

[OFFICIAL ENGLISH TRANSLATION]

2001-3229(IT)I

BETWEEN:

ROBERT BOULANGER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on June 28, 2002, at Sherbrooke, Quebec, by

the Honourable Judge Louise Lamarre Proulx

Appearances

For the Appellant: The Appellant himself

Counsel for the Respondent: Stéphane Arcelin

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1996, 1997, 1998 and 1999 taxation years are allowed, without costs, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis of the conclusions stated in paragraphs 24 to 31 of the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 6th day of September 2002.

"Louise Lamarre Proulx"

J.T.C.C.

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Date: 20020906
Docket: 2001-3229(IT)I

BETWEEN:

ROBERT BOULANGER,

Appellant,

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REASONS FOR JUDGMENT

Lamarre Proulx, J.T.C.C.

[1] This is an appeal under the informal procedure for the 1996 to 1999 taxation years.

[2] The point at issue is whether the expenses incurred by the appellant during the years in issue were incurred in order to earn income from his business, which is his architectural practice.

[3] The facts of this case are described as follows in paragraphs 2, 3, 5 and 8 of the Reply to the Notice of Appeal (the "Reply"):

[TRANSLATION]

2. In computing his income for the 1996, 1997, 1998 and 1999 taxation years, the appellant deducted the amounts of \$9,575, \$22,747, \$24,516 and \$22,457, respectively, claimed as losses from a professional practice.

3. By notice of reassessment dated October 30, 2000, in computing the appellant's income for the 1996 taxation year, the Minister of National Revenue (the "Minister") disallowed an amount of \$4,888 claimed as expenses of a professional practice.

...

5. By notice of reassessment dated October 30, 2000, in computing the appellant's income for the 1997, 1998 and 1999 taxation years, the Minister disallowed the amounts of \$22,747, \$24,516 and \$22,457, respectively, claimed as losses from a professional practice.

...

8. In making those reassessments, the Minister assumed, in particular, the following facts:

General and background

- (a) the appellant is an architect and has more than 45 years' experience in the field;
- (b) during the years in issue, the appellant offered architectural services under the name "J. Robert Boulanger – Architect";
- (c) during the years in issue, the appellant occupied part of his family residence located at 115 Rue Vimy Nord in Sherbrooke to carry on his professional activities;
- (d) pensions and RRSPs have been the appellant's main sources of income since 1992;

...

Audit of the Statement of Revenue and Expenditure for the 1996, 1997 and 1998 taxation years

- (e) analysis of the various expenses claimed resulted in a reduction of those losses:

	<u>1996</u>	<u>1997</u>		<u>1998</u>
(i) <u>expenses disallowed</u>			<i>[claimed]</i>	
(a) office expenses and stationery	\$1,061	\$2,440	<i>[\$2,780]</i>	\$960
(b) advertising and entertainment expenses	770	736	<i>[736]</i>	589
(c) telephone	471	277	<i>[1,159]</i>	267
(d) automobile expenses	2,586	2,989	<i>[6,647]</i>	2,149
(e) rent <i>[warehouse]</i>		1,500	<i>[1,500]</i>	1,500
(f) interest, bank charges	0	4,681	<i>[4,681]</i>	5,687
(g) CCA computer	<u>0</u>	<u>0</u>		<u>3,512</u>
	<u>\$4,888</u>	<u>\$12,623</u>		<u>\$14,664</u>
(ii) <u>amended losses</u>				
annual loss claimed	\$9,575	\$22,747		\$24,516
less: disallowed expenses	<u>4,888</u>	<u>12,623</u>		<u>14,664</u>
revised annual loss	<u>\$4,687</u>	<u>\$10,124</u>		<u>\$9,852</u>

- (f) the amount disallowed for each of the disallowed expenses comes from a review of the calculation of the personal portion;

Evaluation – Reasonable expectation of profit

- (g) the gross income reported by the appellant from architectural-related activities was as follows during the 1987 to 1999 taxation years:

(i)	1987	\$122,544
(ii)	1988	\$146,845
(iii)	1989	\$204,506
(iv)	1990	\$259,164
(v)	1991	\$258,458
(vi)	1992	\$138,827
(vii)	1993	\$75,497
(viii)	1994	\$82,845
(ix)	1995	\$95,282
(x)	1996	\$25,623
(xi)	1997	\$741
(xii)	1998	\$3,121
(xiii)	1999	\$722

- (h) the appellant reported the following amounts in respect of net income and losses from his professional activities during the 1987 to 1999 taxation years:

(i)	1987	\$19,965
(ii)	1988	\$44,708
(iii)	1989	\$75,731
(iv)	1990	\$88,359
(v)	1991	\$98,503
(vi)	1992	(\$15,644)
(vii)	1993	\$11,989
(viii)	1994	\$16,528
(ix)	1995	(\$31,014)
(x)	1996	(\$9,575)
(xi)	1997	(\$22,747)
(xii)	1998	(\$24,516)
(xiii)	1999	(\$22,457)

- (i) during the taxation years in issue, the appellant did not sign more than five contracts a year;

- (j) the appellant attributed the drastic decline in his turnover to the following factors:
 - (i) strong competition in the region;
 - (ii) for Province of Quebec contracts, architects are selected for a project from a central registry, following which each architect submits his or her bid;
- (k) during the years in issue, the appellant did not hire any employees;
- (l) examination of the day planners for the taxation years in issue showed that most of the appellant's schedule was devoted to personal activities;
- (m) the appellant had no reasonable expectation of making a profit from the activity connected with architectural services during the period from 1997 to 1999;
- (n) the expenses assumed annually for the activity connected with architectural services for the 1997, 1998 and 1999 taxation years constituted the appellant's personal or living expenses and were not incurred by the said appellant to gain income from operating a professional practice.

[4] In the Notice of Appeal, the points raised are as follows:

[TRANSLATION]

...

I was not even able to substantiate my expenses or discuss them because she also said that the cuts were minor and that it was better to abide by the disallowance of the net professional losses for 1997, 1998 and 1999. Here again, I noticed that her decision was irrevocable and that, because of my age and the prevailing economic situation, there was no reasonable hope of obtaining new work and capitalizing on it.

At her request, I gave her all the documents she wanted and submitted to her my financial statements for 2000 with all the relevant details. She was very surprised to see that, despite those predictions, I did not have losses but indeed had a net profit.

...

In my case, I suspect there was discrimination as a result of my age, and that is contrary to the "Charter of Rights". . . .

[5] The findings sought by the respondent are stated in paragraphs 11, 12 and 13 of the Reply, as follows:

[TRANSLATION]

11. He contends that the expenses assumed annually for the activity connected with architectural services for the 1997, 1998 and 1999 taxation years constituted the appellant's personal or living expenses and were not incurred by the said appellant for the purpose of gaining income from a professional practice but that they constituted personal expenses for the said appellant within the meaning of the *Act*.
12. He contends that, if the Court were to find that the expenses claimed annually for operating the activity connected with architectural services were incurred by the appellant during the 1997 and 1998 taxation years for the purpose of gaining business income or producing an income from a business, expenses totalling \$12,623 and \$14,664, respectively, were not deductible because they constituted personal expenses.
13. He contends that the Minister is entitled to disallow an amount of \$4,888 in respect of expenses incurred in operating the activity connected with architectural services for the 1996 taxation year.

[6] The witnesses were the appellant and Chantal Boisvert for the respondent.

[7] The appellant has been an architect since 1953. From 1954 to 1961, he was employed at an architectural firm. From 1961 to 1979, he worked with two other partners. From 1979 to 1993, he practised alone at an office outside his family residence. From 1993 to the present, he has carried on his profession at that residence.

[8] He admitted subparagraphs 8(a) to (d) and 8(g) to (k) of the Reply. With respect to the gross income indicated in subparagraph 8(g) of the Reply, the appellant told the Court that, in 2000 and 2001, he had earned gross income of \$17,929 and \$16,612 for net earnings of \$878 and \$1,273.

[9] He filed the financial statements to December 31, 2000, and to December 31, 2001, as Exhibits A-1 and A-2. No accountant's name appears on the

statements. It must therefore be considered that they were prepared by the appellant or under his immediate guidance. For 2000, it should be noted that expenses were \$8,000 less than for the two previous years. Gross income amounted to \$17,929, whereas it was \$722 and \$3,121 in the two previous years. Of that amount of \$17,929, \$14,153.90 was in accounts receivable.

[10] According to the financial statements for the year ending on December 31, 2001, gross income was \$16,612 and expenses were \$16,101. There was \$11,345.87 in accounts receivable.

[11] With respect to subparagraph 8(i) of the Reply, the appellant said that he had signed nine contracts in 1996, none in 1997 and 1998, one in 1999 and two in each of the years 2000 and 2001.

[12] The appellant filed, as Exhibit A-3, a list of architectural works done and potential clients met from October 11, 1993, to June 12, 2002. He opened 21 files for that purpose.

[13] With respect to subparagraph 8(j) of the Reply, the appellant said that there were 30 architects in the region.

[14] As to subparagraph 8(k) of the Reply, the appellant explained that, when needed, he would retain the services of a draftsman. Thus, for a contract to transform a seniors residence in Bromptonville in 2001, he had retained the services of a draftsman for \$700.

[15] As Exhibit A-4, he filed a letter dated April 18, 1997, to the Centre universitaire de santé de l'Estrie concerning his professional fees. In it, he agreed to reduce seven invoices totalling \$41,223.90 to a single invoice for \$28,450 in exchange for immediate payment. The first invoice was dated September 30, 1996, and the last, February 28, 1997.

[16] Chantal Boisvert is now an objections officer. She acted in this case as an auditor. Her report was filed as Exhibit I-1. It shows that the appellant has his name listed in the yellow pages of the telephone directory under the heading "Architect". He is still a member of the Province of Quebec Association of Architects, even though he no longer has to pay dues since he is over 70 years of age. He still has liability insurance because he has to keep it for 10 years after he has terminated his architectural activities. His name is on the central registry of architects kept by the Government of Quebec.

[17] The appellant says he seeks work from municipal, school and provincial authorities and from hospitals and educational institutions. He also solicits his former clients annually. He acknowledged that he spends seven months of the year at his summer home in Ste-Catherine d'Hatley, Magog, but said that he regularly spends approximately 35 hours a week at his office in his Sherbrooke residence. He keeps up to date on what is going on in his profession. For example, he has taken courses on the National Building Code.

[18] I note two questions from the [TRANSLATION] "*Questionnaire on Professional Activities*," included in Exhibit I-1: question 2B and his answer, as well as question 10A and his answer, which read as follows:

[TRANSLATION]

2. B. At first, what were your long-term objectives? If your business has not progressed as planned, explain why.

Business very good until 1991. Slowdown from 1991 to 1996. Very little work since 1996.

...

10. A. Give the specific reasons for the losses incurred to date. Report any exceptional situations such as fire, flood, theft, etc. as well as the dates in question.

The losses were caused by the lack of income versus the regular office overhead in anticipation of obtaining a contract.

[19] The auditor explained that with respect to the use of the residence, the appellant had claimed 75 percent of the area of the residence. She considered that he used at most 37 percent, considering the plans of the house and the fact that he had no employees. As to automobile use, she allowed 35 percent on the basis of the small number of contracts and the fact that the appellant's office was the usual place of work, whereas the appellant had claimed 68 percent. She considered the interest on the bank loans as a personal expense because the nature of the operations and the site did not require bank loans. In her view, they were loans taken out for living expenses.

Conclusion

[20] This Reply was prepared on October 25, 2001, and the decision of the Supreme Court of Canada in *Stewart v. Canada*, [2002] S.C.J. No. 46 (Q.L.), was rendered on May 23, 2002. I quote paragraph 53 from that decision:

We emphasize that this "pursuit of profit" source test will only require analysis in situations where there is some personal or hobby element to the activity in question. With respect, in our view, courts have erred in the past in applying the REOP test to activities such as law practices and restaurants where there exists no such personal element: see, for example, *Landry*, supra; *Sirois*, supra; *Engler v. The Queen*, 94 D.T.C. 6280 (F.C.). Where the nature of an activity is clearly commercial, there is no need to analyze the taxpayer's business decisions. Such endeavours necessarily involve the pursuit of profit. As such, a source of income by definition exists, and there is no need to take the inquiry any further.

[21] In the current state of the law as determined by the supreme legal authority of this country, I must consider the practice of the architectural profession by an architect entitled to carry on that profession as a source of income. Under sections 3 and 9 and paragraph 18(1)(a), the appellant is entitled to deduct the expenses incurred for the purpose of gaining income from practicing his profession.

[22] Section 67 of the *Act* was not raised by the respondent. That section provides that, in computing income, no deduction shall be made in respect of an outlay or expense in respect of which any amount is otherwise deductible under the *Act*, except to the extent that the outlay or expense was reasonable in the circumstances. This provision must be raised in the reply to the notice of appeal because it requires relevant evidence for it to apply.

[23] However, paragraph 18(1)(h) was raised, and I must consider it. The personal portion of the expenses may not be claimed.

[24] I will consider each class of expenses disallowed on this point, starting with office expenses and stationery. The auditor analyzed the expenses on the basis of the invoices and found that approximately \$200 to \$300 in stationery expenses could be allowed each year for business purposes. I accept the auditor's findings because, in the financial statements prepared by the appellant for 2000 and 2001 (Exhibits A-1 and A-2), the appellant entered the same amount.

[25] As to the annual average of \$750 in advertising and entertainment expenses, the auditor completely disallowed them. I find that the expenses claimed were not excessive because the appellant must appear in public life for the purposes of carrying on his profession.

[26] As to the telephone and automobile expenses, the percentages determined by the auditor for business and personal use seem valid to me.

[27] The auditor completely disallowed the warehouse expenses. I believe they are connected with the appellant's continuing professional activity. They can be allowed.

[28] With respect to the interest on bank loans, the onus was on the appellant to explain clearly how those loans were connected to his professional practice. I had no clear evidence on that point. They cannot be allowed.

[29] As to the use of the residence by the appellant for business purposes, I find that the percentage determined by the auditor is correct.

[30] The 1999 taxation year is in issue. The auditor conducted no analysis of personal expenses for that year. Business expenses must be computed in the same way as those of the previous year, with the required adjustments.

[31] The appeals are allowed and the assessments are referred back to the Minister for reconsideration and reassessment on the basis of the conclusions stated in paragraphs 24 to 31 of these Reasons.

Signed at Ottawa, Canada, this 6th day of September 2002.

"Louise Lamarre Proulx"

J.T.C.C.