

Taxpayer wins interest deductibility case at Federal Court of Appeal: The TDL Group Co. v. The Queen, 2016 FCA 67

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The Appellant, the TDL Group Co. (TDL), was denied an interest deduction on money it borrowed to purchase additional common shares of its wholly-owned U.S. subsidiary, Tim Donut U.S. Limited, Inc. (Tim's U.S.). TDL appealed the reassessment and was unsuccessful at the Tax Court. Osler was subsequently retained as counsel for [TDL's successful appeal](#) to the Federal Court of Appeal (FCA).

Wendy's International Inc. (Wendy's), TDL's ultimate parent company at the time, lent C\$234 million to a U.S. subsidiary, Delcan Inc., which lent the full amount to TDL at a rate of 7.125%. TDL used the borrowed money to purchase shares of Tim's U.S. Tim's U.S. used the funds it received to make an interest-free loan to Wendy's. Seven months later on November 4, 2002, Buzz Co. (a newly incorporated subsidiary of Tim's U.S., which had assumed the loan from Tim's U.S.) demanded repayment of the loan from Wendy's and the loan was replaced with a new interest bearing promissory note.

Although not mentioned in the reasons from the FCA, the ultimate purpose of these transactions was to fund a long-term expansion of Tim Hortons in the U.S.

In order for interest to be deductible under subparagraph 20(1)(c)(i) of the *Income Tax Act* (Canada), the borrowed funds must be used for the purpose of earning non-exempt income. The Tax Court found that TDL had no reasonable expectation of income at the time it acquired the shares in Tim's U.S., as evidenced by the fact that Tim's U.S. used the money to make an interest-free loan back to Wendy's. The Tax Court disallowed TDL's interest deduction for the seven-month period in which Tim's U.S. was not earning interest on its loan to Wendy's. (Only the interest payable over the initial seven-month period was before the Tax Court; the CRA accepted that the interest after that period, once the interest bearing promissory note was in place between Wendy's and Buzz Co., was deductible.)

Applying *Ludco Enterprises Ltd. v The Queen*, 2001 SCC 62, the FCA held that a taxpayer's purpose when using borrowed monies is to be assessed *at the time the monies are used*. Therefore, the correct inquiry is what TDL's purpose was at the time it subscribed for the shares in Tim's U.S. This point in time test meant that the reasoning of the Tax Court was flawed: it would be paradoxical for there to be no income earning purpose for the loan for the first seven months, followed by an income earning purpose for the rest of the life of the loan.

According to the FCA, this paradox arose from two errors of law: i) the Tax Court imported into subparagraph 20(1)(c)(i) a requirement that TDL have a reasonable expectation of receiving income on the shares within the first seven months of ownership; and, ii) the Tax Court's conclusion was coloured by a concern with tax avoidance, which was specifically cautioned against in *Shell Canada Limited v. Canada*, [1999] 3 SCR 622.

On the basis of these errors, the FCA allowed the appeal and awarded costs to TDL at both levels.