Shareholder Loans - Capital or Non-Capital Losses

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SRI Homes Inc v The Queen, 2014 TCC 180

The TCC stated that the law surrounding the losses sustained on the disposition of a shareholder loan made to the corporation was canvassed by Justice Campbell in her decisions in *Valiant Cleaning Technology Inc. v. The Queen*, 2008 TCC 637, and *Excell Duct Cleaning Inc. v. The Queen*, 2005 TCC 776, at paragraph 7 where she stated:

> In *Easton v. R.* (1997), 97 D.T.C. 5464 (Fed. C.A.), the Federal Court of Appeal stated the general proposition that an advance made by a shareholder to or on behalf of a corporation will be treated as a loan for the purpose of providing working capital to the corporation. Any resulting loss would therefore be capital in nature as either the loan was given to generate a stream of income or to secure an enduring benefit. However the Court in *Easton*recognized certain exceptions to this general proposition. One of these exceptions exists where the loan was made in the ordinary course of the business. This exception has been recognized as extending to cases where the loan was made for income producing purposes as it related to the taxpayer's own business (*R. v. Lavigueur* (1973), 73 D.T.C. 5538 (Fed. T.D.) and *Paco Corporation v. R.* (1980), 80 D.T.C. 6328 (Eng.) (Fed. T.D.)). Other examples of this exception are where the loan was made for the purpose of increasing the profitability of the taxpayer's own business (*Williams Gold Refining Co. of Canada v. R.*, 2000 D.T.C. 1829 (T.C.C. [General Procedure])) and where the loan was made for the purpose of protecting the existing goodwill of the taxpayer's business (*Berman & Co. v. Minister of National Revenue* (1961), 61 D.T.C. 1150 (Can. Ex. Ct.)).

Therefore, the default position is that the loss from the disposition of a shareholder loan is on account of capital (a capital loss), unless one of the exceptions applied to the case.

The Court agreed that the following activities were a money lending business: (i) Trade Receivables financing; (ii) Inventory financing; (iii) working capital/start-up financing; and (iv) consumer financing (see para 34). But the shareholder loans in this case did not fall under either of those headings of money lending business. However, the shareholder did make the advance for purposes of earning money from its own business, thus satisfying one of the exceptions.

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