

Docket: 2001-4435(IT)I

BETWEEN:

BERTHE BOULIANNE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on common evidence with the appeals of *Marc Lemieux*
(2001-4455(IT)I) on July 9 and 10, 2003, at Sept-Îles, Quebec

Before: The Honourable Judge Alain Tardif

Appearances:

For the Appellant: The Appellant herself

Counsel for the Respondent: Alain Gareau

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1997 and 1998 taxation years are dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 31st day of July 2003.

"Alain Tardif"

J.T.C.C.

Translation certified true
on this 23rd day of July 2004.

Sophie Debbané, Revisor

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Citation: 2003TCC514
Date: 20030731
Dockets: 2001-4435(IT)I
2001-4455(IT)I

BETWEEN:

BERTHE BOULIANNE,
MARC LEMIEUX,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

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REASONS FOR JUDGMENT

Tardif, J.T.C.C.

[1] The parties agreed to proceed on common evidence.

[2] The two cases involve appeals from notices of assessment for the 1997 and 1998 taxation years.

[3] The point for determination is whether the Minister of National Revenue (the "Minister") correctly determined the respective amounts of \$34,826 and \$30,173, claimed as current expenses, in respect of capital expenditures for properties located in Sept-Îles in computing the appellants' income and in accordance with their shares in the partnership "Gestion Bermanie Enr." for the 1997 and 1998 taxation years.

[4] The facts assumed in making and confirming the assessments are similar in both cases. They are the facts reproduced in paragraph 7 of the Reply to the Notice of Appeal. Those facts read as follows:

[TRANSLATION]

- (a) "Gestion Bermanie Enr." is a partnership comprising Marc Lemieux and Berthe Boulianne;
- (b) The appellants are married under the legal regime of the partnership of acquests and declare that they live at 385 Avenue Dequen in the town of Sept-Îles;
- (c) The partnership "Gestion Bermanie Enr." was registered under number 3346741542 on April 25, 1997, electing domicile for its head office at 385 Avenue Dequen in the town of Sept-Îles;
- (d) On April 2, 1997, the appellants purchased a building located at 494 Avenue Franquelin in the town of Sept-Îles for \$475,000;
- (e) The Minister considered that the building located on Rue Franquelin in the town of Sept-Îles was transferred to the partnership that same day;
- (f) On September 16, 1997, the partnership "Gestion Bermanie Enr." acquired a building located at 60 Rue Père-Divet in the town of Sept-Îles for \$350,000;
- (g) Each of the partners has a 50 percent share in the partnership "Gestion Bermanie Enr.";

Audit

- (h) As a result of an office audit, the Minister learned that the buildings located on Rue Père-Divet and Avenue Franquelin in the town of Sept-Îles were acquired in the context of a bank repossession;
- (i) The Minister assumed that the cost of the buildings had been negotiated considering the major repairs that the partnership "Gestion Bermanie Enr." would have to make in order to hope to operate the said buildings on a profitable basis;
- (j) The Minister also assumed that, when a used property is acquired and repairs must be made to restore it to good condition so that it can be used, the cost of the work is considered a capital

expenditure, even though it would be a current expense in other circumstances;

- (k) The expenses claimed under the head "Maintenance and Repairs" were audited by reviewing the supporting documentation;
- (l) By reviewing the said supporting documentation, the Minister determined that certain outlays claimed as current expenses under the head "Maintenance and Repairs" were in fact capital expenditures:

	<u>Buildings</u>	<u>Movables</u>	<u>Total</u>
1997	\$16,742	\$18,084	\$34,826
1998	\$21,655	\$8,518	\$30,173

[5] First, the appellant Marc Lemieux admitted the facts stated in subparagraphs (a), (b), (c), (d), (e), (f), (g), (h) and (k).

[6] Mr. Lemieux explained and described the circumstances and context of the acquisition of the two income properties. He testified that they were buildings requiring major repairs and renovations.

[7] Consisting mainly of small one-and-a-half-room units commonly called "studios", the two buildings embodied a very special concept. Following the acquisition, the appellants transformed a number of studios into one-bedroom apartments.

[8] Following extensive work, the appellants determined that the acquisition costs of the two buildings had been \$533,709.54 and \$528,865.62, whereas the actual outlays for the acquisitions had been \$475,000 and \$350,000—the difference explained by the inclusion of amounts paid out for the various work characterized as capital expenditures. In other words, a significant portion of the cost of the repairs was capitalized.

[9] The appellants claimed amounts of \$71,696.75 and \$97,096.94 as current maintenance and repair expenses for the 1997 and 1998 taxation years.

[10] Of those amounts, the respondent refused to consider as current expenses maintenance and repair amounts of \$34,826 for the 1997 taxation year and \$30,173 for the 1998 taxation year.

[11] In support of his claims, Mr. Lemieux argued that this is a very particular case as a result of the following facts:

- there were two buildings containing several tens of small apartments;
- the apartments were rented by the month; very few leases were signed for long periods;
- one of the buildings had a very bad reputation in terms of tenant quality;
- a number of tenants were irresponsible and not very respectful of the property of others;
- some tenants were untidy, while others readily caused damage of all kinds;
- it was difficult to assert their rights and, especially, to obtain compensation for damage caused to their apartments;
- they had a firm desire to enhance the premises to make them clean, well maintained and well administered apartments so as to maximize profitability.

[12] Berthe Boulianne, a co-owner, confirmed her spouse's testimony with her own.

[13] The evidence established unequivocally that the buildings owned by the partnership "Gestion Bermanie Enr." constituted a special rental concept. That special feature required the owners to be very careful, alert and involved in the rental and maintenance process. Tenant turnover was substantially greater than for multiple-unit buildings with three to six apartment units, which are generally leased for a minimum 12-month period.

[14] The evidence shows that the painting, furniture, carpets and premises generally had a very short economic life, all requiring much more frequent and much larger maintenance and repair expenses than for traditional apartment buildings. The appellants managed to show that their claims on this point were valid.

[15] I must determine whether the outlays of \$34,826 for the 1997 taxation year and \$30,173 for the 1998 taxation year were current maintenance and repair expenses or capital expenditures.

[16] The outlays were made in the months following the acquisition and even before the transfer of ownership, according to the document filed as Exhibit A-7.

[17] The "Gestion Bermanie Enr." partnership, in which the appellants were the sole partners on a 50-50 basis, acquired the buildings for consideration that reflected the deteriorated condition of the premises but also a high vacancy rate.

[18] The appellants were aware of the situation and knew that the rehabilitation of the premises required substantial outlays. They also wanted to restore the image of the two buildings by means of the partnership "Gestion Bermanie Enr."

[19] They had to invest significant amounts of money to do the structural work, exterior cladding and windows; significant expenditures were incurred on the interiors to repair or replace carpets and to purchase a variety of furnishings and furniture, such as mattresses, love seats, and refrigerators.

[20] The various disallowed amounts are stated in Exhibit A-7. Although that exhibit does not provide a breakdown of the invoices, except for the section on electrical work, where the invoices were filed by consent the day after the hearing, it does show the date and nature of the expenses incurred. They were mainly for carpets, electrical work, replacement tiles, furniture, such as mattresses, love seats, stoves, tables, and refrigerators, decoration expenses and certain other inherent expenses, such as those to move or install toilets.

[21] Marc Lemieux provided very few details on the content of the various invoices, even though the Court reminded him on a number of occasions that it was important to have more details in order to characterize the nature of the expenses at issue, while telling him that the burden of proof was on him.

[22] Certain expenses claimed might indeed have constituted current and maintenance expenses if the evidence had very clearly shown what they were.

[23] Furthermore, it would have been important to determine whether the outlays were required as a result of the partnership's operation of the premises. In other words, did the expenses claimed arise from apartment rentals under their administration or rather were they expenses needed to restore the premises

following the acquisition? The evidence was utterly deficient on that point. I note from the evidence that the vast majority of expenses were made in the restoration phase as part of a very firm desire to change the reputation of the premises and, ultimately, to be able to present a completely renewed and enhanced project to the public.

[24] I find it clear that operating the premises in the normal course of operations requires maintenance and repair expenses greater than those necessary for operating multiple-unit buildings where tenants are more stable and rental terms much longer.

[25] The economic life of the premises and all movable effects is probably much shorter as a result of greater tenant turnover and traffic. This particular feature of the premises clearly requires more frequent and significant maintenance, repair and replacement expenses.

[26] However, a substantiated and documented case must be made in order to charge such expenses against income generated by operating the buildings.

[27] In this case, not only did the appellants fail to do so, it appears from the documentary evidence that the buildings acquired required significant restoration at the time and even before full occupancy of the premises could be contemplated.

[28] In other words, at the time the two buildings were acquired, the appellants knew that the premises required very significant outlays before they could hope to generate acceptable income.

[29] Certain expenses in the coming years will probably have to be characterized as current maintenance and repair expenses, whereas expenses of this kind, having regard to the very special concept of the buildings, are generally capital expenditures.

[30] Marc Lemieux's explanations on the relevance of the contents of the invoices amounted much more to a self-interested interpretation than simply an objective description. Furthermore, a number of heads reflecting very large amounts clearly appeared to be capital expenditures. I refer in particular to the cost of replacing cabinets and carpets, doing electrical work, decorating and so forth.

[31] The day after the hearing, with the consent of the respondent party, Mr. Lemieux filed jointly the details of the invoices relating to the electrical expenses.

Analysis of those invoices shows beyond a shadow of a doubt that the expenses were not current maintenance and repair expenses but rather structural and restoration expenses, thus confirming the first perception that such large outlays could not be mere maintenance expenses.

[32] In support of her claims, the respondent referred to two highly relevant decisions in *Canada v. Johns-Manville Canada Inc.*, [1985] 2 S.C.R. 46; [1985] S.C.J. No. 44; and *M.N.R. v. Haddon Hall Realty Inc.*, 62 DTC 1001, p. 1002.

[33] The appellants' partnership acquired two buildings of which the general condition was somewhat run-down. At that point, it was imperative that major work be done to revive the project. The partnership did in fact invest a great deal to restore the premises.

[34] It was shown on a balance of probabilities that the expenses in issue resulted more from the state of the premises at the time of acquisition than from the results of rental operations. Consequently, the expenses were of a capital nature and were not current expenses since the evidence showed that rental operations had barely begun.

[35] It is possible that some tenants might have caused specific damage of which the repair costs should have been characterized as current or maintenance expenses; the evidence did not demonstrate this but rather showed decisively that the various outlays had served to restore the premises to a condition in which they could be rented.

[36] For these reasons, the appeals shall be dismissed.

Signed at Ottawa, Canada, this 31st day of July 2003.

"Alain Tardif"

J.T.C.C.

Translation certified true
on this 23rd day of July 2004.

Sophie Debbané, Revisor