Newmont Canada Corporation v The Queen, 2012 FCA 214

Shareholder Loans on Account of Income or Capital? - Rebuttable Presumption Of Capital Nature.

Newmont Canada Corporation v The Queen, 2012 FCA 214

There were two issues in this appeal, being whether the taxpayer corporation was entitled to deduct:

- $7,250,000 of unrecovered principal in 1992, and $78,294 in 1994 under section 9 of the ITA in respect of loans made to Windarra that was not fully repaid, and
- $156,888 in 1992 under subparagraph 20(1)(p)(i) in respect of interest previously included in income but not actually received.

The FCA held that the TCC did not commit an overriding and palpable error in holding that the loan was on account of capital because the taxpayer obtained an asset of enduring benefit, and did not come within the first exception in *Easton.* There is a rebuttable presumption that a shareholder loan is on account of capital, and there was evidence to support the TCC's decision that the loan was on account of capital. The judge was not wrong to not refer to evidence to the contrary.

BUT did commit an overriding and palpable error by disallowing the interest deduction where the taxpayer had demolished the Minister's assumptions by providing a *prima facie* case without the Minister providing evidence to displace the taxpayer's position.

FACTS

The taxpayer was a public corporation during the relevant period, involved in running a mine, and exploring for minerals in Canada and the US. The taxpayer had made a number of investments and loans to junior minors, including the loan to Windarra. The loan was meant to fund Windarra's exploration and development costs and to be repaid out of 80% of available cash flows, and the Taxpayer would buy shares of Windarra.

Windarra's exploration work was shut down and the taxpayer wrote down the loan to Windarra. Eventually the taxpayer and Windarra entered into a settlement agreement wherein the loan was settled for payment of $1000,000 to the taxpayer. $78,294 of this amount was never paid.

In preparing its tax returns, the taxpayer deducted the amounts above in respect of the Windarra loan, but in 1992 reported the disposition of the Windarra shares as dispositions of capital property. The MNR reassessed and allowed the deduction for interest included but not received, but denied the deduction in respect of the loan.

The TCC below held that the unrecovered principal was a loss on account of capital as what the taxpayer acquired assets of enduring benefit. This was because:

> 155 The Windarra Loan provided Windarra with working capital to fund its share of the exploration and development costs in respect of the Magnacon property. The Windarra Loan was given to generate a stream of income (interest) for Hemlo Gold and to enable Windarra to develop the Magnacon property. The successful development of the property would have secured for Hemlo Gold an enduring benefit in the form either of dividends or an increase in the value of the Windarra Shares. [emphasis added]

The TCC judge also noted that the loans to and shares in Windarra were recorded as "investments and advances" on the taxpayer's balance sheet, consistent with the taxpayer's annual reports. The Taxpayer unsuccessfully argued in front of the TCC that the transaction fell within the first exception in *Easton v. Canada*, [1998] 2 F.C. 44, because it was made to fund profit-making activities in Windarra and not made to income-producing purposes relating to the taxpayer's own business.

As for the interest income, the taxpayer was unable to produce its ledgers as to how amounts were recorded, and all it had were working papers. The TCC did not see this as "being something more reliable than a conclusion based on unsubstantiated assumptions", and did not allow the additional interest deduction.

ANALYSIS

WindarraLoan

The Court began by citing the limitation of deduction on account of capital found in paragraph 18(1)(b), and noted that the ITA doesn't define what constitutes "loss of capital, or a payment on account of capital" making it necessary to look to the jurisprudence. This is a fact driven inquiry. The FCA referred to the decision of the SCC in *Canada (Minister of National Revenue) v. Algoma Central Railway*, [1968] S.C.R. 447, where it was said that no single test applies in making the determination, but must be derived from many aspects of the whole circumstances.

The FCA then refereed to the decision in *Imperial* Tobacco Canada Limited v. Her Majesty the Queen, 2011 FCA 308, 425 N.R. 88 where at paragraph 22 the words found in *British Insulated and Helsby Cables v. Atherton*, [1926] A.C. 205 (H.L.) at pages 213-14 were quoted:

> [...] when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital. [emphasis added]

In *Easton* the FCA held that in circumstances where a shareholder lends money to a

corporation, there is a rebuttable presumption that the shareholder loan is on account off capital:

> 16 As a general proposition, it is safe to conclude that an advance or outlay made by a shareholder to or on behalf of the corporation will be treated as a loan extended for the purpose of providing that corporation with working capital. In the event the loan is not repaid the loss is deemed to be of a capital nature for one of two reasons. Either the loan was given to generate a stream of income for the taxpayer, as is characteristic of an investment, or it was given to enable the corporation to carry on its business such that the shareholder would secure an enduring benefit in the form of dividends or an increase in share value. As the law presumes that shares are acquired for investment purposes it seems only too reasonable to presume that a loss arising from an advance or outlay made by a shareholder is also on capital account. [emphasis original]

The FCA however recognised two exception:

> There are two recognized exceptions to the general proposition that losses of the nature described above are on capital account. First, the taxpayer may be able to establish that the loan was made in the ordinary course of the taxpayer's business. The classic example is the taxpayer/shareholder who is in the business of lending money or granting guarantees. The exception, however, also extends to cases where the advance or outlay was made for income-producing purposes related to the taxpayer's own business and not that of the corporation in which he or she holds shares. For example, in *Berman, L., & Co. Ltd. v. M.N.R.*, [1961] CTC 237 (Ex. Ct.) the corporate taxpayer made voluntary payments to the suppliers of its subsidiary for the purpose of protecting its own goodwill. The subsidiary had defaulted on its obligations and as the taxpayer had been doing business with the suppliers it wished to continue doing so in future. (*Berman* was cited with apparent approval in the Supreme Court decision in *Stewart & Morrison Ltd. v. M.N.R.*, [1974] S.C.R. 477, at page 479.)

The taxpayer argued that the TCC committed a palpable and overriding error when it found that the "Windarra Loan was given to generate a stream of income (interest) for Hemlo Gold" and that, if Windarra's properties were successful, the Windarra shares would have become an asset of enduring benefit as a source of dividends or due to an increase in their value. The FCA disagreed and held that the TCC judge was not referring to interest income as the enduring benefit. While there was evidence to support the taxpayer's argument, there was also evidence to support the judge's conclusions, including:

- Hemlo Gold showed the Windarra shares and the Windarra Loan on its balance sheet as investments and advances.
- The acquisition of indirect interests in junior mining companies, such as Windarra, was made pursuant to Hemlo Gold's long-term investment program.

- Hemlo Gold's annual reports for 1987, 1988 and 1989 referred to the shares and loans as being long-term investments.

- For tax purposes Hemlo Gold treated the disposition of its shares in junior oil companies as being on account of capital.

- The Windarra Loan was part of a package deal. As Mr. Baylis testified, Hemlo Gold provided the Windarra Loan to prevent the dilution of Hemlo Gold's holdings in Windarra. This purpose did not relate to Hemlo Gold's income-producing activities.

The FCA held that the money's could be characterized as "sums expended on the structure within which the profits were to be earned", one of the expressions descriptive of a capital transaction cited with approval by the Supreme Court in Johns-Manville. As the Judge found, the purpose of the Windarra Loan was to provide Windarra with working capital so as to ensure that Hemlo Gold's holdings in it were not diluted. The TCC did not commit a palpable and overriding error in ignoring the other evidence by not expressly referring to them. The TCC decision is entitled to deference.

Interest Deduction

The FCA concluded that the TCC had committed an overriding and palpable error. Here, the Taxpayer had demolished the Minister's assumptions by providing the court with a *prima facie* case that the assumptions were wrong. The onus shifted onto the Minister to prove the assumptions to be correct on a balance of probabilities, and there was no evidence on record to impugn the evidence of the taxpayer's witness.

However, the FCA noted that its up to the taxpayer to prove that the interest amounts had become bad debt, and that no amount of the settlement between the taxpayer and Windarra was allocated to monies owing on account of interest. The settlement agreement stated that the amount was on account of principal., and this established on a *prima facie* basis that all interest owing had become a bad debt. The Minister did not provide evidence to rebut this *prima facie* case.