Docket: 2005-2470(IT)G

BETWEEN:

DAVID A. MORGAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on September 22, 2006, at Hamilton, Ontario

By: The Honourable Justice E.A. Bowie

Appearances:

Counsel for the Appellant:	John H. Loukidelis
Counsel for the Respondent:	Bobby Sood

JUDGMENT

The appeals from reassessments made under the *Income Tax Act* for the 2000 and 2001 taxation years are dismissed, with costs.

Signed at Ottawa, Canada, this 16th day of August, 2007.

"E.A. Bowie"

Bowie J.

Citation: 2007TCC475
Date: 20070816
Docket: 2005-2470(IT)G

BETWEEN:

DAVID A. MORGAN,

Appellant,

and

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Respondent.

REASONS FOR JUDGMENT

Bowie J.

[1] These appeals are brought from reassessments for income tax for the taxation years 2000 and 2001. Counsel advised me at the hearing that the only issue now being pursued by the appellant is his claim that in computing his income for the years in question, he may deduct the amounts of $35,000 and $52,500 paid to his wife Karen Morgan under subparagraph 8(1)(*i*)(ii) of the *Income Tax Act* (the *Act*). The respondent's position is that the amounts do not qualify for deduction under that subparagraph, and the amount of the payments were not reasonable, and therefore their deduction is barred by section 67 of the *Act.*

[2] The parties filed a Statement of Agreed Facts at the hearing. It reads as follows:

> 1. This is an appeal from the following notices of reassessment (the "Reassessments");
>
> | Date of Mailing | Taxation Year |
> |---|---|
> | February 9, 2005 | 2000 |
> | February 9, 2005 | 2001 |
>
> 2. The facts set out below are stated as of all times relevant to the matters under appeal except as otherwise noted.

3. The Appellant was an individual resident in Canada for the purposes of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "*Act*").

4. Karen Morgan was an individual resident in Canada for the purposes of the *Act*.

5. The Appellant was married to Karen Morgan.

6. The Appellant was an employee of Merrill Lynch Canada.

7. Until July 2000, the Appellant was a financial consultant with Merrill Lynch Canada in St. Catharines, Ontario.

8. From July 2002, through the rest of the period relevant to this appeal, the Appellant was a financial consultant and the manager of the Merrill Lynch Canada branch in St. Catharines, Ontario.

9. Merrill Lynch Canada compensated the Appellant by paying salary and commissions to him.

10. The Appellant's commission income was fixed by reference to the volume of the Appellant's sales or the contracts he negotiated.

11. The Appellant, in computing income for the purposes of the *Act*, deducted the following expenses in the following amounts (rounded to the nearest dollar) in the taxation years indicated (collectively, the "Expenses"):

Expenses	Amount Deducted in 2000 ($)	Amount Deducted in 2001 ($)
Accounting and legal fees (for carrying charges)	268	268
Advertising and Promotion	3,781	6,995
Allowable motor vehicle expenses	10,144	9,184
Food, beverages and entertainment	1,278	1,562
Lodging	791	Nil
Parking	76	270
Supplies	2,359	391
Other expenses: Salary to Karen Morgan as an assistant	36,066 includes $1,066 bonus to Edmond Seto	2,500
Other expenses: Licences	Nil	2,088
Other expenses: Rental of office		

equipment	3,252	4,618
Other expenses: Other	Nil	482
Total	58,014	78,358

12. Karen Morgan issued invoices to the Appellant charging him for services described on the invoices. The invoices state that they are for services Karen Morgan rendered to the Appellant in 2000 and 2001. The Respondent does not accept the invoices were necessarily issued on the date shown on them or that services were performed as described in the invoices.

13. The Appellant paid $35,000 and $52,500 to Karen Morgan in 2000 and 2001 respectively in payment of the amounts shown on the invoices.

14. Karen Morgan, in reporting her income for the purposes of the *Act* in 2000 and 2001, included the amounts described in paragraph 13.

15. Karen Morgan later filed a T1 adjustment request for 2000 and 2001 asking that the amounts described in paragraph 13 be deleted from her income. The Minister acceded to this request and accordingly issued notices of reassessment for those taxation years.

16. Karen Morgan was a registrant for the purposes of the goods and services tax (the "GST") levied under Part IX of the *Excise Tax Act* (Canada).

17. Karen Morgan collected and remitted GST in respect of the amounts described in paragraph 13.

18. The total amount of the Expenses deducted in each year was less than the Appellant's income in the year from commissions.

19. Merrill Lynch Canada signed a form T2200 certifying that the Appellant met the conditions set out in section 8 of the *Act* in each of 2000 and 2001.

20. For the purposes of this appeal, the parties agree that the Appellant complied with the requirements of subsection 8(10) of the *Act* as far as the filing of the T2200 in 2000 and 2001 is concerned.

21. In the Reassessments, the Minister reassessed the Appellant on the basis that, in computing his income for employment, he was entitled to deduct only $25,953 in 2000 and $26,217 in 2001 in respect of the Expenses.

22 In the Reassessments, the Minister denied certain of the Expenses, including in their entirety, amounts paid to Karen Morgan for her services as an assistant and in satisfaction of amounts payable under a lease of two laptop computers as follows:

Expense	Amount Deducted in 2000 ($)	Amount Deducted in 2001 ($)
Other expenses: Salary to assistant	35,000	52,500
Other expenses: Rental of office equipment	3,252	4,618

23. The parties have agreed that the Reassessments were correct except that the Appellant continues to maintain he was entitled to deduct in full the amounts he paid to Karen Morgan for her services as an assistant and in satisfaction of the amounts payable under the laptop leases.

[3] The appellant in his evidence described his employment history in some detail, culminating with his appointment as Branch Manager of the office of Merrill Lynch at St. Catharines, Ontario, in July 2000. Prior to that appointment he had been a financial consultant in that office. After the appointment he continued to work as a financial consultant with his own clients, and in addition he assumed responsibility for supervision of the other financial consultants and for oversight of the entire office, including the administrative staff. He personally had some 400 clients whom he continued to serve. He described the office as consisting at that time of 10 financial consultants in addition to himself, and a support staff of four. In addition he, as the manager of the office, was assisted in his work from time to time by an intern or trainee. The interns were people who were in training to become financial consultants, but had not yet met the licensing requirements of that position. They were able, however, to deal with routine telephone inquiries and other simple tasks in the office. The appellant's view was that the office did not have adequate support staff, and that to do his job properly he needed to have an assistant in addition to the staff employed and paid by Merrill Lynch. His wife Karen Morgan, he said, was well suited to fill the gap.

[4] Karen Morgan attended Niagara College, where she studied accounting and computer software, and thereafter she obtained a degree in Business Communications from Brock University. After graduation, she worked for about three years at a public accounting firm. In 1990 she started her own business, under the firm name Complete Business Solutions, providing accounting services to small businesses. Mr. Morgan testified that this training qualified her to provide the kind of services that he required, and so he retained her to assist him in his duties, first when he was a financial consultant, and later in his capacity as Branch Manager. He began to pay her for this work, he said, in the mid-1990s.

[5] Perhaps unwisely, Mr. and Ms. Morgan had no written contract to define the terms of her employment. The appellant described his wife's duties as including such things as reviewing his transactions for the year and reconciling those with his commission income, reconciling the profit and loss statements for the branch, reviewing and summarizing for him various financial industry publications, arranging for seminars and arranging and attending at social events for his clients. Mr. Morgan taught a course on investment at Frontier College, and Ms. Morgan's work included preparation of course materials for it.

[6] There are some inconsistencies in the evidence of Mr. and Ms. Morgan that cause me concern. Mr. Morgan testified that in 2000 his wife charged him $30.00 per hour for her time. He did not explain how that amount was arrived at. Her evidence was that when she began to work for him she consulted Workopolis.com, an employment-related website containing information as to the qualifications and rates of pay applicable to numerous jobs. From this information, she said, she concluded that with her qualifications she could expect to earn somewhere between $30,000 and $50,000 per year. At that time, she had three clients of her bookkeeping business, one of whom she charged $16.00 per hour and the others $20.00. She decided that she should charge her husband on the basis of $35,000 per year, working full time for him, except for continuing to serve her three other clients. She said that her invoices to her husband were not based on an hourly rate, and that the availability of money from which he could pay her was one factor in determining the amount and the timing of her invoices, as was the information that she had found on the Workopolis website.

[7] Exhibit A-1 contains copies of the invoices that Ms. Morgan sent to her husband for work during the period from January 1, 2000 to December 31, 2001. With each invoice there are monthly sheets indicating the work done and detailing the hours worked for each day. She testified that these sheets were prepared by her at the end of 2004 and the beginning of 2005, long after the time in question. She said

that the original invoices did not contain the particulars of the work done that now appears in Exhibit A-1. This was added by her later, using her diaries from the years 2000 and 2001. She also testified that those diaries did not contain a precise record of the hours worked, nor all the detail that now appears on the copies of the invoices. The diaries themselves were not entered as exhibits; Mr. Morgan testified that they were lost in a move. Ms. Morgan testified that she destroyed them after she prepared the documents that were made exhibits. Either way, the evidence is less than totally satisfactory, and it leaves a question as to the degree to which the monthly timesheets should be considered reliable.

[8] The copies of invoices and timesheets purport to show that in 2000, Ms. Morgan billed Mr. Morgan on the basis of $30.00 per hour consistently in each of the four periods of three months for which she delivered invoices. In fact, these sheets indicate that she worked exactly 311.5 hours during each of the last three billing periods. While she testified that she billed on the assumption that her time was worth about $35,000 per year, in 2000 she apparently billed her husband that amount for 1,089 hours worked, according to the timesheets. This amounts to exactly $30.00 per hour plus the associated 7% gst.

[9] Her billings for 2001 as reflected in Exhibit A-1 are less regular. For the first three month period she apparently billed at the rate of $11.76 per hour for 155 hours. During the second quarter it was $19.15 per hour for 364.25 hours, and in the third quarter $26.01 per hour for 357.5 hours. The billing was apparently at $80.35 per hour for 231.5 hours during October and November, and $114.81 per hour for 81 hours during December. This comes to a total of $52,500 (including gst) for what is shown in Ms. Morgan's timesheets as 1,430 hours. None of this gives me great confidence in the accuracy of the documents, although they were entered into evidence without objection. Nor does it instill confidence in her testimony; for example, while Ms. Morgan said that she did not bill strictly according to the hours worked, it appears that she did exactly that throughout 2000. In 2001, viewed globally, her time seems to be billed at an average of $34.15 per hour, but at a much higher rate in December than in January. I note, too, that much of the time billed for in December 2001, and some time earlier as well, was said to have been spent attending social functions

[10] Copies of the cancelled cheques in payment of the invoices are in the evidence, and they show, contrary to paragraph 13 of the Statement of Agreed Facts, that of the $35,000 invoiced for the year 2000, only 25,000 was paid in that year; the remaining $10,000 was paid by three cheques dated January 15, 2001, May 9, 2001 and May 23, 2001. I have no doubt that Ms. Morgan did some useful work for her

husband during the two years under appeal, but it appears that the amounts that she invoiced and was paid were driven at least as much by income-splitting objectives as by any contractual arrangement.

[11] The appellant's counsel has defined the issues in the appeal in the following way at pages 13 and 14 of his written submission:

> 50. The Appellant respectfully submits that there are three issues between the parties to this appeal:
>
> (i) Was the Appellant required to incur expenses and hire an assistant in the course of his employment?
>
> (ii) Did the Appellant incur the Disputed Expenses for the purpose of earning the income from David's employment?
>
> (iii) Were the Disputed Expenses reasonable?

In my view, question (i) correctly defines the issue as to the appellant's entitlement to deduct the amounts that he paid to his wife during the years under appeal. Subparagraph 8(1)(*i*)(ii) of the *Act* reads:

> 8(1) 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*) 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,
>
> …
>
> to the extent that the taxpayer has not been reimbursed, and is not entitled to be reimbursed in respect thereof;

To qualify for a deduction under this provision, the appellant must show that he was required by his contract of employment to incur the expenditure. The contract must therefore require that he hire and pay the assistant.

[12] Although there are decisions to the contrary,[1] this is the view taken by Bowman A.C.J., as he then was, in *Schnurr v. The Queen*,[2] where he said:

> 9 I come then to the real point in this case. To deduct the cost of a salary paid to an assistant, the employee must meet the conditions in subparagraph 8(1)(*i*)(i) that the payment or the salary to the employee was required by the contract of employment. Tab 1 of Exhibit A-1 is a letter dated 30 July, 1992, to the appellant from a Vice-President of Nesbitt Thomson. It says nothing explicit about the hiring of an assistant. It was however implicit in the relationship with Nesbitt Thomson that if Mr. Schnurr is to generate the sort of business for Nesbitt Thomson that it expected him to, he is required to hire someone to perform the type of services that his wife performed. Such a provision need not be explicitly set out in the agreement between the employer and the employee.
>
> 10 This view is consistent with the administrative practice set out in paragraph 1 of Interpretation Bulletin IT352R2, which reads:
>
> > 1. Subject to certification by the employer (see 13 below), subparagraphs 8(1)(*i*)(ii) and (iii) allow a taxpayer, in computing income for a taxation year from an office or employment, to deduct amounts paid in the year as expenses for office rent, supplies and salary to an assistant or substitute. These expenses are deductible provided the following requirements are met:
> >
> > (a) the taxpayer is required by the contract of employment to pay for such office rent or salary, or to provide and pay for such supplies;
> >
> > (b) the taxpayer has not been reimbursed and is not entitled to reimbursement for such expenses;
> >
> > (c) these expenses may reasonably be regarded as applicable to the earning of income from the office or employment; and
> >
> > (d) in the case of supplies, they are consumed directly in the performance of the taxpayer's duties of the office or employment.
> >
> > Ordinarily, (a) above necessitates that there be an express requirement within the terms of a written contract of employment. Nevertheless, such a requirement for the payment of office rent, supplies or salary to an assistant or substitute may exist where the taxpayer can establish that it was tacitly understood by both parties (the taxpayer and the employer) that such payment was to be made by the taxpayer and was, in fact, necessary under the circumstances to fulfill the duties of the employment.

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1 See *Baillargeon v. M.N.R.*, 90 DTC 1947; *Longtin v. The Queen*, 2006 DTC 3254.

2 2004 DTC 3531; 2004 TCC 684.

> 11 It is also consistent with the decisions of this Court in *Baillargeon v. M.N.R.*, [1990] T.C.J. 712 and *Madsen v. Canada*, [2001] T.C.J. 246, the decision of the Federal Court of Canada in *Canada v. Gilling*, [1990] F.C.J. 284 and the Federal Court of Appeal in *Verrier v. Canada*, [1990] 3 F.C. 3.

He went on to say at paragraph 19:

> 19 The filing of forms T2200 serves a dual function: it is a statutory condition precedent to the claiming of an employment expense deduction under subsection 8(1)(*i*) and it provides evidence of the terms of employment. I doubt that the form is conclusive or determinative if the evidence showed it to be wrong but it is at least *prima facie* evidence.

That the contract must mandate the hiring as well as the paying of the assistant accords with the plain words of the statute. In the present case the evidence of the appellant negatives that requirement. The evidence contains a letter dated July 4, 2000 appointing the appellant to the position of Resident Manager of the St. Catharines office of Merrill Lynch. It is silent as to the subject of hiring an assistant. The forms T2200 signed on behalf of Merrill Lynch and filed by the appellant answer yes to the question “did you require this employee under a contract of employment to pay for a substitute or assistant?”. The evidence established that the forms were completed by Karen Morgan, and the appellant was unable to say whether the person who signed on behalf of Merrill Lynch in fact read the completed form. Mr. Morgan testified specifically that he was “permitted” rather than “required” by the contract of employment to hire and pay an assistant. Both the English verb “to require” and the verb “obliger” that appears in the French version of the *Act* are necessarily imperative. In view of this testimony of the appellant, it is not possible to find that it was implicit in the contract that he was “required” to hire an assistant, and it is equally impossible to find that the amounts that he paid to his wife come within subparagraph 8(1)(*i*)(ii).

[13] It is not necessary to deal with the second issue stated by the appellant, in view of the appellant’s concession with respect to the computer lease payments, Nor is it strictly necessary to deal with the third issue, given my conclusion as to issue number one, but as much of the evidence was directed to that issue, I shall refer to it briefly. Counsel for the respondent argued that it was not reasonable for the appellant to pay his wife about 20% of his total income in the year 2000 and about 30% of it in 2001 for the administrative work described in her invoices.

[14] The following passage from the judgment of Cattanach J. in *Gabco Ltd. v. M.N.R.*[3] has long been accepted as a correct statement of the law in connection with section 67 of the *Act*:

> It is not a question of the Minister or this Court substituting its judgment for what is a reasonable amount to pay, but rather a case of the Minister or the Court coming to the conclusion that no reasonable business man would have contracted to pay such an amount having only the business considerations of the appellant in mind.

Considering, too, the rates at which Ms. Morgan billed her time to her other clients, and considering too that a certain part of the time for which she billed, particularly in December 2001, was spent attending social events, I am of the view that no reasonable business person in an arm's length relationship would have agreed to the billings that Mr. Morgan paid. The best measure of what would be reasonable that can be found in the evidence before me is Ms. Morgan's evidence that, on the basis of the information she gleaned from Workopolis.com, $35,000 per year would be a reasonable amount to charge. I am not overlooking her evidence that in June 2003, she obtained a job at an annual salary of $55,000 plus bonus. However, she left that job after about four months, and the evidence is scant about the circumstances of the job and her separation from it. Assuming that an average work year for an office assistant is about 1,800 hours, Ms. Morgan worked for her husband for about 60% of a work year in 2000, and about 80% in 2001. Had I found that the employment satisfied the requirements of paragraph 8(1)(*i*)(ii) of the *Act*, I would have found the reasonable remuneration for the purposes of section 67 to be $21,000 for the 2000 taxation year, and $28,000 for 2001.

[15] The appeals are dismissed, with costs.

Signed at Ottawa, Canada, this 16th day of August, 2007.

"E.A. Bowie"

Bowie J.

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[3] [1968] 2 Ex.C.R. 511 at 522.

CITATION:	2007TCC475
COURT FILE NO.:	2005-2470(IT)G
STYLE OF CAUSE:	DAVID A. MORGAN and HER MAJESTY THE QUEEN
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