

Dockets: 2008-2256(IT)I
2008-2260(IT)I

BETWEEN:

AUDREY J. ARCHIBALD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent;

AND BETWEEN:

IAN G. ARCHIBALD,

Appellant,

and

HER MAJESTY THE QUEEN.

Respondent.

Appeals heard on April 1, 2009 at Edmonton, Alberta

By: The Honourable Justice Judith Woods

Appearances:

For the Appellants: Ian G. Archibald

Counsel for the Respondent: Holly A. Peterson

JUDGMENT

The appeals with respect to assessments made under the *Income Tax Act* for the 2004 taxation year are allowed, and the assessments are referred back to the Minister

of National Revenue for reconsideration and reassessment on the basis that the legal fees claimed are deductible in computing a partnership loss.

The appellants are entitled to their costs, if any.

Signed at Ottawa, Canada this 22nd day of April 2009.

“J. Woods”

Woods J.

Citation: 2009 TCC 215
Date: 20090422
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REASONS FOR JUDGMENT

Woods J.

[1] These are appeals from income tax assessments issued to Ian and Audrey Archibald for the 2004 taxation year. The issue concerns the deductibility of legal fees relating to a new business venture.

[2] Mr. Archibald and his wife have carried on business in partnership for many years, with profits being shared 75 percent to Mr. Archibald and 25 percent to Mrs. Archibald. Although the evidence as to the activities of the partnership was not as

clear as I would like, it appears that partnership income was derived from consulting activities carried on by Mr. Archibald.

[3] In their income tax returns for the 2004 taxation year, the appellants reported aggregate net losses from the partnership in the amount of \$18,372.09. Included in this loss was a deduction for legal fees in the amount of \$14,216.21.

[4] The appellants submit that the legal fees are deductible as an expense incurred by the partnership to earn income.

[5] The legal fees were billed by a law firm in connection with advice and preparation of documents in relation to the issuance of securities to investors in a new corporation. From my understanding, it was proposed that the funds be used by the new corporation to purchase existing resort condominiums and market fractional interests in them. A major part of the legal work was the preparation of an offering memorandum for the sale of the securities.

[6] Mr. Archibald testified that it was expected that the partnership would earn income from the venture in two ways, by earning commissions on the sale of the securities and by compensation for managing the corporation.

[7] As it turned out, sufficient investors could not be found and the venture was abandoned.

[8] The respondent submits that the legal fees are not deductible in computing income from the partnership because the fees were incurred by the corporation and not the partnership.

Analysis

[9] Whether the legal fees were incurred by the partnership or not depends on the legal nature of the arrangement between the partners and the corporation. This was a small venture and the arrangement was not documented. Accordingly, the nature of the arrangement must be determined by implication based on the surrounding circumstances.

[10] My conclusion is that the appellants have established on a balance of probabilities that the legal expenses were incurred by the partnership.

[11] It is clear that Mr. Archibald was legally obligated to pay the legal fees. The invoices were issued to him and a judgment for unpaid fees was issued against him. The new corporation, which had just been incorporated by the law firm, was also listed on one of the invoices and on the judgment but this does not remove Mr. Archibald's liability. The evidence also indicates that the law firm placed a lien on the family home to collect the debt.

[12] I will first consider whether Mr. Archibald or the partnership incurred the fees. Counsel for the Minister argued that there was insufficient evidence linking the partnership to the expense.

[13] At first blush this argument has merit because none of the documentation is in the name of the partners or the partnership. Further, Mr. Archibald testified that he likely would have received a salary from the corporation. From a legal perspective, the notion of "salary" is inconsistent with business income earned by a partnership.

[14] Despite these difficulties, I have concluded that Mr. Archibald did incur the legal fees on behalf of the partnership based on the evidence as a whole.

[15] According to Mr. Archibald's testimony, which was not challenged, all of his varied business activities have been carried on on behalf of the partnership. There is no reason to think that income in this venture that was generated from Mr. Archibald's efforts would be any different.

[16] Mr. Archibald referred in his testimony to potentially receiving a salary from the new corporation. This is not consistent with the partnership earning income because salary could only be paid to an individual as an employee.

[17] My impression from Mr. Archibald's testimony is that he was trying to convey that the partnership would earn income from services provided by him. I do not think that he was using the term "salary" in a legal sense.

[18] I conclude that the legal fees were not incurred by Mr. Archibald personally but on behalf of the partnership.

[19] It remains to be considered whether the partnership incurred the fees on its own behalf or on behalf of the corporation.

[20] From a common sense perspective of the arrangement, I conclude that the partnership incurred the fees on its own behalf, with a contingent right to be reimbursed by the corporation if the venture proceeded.

[21] The new venture was likely a highly risky one from the partnership's perspective. It appears to have been a new type of venture for Mr. Archibald, and the legal fees were incurred prior to his knowing whether sufficient investors would be interested.

[22] The draft offering memorandum contemplates the payment of legal fees. It is likely that the legal fees would have been reimbursed by the corporation to the partnership if the venture had proceeded. Unless the securities' issue proceeded, however, the partnership was not expecting to be reimbursed.

[23] I conclude, then, that the fees were incurred by the partnership on its own behalf.

[24] This is sufficient to dispose of the appeals. I would mention that there were other arguments raised in the reply, but these were not pursued at the hearing. The arguments were that the fees were not laid out to earn income and that they were on account of capital. As these arguments were not pursued, it is not necessary for me to consider them here.

[25] In the result, the appeals will be allowed, and the assessments will be referred back to the Minister for reassessment on the basis that the legal fees claimed are deductible in computing the partnership loss.

[26] The appellants are entitled to their costs, if any.

Signed at Ottawa, Canada this 22nd day of April 2009.

“J. Woods”

Woods J.

CITATION: 2009 TCC 215

COURT FILE NOs.: 2008-2256(IT)I
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STYLES OF CAUSE: AUDREY J. ARCHIBALD v.
HER MAJESTY THE QUEEN and
IAN G. ARCHIBALD v.
HER MAJESTY THE QUEEN

PLACE OF HEARING: Edmonton, Alberta

DATE OF HEARING: April 1, 2009

REASONS FOR JUDGMENT BY: The Honourable Justice J. Woods

DATE OF JUDGMENT: April 22, 2009

APPEARANCES:

For the Appellants: Ian G. Archibald

Counsel for the Respondent: Holly A. Peterson

COUNSEL OF RECORD:

For the Appellant:

Name: n/a

Firm:

For the Respondent: John H. Sims, Q.C.
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