Docket: 2011-1174(IT)I

BETWEEN:

DAVID KENT LESTER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 15, 2011, at Toronto, Ontario.

Before: The Honourable Justice Lucie Lamarre

Appearances:

Agent for the Appellant:	John Ayres
Counsel for the Respondent:	Ernesto Caceres

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2003 taxation year is allowed, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

1) The appellant is entitled to deduct half of the gas expenses for his Hamilton residence (50% x $1,439.69 = $720.00);

2) The appellant is entitled, for his 2003 calendar year, to a GST rebate, pursuant to subsection 253(1) of the *Excise Tax Act*, in respect of motor vehicle expenses in the amount of $7,200 as conceded by the respondent and in respect of the gas expenses hereinabove allowed ($720.00).

The appellant is not entitled to any other relief.

There is no award of costs.

Signed at Montreal, Quebec, this 29th day of November 2011.

"Lucie Lamarre"

Lamarre J.

Citation: 2011 TCC 543
Date: 20111129
Docket: 2011-1174(IT)I

BETWEEN:

DAVID KENT LESTER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Lamarre J.

[1] This is an appeal from a reassessment by the Minister of National Revenue (**Minister**) under the *Income Tax Act* (**ITA**) disallowing legal fees, office-in-home expenses and other office expenses that were claimed by the appellant in computing his employment income for the 2003 taxation year. As well, the Minister, in reassessing the appellant, disallowed the goods and services tax rebate (**GST Rebate**) that the appellant had claimed for the 2003 calendar year pursuant to subsection 253(1) of the *Excise Tax Act* (**ETA**), in respect of the legal fees and the motor vehicle expenses claimed. In her Reply to the Notice of Appeal (paragraph 39), the respondent conceded the GST Rebate payable to the appellant in respect of motor vehicle expenses in the amount of $7,200.

[2] In his 2003 tax return, the appellant declared only employment income, except for a GST Rebate from a previous year reported as other income (Exhibit R-5 and the testimony of John Ayres, who was the appellant's accountant and his agent at the hearing).

[3] The appellant and his brother are the majority shareholders of a group of six publishing and marketing corporations in the snowmobile and all-terrain vehicle industries in Canada and the United States. It was determined that one of the six corporations, Rustless Manufacturing Inc. (**Rustless**), would be used as the payroll corporation for all employees of the group. Rustless invoiced all the other corporations for work done by the employees (including the appellant) and paid the employees their salaries. John Ayres explained in court that all employees had a standard salary and that any surplus funds in the corporations were distributed among different employees, depending on the work done by each of them. In the case of the appellant, as he was a majority shareholder, if the corporations did not earn enough revenues in any particular pay period, his salary could be lowered or simply reduced to nil for that period. That is why the appellant considered himself as both a salaried employee and a self-employed person. However, the evidence did not disclose that he was paid otherwise than by salary. He did not receive any commission income, as shown by his tax return (Exhibit R-5) and the T2200 form (Declaration of Conditions of Employment) filed as Exhibit R-4.

Legal fees

[4] The revised legal fees in the amount of $19,556.43 claimed by the appellant include an amount of approximately $470 paid to the accountant to prepare the appellant's tax return (Exhibit B of Exhibit A-1), and the balance was paid to a law firm.

[5] The legal fees were incurred after the appellant and his brother discovered that a third significant shareholder during the 2002 and 2003 taxation years had misused corporate funds. The appellant and his brother filed a lawsuit in the Superior Court of Justice of Ontario against that other shareholder, who in turn filed a counterclaim against them. Those lawsuits eventually led to the breaking up of the business relationship among the three shareholders. The lawsuit was resolved by an offer to purchase and sell signed by the parties in July 2002 and the ultimate final settlement of the legal matters in December 2002. In his notice of appeal, the appellant stated that "the monies spent on the legal fees ensured that [he] would be able to continue to earn his income from Rustless".

[6] According to the Argument for Tax Court filed by the appellant, the legal bills amounted to $68,004.67 and were proportionally split among the appellant, his brother and Rustless. The actual payment of the total amount was made through Rustless' bank account. However, the appellant's portion of the legal fees was treated

as a taxable employment benefit and an amount of $19,177.60 was added to his payroll account and included on his 2003 T4 slip issued by Rustless (Exhibits K, L and M of Exhibit A-1). The appellant included that amount in his employment income but claimed a deduction of the same amount (Exhibit R-5).

[7] For employees, the only deduction that can be claimed with respect to legal fees is that which is specifically permitted by the application of paragraph 8(1)(*b*) and subsection 8(2) of the ITA:

> Deductions
>
> **8(1) Deductions allowed**. In computing a taxpayer's income for a taxation year from an office or employment, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto:
>
> . . .
>
> **(*b*) Legal expenses of employee** — amounts paid by the taxpayer in the year as or on account of legal expenses incurred by the taxpayer to collect or establish a right to salary or wages owed to the taxpayer by the employer or former employer of the taxpayer;
>
> **8(2) General limitation.** Except as permitted by this section, no deductions shall be made in computing a taxpayer's income for a taxation year from an office or employment.

[8] The appellant and his accountant tried to explain in court that the purpose of the litigation for which the legal fees are being claimed was for the appellant and his brother to take control of the publishing companies and thus ensure that the appellant would be able to continue to earn his livelihood through those corporations. The appellant stated that he incurred the legal fees to establish a right to income from those sources in the future. In a letter sent to the Canada Revenue Agency (**CRA**) on September 26, 2007 (Exhibit R-1), John Ayres wrote the following:

> . . . Upon making the decision to split the companies up, Kent and Mark Lester decided to actively pursue having a Letter of Intent drawn up to buy out the other shareholder, ... The legal invoices enclosed in the amount of $39,112.87 are the fees which Kent and Mark Lester incurred in order to facilitate the break up of the companies.

[9] In a subsequent letter sent to the CRA on January 14, 2011 (Exhibit R-2), Mr. Ayres indicated that the upshot of the civil action was that the various

corporations were broken up, resulting in a change of control for those corporations. However, he stated that the civil action was commenced in order for the appellant to secure his interest in the corporations and to ensure that he would be able to continue to generate income from them.

[10] The appellant filed in court the offer to purchase and sell (Exhibit C of Exhibit A-1), the affidavits filed in the Ontario Superior Court of Justice by the accountants of both parties (Exhibits D and E of Exhibit A-1), letters written by counsel of both parties regarding the terms of the resolution of the litigation brought before the Ontario Superior Court of Justice (Exhibits F and G of Exhibit A-1), and the invoices for legal fees from the appellant's lawyer detailing the professional services rendered (Exhibits H, I, and J of Exhibit A-1). All these documents relate to the sale of shares that resulted in the restructuring of the corporations. The statement of claim filed by the appellant in the Ontario Superior Court of Justice was not provided in the course of the hearing of the present appeal. I am not in a position, therefore, to determine what the essential nature of the claim was and, thus, whether the intent of the appellant in filing his lawsuit against the third shareholder was anything other than to buy him out. The fact that the appellant wanted to ensure that he would be able to continue generating income from the corporations he now controls with his brother might have been (and most probably was) something he considered when he launched his lawsuit. However, the reality is that the appellant was invoiced for legal fees incurred for the buying out of another shareholder and for the restructuring of the corporations (which was ultimately admitted by Mr. Ayres in his testimony).

[11] It is difficult to conclude in those circumstances that the legal expenses were incurred to collect or establish a right to salary or wages owed to the appellant by the employer, as required by paragraph 8(1)(*b*) of the ITA.

[12] Rustless, the employer, did not owe the appellant a salary, and the appellant did not commence the lawsuit against his former co-shareholder in order to establish a right to salary owed to him by Rustless.

[13] As Sharlow J.A. of the Federal Court of Appeal said in *Fenwick v. Canada*, [2008] F.C.J. No. 1655 (QL), 2008 FCA 370, paragraph 8(1)(*b*) of the ITA has a relatively narrow scope. She stated at paragraph 7:

> . . . Paragraph 8(1)(b) has a relatively narrow scope. It is intended to apply where an employee incurs legal expenses in attempting to collect unpaid salary or wages, or in attempting to resolve a dispute with an employer or former employer as to the

> amount of salary to which the employee is entitled (see Loo v. Canada, 2004 FCA 249). In the latter case, it is usually the employee alleging an underpayment.

[14] In the present case, the appellant's right to retain his remuneration in his capacity as an employee was not at issue. The appellant brought the lawsuit in his capacity as a shareholder, not as an employee. As was the case in *Fenwick*, the fact that the appellant is wearing two hats (being a controlling shareholder and an employee) does not alter the interpretation to be given to paragraph 8(1)(*b*). As Woods J. said in *Fenwick v. The Queen*, 2008 TCC 243, at paragraph 40, to do so would lead to an inequitable application of the section to taxpayers in similar circumstances. This, in my view, also answers the other argument raised by the appellant here, namely, that he was both self-employed and an employee. In filing his tax return, the appellant reported employment income only, and Rustless issued a T4 slip. As a majority shareholder of the group of corporations, the appellant was aware that he was being treated as an employee, and he accepted that treatment. He cannot after the fact change his mind and claim that he was not really an employee. In *Shell Canada Ltd v. Canada*, [1999] 3 S.C.R. 622, the Supreme Court of Canada stated the following at paragraph 39:

> 39 This Court has repeatedly held that courts must be sensitive to the economic realities of a particular transaction, rather than being bound to what first appears to be its legal form: *Bronfman Trust*, *supra*, at pp. 52-53, *per* Dickson C.J.; *Tennant*, *supra*, at para. 26, *per* Iacobucci J. But there are at least two *caveats* to this rule. First, this Court has never held that the economic realities of a situation can be used to recharacterize a taxpayer's *bona fide* legal relationships. To the contrary, we have held that, absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect: *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298, at para. 21, *per* Bastarache J.

[15] The appellant failed to convince me that his employment status did not represent the bona fide legal relationship that he himself established with Rustless. Therefore, he is not entitled to claim that, because he is a majority shareholder, he is in a position to recharacterize his employee status (giving rise to employment income) as self-employed status (giving rise to business income), in order to be able to deduct his legal expenses against his income (which, however, is an issue I do not have to decide here).

[16] For the same reason, the appellant cannot deduct the expenses that he paid to the accountant for the preparation of his 2003 tax return. That is not a deduction permitted by section 8 of the ITA.

Office-in-home expenses and office expenses

[17] The appellant claimed half of the insurance, property tax, mortgage interest and gas expenses for his residence in Hamilton on the basis that half of the house was used for his work. In his notice of appeal, the appellant stated that the majority of his work was performed from the second floor of his residence. The square footage of his residence is approximately 2500, with 1000 square feet of that space being used for his work. As the corporations' main administrative and editorial offices are located in Minden, Ontario, the appellant decided to maintain a suite of offices in his home in order to perform his duties there rather than burdening the corporations with additional costs for office rent and with related overhead costs. The appellant's home address was even provided to the suppliers of the various corporations for various shipments. As proof that he was working from home, the appellant filed the telephone bills for his residence that were sent to the corporations' headquarters in Minden (Exhibit P of Exhibit A-1). They show a considerable number of long distance calls made in 2003 during business hours, of which quite a few were made to the office in Minden.

[18] The appellant also filed Purolator invoices as evidence that quite a few packages were sent to and from his residence for the corporations (Exhibit Q of Exhibit A-1).

[19] Sales receipts showing work done for one of the corporations on a computer located at the home address of the appellant was also filed (Exhibit R of Exhibit A-1). An invoice sent to the appellant's home address for booth space for one of the corporations at a trade show was filed as Exhibit S of Exhibit A-1.

[20] The four last-mentioned exhibits were filed by the appellant to support his claim that a lot of work-related activities were going on at his home.

[21] The appellant also claimed expenses paid with regard to a property described as Pt. Lot 4, Concession 14, Snowdon Township, in Minden, Ontario, which is another residence that belongs to him. It appears from the postal address that this place is not where the administrative office of the corporations in Minden is located. The expenses claimed are the property taxes as well as hydro, telephone and fuel expenses. Again, 50% of those expenses for the year were claimed.

[22] The expenses claimed by the appellant for the office-in-home at his residence in Hamilton and for the Minden property were disallowed by the Minister on the basis that they were not deductible pursuant to paragraph 8(1)(*i*) of the ITA.

[23] Further, the respondent submitted that during the year at issue the appellant did not use any work space in those two places to principally perform the duties of his employment, nor did he use any work space there during that year exclusively for the purposes of his employment, nor did he use any such space on a regular and continuous basis for meeting customers or other persons in the ordinary course of performing the duties of his employment.

[24] Subparagraphs 8(1)(*i*)(ii) and (iii) and subsection 8(13) of the ITA are reproduced hereunder:

> Deductions
>
> **8(1) Deductions allowed**. In computing a taxpayer's income for a taxation year from an office or employment, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto.
>
> . . .
>
> **(*i*) Dues and other expenses of performing duties** — amounts paid by the taxpayer in the year as
>
> . . .
>
> (ii) office rent, or salary to an assistant or substitute, the payment of which by the officer or employee was required by the contract of employment,
>
> (iii) the cost of supplies that were consumed directly in the performance of the duties of the office or employment and that the officer or employee was required by the contract of employment to supply and pay for,
>
> . . .
>
> to the extent that the taxpayer has not been reimbursed, and is not entitled to be reimbursed in respect thereof;
>
> **8(13) Work space in home**. Notwithstanding paragraphs 8(1)(*f*) and 8(1)(*i*),
>
> (*a*) no amount is deductible in computing an individual's income for a taxation year from an office or employment in respect of any part (in this subsection

> referred to as the "work space") of a self-contained domestic establishment in which the individual resides, except to the extent that the work space is either
>
> (i) the place where the individual principally performs the duties of the office or employment, or
>
> (ii) used exclusively during the period in respect of which the amount relates for the purpose of earning income from the office or employment and used on a regular and continuous basis for meeting customers or other persons in the ordinary course of performing the duties of the office or employment;
>
> (*b*) where the conditions set out in subparagraph 8(13)(*a*)(i) or 8(13)(*a*)(ii) are met, the amount in respect of the work space that is deductible in computing the individual's income for the year from the office or employment shall not exceed the individual's income for the year from the office or employment, computed without reference to any deduction in respect of the work space; and
>
> (*c*) any amount in respect of a work space that was, solely because of paragraph 8(13)(*b*), not deductible in computing the individual's income for the immediately preceding taxation year from the office or employment shall be deemed to be an amount in respect of a work space that is otherwise deductible in computing the individual's income for the year from that office or employment and that, subject to paragraph 8(13)(*b*), may be deducted in computing the individual's income for the year from the office or employment.

[25] There does not seem to be any dispute regarding the fact that the appellant was required by his contract of employment to incur the office-in-home expenses without being reimbursed for them (see Form T2200, Exhibit R-4). However, the respondent relied on *Horbay v. Canada*, [2002] T.C.J. No 684 (QL), *Thompson v. M.N.R.*, [1989] F.C.J. No 808 (QL) (FCTD), and *Felton v. M.N.R.*, 89 DTC 233, to argue that interest on money borrowed, insurance premiums and property taxes cannot be considered as being the equivalent of, or as being, in the nature of, office rent under subparagraph 8(1)(*i*)(ii) of the ITA.

[26] I agree with the respondent that office rent cannot be extended to include property taxes, mortgage interest and insurance. Subparagraph 8(1)(*i*)(ii) permits a deduction for office rent. There is no ambiguity in the way that provision is drafted. In *Placer Dome Canada Ltd v. Ontario (Minister of Finance)*, [2006] 1 S.C.R. 715, 2006 SCC 20, the Supreme Court of Canada stated the following at paragraphs 23 and 24:

> 23 The interpretive approach is thus informed by the level of precision and clarity with which a taxing provision is drafted. Where such a provision admits of no ambiguity in its meaning or in its application to the facts, it must simply be applied. Reference to the purpose of the provision "cannot be used to create an unexpressed exception to clear language": see P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (5th ed. 2005), at p. 569*; Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622. Where, as in this case, the provision admits of more than one reasonable interpretation, greater emphasis must be placed on the context, scheme and purpose of the Act. Thus, legislative purpose may not be used to supplant clear statutory language, but to arrive at the most plausible interpretation of an ambiguous statutory provision.
>
> 24 Although there is a residual presumption in favour of the taxpayer, it is residual only and applies in the exceptional case where application of the ordinary principles of interpretation does not resolve the issue: *Notre-Dame de Bon-Secours*, at p. 19. Any doubt about the meaning of a taxation statute must be reasonable, and no recourse to the presumption lies unless the usual rules of interpretation have been applied, to no avail, in an attempt to discern the meaning of the provision at issue. In my view, the residual presumption does not assist PDC in the present case because the ambiguity in the *Mining Tax Act* can be resolved through the application of the ordinary principles of statutory interpretation. . . .

[27] Subparagraph 8(1)(*i*)(ii) of the ITA contains no ambiguity in its meaning. A deduction for office rent does not contemplate interest, property tax and insurance expenses. This has already been decided by this Court, as can be seen from the following passage in *Horbay*, *supra*, at paragraph 7:

> 7 The Court accepts the interpretation adopted by McNair, J. of the Federal Court in The Queen v. Thompson, 89 D.T.C. 5439 in which the appeal was on an identical basis. McNair, J. referred to the judgment of Rip, T.C.J. in Felton v. M.N.R., 89 D.T.C. 233 (T.C.C.) and stated at pages 5443 and 5444:
>
> > The strict ratio of the case is contained in the following passage from the judgment of Rip T.C.J. at pp. 234-35:
> >
> > > The words "rent" and "loyer" in subparagraph 8(1)(i)(ii) contemplate a payment by a lessee or tenant to a lessor or landlord who owns the office property in return for the exclusive possession of the office, the property leased by the latter to the former.
> > >
> > > The payments by Mr. Felton to a money-lender of interest on money borrowed, to a utility supplier for the utility, to maintenance personnel for maintenance, to an insurer for insurance and to a municipality in respect of taxes are not payments of rent by a lessee

> to a lessor. None of these payments by Mr. Felton was for the use or occupancy or possession of property owned by another person.

Obviously, the judges of the Tax Court in both Philips and Felton applied the plain meaning rule of statutory interpretation in determining that the home office expenses of an employee were not deductible as office rent under s. 8(1)(i)(ii), notwithstanding the illogical unfairness of the section in permitting the selfsame deduction in the case of business or professional persons.

This modern rule for the interpretation of taxing statutes was admirably expounded by Estey J. in Stubart Invetments [*sic*] Ltd. v. The Queen, [1984] 1 S.C.R. 536, 84 D.T.C. 6305. The learned judge recalled the strict rule of statutory interpretation invoked for many years, whereby any ambiguities in the charging provisions of a tax statute were to be resolved in favour of the taxpayer. He pointed out that the converse was true where a taxpayer sought to rely on a specific exemption or deduction provided in the statute. In that case, the strict rule required that the taxpayer's claim fall clearly within the exempting provisions, and any doubt in that regard had to be resolved in favour of the Crown. Indeed, he perceived the introduction of exemptions and allowances as marking "the beginning of the end of the reign of the strict rule". The learned judge stated the following conclusion in the S.C.R. report of the case at p. 578 (see D.T.C. at p. 6323):

> Professor Willis, in his article, supra, accurately forecast the demise of the strict interpretation rule for the construction of taxing status [*sic*]. Gradually, the role of the tax statute in the community changed, as we have seen, and the application of strict construction to it receded. Courts today apply to this statute the plain meaning rule, but in a substantive sense so that if a taxpayer is within the spirit of the charge, he may be held liable. See Whiteman and Wheatcroft, supra, at p. 37.
>
> While not directing his observations exclusively to taxing statutes, the learned author of Construction of Statutes (2nd ed. 1983), at p. 87, E.A. [Driedger], put the modern rule succinctly:
>
> > "Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament."

...

> The question remains: Are the amounts claimed for home office expenses in the 1980 and 1981 taxation years deductible as "office rent" under s. 8(1)(i)(ii) of the Income Tax Act? In my view, the plain meaning of the words of the statutory provision read in context with the scheme of the Act as a whole precludes any possibility of an affirmative answer to the question. This was the approach adopted by the judges of the Tax Court of Canada in Phillips and Felton, with which I fully concur. In the result, I find that the Minister was correct in his reassessments of the defendant's income for the 1980 and 1981 taxation years, save only for the amounts claimed for utilities, heating and hydro in 1980.

[28] However, hydro and fuel costs can be deducted as office-in-home expenses pursuant to subparagraph 8(1)(*i*)(iii). That this is so has been accepted in *Thompson*, *supra*, and in Interpretation Bulletin IT-352R2 at paragraph 5. Counsel for the respondent does not dispute such deductions as long as subsection 8(13) does not apply.

[29] With respect to the Hamilton residential property, I am satisfied on the evidence before me that it can be said that the appellant principally performed the duties of his employment there in 2003, so that subsection 8(13) does not preclude the deduction of the gas expenses. However, no evidence was provided by the appellant with respect to the Minden property and the Minister's assumptions of fact shall stand with regard to that property. I therefore allow the appeal on the following basis:

1) The appellant is entitled to deduct half of the gas expenses for his Hamilton residence (50% x $1,439.69 = $720.00).

2) The appellant is entitled, for his 2003 calendar year, to a GST rebate, pursuant to subsection 253(1) of the ETA, in respect of motor vehicle expenses in the amount of $7,200, as conceded by the respondent, and in respect of the gas expenses hereinabove allowed ($720.00).

[30] The appellant is not entitled to any other relief.

[31] There is no award of costs.

Signed at Montreal, Quebec, this 29th day of November 2011.

“Lucie Lamarre”

Lamarre J.

CITATION:	2011 TCC 543
COURT FILE NO.:	2011-1174(IT)I
STYLE OF CAUSE:	DAVID KENT LESTER v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	November 15, 2011
REASONS FOR JUDGMENT BY:	The Honourable Justice Lucie Lamarre
DATE OF JUDGMENT:	November 29, 2011

APPEARANCES:

Agent for the Appellant:	John Ayres
Counsel for the Respondent:	Ernesto Caceres

COUNSEL OF RECORD:

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Name:	
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