Citation: 2008 TCC 415
Date: 20080721
Docket: 2006-3212(IT)G

BETWEEN:

MICHAEL JARJOURA,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

For the Appellant: The Appellant himself
Counsel for the Respondent: David Besler

REASONS FOR JUDGMENT

(Delivered orally from the Bench
on May 29, 2008, in Calgary, Alberta)

Miller J.

[1] The Minister of National Revenue assessed Mr. Jarjoura for the 1997 and 1998 taxation years to include in his income the following:

(i) $34,162 and $36,164, respectively, as automobile benefits received as a shareholder of Uniserve International Products Inc.;

(ii) $3,900 and $4,300, respectively, as home rental benefits;

(iii) $8,768 and $16,916, respectively, as repair and maintenance benefits related to the home; and

(iv) $78,000 and $162,000, respectively, as business income arising from an invalid subsection 85(1) *Income Tax Act* election.

[2] Regrettably the parties did not hold a pre-hearing conference as this case, frankly, called out for settlement.

[3] Firstly, the facts with respect to the automobiles. In 1997, Uniserve, a company engaged in the manufacturing of stationery, and employing over 40 employees, owned at least four automobiles. The ones in question are a 1996 Ford Explorer, a 1996 Lincoln Town Car that was sold in September of that year, a 1995 Windstar wagon that was sold at the end of November, and a 1998 Ford Explorer that was bought at the end of November.

[4] In 1998, Uniserve owned the following: the 1996 Ford Explorer that it sold in March, the 1998 Ford Explorer that it still owned, a 1998 Lincoln Town Car that it acquired in March, and a 1998 Ford Windstar that it acquired in May.

[5] Effectively, the company had two or three of these cars at any one time. The Lincolns were driven minimally 200 to 300 kilometres per month. According to Mr. Jarjoura, they were used exclusively for business purposes, primarily taking customers out, or entertaining bank managers or other professional advisors.

[6] The Ford Explorers were for Mr. Jarjoura's main use. He indicated he traveled approximately 8,000 kilometres per year personally, going to and from work and traveling with family. The average monthly kilometres for these vehicles was estimated by Canada Revenue Agency as just over 1,000. As there were only three months where the ownership of these vehicles overlapped, I accept that the total usage was probably 12,000 kilometres.

[7] With respect to the Windstar wagon, Mr. Jarjoura's evidence was that several employees had use of these vehicles for business purposes. Uniserve had Wal-Mart and Zellers as major clients. There were always requirements to deliver product or pick up supplies.

[8] The company also had an Econoline van used for business purposes. I, however, heard no evidence of personal use. Cars were stored at Mr. Jarjoura's home, but the home was also owned by Uniserve.

[9] Next, the facts with respect to the rental benefits. Mr. Jarjoura had his home built in 1986, and sold it to Uniserve in 1995. It was a 2,400 square-foot home sitting on a large landscaped property. Mr. Jarjoura paid the company rent of $1,150 per month from January 1997 to April 1998, and $1,250 per month thereafter.

[10] The Respondent obtained a market-rent analysis, which was based on seven direct comparables, and it estimated the fair market value rent at $1,475 per month in 1997, and $1,570 per month in 1998. Mr. Jarjoura indicated his property was costly to maintain, and would thus reduce the rent any family would be prepared to pay.

[11] Next, the facts with respect to the repairs and maintenance benefits. The repairs and maintenance of approximately $26,000 over the two years went to some kitchen refurbishing, patio work, window coverings, security system, replacing a barbecue gas line and barbecue, and some landscaping. The nature of the work appears to be what would be required to maintain a 10 to 15-year-old executive home in good condition.

[12] The Minister allowed approximately $1,500 as representing what the Minister believed would be a reasonable amount a landlord would pay for an arm's-length tenant.

[13] Next, the facts with respect to the business income. Mr. Jarjoura spent countless hours working on perfecting machines that manufactured coin wrappers. Uniserve paid for the cost of the parts for the machines and provided the workspace and machine shop where they were assembled. Mr. Jarjoura provided the know-how and developed the machines to the point they went from requiring three people to two people to one person to supervise them, to ultimately no supervision at all. They generated considerable income in August 1997 and March 1998. Mr. Jarjoura invoiced Uniserve $78,000 and $162,000 for the fabrication of three and six machines, respectively.

[14] He obtained the advice of Bennett Jones and Deloitte & Touche, and a rollover agreement and election pursuant to subsection 85(1) of the *Income Tax Act* was prepared for this transaction. The rollover attributed all but a dollar to the machines themselves with a dollar to Mr. Jarjoura's intellectual property. This was determined to be in error. The value Mr. Jarjoura was to transfer was his know-how, not the hard tangible asset of the machines.

[15] There were discussions with Canada Revenue Agency officials regarding amending the election. Mr. Jarjoura explained that Canada Revenue Agency had

been prepared to not bring the $240,000 into business income, so amended forms were never filed. When it was clear no final agreement could be reached on all tax matters in issue, the $240,000 remained to be included in income, and no amended return was ever filed. The company had, by this time, gone into bankruptcy. Those are how I perceive the facts.

[16] So how is Mr. Jarjoura to be taxed on each of these issues?

[17] First, the automobile benefits. There is both a standby charge and operating expense benefit at issue. A standby charge, in accordance with subsection 6(2) of the *Act* is reduced to zero if the car is driven exclusively for business. I take, from Mr. Jarjoura's evidence, which I accept, that the Lincoln Town Cars and the Windstar wagon were only used for business by him or other employees. No benefit arises from such use.

[18] It is only then the Explorers, which Mr. Jarjoura acknowledged he drove personally, which are subject to any automobile standby charge or operating expense benefit. As indicated earlier, I find Mr. Jarjoura's personal use was approximately two-thirds of the total use, one-third being for business purposes. The standby charge formula works such that no reduction is available unless the car is used substantially all of the time for business purposes. Substantially all of the time means approximately 90 percent. As Mr. Jarjoura only used the Explorers one-third of the time for business, he is subjected to the full standby charge. No reduction is in order.

[19] In summary, Mr. Jarjoura is subject to an automobile benefit in 1997 of $13,162 on the 1996 Explorer, and $1,155 on the 1998 Explorer, for a total benefit of $14,317 pursuant to subsection 15(5), and in 1998, he is subject to an automobile benefit of $2,193 on the 1996 Explorer, and $13,869 on the 1998 Explorer, for a total of $16,062 benefit.

[20] Next, the repairs and maintenance benefit. I find that the repairs and maintenance as described by Mr. Jarjoura, and as outlined in the auditor's papers, reflect work required to keep an executive home looking like an executive home. The repairs did not add any major new element to the premises but kept them to the standard at the time that Mr. Jarjoura sold the property to Uniserve.

[21] The Respondent argues the expenditures went well beyond what a reasonable landlord would provide to an arm's-length tenant. There are no facts or expert evidence to substantiate this assertion, and it is certainly not worthy of judicial notice.

Indeed, a tenant renting a superior executive home may well expect a certain standard to be maintained.

[22] I further find that the Respondent appears to want to double up on this benefit. If the Respondent has correctly estimated the fair market value rent of a superior property, then capital expenditures to maintain that property should be factored into that rental benefit. It strikes me as seeking to find a benefit from the value of the tree as well as from the fruit of the tree. You do not value both, you choose one or the other. I conclude that Mr. Jarjoura received no taxable benefit from the repairs and maintenance.

[23] With respect to the rental benefit, Mr. Jarjoura paid $1,150 and $1,250 per month during the period in question. The Minister obtained an appraisal of $1,475 and $1,575 a month from the appraiser, David Jang. He based his appraisal on seven comparables. Mr. Jarjoura maintained that due to the large property and necessary increased maintenance costs, the appraisal was unrealistic. This is purely speculation on Mr. Jarjoura's part. He has provided no concrete evidence, expert or otherwise, to convince me the appraisal report is incorrect. Mr. Jarjoura is therefore subject to a rental benefit of $3,900 in 1997 and $4,300 in 1998.

[24] Finally, the business income. I accept Mr. Jarjoura's testimony that what he was really transferring to the company was his know-how. I recognize that the machines were valued based on an appraisal he obtained from American Appraisal Canada Inc., and that that appraisal was simply for the machines, yet he did not have the hard assets - the machines to transfer. The company bought the materials and built them, but could not have done so without Mr. Jarjoura's know-how.

[25] The Respondent argues that we have no true reliable appraisal to determine the value of the know-how. Frankly, it does not matter. If I accept, as I do, that whatever Mr. Jarjoura was transferring into the company was done on a roll-over basis and was eligible for such a transfer, no tax consequences arise in the year of the rollover. When the shares are sold or redeemed this question necessarily has to be answered, but for purposes of this appeal, I am satisfied there was a non-taxable transaction. Given the company has gone bankrupt, any subsequent sale or redemption becomes purely academic.

[26] I am strengthened in my view that Mr. Jarjoura did not receive any income on this transaction by the fact that he held nothing more of value after the transfer than before. He was a 100% owner of Uniserve before the transaction and a 100% owner of Uniserve after the transaction, now holding two types of shares instead of one. His

worth was not increased one penny, and subjecting him to tax on $240,000 is entirely inappropriate.

[27] In summary, I allow the appeal and I refer the matter back to the Minister for reconsideration on the following basis.

(i) Mr. Jarjoura has automobile benefits of $14,317 in 1997, and $16,062 in 1998.

(ii) Mr. Jarjoura has rental benefits of $3,900 in 1997 and $4,300 in 1998.

(iii) Mr. Jarjoura does not have business income of $78,000 and $162,000 in 1997 and 1998.

(iv) Mr. Jarjoura does not have any repairs and maintenance benefit.

[28] I would like to comment that it appears Mr. Jarjoura and the auditor did not see eye to eye. I have only heard Mr. Jarjoura's version, but I would hope that leaving an assessment open for several years when it appears clear tax has been paid – I am referring to the bonus here -- simply because a settlement cannot be reached on all issues, is not a practice to be encouraged. It creates ill will, and does little to strengthen taxpayers' confidence in their taxation system.

[29] I am prepared to award costs, and Mr. Jarjoura, I would like to hear from you sir, and from Mr. Besler, as to what you are seeking in that regard, taking into account what settlement offers were on the table. Mr. Jarjoura, would you like to make some comments with respect to any costs you might be seeking?

Appellant: My Lord, I am not a solicitor, and I really have no idea, all that I know is it cost me thousands of dollars initially, but I still have an outstanding remaining balance to my lawyers who acted on behalf for the amount, I believe, $7,000. I leave that decision entirely up to Your Lordship. My Lord, I do not have any specific amount in mind. I am not familiar with costs. I know I spent lots of hours, lots of time over and above what had transpired in the last six and a half years, so I will accept whatever Your Lordship awards in that regard. In regard to the offer, I had stated all along that I take full responsibility of any assessment of the vehicle I personally used, and I have no objection toward that, My Lord. That is the extent of my offer to them except that they offered me to reduce the rental benefit to half, and I accepted that on the basis that they accepted half of the reduction on the personal use of one vehicle, that is where the offer was then.

> Respondent: Just sort of to advise you, I guess, in fairness to Mr. Jarjoura, the offers went back and forth. If we look at the Minister's last offer on an issue-by-issue basis, we would have -- the auto benefit was similar to what the Minister had offered, the rental benefit was actually, the Minister came out ahead on that one. The business income, of course, the Minister, that was one of the sticking points in settlement, and the Minister had suggested allowing a capital loss in the year the company went bankrupt, so in terms of dollars -straight dollars, Mr. Jarjoura has come quite ahead of what the Minister had proposed, and again, with repairs and benefits, the Minister had reduced them, but not that much, so Mr. Jarjoura has come out ahead on that, so, you know, the Minister was, actually, was ahead on two in offering, but in terms of total dollars, Mr. Jarjoura has come out ahead of what the Minister had proposed.

[30] I will take that into account. I have also heard a very frustrated taxpayer. Again, I have not heard the auditor's side of it, but it appears there was some lengthy delay where only one issue was outstanding. Going to Court and spending a full day in Court is an expensive proposition. I would rather set a lump sum, than detailing a bill of costs. Mr. Jarjoura, I am going to set costs at $5,000.

Signed at Ottawa, Canada, this 21st day of July 2008.

"Campbell J. Miller"

C. Miller J.

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