Citation: 2008TCC202
Date: 20080421
Docket: 2003-2864(IT)G

BETWEEN:

STEPHEN RAPHAEL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Counsel for the Appellant: Richard W. Pound
Counsel for the Respondent: Ernest Wheeler

REASONS FOR JUDGMENT

**(Delivered orally from the Bench
on May 3, 2005, in Montreal, Quebec.)**

McArthur J.

[1] This is an appeal from an assessment for the 2001 taxation year. The Minister of National Revenue did not allow the Appellant the deduction from income with respect to his payment after a court Judgment of $49,759, court costs of $1,867 and legal fees of $22,059, totalling approximately $74,000.

[2] The Appellant's position includes that the $74,000 expense was incurred solely in connection with the consequences of his resignation from Lafferty, Harwood & Partners Ltd. (LH), to join RBC Dominion Securities (RBC), in order to increase his income from employment, and this is deductible under paragraph 8(1)(*f*) of the *Income Tax Act*.

[3] The Respondent's position includes that the amount paid by the Appellant was not paid for the purposes of earning income from employment, but rather was in consequence of the breach by the Appellant of an employment contract with LH and, therefore, not deductible from employment income. He added that the amount was an

outlay on account of capital and not deductible from employment income under subparagraph 8(1)(*f*)(v).

[4] For the most part, the facts are not in dispute and they are set out in an Agreed Statement of Facts which states as follows:

1. The Appellant is an investment broker domiciled and residing at 2 Prospect Avenue in the borough of Westmount, Montreal, Quebec, H3Z 1W4.

2. The Appellant appeals from a Notice of Assessment (the "Assessment") dated June 17, 2002 in respect of the 2001 taxation year 2001 (*sic*) issued by the Minister of National Revenue (the "Minister").

3. In February 1999, the Appellant left his employment with Lafferty, Harwood & Partners Ltd. ("LH&P") to join RBC Dominion Securities ("RBC") in order, *inter alia*, to increase his income from employment. …

4. The immediate increase in income was represented by a "signing bonus" from RBC in the amount of $250,000.

5. The Appellant's income was derived solely from commissions produced as a result of buying and selling stocks and bonds on behalf of clients.

6. Both at LH&P and RBC, the Appellant, with the exception of the "signing bonus, earned all of his income from commissions. If he failed to generate income from commissions, he would have had no income.

7. The Appellant did not adhere to or to follow any investment advice or directions generated from his employers and conducted his own research, at his own cost, in respect of investments that he was following for purpose of advising his clients.

8. In return for approximately 50% of the commissions generated by the Appellant, his employer provides office premises, research and support and secretarial assistance for the benefit of the Appellant. One of the reasons why the Appellant left LH&P was because he believed that the research function there was collapsing. There was a difference in philosophy between the Appellant and LH&P regarding such matters.

9. In order to maximize client retention and earnings, when the Appellant resigned from LH&P, he did not give any prior notice of termination, which the Appellant maintains to be a common practice within the industry. …

10. The great majority of the Appellant's clients followed him to RBC from LH&P.

11. An additional advantage for the Appellant in transferring from LH&P to the new broker was the availability of opportunities to earn additional income from underwriting activities, which was not possible at LH&P, since it did not carry on any underwriting activity.

12. The parties agree that the status of the Appellant as an employee is not in issue, nor that the Appellant meets the conditions set forth in subparagraphs 8(1)(*f*)(i) through (iv) inclusive.

13. Following his departure, LH&P instituted legal proceedings in the Quebec Superior Court against the Appellant, claiming the loss of its share of the income (50% of the Appellant's commissions) that might have been expected to accrue to it during the period of six months, a period that LH&P would have regarded as reasonable notice on the part of the Appellant. The Appellant had produced some 46% of the income of LH&P.

14. The Appellant defended against that claim, but a judgment was rendered against him in June 2001 for an amount of $49, 759, 39, plus court costs of $1,867.89. He also incurred legal fees of $22,059.69 in the process. There is no issue as to the amounts or characterization of the amounts, nor as to their payment by the Appellant. …

15. In his 2001 income tax return, the Appellant deducted the amount of $73,686.97, being the total of the amount awarded, court costs and lawyers' fees incurred as a result of the claim by LH&P.

16. In the 2001 taxation year, the Appellant's earned income was solely derived from commissions from RBC.

17. In his assessment of the Appellant's income tax return, the Minister disallowed the deduction on the basis that such expenses did not qualify under paragraph 8(1)(*b*) nor under paragraph 8(1)(*f*) of the *Act*.

18. The Appellant served a timely notice of objection to the Assessment pursuant to subsection 165(3) of the *Act* and the Minister confirmed the Assessment on June 11, 2003.

[5] Further, the relevant parts of paragraph 8(1)(*f*) of the *Act* read as follows:

> 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 be reasonably regarded as a applicable thereto
>
> (*a*) …

> (*f*) where the taxpayer was employed in the year in connection with selling of property or negotiating of contracts, for the taxpayer's employer and,
>
> (i) under the contract of employment was required to pay the taxpayer's own expenses,
>
> (ii) …
>
> (iii) was remunerated in whole or in part by commissions or other similar amounts fixed by reference to the volume of the sales made or the contracts negotiated, and...
>
> (iv) was not in receipt of an allowance for travel expenses in respect of the taxation year that was, by virtue of subparagraph 6(1)(*b*)(v), not included in computing the taxpayer's income, amounts expended by the taxpayer in the year for the purpose of earning the income from the employment (not exceeding the commissions or other similar amounts referred to in paragraph (iii) and received by the taxpayer in the year) to the extent that these amounts were not
>
> (v) outlays, losses or replacements of capital or payments on account of capital, except as described in paragraph (j),

It is subparagraph (v) that will be the centre of our attention in this judgment. Paragraph 8(1)(*f*) permits the deduction of certain expenses providing certain conditions are met. Fortunately, the parties agreed in paragraph 12 of the Agreed Statement of Facts set out above, that the Appellant was an employee and he met the conditions of subparagraphs 8(1)(*f*)(i) through to and including (iv).

[6] To summarize, counsel for the Respondent submits primarily that the amount is not deductible because it was a payment on account of capital, and excluded from deductibility under subparagraphs 8(1)(*f*)(iv) and (v), and secondly, that it was not an amount expended to earn income. More precisely, counsel stated that it was not expended to earn commissions from the Appellant's new employment with RBC. And that it was paid because he breached his employment contract with LH and is a capital payment. He referred to the case in *Atkins v. The Queen*,[1] which I shall refer to later.

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[1] 76 DTC 6258.

[7] The Appellant, Stephen Raphael is a highly successful stockbroker. I have no doubt he is intelligent, ambitious and aggressive. During a 12-month period prior to January 30, 1999, he earned approximately $965,000 in commissions with LH.

[8] In order to increase his earnings and provide better services for his clients, he left the employ of LH for the much larger firm of RBC. In doing so, he received considerable benefits not available to him at LH, and they included a $250,000 signing bonus, payout commissions of 55% of his gross commissions, as opposed to 50%, and access to greater research facilities. LH sued him for damages it suffered because he left, without notice. LH was awarded about $50,000 and in addition, the Appellant paid approximately $24,000 in legal fees and disbursements.

[9] The parties acknowledged that paragraph 8(1)(*b*) of the *Act* does not apply, and for the purposes of this appeal, the total amount of $74,000 is treated as one homogeneous amount. The question before me narrows down to whether the $74,000 was an outlay on account of capital or income. I do not accept the Respondent's position that the money paid is an outlay of capital.

[10] The Respondent is relying on the decision of the Federal Court of Appeal in *The Queen v. Atkins*, where it was held that monies paid "in lieu of notice of dismissal" were paid in respect of the "breach" of contract of employment, and not paid as a benefit under the contract, or in respect of the relationship that existed under the contract before that relationship was wrongfully terminated. In the present appeal case, we have the opposite situation, in that it is the employer who sued the employee for a breach of contract of employment. I believe the justification of the Federal Court of Appeal in *Atkins* is to be used with some caution.

[11] In *Jack Cewe Limited v. Jorgensen*,[2] the Supreme Court of Canada questioned the validity of the *Atkins* reasoning, and on page 6234, Pigeon J. stated:

> I have great doubt as to the validity of this reasoning. Damages payable in respect of breach of contract of employment are certainly due only by virtue of this contract. I fail to see how they can be said not to be paid as a benefit under the contract. They clearly have no other source.

The law has evolved since *Atkins*, and the Court should take into account all the surrounding circumstances.

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[2] 80 DTC 6234.

[12] I find that the amounts expended by the Appellant were for the purpose of earning income from employment and that these amounts were not outlays of a capital nature. Obviously, I agree with the Appellant's position, as submitted by his counsel. The case closest to the present situation is one referred to by both parties, *Vango v. The Queen*,[3] wherein the Appellant was also a stockbroker. He defended himself from accusations by the Toronto Stock Exchange accusing him of serious offences that could have cost him his license. The Minister denied his deductions of legal fees of $7,500 and a fine of $4,200, which he paid in defending himself.

[13] Judge Bowman did not have the luxury that I have where the parties have agreed that Mr. Raphael was an employee and not an independent contractor. But he concluded that the Appellant incurred legal expenses in order to keep his job with Nesbitt, Thompson. The monies were spent to modify a charge which, had it stood, could have resulted in his being dismissed and might indeed have prevented his working again in the securities business. The legal fees were therefore expended for the purpose of earning the Appellant's employment income. In result, the legal fees were deductible because they were not on capital account and since they had been expended for the purpose of earning income.

[14] Bowman J. quoted with approval, Lord Pearce in *B.P. Australia Ltd. and the Commissioner of Taxation*[4] as follows:

> The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a common sense appreciation of all the guiding features which must provide the ultimate answer.

And I could underline that it is a common sense appreciation because in this instance, I think there is little doubt that the common sense answer to the question is that the payment was on income account.

[15] Further, the payment in *Vango* is closer to being capital than the payment in this appeal. In *Vango*, the Appellant incurred costs to save his livelihood, his license,

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3 [1995] T.C.J. No. 659.

4 [1996] A.C. 224.

which was his license to sell securities. Lord Pearce directs us to look at all or many aspects of the circumstances. The Appellant left LH, without notice, to keep his established clients. It is common in the business for employees to switch firms and he did it primarily to earn more income. He took a business risk that he would not have to pay a price for his decision not to give notice. However, he did have to pay approximately $74,000 which pales in comparison to the $250,000 bonus he received. As it turned out, it was a business risk worth taking. Clearly the payment was made for sound business reasons to augment income, and is not capital.

[16] For these reasons, the appeal is allowed, with costs.

Signed at Ottawa, Canada, this 21st day of April 2008.

"C.H. McArthur"

McArthur J.

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COURT FILE NO.:	2003-2864(IT)G
STYLE OF CAUSE:	STEPHEN RAPHAEL and HER MAJESTY THE QUEEN
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REASONS FOR JUDGEMENT BY:	The Honourable Justice C.H. McArthur
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APPEARANCES:

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