Docket: 2010-2580(GST)I

BETWEEN:

LAND AND SEA ENTERPRISES LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on January 13, 2011, at Charlottetown,
Prince Edward Island

Before: The Honourable Justice Diane Campbell

Appearances:

Agent for the Appellant:	J. Gerald Arsenault
Counsel for the Respondent:	Toks C. Omisade

JUDGMENT

The appeal from the assessment made under Part IX of the *Excise Tax Act* with respect to the Notice of Assessment dated May 23, 2007, for the period May 1, 2004 to April 30, 2005, is allowed, without costs, on the following basis:

The Appellant is permitted to claim input tax credits in respect to the full amount of Invoice Numbers 9726, 9873 and 9829 in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 16th day of February 2011.

"Diane Campbell"

Campbell J.

Citation: 2011 TCC 101
Date: February 16, 2011
Docket: 2010-2580(GST)I

BETWEEN:

LAND AND SEA ENTERPRISES LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Campbell J.

[1] This appeal is from an assessment under the *Excise Tax Act* (the "*Act*") for the period May 1, 2004 to April 30, 2005. Following an audit of the Appellant, the Minister of National Revenue (the "Minister") denied input tax credits ("ITCs") in the amount of $9,358.76. The issue is whether the Appellant is entitled to claim these ITCs.

[2] The Appellant corporation was incorporated in 1991, originally with the name "Troy Construction Limited". Its initial activities included diving, pipeline welding and painting of parking lots and intersections. As the corporate activities moved toward a focus on farming, the corporation changed its name around 2006 to 2007.

[3] The Appellant's sole officer and shareholder is Kimball Johnston. He testified that, during the period under appeal, the corporation had commenced the process of transitioning from its prior ventures to a farming venture with a focus on horses, including boarding, breeding, selling horses, stud services and raising and training foals. As a result, the Appellant claims that the costs relating to the claimed ITCs were incurred during this period while the corporation was transitioning to the horse operations. In addition to these activities, the Appellant also owned a fishing boat,

which it leased to Mr. Johnston, who used the boat for his own commercial lobster fishing activities. The lobster license is in the name of Mr. Johnston. It was also the Appellant's position that Mr. Johnston acted as agent for the company when he incurred costs in his personal name.

[4] The ITCs, which the Appellant claimed, relate to the following:

(1) the construction of a new barn;

(2) the purchase of a tractor;

(3) farm supplies;

(4) legal account respecting a land purchase;

(5) 50 per cent of the ITCs relating to fuel, utilities and phone expenses; and

(6) 50 per cent of the ITCs relating to meals.

[5] The Respondent's position is that the Appellant is not entitled to the ITCs in respect of the new barn because, if the Appellant acquired it during this period for improvement of its capital property, the Appellant did not use the barn in the course of its commercial activities immediately after it was acquired. In the alternative, the Respondent argued that the new barn was not for use or supply in the course of the Appellant's commercial activities. In respect to the other items, the Respondent argued that the tractor was not acquired for use primarily in the Appellant's commercial activities and that the remaining items were personal expenditures of Mr. Johnston and his spouse.

[6] To successfully claim ITCs, the Appellant must establish that it acquired these items for consumption, use or supply in the course of its commercial activities pursuant to subsection 169(1) of the *Act*. This subsection reads as follows:

> **169. (1) General rule for [input tax] credits** - Subject to this Part, where a person acquires or imports property or a service or brings it into a participating province and, during a reporting period of the person during which the person is a registrant, tax in respect of the supply, importation or bringing in becomes payable by the person or is paid by the person without having become payable, the amount determined by the following formula is an input tax credit of the person in respect of the property or service for the period:
>
> $$A \times B$$
>
> where

A is the tax in respect of the supply, importation or bringing in, as the case may be, that becomes payable by the person during the reporting period or that is paid by the person during the period without having become payable; and

B is

(a) where the tax is deemed under subsection 202(4) to have been paid in respect of the property on the last day of a taxation year of the person, the extent (expressed as a percentage of the total use of the property in the course of commercial activities and businesses of the person during that taxation year) to which the person used the property in the course of commercial activities of the person during that taxation year,

(b) where the property or service is acquired, imported or brought into the province, as the case may be, by the person for use in improving capital property of the person, the extent (expressed as a percentage) to which the person was using the capital property in the course of commercial activities of the person immediately after the capital property or a portion thereof was last acquired or imported by the person, and

(c) in any other case, the extent (expressed as a percentage) to which the person acquired or imported the property or service or brought it into the participating province, as the case may be, for consumption, use or supply in the course of commercial activities of the person.

[7] Subsection 169(4) of the *Act* references the documentation and prescribed information that a registrant must provide in support of an ITC claim. Subsection 169(4) of the *Act* states:

(4) Required documentation - A registrant may not claim an input tax credit for a reporting period unless, before filing the return in which the credit is claimed,

(a) the registrant has obtained sufficient evidence in such form containing such information as will enable the amount of the input tax credit to be determined, including any such information as may be prescribed; and

(b) where the credit is in respect of property or a service supplied to the registrant in circumstances in which the registrant is required to report the tax payable in respect of the supply in a return filed with the Minister under this Part, the registrant has so reported the tax in a return filed under this Part.

[8] The prescribed information is fully set out in the *Input Tax Credit Information (GST/HST) Regulations*, (SOR/91-45) (the "*Regulations*"), section 3.

[9] Commercial activity is defined in subsection 123(1) of the *Act* as follows:

"commercial activity" of a person means

> (a) a business carried on by the person (other than a business carried on without a reasonable expectation of profit by an individual, a personal trust or a partnership, all of the members of which are individuals), except to the extent to which the business involves the making of exempt supplies by the person,
>
> (b) an adventure or concern of the person in the nature of trade (other than an adventure or concern engaged in without a reasonable expectation of profit by an individual, a personal trust or a partnership, all of the members of which are individuals), except to the extent to which the adventure or concern involves the making of exempt supplies by the person, and
>
> (c) the making of a supply (other than an exempt supply) by the person of real property of the person, including anything done by the person in the course of or in connection with the making of the supply.

Analysis:

[10] If the Appellant is to successfully claim ITCs pursuant to subsection 169(1), three conditions must be met:

(1) the claimant/Appellant must have acquired the supply;

(2) the Goods and Services Tax ("GST") must be payable or was paid by the claimant/Appellant on the supply; and

(3) the claimant/Appellant must have acquired the supply for consumption or use in the course of its commercial activities.

(*General Motors of Canada Ltd. v The Queen*, 2008 TCC 117 at paragraph 30, [2008] TCJ No. 80 [*General Motors*]).

[11] In addition to acquiring the supply as a GST registrant, the other two conditions must be met to qualify for an ITC. My reasons in *General Motors* followed the decision in *Y.S.I.'s Yacht Sales International Ltd. v The Queen*, 2007 TCC 306, [2007] T.C.J. No. 187, in which Justice Woods, at paragraph 57, concluded that the proper entitlement to an ITC remains with the person who is liable contractually for payment and not the person that may have actually paid it. Also, the supply must be for use or supply in the course of the registrant's commercial activities.

[12] The largest amount which the Appellant is claiming is in respect to the construction of the new barn. The issue arises in this appeal as to whether the Appellant was involved, during the period under appeal, in the commercial activity of the various related horse operations. There is no question, according to the evidence, that the Appellant is presently engaged in this commercial activity, but was it so engaged, even on a start-up basis, during the period under appeal? In *Gartry v The Queen*, [1994] T.C.J. No. 240, 94 D.T.C. 1947, former Chief Justice Bowman, at page 1949, offered the following view on determining when a business commences:

> …In determining when a business has commenced, it is not realistic to fix the time either at the moment when money starts being earned from the trading or manufacturing operation or the provision of services or, at the other extreme, when the intention to start the business is first formed. Each case turns on its own facts, but where a taxpayer has taken significant and essential steps that are necessary to the carrying on of the business it is fair to conclude that the business has started….

[13] In *Kaye v The Queen*, [1998] T.C.J. No. 265, 98 D.T.C. 1659, former Chief Justice Bowman again, tackling the issue of whether a business had been established at a particular time, made the following comments at paragraphs 4, 5, and 7:

> [4]…It is the inherent commerciality of the enterprise, revealed in its organization, that makes it a business. Subjective intention to make money, while a factor, is not determinative, although its absence may militate against the assertion that an activity is a business.
>
> [5] One cannot view the reasonableness of the expectation of profit in isolation. One must ask "Would a reasonable person, looking at a particular activity and applying ordinary standards of commercial common sense, say 'yes, this is a business'?" In answering this question the hypothetical reasonable person would look at such things as capitalization, knowledge of the participant and time spent. He or she would also consider whether the person claiming to be in business has gone about it in an orderly, businesslike way and in the way that a business person would normally be expected to do.
>
> …
>
> [7] Ultimately, it boils down to a common sense appreciation of all of the factors, in which each is assigned its appropriate weight in the overall context. One must of course not discount entrepreneurial vision and imagination, but they are hard to evaluate at the outset. Simply put, if you want to be treated as carrying on a business, you should act like a businessman.

[14] It is clear that an activity may be considered a commercial activity well in advance of the stage of profitability. It will always be a question of fact. Expenditures giving rise to ITCs in the start-up phase of a commercial activity may be eligible

provided that there is clear intention to commence a business and that measurably significant and fundamental steps and actions have been put into place.

[15] When I look at the totality of the evidence, I believe that there were business activities being conducted in the start-up phase. However, the question is whether, during the start-up phase, it was the business of the Appellant or of Mr. Johnston. The Appellant had no legal ownership of any of the horses during this period. The land upon which the new barn was constructed belonged to Mr. Johnston and his spouse during this period. While there was a lease agreement in place respecting a separate shop building, there was no such agreement respecting the barn during the period under appeal. The majority of the invoices respecting the construction of the barn are in the name of Kimball Johnston, not the Appellant.

[16] Some of the problem with the Appellant successfully claiming all of the ITCs during this period is the inability of Mr. Johnston to separate his activities from that of the Appellant and to maintain proper supporting records. As 100 per cent owner of the Appellant, he treated his own commercial activities interchangeably with those of the Appellant corporation, failing to recognize the importance legally of the Appellant as a separate and distinct entity. Piercing this corporate veil and treating the corporate entity and its shareholders as one unified entity will be done only in those rare cases where there exists the clearest of compelling circumstances. In *The Queen v Jennings*, [1994] F.C.J. No. 953, 94 D.T.C. 6507, Robertson, J.A., at page 6508, quoted the Supreme Court of Canada in *Kosmopoulos v Constitution Insurance Co.*, [1987] 1 S.C.R. 2, where Wilson, J., at pages 10-11, stated:

> The law on when a court may disregard [the principle of separate corporate entities] by "lifting the corporate veil" and regarding the company as a mere "agent" or "puppet" of its controlling shareholder or parent corporation follows no consistent principle. *The best that can be said is that the "separate entities" principle is not enforced when it would yield a result "too flagrantly opposed to justice, convenience or the interests of the Revenue" ...*
>
> There is a persuasive argument that "those who have chosen the benefits of incorporation must bear the corresponding burdens, so that if the veil is to be lifted at all that should only be done in the interests of third parties who would otherwise suffer as a result of that choice"… Mr. Kosmopoulos was advised by a competent solicitor to incorporate his business in order to protect his personal assets and there is nothing in the evidence to indicate that his decision to secure the benefits of incorporation was not a genuine one. *Having chosen to receive the benefits of incorporation, he should not be allowed to escape its burden. He should not be permitted to "blow hot and cold" at the same time*. [Emphasis added]

[17] The importance of the proper maintenance of documentation respecting ownership is recognized within the *Act* and more specifically in the *Regulations*, where non-compliance with the prescribed documentary requirements will result in a denial of ITCs. Mr. Johnston's explanation, for why many of the invoices for the barn were in his name, was that he belonged to a small business community in Prince Edward Island where he is well known and so the names were used interchangeably on the invoices. However, that does not absolve him from the requirement to ensure that proper record-keeping is maintained and that the corporate activities of the Appellant are not intermingled haphazardly with his own commercial endeavours.

[18] I must conclude that, based on the evidence before me, there are no compelling circumstances that would support a decision to disregard the well-established legal principle of separate legal corporate identity and to treat the Appellant and Mr. Johnston as one. Mr. Johnston has a good deal of previous business experience. The Appellant was first incorporated as Troy Construction Ltd. in 1991. It was involved in several different business ventures spanning a fourteen to fifteen year period. Mr. Johnston is personally engaged in the fishing industry and is himself a GST registrant who presumably has filed personally for ITCs. Maintenance of proper record-keeping should not be a foreign concept to Mr. Johnston. Other than the few invoices that were in the Appellant's name, there was no other documentary evidence submitted to support the Appellant's contention that it had an interest in the horse operations during this period. The horses were not transferred to the corporation until 2007. There was no evidence that the Appellant actually acquired property or services (except for the limited number of invoices) during this period. When giving evidence respecting registration of the horses, Mr. Johnston testified as follows:

[Mr. Johnston] A.	You can buy a horse that is in your name, Sir, and it's registered through the American Quarter Horse in your name, and I can buy that horse, show it on my books and resell it and it would be a transaction through my business, but the American Quarter Horse Association doesn't require that I put it in my name, as well as the end user's name. It's only if you are showing the horse that the American Quarter Horse Association requires that it be in your name and you show the horse.
[Mr. Omisade] Q. 106	So when you purchased these horses, was it you and your spouse who purchased these horses?
[Mr. Johnston] A.	I guess it would be me.

(Transcript, page 54, line 16 to page 55, line 4).

According to his evidence, registration of a horse is linked to showing that horse, not ownership. He does state that, in respect to a purchase of a horse, that transaction could or would be shown "on my books" which I assume meant the Appellant's books. However, there was no such documentary evidence presented to suggest that any purchases or sales were recorded in the Appellant's records during this period. Mr. Johnston also testified that he had a shareholder's loan with respect to these horses but, again, no documentary evidence was produced to support the existence of such a loan, nor were cancelled cheques from the Appellant corporation to Mr. Johnston submitted in respect to reimbursement.

[19] With respect to the Appellant's argument that Mr. Johnston acted as the Appellant's agent in the purchase of these items, although such an agency relationship may be legitimately recognized in some circumstances, I do not believe the appropriate circumstances exist in this appeal. Mr. Johnston is the sole owner of the business and it was upon his shoulders to ensure that, if he was acting as the Appellant's agent, correct documentation from third parties reflected that the purchases were for the Appellant's operations. The *Companies Act*, R.S.P.E.I. 1988, c. C-14, section 29 permits corporations to create and pass by-laws appointing corporate agents. However, no such by-law was submitted into evidence.

[20] It is clear that the Appellant corporation was in existence legally during this period. It is also clear that the business activities of horse breeding, showing and boarding were underway and in the initial start-up stage. What is not as clear-cut is whether, during this period, those activities were the business initiatives of the Appellant or of Mr. Johnston. There was no distinct demarcation between the Appellant's activities and Mr. Johnston's business activities during this period, although after the audit, it appears that these activities clearly became those of the Appellant. However, during the period under appeal, the evidence does not support that these start-up activities were those of the Appellant. Based on the facts, I am prepared to allow the Appellant to claim ITCs in respect to the following:

(A) <u>New Barn:</u>

Quality Truss Invoices 9726, 9873 and 9829 (in the amounts of $17,050.45, $192.60 and $588.50, respectively) all invoiced to Troy Construction Ltd..

In respect to the other invoices, the "statement of account" dated April 30, 2005 from Schurman Building Supplies to Troy Construction Ltd. contains none of the required information pursuant to the *Regulations* and, more specifically, contains no description of the supplies as required pursuant to subparagraph 3(3)(c)(iv) of the *Regulations*. The remaining invoices are addressed to Kimball Johnston, and there is no evidence that the Appellant reimbursed Mr. Johnston for any of these amounts.

(B) Tractor:

The Appellant acquired the tractor in August, 2004. According to Mr. Johnston, he used the tractor for corporate/commercial activities but also in his own commercial activities of fishing. As with the new barn, there was no clear demarcation between these activities and there was a failure to provide evidence to substantiate the claim for ITCs. He simply gave examples of what the tractor was used for and summed it up by stating it was employed for "…whatever else needs to be done around the farm". (Transcript, page 72, lines 2-3). I remain unconvinced, based on the evidence, that the tractor was employed "primarily" in the Appellant's commercial activities pursuant to subsection 199(2) and this is in part due to the intermingling that was occurring during this period.

(C) Farm Supplies:

These amounts were incurred in Mr. Johnston's name. There is no documentary evidence that the Appellant owned any horses during this period. In fact, the evidence supports that the horses were not transferred to the Appellant until 2007. Consequently, these are personal expenditures of Mr. Johnston.

(D) Legal Account:

This account is for legal fees incurred by Mr. Johnston and his spouse for the purchase of property in their names. This is clearly a personal expenditure.

(E) Fuel, Utilities, Phone Expenses:

The utilities and phone expenses are personal expenditures, as no evidence was produced to support that the amounts relate solely to the Appellant's activities. In addition, according to the evidence of the auditor, the utility amount related to a property located in New Brunswick. The evidence respecting the fuel expenses was that the Appellant owned a diesel one-ton truck, in addition to the boat, which it used exclusively and that the Johnstons owned gasoline vehicles. The fuel expenses were incurred by Mr. Johnston personally, according to VISA statements, and Mr. Johnston stated that these fuel purchases were all in respect to the diesel vehicle. Invoices were not provided to the auditor and since the Appellant claimed 100 per cent of the fuel expenses for the Appellant's vehicle without maintaining a log, she allowed 50 per cent of the amount claimed as business use. Except for Mr. Johnston's evidence that this vehicle was used solely by the Appellant, I have neither records (including invoices), nor sufficient evidence respecting how this vehicle was used on a daily basis. The onus on the Appellant is that much greater when 100 per cent use, respecting a vehicle, is claimed as business use and, in addition, where intermingling of personal and corporate activities has occurred as in this appeal.

(F) Meals:

The Appellant made no submissions respecting this item and I am therefore not interfering with the Minister's conclusions.

[21] The appeal is allowed, without costs, to permit the Appellant to claim ITCs in respect to the full amount of Invoice Numbers 9726, 9873 and 9829.

Signed at Ottawa, Canada, this 16th day of February 2011.

"Diane Campbell"

Campbell J.

CITATION:	2011 TCC 101
COURT FILE NO.:	2010-2580(GST)I
STYLE OF CAUSE:	LAND AND SEA ENTERPRISES LTD. AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Charlottetown, Prince Edward Island
DATE OF HEARING:	January 13, 2011
REASONS FOR JUDGMENT BY:	The Honourable Justice Diane Campbell
DATE OF JUDGMENT:	February 16, 2011

APPEARANCES:

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Counsel for the Respondent:	Toks C. Omisade

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