

Docket: 2019-1671(IT)I

BETWEEN:

PAUL HÉBERT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on October 31, 2019, at Montréal, Quebec.

Before: The Honourable Justice Dominique Lafleur

Appearances:

For the appellant:	The appellant himself
Counsel for the respondent:	Julien Dubé-Sénécal

JUDGMENT

The appeal from the reassessments made pursuant to the *Income Tax Act* for the 2014, 2015 and 2016 taxation years is allowed, without costs, and the reassessments are referred back to the Minister of National Revenue (the Minister) for reconsideration and reassessment, taking the following into account:

- i) In computing his business income for the 2014 taxation year, the appellant is entitled to an additional \$1,271 deduction for garden maintenance expenses;
- ii) Given the concessions made by the Minister at the beginning of the hearing, in computing his business income for the 2015 taxation year, the appellant is entitled to an additional \$5,616 deduction for office expenses;

- iii) For the 2016 taxation year, an amount of \$11,123.57 rather than \$14,331 must be added in computing the appellant's net business income.

Signed at Ottawa, Canada, this 27th day of November 2019.

“Dominique Lafleur”

Lafleur J.

Citation: 2019 TCC 266

Date: 20191127

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BETWEEN:

PAUL HÉBERT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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REASONS FOR JUDGMENT

Lafleur J.

[1] Paul Hébert is appealing the reassessments made by the Minister of National Revenue (the Minister) pursuant to the *Income Tax Act* (the Act) for the 2014, 2015 and 2016 taxation years.

[2] In computing his business income for the 2014 and 2015 taxation years, Mr. Hébert deducted certain expenses, but the Minister disallowed the deductions. At the beginning of the hearing, the Minister conceded that the office expenses of \$5,616, the deduction of which was disallowed in computing business income for the 2015 taxation year, were deductible in computing Mr. Hébert's business income. Thus, this concession by the Minister puts an end to the debate for the 2015 taxation year.

[3] With respect to the 2016 taxation year, the Minister added an amount of \$14,331 in computing Mr. Hébert's net business income. This is the amount he received, net of legal fees and legal expenses, as a result of the recovery of a debt owed to him by Robert Hardy Inc. ("Hardy"), which was previously considered a bad debt and had been deducted as such in computing Mr. Hébert's business income for the 2014 taxation year.

[4] Therefore, only the issues relating to the reassessments made for the 2014 and 2016 taxation years remain in dispute before the Court, namely:

- a) Is Mr. Hébert entitled to deduct a total of \$8,516 as business-use-of home expenses, which he said he incurred for the purpose of gaining or producing income from a business during the 2014 taxation year?
- b) Does Mr. Hébert have to include in his business income for the 2016 taxation year an amount of \$14,331 that he received as a result of the settlement with Hardy?

[5] Mr. Hébert and Mr. Tremblay, an auditor at the Canada Revenue Agency (the CRA), testified at the hearing.

[6] Unless otherwise indicated, any statutory provision referred to in these reasons is a provision of the Act.

I. FACTS

[7] Mr. Hébert has been a member of the Ordre des ingénieurs du Québec since 1969 and the Institut de médiation et d'arbitrage du Québec since 1994. Mr. Hébert worked for many years as a civil engineer in his own company. After selling the company, in 2011 he launched his consulting business, through which he personally provided civil engineering expertise and support services.

[8] Also, Mr. Hébert is an instructor at the École de technologie supérieure. He teaches one day a week during the fall session and two days a week during the winter session.

2014 taxation year

[9] For the 2014 taxation year, Mr. Hébert reported business income of \$150,528 and deducted expenses totalling \$113,330, for a net business income of \$37,198. The dispute concerns the deduction of business-use-of home expenses totalling \$8,516.

[10] Mr. Hébert uses the basement of his personal residence for business purposes. The parties agreed that 35.83% of the residence was used for business purposes.

[11] Mr. Hébert deducted, as business expenses, amounts totalling \$1,271 paid for garden maintenance, planting annual flowers and for Christmas decorations (the “garden expenses”); amounts totalling \$1,401 paid for pool maintenance, including opening and closing the pool as well as pool repairs (“pool expenses”); and amounts totalling \$5,844 paid for removing the fireplace from the living room of the residence and for finishing work after the fireplace was removed (the “fireplace expenses”). These expenses represent 35.83% of the total expenses incurred by Mr. Hébert in this regard.

[12] Garden expenses were paid to Art & Jardins, which has been providing Mr. Hébert with maintenance services for 11 years.

[13] According to Mr. Hébert, he sometimes held arbitration sessions by his pool, located at the back of the residence. Mr. Hébert testified that neither he nor his wife really used the pool, which was used more by his clients. He further testified that he also incurred pool maintenance expenses before he started his business.

[14] Mr. Hébert also introduced photos of his residence into evidence. According to Mr. Hébert, he and his wife did not really use the living room, because there was no television set in that room. After the fireplace was demolished, a second couch was installed in the living room, which was used to hold arbitration meetings in his lovely residence overlooking the river. He testified that the living room could be used once every two months or so to hold such meetings. This allowed him to avoid the cost of holding these meetings at Club Saint-James. Similarly, the demolition allowed him to comply with city bylaws, which prohibited the use of wood burning fireplaces.

2016 taxation year

[15] Mr. Hébert testified that Hardy, a masonry company, was hired to repair the facade of a building located in Montréal. When the contractor came to the site to perform the work, he noticed that the facade had become detached from the building and that the foundation had to be strengthened before the facade was repaired. He therefore retained Mr. Hébert’s engineering services to determine the work to be performed. However, the owner of the building refused to pay the costs incurred by Hardy. Subsequently, Mr. Hébert was also hired as an expert in the lawsuit that Hardy brought against the owner of the building. Mr. Hébert testified that he had not invoiced all the fees he should have, given the huge losses suffered by the contractor in connection with this project.

[16] The copy of Mr. Hébert's 2014 business ledger, which was produced in evidence, showed that the accounts receivable from Hardy totalled \$24,612.10. Mr. Hébert had to file a motion to institute proceedings to recover the fees owed by the contractor. By way of settlement, and in accordance with the Settlement agreement between Mr. Hébert and Hardy, the debt was paid in full by Hardy. However, the law firm retained by Mr. Hébert to represent him in this case invoiced him for \$10,282.43 in legal fees and legal expenses. As a result, Mr. Hébert received a net amount of \$14,329.67.

[17] The auditor stated that the reassessment for 2016 had been made based on the contents of a letter that Mr. Hébert's accountant had sent to the CRA. In fact, Mr. Hébert's accountant had requested that an amount of \$14,331 be added in computing Mr. Hébert's net business income for 2016 because the Minister had granted a deduction for bad debt for the 2014 taxation year in respect of this debt.

II. THE ACT

[18] For the 2014 taxation year, the relevant provisions of the Act are subsection 9(1), paragraphs 18(1)(a) and (h), as well as subsection 248(1):

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.

General limitations — 18(1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of

General limitation — (a) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property;

...

Personal and living expenses — personal or living expenses of the taxpayer, other than travel expenses incurred by the taxpayer while away from home in the course of carrying on the taxpayer's business;

...

248(1)

personal or living expenses includes

- (a) the expenses of properties maintained by any person for the use or benefit of the taxpayer or any person connected with the taxpayer by blood relationship, marriage or common-law partnership or adoption, and not maintained in connection with a business carried on for profit or with a reasonable expectation of profit,
- (b) the expenses, premiums or other costs of a policy of insurance, annuity contract or other like contract if the proceeds of the policy or contract are payable to or for the benefit of the taxpayer or a person connected with the taxpayer by blood relationship, marriage or common-law partnership or adoption, and
- (c) expenses of properties maintained by an estate or trust for the benefit of the taxpayer as one of the beneficiaries;

[19] For the 2016 taxation year, the relevant provisions of the Act are paragraphs 12(1)(i) and 20(1)(p):

12(1) There shall be included in computing the income of a taxpayer for a taxation year as income from a business or property such of the following amounts as are applicable

...

Bad debts recovered

(i) any amount, other than an amount referred to in paragraph 12(1)(i.1), received in the year on account of a debt or a loan or lending asset in respect of which a deduction for bad debts or uncollectable loans or lending assets was made in computing the taxpayer's income for a preceding taxation year;

20(1) Notwithstanding paragraphs 18(1)(a), 18(1)(b) and 18(1)(h), in computing a taxpayer's income for a taxation year from a business or property, 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

...

Bad debts

(p) the total of

(i) all debts owing to the taxpayer that are established by the taxpayer to have become bad debts in the year and that have been included in computing the taxpayer's income for the year or a preceding taxation year, and,

(ii) . . .

III. ANALYSIS

2014 taxation year

[20] Subsection 9(1) stipulates that 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. The term "profit" is not defined in the Act. Under subsection 9(1), the taxpayer can deduct expenses incurred to make this profit, subject to the limitations set out in the Act. Paragraph 18(1)(a) sets out a general limitation applicable to deductible expenses. Pursuant to paragraph 18(1)(a), in computing income from a business, a taxpayer can only deduct an expense if it was made or incurred for the purpose of gaining or producing income from the business. Also, paragraph 18(1)(h) stipulates that personal or living expenses cannot be deducted in computing the income from the business.

[21] According to the respondent, garden, pool and fireplace expenses are "personal or living expenses" incurred by Mr. Hébert which, pursuant to paragraph 18(1)(h), are not deductible in computing his business income. The question of whether the amount of the expenses is reasonable is not at issue.

[22] According to Mr. Hébert, all of these expenses are deductible in computing his business income. The garden and pool expenses allowed him to continue to pursue his professional activities. Otherwise, he would have been obliged to do the work himself. Mr. Hébert testified that his residence had to be impeccable because he received clients there. He also said clients used the pool and that he had held arbitration sessions by the pool. Finally, he testified that the fireplace was removed to provide enough space to hold arbitration sessions in the living room of the residence and to bring the house into compliance with city bylaws.

[23] For the following reasons, the garden expenses are deductible in computing Mr. Hébert's business income because Mr. Hébert incurred these expenses for the purpose of gaining or producing income from his business. However, the pool and fireplace expenses are not deductible in computing Mr. Hébert's business income

because Mr. Hébert did not incur these expenses for the purpose of gaining or producing income from his business, and they were personal expenses.

[24] The principle used to determine the deductibility of an expense comprising both personal and business elements was reviewed by the Supreme Court of Canada in *Symes v. Canada*, [1993] 4 SCR 695. In that case, the issue was whether child care expenses incurred by a lawyer could be deducted in computing the income from her profession.

[25] Iacobucci J., for the majority, held that, even though child care expenses have traditionally been considered personal expenses and therefore not deductible, it was also necessary to consider the issue of whether these expenses were, nevertheless, deductible under the exception in paragraph 18(1)(a).

[26] In other words, if a taxpayer incurs an expense for the purpose of gaining or producing income from a business, the deduction will not be prohibited under paragraph 18(1)(h) even if the expense is personal.

[27] Iacobucci J. made the following observations at pages 735 and 736:

. . . these concepts ask: Does the expense satisfy a need of the business or a need of the taxpayer? . . . there are a great many expenses which are never alleged to be “personal expenses” at all. With respect to these, the approach is ordinarily much more objective, and the analysis is generally confined to s. 9 of the *Act*. It is only when an expense is alleged to be a “personal expense” that one must go further and ask what is meant by the concept of “business need”.

Upon reflection, therefore, no test has been proposed which improves upon or which substantially modifies a test derived directly from the language of s. 18(1)(a). The analytical trail leads back to its source, and I simply ask the following: did the appellant incur child care expenses for the purpose of gaining or producing income from a business?

[28] We must therefore analyze the purpose for which the expense was incurred. Iacobucci J. also set out a number of factors to be considered in deciding whether an expense is deductible in computing business income, namely:

- i) Is the expense normally incurred by others involved in the taxpayer’s business?
- ii) Is the deduction ordinarily allowed as a business expense by accountants?

- iii) Would the expense have been incurred if the taxpayer was not engaged in the pursuit of business income?

[29] Based on these principles, I find that the garden expenses are deductible in computing Mr. Hébert's business income. Although they comprise a personal element, the garden expenses were intended to ensure that the residence, part of which was used for business purposes (35.83%), was in perfect condition to receive Mr. Hébert's business clients. Therefore, Mr. Hébert incurred these expenses for the purpose of gaining or producing income from a business. These were maintenance expenses that are usually incurred by a person involved in Mr. Hébert's line of business.

[30] According to the respondent, because the evidence showed that very few clients went to Mr. Hébert's residence, there is no reason to allow the deduction of these expenses. I cannot accept that argument. The evidence showed that Mr. Hébert did indeed receive clients at his residence. Furthermore, the respondent does not question the fact that 35.83% of the residence was used for business purposes. The garden expenses for which Mr. Hébert claimed the deduction actually represent 35.83% of the total garden expenses that he incurred during the 2014 taxation year.

[31] The respondent also argues that Mr. Hébert would have incurred such garden maintenance costs even if he did not operate a business. As a result, these expenses cannot be deducted in computing the business income. However, having found that Mr. Hébert incurred the expenses for the purpose of gaining or producing income from a business and that these expenses are standard maintenance expenses, I do not accept this argument.

[32] The pool and fireplace expenses cannot be deducted in computing Mr. Hébert's business income.

[33] First, with regard to the pool expenses, Mr. Hébert's testimony did not persuade me that his clients used the pool. Mr. Hébert indicated that he had already held arbitration sessions by the pool. However, Mr. Hébert's testimony in this regard is somewhat vague. In addition, the fact that Mr. Hébert and his wife did not use the pool is not relevant in ruling on the deductibility of these expenses.

[34] Based on some of the criteria described above, the pool expenses are not deductible in computing the income from the business operated by Mr. Hébert. A taxpayer operating the same type of business will not usually incur this type of

expense. A pool is not commonly used in operating an engineering services business. The evidence also showed that these expenses would have been incurred even if Mr. Hébert did not intend to gain or produce income from a business. The pool expenses are therefore not deductible in computing the income from Mr. Hébert's business, pursuant to paragraph 18(1)(a). These expenses are also personal expenses, which cannot be deducted pursuant to paragraph 18(1)(h).

[35] Regarding the fireplace expenses, Mr. Hébert's testimony did not persuade me that he used the living room in the course of operating his business. Mr. Hébert said he had already conducted arbitration sessions in the living room, and that he had removed the fireplace to provide room for a second couch in order to hold arbitration sessions. However, Mr. Hébert said he did not contest that he used 35.83% of his residence for business purposes. The evidence showed that there was a room for receiving clients in the basement, which was part of the area of the residence used for business purposes. Tab 6 of Exhibit I-1 provided a response to the auditor's request to describe the rooms in the residence that are used to operate the business. In it, Mr. Hébert indicated that the whole basement, which measured 688 square feet and had its own entrance, was used for business purposes. It contains a 187-square foot office, a 377-square foot meeting room, a 48-square foot bathroom, and a 56-square foot storage room. The residence has a total area of 1,941 square feet.

[36] Based on the principles set out in *Symes*, I see no connection between the purpose of the fireplace expenses and the operation of Mr. Hébert's business. In this regard, Mr. Hébert's testimony was vague: he simply said he had already held arbitration sessions in his living room. Mr. Hébert would have incurred the fireplace expenses even if he did not operate a business; and these would not normally have been incurred by someone operating the same type of business. Mr. Hébert also testified that removing the fireplace enabled him to comply with city bylaws prohibiting the use of wood burning fireplaces. However, this is not related to Mr. Hébert's business.

[37] The fireplace expenses are therefore not deductible in computing the income from Mr. Hébert's business, pursuant to paragraph 18(1)(a). These expenses are also personal expenses, which cannot be deducted pursuant to paragraph 18(1)(h).

2016 taxation year

[38] According to Mr. Hébert, no amount should be added in computing his income following receipt of the amount of \$24,612.10 from Hardy as part of the

settlement of the unpaid bill. First, his counsel confirmed that the amount received from Hardy in the settlement was not taxable because it was provided to compensate for the losses suffered by Mr. Hébert in connection with his contract with Hardy. In addition, according to Mr. Hébert, this amount should receive the same treatment as lottery winnings and should therefore not be taxable. Mr. Hébert also said the engineers' code of ethics prevented him from terminating his contract with Hardy.

[39] Mr. Hébert's arguments cannot be accepted for the following reasons.

[40] The amounts that Hardy paid Mr. Hébert under the Settlement agreement amounted to \$24,612.10 and represent the fees that Hardy owed Mr. Hébert. This \$24,612.10 amount is also equal to the amount of the accounts receivable indicated in the 2014 corporate ledger. This amount cannot be considered non-taxable lottery winnings. Similarly, it cannot be considered compensation for the losses suffered by Mr. Hébert as a result of the professional contract that he performed for Hardy.

[41] Paragraph 12(1)(i) expressly stipulates that the amount to be included in computing the income of a taxpayer for a taxation year as income from a business is the amount received during the year “. . . on account of a debt . . . in respect of which a deduction for bad debts . . . was made . . .”

[42] Pursuant to paragraph 12(1)(i), the Minister considered that the total amount of Hardy's debt, which had been deducted as bad debt, was \$25,905. Also, the Minister probably considered that the legal fees and legal expenses paid by Mr. Hébert in connection with the unpaid bill represented deductible expenses in computing Mr. Hébert's business income for the 2016 taxation year. The Minister therefore added the amount of \$14,331 to Mr. Hébert's net business income, which is approximately the difference between the amount of \$24,612.10 received by Mr. Hébert and the \$10,282.43 of legal fees and legal expenses that he incurred in connection with the unpaid bill. The issue of the deductibility of the legal fees and legal expenses is not in dispute, the Minister having in fact granted such a deduction by assessing Mr. Hébert for the 2016 taxation year.

[43] However, as noted above, the evidence showed that Hardy's debt, which was deducted as a bad debt pursuant to paragraph 20(1)(p), was limited to an amount of \$21,406 (Exhibit I-1, Tab 5). The other debts that were eligible for a deduction for bad debt in computing Mr. Hébert's business income for the 2014 taxation year are the receivables from S. Tremblay (\$2,574) and PL Legris Maçonnerie (\$1,925).

[44] The document entitled Settlement agreement explicitly mentions the amount that Hardy owed Mr. Hébert, which totals \$24,612.10. Thus, the amounts recovered by Mr. Hébert during 2016 only involve the receivables from Hardy for unpaid fees. They do not involve the receivables from S. Tremblay or PL Legris Maçonnerie.

[45] Pursuant to paragraph 12(1)(i), only amounts received in respect of which a deduction for bad debts was made are to be included in computing business income in the year such amounts were received. In this case, because the amount granted for 2014 as a deduction for bad debt in respect of Hardy's debt amounted to \$21,406, and not \$ 24,612.10, the amount to be included in computing Mr. Hébert's business income in 2016, pursuant to paragraph 12(1)(i), cannot exceed this \$21,406 amount.

[46] As indicated above, the Minister does not dispute the deductibility of the legal fees and legal expenses totalling \$10,282.43 incurred by Mr. Hébert in connection with the unpaid bill. As a result, the amount that must be added to Mr. Hébert's net business income is the difference between \$21,406 (amount to be included in computing business income pursuant to paragraph 12(1)(i)) and \$10,282.43 (amount deductible in computing business income in accordance with the general rules for computing profit under section 9 and section 18), i.e. \$11,123.57.

IV. CONCLUSION

[47] For all these reasons, the appeal from the reassessments made pursuant to the *Income Tax Act* for the 2014, 2015 and 2016 taxation years is allowed, without costs, and the reassessments are referred back to the Minister for reconsideration and reassessment, taking the following into account:

- i) In computing his business income for the 2014 taxation year, the appellant is entitled to an additional \$1,271 deduction for garden maintenance expenses;
- ii) Given the concessions made by the Minister at the beginning of the hearing, in computing his business income for the 2015 taxation year, the appellant is entitled to an additional \$5,616 deduction for office expenses;
- iii) For the 2016 taxation year, an amount of \$11,123.57 rather than \$14,331 must be added in computing the appellant's net business income.

Signed at Ottawa, Canada, this 27th day of November 2019.

“Dominique Lafleur”

Lafleur J.

CITATION: 2019 TCC 266

COURT FILE NO.: 2019-1671(IT)I

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DATE OF HEARING: October 31, 2019

REASONS FOR JUDGMENT BY: The Honourable Justice Dominique Lafleur

DATE OF JUDGMENT: November 27, 2019

APPEARANCES:

For the appellant: The appellant himself
Counsel for the respondent: Julien Dubé-Sénécal

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