Docket: 2003-4236(IT)I

BETWEEN:

NANCY MCNEIL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on August 16, 2004 and January 24, 2005
at Vancouver, British Columbia

Before: The Honourable Justice J.E. Hershfield

Appearances:

Agent for the Appellant:	James Duncan McNeil
Counsel for the Respondent:	Raj Grewal

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1997 and 1999 taxation years are allowed, without costs, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to claim expenses in the amount of $75.00 for the 1997 taxation year and $6,438.13 for the 1999 taxation year in accordance with and for the reasons set out in the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 10th day of February 2005.

"J.E. Hershfield"

Hershfield J.

Citation: 2005TCC124
20050210
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BETWEEN:

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Appellant,

And

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REASONS FOR JUDGMENT

(Edited from Reasons for Judgment delivered orally from the Bench on January 25, 2005 in Vancouver British Columbia.)

Hershfield J.

[1] The Appellant appeals her 1997 and 1999 taxation years. At a break in the hearing of the appeals the Appellant agreed that she did not wish to proceed with her appeal for 1997 subject to the allowance of an expense for $75.00 as carrying costs in respect of investments. The Respondent being satisfied as to the incurrence of the expense, based on evidence produced, agreed to the allowance. Accordingly the appeal in respect of the Appellant's 1997 taxation year is allowed to that extent and on that basis.[1]

[2] A similar concession was made for the 1999 taxation year in the amount of $6,438.13 which leaves one issue before me for that year. That issue is whether the Appellant is conducting a business in respect of which she is entitled to deduct further expenses as claimed. The Respondent's position is that there is no business and that the expenses in dispute are personal expenses.

[1] A similar concession by the Respondent is documented in respect of the 1998 year in Exhibit R-6 allowing like expenses of $4,592.41. However the 1998 year is not before me, so I make no judgment in respect of it.

[3] The activity in question is the Appellant's investment activity managed by her husband and in 1999 participated in by family members, namely her 12-year old twins and her husband's parents. The Appellant, her mother-in-law and her husband appeared as witnesses as did the CRA auditor. I accept that the non-personal and non-spousal contributions to the investment pool that constituted the activity were in the amount of some $16,600.00 in 1999 and that there was a trust-based, loose arrangement whereby the Appellant was to receive 20% of the profits earned by the family investors. I also accept, as loose as the pooling arrangement was, that the contributions to it increased in 2000 as did the number of family members participating in it.

[4] The pooling arrangement is not documented. Indeed the evidence is clear that the parties to it did not have the benefit of any fixed parameters as to how profits would be determined. For example, in 1999 the Appellant reported gains on the sale of mutual fund units and common stock in publicly traded companies in the order of $18,000.00. Same was reported together with some $2,000.00 of dividend and interest income as business income although it seems that reported investment gains were reduced to their *taxable* capital gain amount before being included as business income.[2] Expenses were then claimed against this income creating a loss of some $8,000.00 so the family members paid no fees and shared no profits. Such expenses included management and administration fees ($1,329.00), meals and entertainment ($438.00), office expenses for a home office ($1,479.00), supplies ($1,905.00), motor vehicles expenses ($1,823.00), travel ($1,478.00) and advertising expenses ($459.00). No rational business basis for the incurrence of these expenses was described so as to distinguish personal expenditures from expenditures related to the subject activity. Advertising expenses, for example, were said to have been incurred in relation to their children's archery and speed-skating clubs on the basis that speed and accuracy were promotable hallmarks of the activity in which the Appellant was engaged. Not to recognize the personal benefit derived from such expenditures without establishing any reasonable connection to an income source, shatters any confidence I might otherwise have in the judgment and credibility of the Appellant and her husband in terms of their having established, in claiming expenses, the required connection between the expenditure and an income source. In this regard the Respondent's assumptions that the expenses were personal have not been

[2] Indeed Schedule 'B' to the Reply indicates that the business income reported included revenues of $17,526.00 on account of "capital gains – taxable". The Appellant appears to want both capital gains treatment and business income treatment.

disproved. That is, aside from the question of whether there is a business in this case, the Appellant has not satisfied her burden of proof that the expenses claimed are sufficiently connected to an income earning endeavour so as to meet the test that they be incurred for the purposes of earning income.

[5] Even if the family members trusted this loose arrangement of calculating profits in a year, loose connections between expenses and an income source are not sufficient for income tax purposes and the taxpayer's simple assertions that they are, is not sufficient. Also, the method of accounting for expenses seems to leave something to be desired. No books and records for the activity were produced at the hearing. Rather, I was led to believe that somewhat arbitrary apportionments were made for expenditures such as management and administration. This is neither good evidence of a business structure nor of expenses properly attributed to a source of income. When expenses by their nature overlap with personal expenses, exacting records are required as to their incurrence in relation to the activity and there must be a reasonable connection between the specific expenditure and the income earning process. The burden to establish this is on the Appellant and this burden has not been satisfied in this case.

[6] In addition to my finding that the expenses in question have not been proved to be sufficiently connected to a source to permit a deduction even if there is a business here, I note that there has been an election under subsection 39(4) of the *Income Tax Act* to treat gains or losses from the disposition of Canadian securities as capital. Virtually the entire pool of investments and virtually all transactions that have taken place in the subject year as part of the subject investment activity involve Canadian securities so that gains and losses from the disposition of such property are thereby precluded from inventory treatment.[3] That is, the Appellant, having calculated the gains and losses on the disposition of the Canadian securities as capital gains and losses, is not entitled then to treat the activity as a business since businesses buy and sell inventory, not capital assets. That is, the election precludes business treatment. If the Appellant wants business or inventory treatment, she would have to establish that subsection 39(4) does not apply, which would require that she establish that she is a trader or dealer in securities as provided in subsection 39(5) of the *Act*. Even if I find that the Appellant's activities constitute a business in this case, that does not necessarily constitute her as a trader or dealer in securities as would be required for the Appellant to escape the consequences of her election under section 39 of the *Act*. Exhibit R-5 showing

[3] There was one minor trade in options.

dispositions of securities for 1998 and 1999 shows less than 100 transactions. A trader might have that number of trades in a month, week or day.

[7] While the foregoing reasons are sufficient to dismiss the appeals in respect of issues not dealt with in paragraphs 1 and 2 above, I will go on to consider whether there is a business here in respect of which legitimate business expenses might have been claimed.

[8] As to whether there is a business, I find that no business exists. There are two elements here to be considered: the activity carried on for the Appellant and the activity carried on for others. The "others" here are family members. Investing for minor children and parents cannot expand what is not a business into a business simply by their involvement, particularly in circumstances such as these where the relationship is so loosely defined. As well, I note that the investment pool in which the family members were included used leverage investment strategies in respect of which there was no purported share of liability by family members. This is not a commercial arrangement. This is the case of one family member, namely the Appellant's husband, who is the individual who manages the family's investments, endeavouring to take a more active and educated role in the management of family monies. But his activities on behalf of the Appellant and her so-called investors fall short of constituting such activity a business. Managing one's family's personal investments is a personal endeavour. All who are fortunate enough to have savings have to partake in investment activities. The degree, nature and organization of the activity can constitute it as a business but this is not the norm.

[9] The cases cited by the Appellant are of no assistance to her. I have reviewed *Hayes*[4], *Shultz,*[5] *Epel*[6] and the two *Stewart*[7] cases referred to me by the Appellant and while there may be some elements of a business here as recognized in these cases, they are not sufficient to change the nature of the "source" here as primarily realized capital gains from the disposition of capital assets. In this regard there is confusion as to the meaning of the word "source". Some reliance has been placed on the Supreme Court of Canada decision in the *Brian Stewart* case. Although

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[4] [2003] T.C.J. No. 514.

[5] 95 DTC 5657.

[6] [2003] T.C.J. No. 601.

[7] *Brian Stewart v. The Queen*, [2002] 2 S.C.R. 645; *Pamela Stewart v. The Queen*, [2001] T.C.J. No. 357.

admitting a personal element, the Appellant argues that there is a profit motive in the investment activity which is sufficient to create a "source" which in the *Stewart* context is then said to be sufficient to constitute a business. For example, the Appellant relies on out of context references in the *Brian Stewart* case such as: at paragraphs 1 and 24, the quotation from *Moldowan* which states that "Source of income, thus, is an equivalent term to business ..."; and, at paragraphs 38 and 51, the quotation from *Smith and Anderson* which states that "Anything that occupies the time and attention and labour of a man for the purpose of profit is business". However, to suggest that these references stand for the principle that investments managed for profit, with great care, attention and sophistication, constitute a source which is thereby a business, is not an accurate understanding of the case law. There *is* a source of income here, namely, securities which yield interest and dividends which are the income from that property source. Income from property is distinguishable from income from business. That there is a source of income from property does not mean there is a business. Further, that the securities invested in may appreciate and give rise to a profit on disposition does not constitute the realized gain as income from a source as the term "source" is used in the *Act* or in cases such as the *Brian Stewart* case. The gain from the disposition of securities is, particularly where a section 39 election has been made, a capital gain and has been included in income since 1972 under section 3 of the *Act* irrespective that such gains are not income from a "source" under that section.[8]

[10] Accordingly, the *Brian Stewart* case is not authority to support the argument that the intention to derive a profit from the interest, dividends and proceeds of disposition of securities constitutes a "source" so as to be determinative of there being a business. Still, the traditional test of discerning whether a business exists can apply to investment activities although in cases involving securities the Courts have generally been consistent in finding that trades in equities and mutual funds are not to be taken as carrying on business. In this regard the Respondent relies on

[8] The Appellant also referred to other paragraphs in the *Brian Stewart* case such as references at paragraph 65 to the notion that hopes of capital gains would not distract from the commercial nature of an activity and at paragraph 68 to the notion that a capital gains motive is something to take into account in determining whether an activity is commercial in nature. Again, however, these references are taken out of context in terms of giving them any weight in the case at bar. For example the reference at paragraph 65 suggesting that hopes of capital gains would not detract from the commercial nature of an activity refers expressly to the commercial nature of a "rental operation". Rental operations are a "source" and may be taken out of the category of personal in nature if they are sufficiently commercial in nature but that does not mean that they constitute a "business".

the *Irrigation Industries*,[9] *Goorah*[10] and *Mandryk*[11] cases. Still, I will consider further the Appellant's arguments that the activity was carried out in a business-like manner and thereby deserves to be treated as a business according to traditional tests referred to in cases like the *Pamela Stewart* case.

[11] In the case under appeal we have a number of factors to consider. There was a financial planner involved in the purchase and sale of units in mutual funds who, in 1998 at least, also arranged for leveraged investments in securities. The Appellant's husband personally engaged in on-line trading in equities other than mutual funds, on behalf of the Appellant. Her husband was paid no fees. In the two years of trades reflected in Exhibit R-5 there was some $80,000.00 in on-line disposition transactions compared to some $160,000.00 of dispositions of units in mutual funds handled by the financial planner. That is to say, roughly one-third of the dollar volume in terms of dispositions were not handled by the Appellant herself or by her husband on her behalf.[12] Looking at the number of transactions over the period it is even more weighted to transactions in mutual fund units as opposed to transactions in other equities. As well, I note that a number of the transactions in mutual fund units (possibly in 1998) were at regular intervals at the same dollar amount. This pattern was not explained. Transactions that gave rise to exactly $500.00 a month from a disposition of mutual fund units impress on me the possibility that such transactions may be structured to accommodate a personal monthly expenditure or debt service. If they were for debt service for investments they would be an allowable expense as acknowledged in paragraphs 1 and 2 of these Reasons. Regardless, I am not dissuaded from viewing the investment strategy here as an effective personal money management strategy. As to the holding period for investments I have been given no reliable evidence but I accept that there may have been a number of trades that, as argued by the Appellant's husband, simply reflected shifts in investment strategies. On balance, looking at the trading activity, there is nothing to suggest that there is more here than a fairly active and sophisticated family investment program being administered by the Appellant's husband.

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[9] 1962 CarswellNat 244 (S.C.C.).

[10] 2001 CarswellNat 1060 (T.C.C.).

[11] 1988 CarswellNat 489 (F.C.T.D.).

[12] Taken from Exhibit R-5 showing dispositions of securities for 1998 and 1999. The exhibit does not isolate all transactions by year so it is difficult to isolate activity for 1999. However, at best, it appears that in 1999 at least 60% of the trades in dollar volumes were in mutual fund units not handled by the Appellant's husband.

[12] I should also note that I accept the husband's statement that he has put a lot of time and effort learning about the investment world. He has become more than a passive player who simply takes advice. He has taken courses and spent time to become a more sophisticated and educated investor and his efforts in this regard started in 1997. He wants me to believe, however, that by 1999 he had worked out investment models and strategies and become so involved as to constitute the investment activities he performed on behalf of his wife and family investors as a business which he carried on on behalf of the Appellant. That he has studied investment models and taken a hands-on role in his wife's investment activities is not sufficient. He is a professional engineer who has given me nothing but anecdotal commentary as to the time and effort he has devoted to the investment activity itself. He has given me no evidence as to the nature of the strategic planning models that he has allegedly developed. I see no evidence of record-keeping in this area. Indeed, as noted earlier, the whole area of record-keeping leaves something to be desired and this is a factor as well in determining whether or not an activity constitutes a business. Also I note that there is no registered business name here or any other of the so-called "badges of trade" as referred to in cases such as *Nichol*.[13] Taking these additional factors into consideration I would still find that the administration and management by the Appellant's husband of the Appellant's investment activities (pooled with other family members or not) is not a business.

[13] Accordingly, and for these reasons, the appeals fail except as noted in paragraphs 1 and 2 above. That is, carrying costs of $75.00 in 1997 and $6,438.13 in 1999 are allowed without costs.

Signed at Ottawa, Canada, this 10th day of February 2005.

"J.E. Hershfield"

Hershfield J.

[13] *Nichol v. The Queen*, 93 DTC 1216.

CITATION:	2005TCC124
COURT FILE NO.:	2003-4236(IT)I
STYLE OF CAUSE:	Nancy McNeil and Her Majesty the Queen
PLACE OF HEARING:	Vancouver, British Columbia
DATES OF HEARING:	January 25, 2004 and August 16, 2004
REASONS FOR JUDGMENT BY:	The Honourable Justice J.E. Hershfield
DATE OF JUDGMENT:	February 10, 2005

APPEARANCES:

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