Docket: 2007-3352(IT)G

BETWEEN:

MICHAEL BRUCE REILLY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on November 4 and 5, 2009 and
continued on April 20, 2010
at Vancouver, British Columbia

Before: The Honourable Justice Wyman W. Webb

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Johanna Russell

JUDGMENT

The appeals from the reassessments made under the *Income Tax Act* for the 2001 and 2002 taxation years are dismissed, with costs.

Signed at Ottawa, Canada, this 17th day of June, 2010.

"Wyman W. Webb"

Webb, J.

Citation: 2010TCC326
Date: 20100617
Docket: 2007-3352(IT)G

BETWEEN:

MICHAEL BRUCE REILLY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Webb, J.

[1] The issue is this appeal is whether the Appellant is entitled to deduct, in computing his income for 2001, certain campaign expenses that were incurred in 1999 when the Appellant was running for the office of mayor of Delta, British Columbia. While the Appellant in his Notice of Appeal had raised the issue of whether he should be allowed to claim certain other expenses in computing his income for 2001 and 2002, the only issue that was dealt with at the hearing was the amount claimed for campaign expenses in 2001. During the hearing the amount that the Appellant claimed that he was entitled to deduct was reduced from $33,185.34 to $31,978.91[1].

[2] The Appellant held forty percent of the shares of United Realty RCK & Associates Ltd. ("United Realty"). He provided his services to United Realty as a self-employed real estate broker / developer / realtor. He charged GST on his services and reported his commission income as self-employment income. He also received directors' fees from United Realty that he reported as income from employment.

---

[1] The Appellant conceded that he was no longer pursuing his claim for buttons ($1,110.13 excluding GST) and tickets ($96.30 excluding GST).

[3] In 1999 the Appellant ran for the office of mayor of Delta, British Columbia. The following are excerpts from the exchange between counsel for the Respondent and the Appellant in relation to the reasons why he ran for mayor and his campaign promises:

> Q Is it fair to say that in '99 you felt fairly passionate about some issues that you wanted to bring or to -- you felt passionate about some issues that you wanted to make changes with, you wanted to bring to the attention of the City of Delta?
>
> A You know, I don't recall being passionate about any issues other than seizing an opportunity to step in and develop a better profile for myself. But on the issue side, I don't -- I can't say that I had any passionate issue that I wanted to deal with, if that's what you're asking.
>
> Q I'm curious about the issue of protecting environmentally sensitive lands and the protection of the environment. Isn't it fair to say you were passionate about those issues at that time?
>
> A No. In fact, I wrote advertorial about talking about developing Burns Bog. I had been approached by the owners of Burns Bog, which is a big controversial issue here. It's 10,000 square -- 10,000 acres of land that there was a proposal for hotels and casinos and all sorts of things on. And in fact I had people who were senators come out to meet with me about it, and people from the casino industry saying that, you know, they'd like me to consider after I finished my run for mayor in helping them to develop the property if possible.
>
> So I was really was on the negative side of the environment in the advertising that I was doing, which did not go over very well with the general public. But as a developer you have to put forward that when you're a developer, yes, you have to be sensitive to the environment but you also have to understand that industry and jobs and housing and these other items have to be created. So if you're saying I was an environmentalist and had a passion for it, no. Absolutely not.
>
> Q So you had no passion for any of the issues that you were speaking about with your electorate?
>
> A No. It was strictly business for me.
>
> Q Well, I suggest to you that your decision to run for the mayor of Delta did have a personal element and it was a personal choice that you were making and not a business choice.
>
> A Well, you can suggest that, and sure, I'd love to be mayor of a city. Basically the type of business that I do is all about real estate and property development rights, and considering that I've done some development I understand the process and I could help others achieve their goal and benefit in a tax base for a community,

yes. From that side I would enjoy being mayor of the city of Vancouver or some other place. It's a great job. In fact the salary is like $100,000 a year, so it's a well paying job.

Q So when you were campaigning to run for this position, weren't you speaking to the electorate and promising them that you would bring their concerns to the attention of the city should you be elected?

A You know, I didn't make any promises to anybody other than if I was elected I would run the city like a business the way I run my development and real estate companies.

Q But wasn't it your primary goal to advance the concerns of the community of Delta in running for mayor, not just running -- not just pushing the concerns of Mr. Reilly, but pushing forward and advancing the concerns and the needs of a community as a whole, the betterment of Delta as a whole?

A You know, for the record, I was after the job of becoming mayor as another job being basically the same as what I do in the real estate development. It would be a three-year contract. I would earn income during that time. That was my only interest. Not so much what you say about bringing the concerns of the citizens to the community. I didn't listen very much to the citizens. I listened to the businesses. That was my -- that was what I was intended to do.

Q So you were most interested in receiving the good salary that was involved with getting the position of the mayor.

A Yes.

[4] It appears that the Appellant was not passionate about any issue except increasing his own profile and earning the salary of mayor. He also did not listen to the citizens of Delta and did not appear to have much interest in their concerns. It will probably not be a surprise that he was not successful in his bid to become mayor.

[5] The Appellant’s argument was that he incurred the campaign expenses to increase his profile and to increase his income as a real estate broker / developer / realtor. He stated that his advertisements not only dealt with his bid to become mayor but also identified his business background and the services that he offered. The campaign expenditures were incurred in 1999. United Realty paid the expenditures on his behalf in 1999. The arrangement was that the Appellant would reimburse United Realty and he did so in 2001. The first issue raised by the Respondent is that since the expenditures were incurred in 1999 they could not be deducted by the Appellant in 2001.

[6] The Appellant's position is that he was entitled to determine his income on a cash basis and since he did not reimburse United Realty until 2001, then he is entitled to deduct this amount in 2001. In this case the Appellant was not ***employed*** by United Realty as a commission salesperson. He claimed, and it was not disputed by the Respondent, that he carried on his realtor / broker / developer activities (in relation to which he was claiming the campaign expenses as a deduction) as an independent contractor. As a result how the Appellant is to compute his income from his activities as a realtor / broker / developer is to be determined pursuant to section 9 of the *Income Tax Act* (the "*Act*") (and the other applicable sections of the *Act*) and not sections 5, 6 and 8 of the *Act*.

[7] Section 5 (which applies to employees) provides that remuneration ***received*** in the year is to be included in income. Paragraph 8(1)(f) of the *Act* (which applies to persons who are "employed in the year in connection with the selling of property or negotiating of contracts for the taxpayer's employer") refers to amounts ***expended.*** Therefore employees would use the cash basis of accounting to compute their income from employment. However the Appellant was not "employed in the year in connection with the selling of property or negotiating of contracts for [his] employer" and therefore paragraph 8(1)(f) of the *Act* does not apply to the Appellant. He was carrying on business and he was claiming that the advertising costs were deductible in computing income from this business.

[8] Subsection 9(1) of the *Act*, which is applicable to the Appellant in determining his income from his business, simply provides that:

> 9. (1) Subject to this Part, a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year.

[9] In *Ken Steeves Sales Ltd.* v. *The Queen*, [1955] Ex. C.R. 108, 55 DTC 1044, [1955] C.T.C. 47, Justice Cameron stated as follows:

> For these reasons I must reach the conclusion that the "Cash Receipts and Expenditure" method purported to have been used by the appellant in this case is a method which is not permissible under the Act. I say that because of the fact that it excludes as an item of income all receivables, which in my opinion form a necessary part of any trader's profit and loss statement. Such a method is incomplete and misleading and one which fails entirely to show the true state of a taxpayer's position or to reflect his true profit or loss. . . .

[10] In *Freeway Properties Inc.* v. *The Queen*, [1985] 1 C.T.C. 222, 85 DTC 5183, Justice Addy of the Federal Court – Trial Division stated that:

> 18 Section 9 of the Income Tax Act indeed states that profit must be accounted for in accordance with normal business practices unless the Act otherwise provides. Several cases were relied upon by counsel for Freeway including *Ken Steeves Sales Ltd* v *Minister of National Revenue*, [1955] C.T.C. 47, 55 D.T.C. 1044, *Industrial Mortgage and Trust Co* v *Minister of National Revenue*, [1958] C.T.C. 106, 58 D.T.C. 6185, to emphasize the importance of relying on normal business practices. I find no difficulty in concluding and indeed it was admitted by the Crown, that Freeway was justified in accounting for its operations on an accrual as opposed to a cash basis. It was in fact obliged to do so.

[11] In *The Fundamentals of Income Tax Law* by Vern Krishna (Carswell, 2009) it is stated at page 164 that:

> In contrast with the requirement of cash basis accounting for employment income, business and property income is usually required to be reported on an accrual basis. The Act does not specifically stipulate a particular method for calculating business or property income. Section 9 says only that a taxpayer's income from a business or property is his or her *profit* therefrom. The term "profit", however, has been judicially interpreted to mean profit calculated in accordance with commercial practice, and commercial practice favours accrual accounting for most businesses. Hence, the accrual method is mandated indirectly through the requirement to adhere to generally accepted accounting principles.
>
> (emphasis was in original text)

[12] In *Canderel Ltd.* v. *The Queen,* [1998] 1 S.C.R. 147, 98 DTC 6100, [1998] 2 C.T.C. 35, Justice Iacobucci of the Supreme Court of Canada stated that:

> **V. Analysis**
>
> (1) General principles of profit computation
>
> 28 In the relatively recent case of *Symes, supra,* this Court considered the general principles which govern the computation of profit for income tax purposes. However, because some of the principles enunciated in *Symes* may have been misinterpreted, I propose to review these general principles in order to resolve the issue in this appeal and to clarify the critical issue of profit computation for the purposes of the Income Tax Act.
>
> *(a) The interpretive framework*
>
> 29 It is appropriate to begin the consideration of profit with s. 9(1) of the Act, which defines a taxpayer's income for a taxation year from a business or property source as "his profit therefrom for the year." Significantly, "profit" is not defined in s. 9(1) or

anywhere else in the Act. It seems to me that this approach was a deliberate legislative choice, particularly given that the Act contains exhaustive definitions of numerous other concepts and terms with which it deals. This choice reflects the reality that no single definition can adequately apply to the millions of different taxpayers bound by the Act. Under our self-assessment system, each taxpayer must be able to compute his or her income in such a way as to constitute an accurate picture of his or her income situation, subject, of course, to express provisions in the Act which require specific treatment of certain types of expenses or receipts.

30 What, then, is the true nature of “profit” for tax purposes? While the concept has been variously expressed, perhaps the clearest and most concise articulation of the term is to be found in the oft-quoted decision of this Court in *Irwin* v. *Minister of National Revenue*, [1964] S.C.R. 662 (S.C.C.) , at p. 664, where profit in a year was taken to consist of “the difference between the receipts from the trade or business during such year ... and the expenditure laid out to earn those receipt.” (emphasis in original) This definition was echoed by Jackett P. in *Associated Investors of Canada Ltd.* v. *Minister of National Revenue*, [1967] 2 Ex. C.R. 96 (Can. Ex. Ct.), where he stated at p. 102:

> Ordinary commercial principles dictate, according to the decisions, that the annual profit from a business must be ascertained by setting against the revenues from the business for the year, the expenses incurred in earning such revenues.

31 Accepting this fundamental definition, in *Symes, supra*, at pp. 722-23, the majority made the following observations about the computation of profit:

> ...the “profit” concept in s. 9(1) is inherently a net concept which presupposes business expense deductions. It is now generally accepted that it is s. 9(1) which authorizes the deduction of business expenses; the provisions of s. 18(1) are limiting provisions only....
>
> Under s. 9(1), deductibility is ordinarily considered as it was by Thorson P. in *Royal Trust*, [*Royal Trust Co.* v. *Minister of National Revenue*, 57 D.T.C. 1055 (Ex. Ct.)] (at p. 1059):
>
>> ...the first approach to the question whether a particular disbursement or expense was deductible for income tax purpose was to ascertain whether its deduction was consistent with ordinary principles of commercial trading or well accepted principles of business ... practice ... (Emphasis added.)
>
> Thus, in a deductibility analysis, one's first recourse is to s. 9(1), a section which embodies, as the trial judge suggested, a form of “business test” for taxable profit.

> This is a test which has been variously phrased. As the trial judge rightly noted, the determination of profit under s. 9(1) is a question of law: *Neonex International Ltd.* v. *The Queen*.... Perhaps for this reason, and as *Neonex* itself impliedly suggests, courts have been reluctant to posit a s. 9(1) test based upon "generally accepted accounting principles" (G.A.A.P.).... Any reference to G.A.A.P. connotes a degree of control by professional accountants which is inconsistent with a legal test for "profit" under s. 9(1). Further, whereas an accountant questioning the propriety of a deduction may be motivated by a desire to present an appropriately conservative picture of current profitability, the Act is motivated by a different purpose: the raising of public revenues. For these reasons, it is more appropriate in considering the s. 9(1) business test to speak of "well accepted principles of business (or accounting) practice" or "well accepted principles of commercial trading". [Emphasis in original.]

32 The great difficulty which seems to have plagued the courts in the assessment of profit for income tax purposes bespeaks the need for as much clarity as possible in formulating a legal test therefor. The starting proposition, of course, must be that the determination of profit under s. 9(1) is a question of law, not of fact. Its legal determinants are two in number: first, any express provision of the *Income Tax Act* which dictates some specific treatment to be given to particular types of expenditures or receipts, including the general limitation expressed in s. 18(1)(a), and second, established rules of law resulting from judicial interpretation over the years of these various provisions.

33 Beyond these parameters, any further tools of analysis which may provide assistance in reaching a determination of profit are just that: interpretive aids, and no more. Into this category fall the "well-accepted principles of business (or accounting) practice" which were mentioned in *Symes*, also referred to as "ordinary commercial principles" or "well-accepted principles of commercial trading", among other terms. A formal codification of these principles is to be found in the "generally accepted accounting principles" ("G.A.A.P.") developed by the accounting profession for use in the preparation of financial statements. These principles are accepted by the accounting profession as yielding accurate financial information about the subject of the statements, and become "generally accepted" either by actually being followed in a number of cases, by finding support in pronouncements of professional bodies, by finding support in the writings of academics and others, or by more than one of these methods: see Peter W. Hogg and Joanne E. Magee, Principles of Canadian Income Tax Law (2nd ed. 1997), at pp. 180-81. What must be remembered, however, is that these are non-legal tools and as such are external to the legal determination of profit, whereas the provisions of the Act and other established rules of law form its very foundation.

34 That is not to minimize the key role played by such well-accepted business principles (as I shall hereafter refer to them) in the profit-computation process. In *Friesen* v. *R.*, [1995] 3 S.C.R. 103 (S.C.C.), in dissent, Major J. made the following observation at p. 127, with which the majority did not disagree:

> The Act does not define “profit” nor does it provide any specific rules for the computation of profit. Tax jurisprudence has established that the determination of profit under s. 9(1) is a question of law to be determined according to the business test of “well-accepted principles of business (or accounting) practice” or “well-accepted principles of commercial trading” except where these are inconsistent with the specific provisions of the *Income Tax Act*....

35 I think this statement aptly describes the proper relationship between tax law and business principles. In the absence of a statutory definition of profit, it would be unwise for the law to eschew the valuable guidance offered by well-established business principles. Indeed, these principles will, more often than not, constitute the very basis of the determination of profit. However, well-accepted business principles are not rules of law and thus a given principle may not be applicable to every case. More importantly, these principles must necessarily take a subordinate position relative to the legal rules which govern.

36 The reason for this is simple: generally speaking, well-accepted business principles will have their roots in the methodology of financial accounting, which, as was expressed in *Symes*, is motivated by factors fundamentally different from taxation. Moreover, financial accounting is usually concerned with providing a comparative picture of profit from year to year, and therefore strives for methodological consistency for the benefit of the audience for whom the financial statements are prepared: shareholders, investors, lenders, regulators, etc. Tax computation, on the other hand, is solely concerned with achieving an accurate picture of income for each individual taxation year for the benefit of the taxpayer and the tax collector. Depending on the taxpayer's commercial activity during a particular year, the methodology used to calculate profit for tax purposes may be substantially different from that employed in the previous year, which in turn may be different from that which was employed the year before. Therefore, while financial accounting may, as a matter of fact, constitute an accurate determinant of profit for some purposes, its application to the legal question of profit is inherently limited. Caution must be exercised when applying accounting principles to legal questions.

37 I do not wish to be taken, however, as minimizing the role of G.A.A.P. in the determination of profit for income tax purposes. Some have inferred from my reasons in *Symes* an intention that G.A.A.P. are to be rejected entirely: see, for example, Hogg and Magee, supra, at pp. 185-87. This is not what I intended. In fact, the better view is that G.A.A.P. will generally form the very foundation of the “well-accepted business principles” applicable in computing profit. It is important, however, for the courts to avoid delegating the criteria for the legal test of profit to the accounting profession, and therefore a distinction must be maintained. That is, while G.A.A.P. may more often than not parallel the well-accepted business principles recognized by the law, there may be occasions on which they will differ, and on such occasions the latter must prevail: see, for example, *Friedberg v. R., supra*.

> 38 Moreover, there will, of course, be situations in which G.A.A.P. will offer various acceptable options in the preparation of financial statements, and the taxpayer will be free, for financial accounting purposes, to adopt whichever option best suits his financial objectives at the given time. In such cases, G.A.A.P. will surely not be determinative as to the method by which an accurate picture of profit may be obtained for taxation purposes, though it may still be useful as a guide to the various acceptable methods of computation, one of which may yield the appropriate result for taxation.
>
> 39 A good example of the relationship among the provisions of the Act, the principles developed in the case law, and G.A.A.P. or well-accepted business principles can be found s. 18(9) of the Act, which requires the amortization of certain prepaid expenses over the periods of time to which they relate. It is possible, although I express no specific opinion on this matter, that some of these expenses could be treated otherwise for the purposes of G.A.A.P. or business practice; perhaps they might be deducted entirely in the year incurred, or even capitalized. However, this possibility is negated for tax purposes by their specific legislative treatment.

[13] Michael Granof, in the text *Financial Accounting: Principles and Issues* (Prentice-Hall, Inc. 1977), stated at page 104 that:

> Central to modern-day accounting is the notion that revenues and expenses should be reported on an accrual basis. The effects of transactions and other financial events on the assets and liabilities of an enterprise should be accorded accounting recognition at the time that they have their primary economic impact, *not necessarily when cash is received or disbursed*. Revenues should be assigned to that period in which they are *earned*. Revenues are said to be *realized* at that point when they are earned. Costs are charged as expenses in the period in which they provide their expected services in an effort to generate revenues.
>
> (emphasis was in original text)

[14] Donald E. Kieso et al. in the text *Intermediate Accounting* (seventh Canadian edition, John Wiley & Sons Canada, Ltd., 2005) stated that:

> Most companies use the **accrual basis** of accounting: they recognize revenue when it is earned and recognize expenses in the period incurred, without regard to the time of receipt or payment of cash. Some small enterprises and the average individual taxpayer, however, use a strict or modified cash basis approach. Under the **strict cash basis** of accounting, revenue is recorded only when the cash is received and expenses are reported only when the cash is paid. The determination of income on the cash basis rests upon the collection of revenue and the payment of expenses, and the revenue recognition and matching principles are ignored. Consequently, cash basis financial statements do not conform with generally accepted accounting principles.
>
> (emphasis was in original text)

[15] It does not seem to me that the decision of the Supreme Court of Canada in *Canderel* should be interpreted to permit taxpayers to choose whether they report their income on an accrual basis or a cash basis. As noted by Justice Iacobucci "[well-established business principles] will, more often than not, constitute the very basis of the determination of profit". Since it is clear that the well-established business principle is that revenues and expenses are to be determined on an accrual basis and not a cash basis and that "cash basis financial statements do not conform with generally accepted accounting principles", it seems to me that only those persons who are granted permission under the *Act* to determine their income on a cash basis may do so. Section 28 of the *Act* grants such permission to persons who are carrying on a farming or a fishing business. Sections 5, 6 and 8 of the *Act* provide that employees will determine their income on a cash basis. However, there is no provision of the *Act* that allows the Appellant, who is not an employee in relation to the services that he is providing as a realtor / broker / developer, to determine his income on a cash basis.

[16] As a result, if the amounts claimed for advertising in relation to his campaign expenses are deductible at all, they are deductible in computing his income for 1999 (which is the year in which they were incurred) and not in 2001. Since the only issue in this case is whether such amounts were deductible in 2001, the Appellant cannot succeed. The Respondent had raised other issues related to whether the expenditures were incurred for the purpose of earning income or whether they were personal expenditures as well as the issue of whether the expenditures were incurred on account of capital. Since the amounts are not deductible in determining the income of the Appellant in 2001 in any event, these additional issues will not be addressed.

[17] As a result the Appellant's appeals from the reassessments made under the *Act* for the 2001 and 2002 taxation years are dismissed, with costs.

Signed at Ottawa, Canada, this 17th day of June, 2010.

"Wyman W. Webb"

Webb, J.

CITATION:	2010TCC326
COURT FILE NO.:	2007-3352(IT)G
STYLE OF CAUSE:	MICHAEL BRUCE REILLY AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Vancouver, British Columbia
DATE OF HEARING:	November 4 and 5, 2009 and April 20, 2010
REASONS FOR JUDGMENT BY:	The Honourable Justice Wyman W. Webb
DATE OF JUDGMENT:	June 17, 2010

APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Johanna Russell

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

For the Respondent:	Myles J. Kirvan Deputy Attorney General of Canada Ottawa, Canada