Canada Revenue Agency | Agence du revenu du Canada

TSO, Ottawa ONT K1A 1A2

Date	Jan 17, 2022
Case number	GB2033 0170 9256

CONCEPCION MANANQUIL
[redacted]

Subject: Notice of objection for the tax years 2018 and 2019

Dear Madam:

This letter refers to your Notice of Objection dated November 26, 2020 to the Income Tax (re)assessment for the 2019 taxation year.

Having carefully reconsidered the assessment(s) with reference to the information and reasons set forth in your Notice of Objection, the Minister of National Revenue renders the following decision:

Your objection is allowed in full.

It is our understanding that you are objecting to the Notice of Assessment dated November 26, 2020 in which your business investment loss of $328,161 was disallowed for the 2019 taxation year. Consequently, the non-capital loss claimed for the 2018 taxation year was disallowed as there was a nil balance for your business investment loss.

In your objection, you explained how throughout the years of 2016, 2017, and 2018 you loaned $328,161 to a corporation wholly-owned by your spouse. Furthermore, you explained how the loan was a complete loss when the business became insolvent in 2019 and that your business investment loss should be allowed at the full value.

We have completed our review of your Notice of Objection and the supporting documentation provided. As a result of our review, the Appeals Division is allowing your objection in full pursuant to paragraph 39(1)(c) of the Income Tax Act (ITA). A taxpayer's allowable business investment loss is 50% of their business investment loss. The business investment loss is defined in paragraph 39(1)(c) of the ITA. In order for a taxpayer to have a business investment loss, subparagraphs 39(1)(c)(i) and (ii) require that the loss on the qualifying debt or shares be realized either from an actual disposition to an arm's length person or from a deemed disposition to which subsection 50(1) applies. Therefore, the only subparagraph relevant for this claim regarding the eligibility of the business investment loss is 39(1)(c)(iv) due to the disposition of debt in a non-arm's length transaction. According to subparagraph 39(1)(c)(iv), the deciding factors of the eligibility of the claim of the business investment loss is if the money advanced by you to the corporation is to be classified as debt, and whether the company was bankrupt and/or a corporation referred to in section 6 of the Winding-Up and Restructuring-Act that was insolvent.

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In regards to the money loaned to the corporation by the taxpayer, in the case of Mackay v The Queen, it cited the decision of this Court in Business Art Inc. v. M.N.R., "It is not uncommon for a shareholder to lend money without interest and without security to the corporation since he anticipates that the loans will assist the corporation to earn income and to pay him income by way of dividends; the loan is made for the purpose of earning income from a property. Although the shareholder is a creditor of the corporation when he advances money to the corporation the shareholder does not see his advance of money to the corporation and his subscription for shares of the corporation as separate investments in two watertight compartments; rather he sees his money entering two compartments which open up into a single compartment for the use of the corporation. Purchasing shares and advancing money to a corporation are two ways of making an investment in the corporation. This is a sensible interpretation." Furthermore, it states, "It is not unusual for a person to invest in a corporation by subscribing for share capital and lending money without interest; as far as he is concerned the shares and his loans constitute a single investment and if later on, he is called on to advance further funds without interest he is only increasing his investment. I cannot subscribe to the theory that in such an example the non-interest bearing loans were not incurred for the purpose of earning income from property; if the loans were not advanced the corporation may have become bankrupt and the shares may have become worthless. Clearly the loans were made to earn income from property, that is, to place the corporation in a position where it will be successful and pay dividends." Furthermore, in the case of Service v The Queen, the decision of the Federal Court of Appeal in Byram v. Canada, paragraphs 21 and 22, "The shareholders of a company are directly linked to that Corporation's future earnings and its payment of dividends. Where a shareholder provides a guarantee or an interest-free loan to that company in order to provide capital to that company, a clear nexus exists between the taxpayer and the potential future income. Where a loan is made for the purpose of earning income through the payment of dividends, this connection is sufficient to satisfy the purpose requirement of subparagraph 40(2)(g)(ii) of the ITA." As a result, the loan made to the company in the years of the company operating, were made for the purpose of gaining or producing income. If you did not lend money to the company, the company may have become bankrupt and the shares may have become worthless. The loans were made to keep the restaurant operating. Furthermore, since you became a shareholder and provided an interest-free loan to the company in order to provide capital to the company, a clear connection exists between the taxpayer and the potential future income.

The next deciding factor is if the company was bankrupt and/or a corporation referred to in section 6 of the Winding-Up and Restructuring-Act that was insolvent. There was no supporting evidence suggesting that the company was bankrupt. According to the section 6 of Winding-Up and Restructuring-Act, the company must (a) is insolvent, or (b) is in liquidation or in the process of being wound up and, on petition by any of its shareholders or creditors, assignees or liquidators. Furthermore, in the Winding-Up and Restructuring-Act, the relevant clause of section 3, a company is deemed insolvent, (a) if it's unable to pay its debts as they become due. There is evidence suggesting that the company fits the criteria of the section 6 Winding-Up and Restructuring-Act pursuant to clause 39(1)(c)(iv)(C) of the Income Tax Act.

As a result, for the reasons mentioned above, the Appeals Division is allowing your objection in full pursuant to subsection 248(1), and paragraph 39(1)(c) of the Income Tax Act.

A Notice of Reassessment will follow under separate cover. Please note he normal processing timeframe for adjustments may be longer than usual. Additional efforts are being made to address the issue. We apologize in advance for any delays.

As part of Canada's COVID-19 Economic Response Plan: Support for Canadians and Businesses- Flexibility for Taxpayers, the CRA is taking action to help Canadians facing hardship as a result of the COVID-19 outbreak. Therefore, arrears interest for the period from March 18, 2020 to September 30, 2020, will not be charged on any tax balances owing.

Were you satisfied with the decision on your objection? Your opinion is important to us. Please take 5 minutes to complete an anonymous survey. Go to canada.ca/cra-objections-survey-2. This is to advise you that the complexity level of your file is medium.