

BETWEEN:

IVY G. NAGUIT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on March 12, 2010, at Toronto, Ontario

Before: The Honourable Justice G. A. Sheridan

Appearances:

Counsel for the Appellant: David M. Piccolo
Counsel for the Respondent: Ricky Y. M. Tang

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeals from the reassessments made under the *Income Tax Act* for the 2004 and 2006 taxation years are allowed, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to business expenses:

1. for travel in 2004 of \$771.00, being 50% of \$1,542.00; and
2. for advertising in 2004 and 2006 of \$5,005.00 and \$2,317.62, respectively.

The appeal from the reassessment of the 2005 taxation year is dismissed.

Signed at Ottawa, Canada, this 19th day of April, 2010.

“G. A. Sheridan”

Sheridan J.

Citation: 2010TCC200
Date: 20100419
Docket: 2009-3457(IT)I

BETWEEN:

IVY G. NAGUIT,

Appellant,

and

HER MAJESTY THE QUEEN,

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REASONS FOR JUDGMENT

Sheridan, J.

[1] The Appellant, Ivy Naguit, is appealing the disallowance of certain business expenses claimed for rent, advertising and travel in the 2004, 2005 and 2006 taxation years. The position of the Minister of National Revenue is that the expenses claimed were either not actually incurred by the Appellant or alternatively, if they were incurred, it was not for the purpose of gaining business income as required by subsection 18(1)(a) of the *Income Tax Act*.

[2] As can be seen from the assumptions set out in paragraph 8 of the Reply to the Notice of Appeal, the Minister does not dispute that the Appellant was carrying on a business in the 2004-2006 taxation years:

- (a) during the 2004, 2005 and 2006 taxation years the Appellant was employed full time at the Sunnybrook Health Sciences Centre (“Sunnybrook”) and earned employment income in the amounts of \$66,601, \$67,041 and \$68,501 respectively;
- (b) during the years under appeal, the Appellant also operated a coconut treats business (the “coconut treats business”) as a sole proprietorship;
- (c) at all material times, the Appellant’s principal residence was located in Hamilton, Ontario;

- (d) during the 2005 and 2006 taxation years, the Appellant also rented an apartment (the “apartment”) in Toronto, Ontario;
- (e) the disallowed rent expense was claimed by the Appellant in relation to using of the apartment as a home office for the coconut treats business;
- (f) the Appellant alleged to have made a trip to Cuba in the 2004 taxation year for the purpose of networking for the coconut treats business;
- (g) the disallowed travel expense was not made and incurred or, if incurred, it was not incurred by the Appellant to earn income from the coconut treats business;
- (h) the Appellant alleged to have incurred amounts in the 2004 and 2006 taxation years for advertising expenses related to website design and maintenance, and printing of flyers, brochures and business cards; and
- (i) the disallowed advertising expenses were not made and incurred or, if incurred, they were not incurred by the Appellant to earn income from the coconut treats business.

[3] The Appellant accepted as correct the gross business income amounts and business losses claimed in 2003-2007 as set out in paragraph 9 of the Reply to the Notice of Appeal:

Year	Gross Business Income	Net Business Loss
2003	\$1,009	\$ 5,782
2004	Nil	\$13,259
2005	\$29	\$10,858
2006	\$56	\$ 9,105
2007	Nil	\$ 6,235
Cumulative Losses		<u>\$45,239</u>

[4] The Appellant was the only witness to testify in this Informal Procedure appeal. Her practice of conducting all business transactions in cash¹ and her failure to keep good books and records (often, items as basic as receipts) made the credibility of her testimony all the more crucial to her success. While she was not untruthful, she was not as forthcoming as she might have been and this weakened the force of her evidence. For example, she referred to two individuals who were closely connected to different aspects of her business dealings as “Mr. Banks” and “Mrs. Verona”.

¹ Exhibits A-3 and A-4. The app’s summary of cash withdrawals in 2004, 2005 and 2006.

While this may have been because of the formality imposed by the courtroom setting, it left the impression that they were third parties; it was later revealed, however, that Mr. Banks and Mrs. Verona are respectively, her husband and her mother-in-law.

[5] Such weaknesses notwithstanding and given the Minister's acceptance from the outset that the Appellant was engaged in a business, I am satisfied that the Appellant is entitled to some of the expenses claimed. The relevant findings of fact are set out below under each category of expense under appeal.

Travel – 2004 (\$4,000)

[6] According to the Appellant, the recipe for the coconut treats sold in her business originated in Cuba. Sometime in 2003, she got the recipe from Mrs. Verona. The Appellant spent much of 2003 and 2004 perfecting the recipe and the packaging of the coconut treats. Her goal, briefly stated, was to develop a tasty and attractive product, without using preservatives, which could withstand the storing and shipping requirements of a web-based business.

[7] Part of the tweaking recipe process involved a trip to Cuba to research local methods for making coconut treats. Mrs. Verona had a contact in Cuba, one Denia Pupo Escalona², who prepared for the Appellant an itinerary of visits with vendors at various locations on the island. The trip was in December 2004 and was booked through a holiday charter company. The flight and hotel cost \$1,542.00 and was paid on the Appellant's Mastercard³. The Appellant also claimed expenses for car rental (\$1,000), gas (\$150), fees for Mrs. Escalona's services (\$200) and \$100 payments to each of the vendors visited. These latter amounts were paid in cash; the Appellant did not have receipts for them.

[8] I do not share the Minister's view that the Appellant's trip to Cuba could not have had a business purpose only because it occurred during a month when Canadians like to escape to the Caribbean and was booked through a company called "Conquest Vacations". It is reasonable to conclude that a flight and hotel package booked through a charter vacation company might offer the most economical means of travel, always a concern in a new business. She did not deny that some of her free time in the evenings was spent in pursuits of a personal nature. All in all, I am satisfied that the Appellant did devote a good portion of her time to investigating the

² Exhibit A-2.

³ Exhibit A-1.

production of coconut treats and that a portion of the Conquest Vacations cost was incurred to earn income in the Appellant's coconut treats business. The Appellant is entitled to a business expense of 50% of the \$1,542.00. No further amount is allowed for the undocumented cash payments claimed.

Rent – 2005 and 2006 (\$5,040 and \$5,085)

[9] By 2005, the Appellant had perfected her product and was engaged in producing coconut treats: this involved extracting the meat from fresh coconuts, cooking the treat mixture and drying it for packaging. Once in the desired form, the treats were packaged and placed in the empty coconut shells which had been prepared for this purpose by the Appellant: the empty shells were halved, sanded and varnished and the bottom flattened to make an attractive, stable container. Premises were needed to cook the treats and to fashion the coconut containers. The Appellant used a rotary sander, a band saw and other small tools in her production of the shell containers.

[10] The Minister accepted that from 2004-2006, the Appellant was renting an apartment in a high-rise building at 33 King Street ("33 King") in downtown Toronto but denied that it was used in the business operation. The evidence revealed that the lease for the apartment was co-signed by Mr. Banks, apparently because as a single woman, the Appellant was nervous about being shown as the only lessee. The Appellant's testimony was that she used 33 King to do the rough work on the coconut shells. Although in business in 2004, she did not claim rental expenses until 2005 and 2006 as until then, she had not realized that was possible. As it turned out, I think the Appellant was badly advised on this point.

[11] The Minister disallowed the claim on two grounds: because, under paragraph 18(12)(b), if 33 King was a "self-contained domestic establishment", the rental expenses claimed by the Appellant were far in excess of her income; and also, under the general limitation of paragraph 18(1)(a) that only expenses incurred to earn income are properly deductible.

[12] I am not persuaded by the Appellant's evidence that 33 King was actually used for business purposes. It seems more likely that this apartment was simply where Mr. Banks lived; because the Appellant was residing with her family in Hamilton and commuting to her job at Sunnybrook as a medical lab technician, it may have been convenient to keep some equipment at 33 King and to stop in from time to time to work on the coconuts. While no exact numbers were provided, the Appellant testified that in all three taxation years, she sold no more than \$200 worth of coconut treats.

From this, and given the labour-intensive nature of preparing the shells and the limitations imposed by her full-time employment, I doubt much time was spent manufacturing the shells at 33 King. To the extent such activity did occur there, it likely had more to do with Mr. Banks' generous nature than a genuine business purpose. Furthermore, it simply makes no sense to me to rent an apartment in a downtown Toronto high-rise to do the kind of work the Appellant described as necessary to the production of coconut treats. Therefore, no amount is allowed for rent in 2005 or 2006.

Advertising - 2004 and 2006 (\$5000 and \$2,849)

[13] The Appellant sold the coconut treats via the internet. I accept her evidence that sometime in 2003, she retained the services of one Roberto Gonzales to design and activate a website for the coconut treats business. A domain search⁴ conducted by the Canada Revenue Agency officials who audited the Appellant shows that the Appellant's site, "cokitos.com", was registered on April 6, 2003; Exhibit A-8 is a printout of the material on the site showing the nature of the product, its history and how to order coconut treats. The Appellant also put in evidence a receipt⁵ from Mr. Gonzales for \$5,005.00 in respect of his services. All in all, the Appellant's evidence with regard to the website, including its design, purpose and actual use, was quite persuasive.

[14] I also accept the Appellant's evidence that in 2006, the Appellant paid Mr. Gonzales a further \$2,317.62⁶ to update the website, adding better graphics and animation and equipping it to accept payment via the internet. Mr. Gonzales also designed a brochure⁷ for the Appellant.

[15] While not a wise practice for someone engaged in a business, the Appellant paid these amounts from the supply of cash she kept at her parents' home in Hamilton. Given that she had a well-paying job at Sunnybrook and that it cost her nothing to live at home, it is not inconceivable that she would have had the funds available to pay Mr. Gonzales the amounts claimed.

⁴ Exhibit A-9.

⁵ Exhibit A-5.

⁶ Exhibit A-6.

⁷ Exhibit A-7.

[16] Finally, in 2006, the Appellant also claimed approximately \$600 for the printing of the brochures by some unknown company. The Appellant did not have a receipt for this cost. There was no persuasive evidence to justify the Minister's disallowance of this expense.

[17] For the reasons set out above, the appeals from the reassessments of the 2004 and 2006 taxation years are allowed and are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to business expenses:

1. for travel in 2004 of \$771.00, being 50% of \$1,542.00; and
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Signed at Ottawa, Canada, this 19th day of April, 2010.

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APPEARANCES:

Counsel for the Appellant: David M. Piccolo
Counsel for the Respondent: Ricky Y. M. Tang

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