[54] See the bottom of page 2 of the minutes of the December 2010 board meeting at Tab 36 of Exhibit A-1. General economic conditions were still difficult.

[86] This resulted in the September default on the balloon payment and as a result GE Capital then called in all the loans causing a financial crisis for Vidabode.

[87] Notwithstanding this when on 22 December 2010 AACI's representative and Mr. MacDonald came to the board meeting they had no funding solutions at all to propose.

[88] The only thing raised by AACI's Board member was a concern that the proposal would dilute their relative ownership of Vidabode. AACI wanted, and obtained, a period within which they could see if they could find funds with which to maintain their relative share ownership. They obtained a 20 day period during which they could see if they could come up with the money in which case Keybrand would sell AACI the appropriate number of shares. This would be 34% of the 19 million shares that Mr. Strassburger was proposing to have the Appellant take.[55] Such a share acquisition would have required AACI to put in more than $6 million. Based on the evidence before me that was simply not going to happen.[56] In addition, although it would have been very beneficial to the Appellant if AACI had taken 34% of the shares that the Appellant was proposing to take, that would not have provided any additional funding for the operations of Vidabode. There is also no suggestion that AACI was considering lending to Vidabode money for it to pay off its payables and keep operating. At the December board meeting Mr. Strassburger does not suggest that Keybrand or BWS would provide funds for payables and operations if AACI put in a significant amount by way of share purchase.

[89] Even though with the share acquisition the Appellant and BWS acquire approximately 80% of the common shares, the Appellant and BWS were unwilling to put up any funds beyond the amount necessary to pay the guarantees.[57]

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[55] Transcript of the December board meeting Tab 36, Exhibit A-1 and page 83 of the Transcript of the first day of hearing.

[56] Not only had AACI not come up with anything when the $3 million balloon payment was becoming due but The sum of AACI's investment in Vidabode by way of loans and the purchase of shares at no time reached $1 million. The most I can find AACI putting in is an amount of over $800,000 in the 2009 financial statements - and only if I assume that the two numbered companies listed in addition to AACI in Note 10 to the financial statements are also related to or owned by AACI; the amount shown owing to AACI is $560,000. AACI paid $10 for its original 6.5 million common shares. It is even less likely that AACI would have bought enough shares in addition to the 19 million to be acquired by the Appellant in order to keep its proportionate share and inject additional new money into Vidabode; that would have cost in in the order of $ 9 million to $10 million – although this alternative was not what was being raised.

[57] Given that the Appellant and BWS would reap most of the benefits of a turnaround the unwillingness to put in new funds in excess of the amount guaranteed is consistent with not expecting that further investment would generate income. I recognize, however, that the limitation could be driven by other considerations.

[90] Given that the Appellant, BWS and Mr. Strassburger's family had no intention of putting any additional money to cover payables or to cover other costs to keep Vidabode open, given that there is no reason to think that the other shareholders of Vidabode would put money in on the necessary scale and given that there was no reason to expect a quick sale of a plant, the reasonable expectation in late December 2010 was that the company would quickly collapse. That is not consistent with a reasonable expectation of income.[58]

[91] It follows that the Appellant is not entitled to deduct the interest on the money borrowed to acquire the shares.

[92] The last issue is in respect of the capital loss on the $500,000 loan. The essential question is the same as for the previous issue: was there a reasonable expectation of income?

[93] The promissory note for the loan dated October 29, 2010 clearly shows that the money was lent at a rate of 10% per annum interest calculated monthly.[59]

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[58] I am not unmindful of Mr. Strassburger's testimony that there were surprises after the December 22, 2010 board meeting. He testified that at the meeting it was agreed that there would be a meeting between Christmas and New Year's to discuss possible sales. This was to be organized by Wanda Arnold. However, she never sent an agenda and never organized a meeting. Mr. Strassburger flew to Nova Scotia on 29 December with a check from the appellant to Vidabode and saw to it that that check was deposited. At that time he saw Wanda Arnold as well as Vidabode's CFO who issued the cheques to GE Capital. See pages 95 to 97 of the Transcript of the first day of hearing.
After New Year's he tried to contact Wanda Arnold but her phone was disconnected; he phoned David MacDonald who told him he did not know where Wanda Arnold was. A week later he called David MacDonald again and his phone was disconnected. He has not spoken to Wanda Arnold or David MacDonald since then. The Vidabode CFO also quit.
Further, on 2 January 2011 the general manager of the Appellant who had started work with the company on the same day that Mr. Strassburger started work advised that he expected that he would have to be on medical leave for seven months with the consequence that Mr. Strassburger would have to spend more time working at the Appellant for the next several months. See pages 97 and 98 of the Transcript of the first day of hearing.
I do not doubt that the events I have just described in the last three paragraphs further reduced any chance of Vidabode successfully overcoming its problems. However, they do not change the fact that for the reasons I already outlined by December 2010 there was already no reasonable expectation of income.
Because of the timing, I do not accept that the disappearance of Ms. Arnold and Mr. MacDonald as well as the resignation of the CFO and the illness of the Appellant's GM were the precipitating event in the decision to put Vidabode into receivership on 5 January 2011. As mentioned earlier, it is on 5 January 2011 that Mr. Strassbuger wrote to BDO Canada to appoint them as a receiver. This is a Wednesday and exactly one week after Mr. Strassbuger went to Nova Scotia with the cheque. Based on Mr. Strassburger's testimony Mr. MacDonald had not disappeared yet and it would be premature on that date to assume Ms. Arnold could not be found.

[59] There were some questions during the hearing relating to whether the loan was converted into shares. The Minister assessed on the basis that there was a loan. The question of conversion arose because the share register shows an issue of 500,000 shares on the same date to the Appellant. It does not make sense to me that shares would have been issued simultaneously with the issue of the promissory note which would then, presumably, have been cancelled on the date of its issue. I accept that the promissory note at Tab 25 of exhibit A-1 reflects the transaction.

[94] On its face the loan is made to earn income. The loan is made two months before the December board meeting and, at that point, the survival of Vidabode was still a possibility. The situation is not yet that of late December.

Conclusion

[95] As a result, the appeal for the 2011 taxation year will be allowed but only to the limited extent necessary to allow the recognition of the capital loss on the $500,000 loan and to make any consequential adjustments to the 2012 taxation year.

[96] Costs are awarded to the Respondent. If the parties cannot agree on costs by September 16, 2019 they shall advise the registry and arrangements shall be made for either written or oral submissions on costs. If it is of assistance to the parties, they should know that based on what I am aware of from the trial I do not see any reason to deviate from the cost rules and the tariff; however, there may be other factors that I am not aware of.

Signed at Ottawa, Canada, this 2nd day of August 2019.

"Gaston Jorré"

Jorré D.J.

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PLACE OF HEARING:	Hamilton, Ontario
DATE OF HEARING:	November 19, 20 and 21, 2019
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