Docket: 2008-2977(IT)G
2008-2710(GST)G

BETWEEN:

LYNCORP INTERNATIONAL LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on September 27 and 28, 2010, at Calgary, Alberta

Before: The Honourable Justice Campbell J. Miller

Appearances:

Counsel for the Appellant:	Ken S. Skingle, Q.C.
Counsel for the Respondent:	Carrie Mymko

JUDGMENT

The appeals from reassessments made under the *Income Tax Act* for the 2002 and 2003 taxation years are allowed, and the reassessments are referred back to the Minister for National Revenue for reconsideration and reassessment on the basis the Appellant is entitled to deduct additional flight expenses of $29,112 in 2002 and $17,610 in 2003.

The appeal from reassessment made under the *Excise Tax Act* for the period January 1, 2002 to December 31, 2003 by Notice of Assessment No. 10CT0700344 dated July 26, 2006 is allowed, and the reassessment is referred back to the Minister for National Revenue for reconsideration and reassessment on the basis the Appellant is entitled to Input Tax Credits in connection with additional flight expenses of $29,112 in 2002 and $17,610 in 2003.

One set of costs is awarded to the Respondent.

Signed at Ottawa, Canada, this 19th day of October 2010.

"Campbell J. Miller"

C. Miller J.

Citation: 2010 TCC 532
Date: 20101019
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BETWEEN:

LYNCORP INTERNATIONAL LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Miller J.

[1] The income tax appeal is about the deductibility by the Appellant, Lyncorp International Ltd. ("Lyncorp"), of flight expenses incurred in 2002 and 2003 on a plane fractionally owned by the Appellant. At that time, the Appellant was owned, operated and directed by one man, Mr. David Mullen. Mr. Mullen left the impression of being the consummate businessman – fingers in a number of commercial ventures. The flights in issue relate primarily to Mr. Mullen's trips checking on the Appellant's several business ventures. The Respondent denied approximately $400,000 of the flight expenses claimed by the Appellant on the basis that the disputed flight expenses were not, in accordance with paragraph 18(1)(*a*) of the *Income Tax Act* (the "*Act*"), incurred for the purpose of gaining or producing income from a business or property of the Appellant, as the expenses were either personal, simply for the convenience of Mr. Mullen, or, if they were not personal, but commercial, they were not incurred for the benefit of the Appellant but for the benefit of other companies, in which the Appellant had invested. This raises the intriguing question, when are expenses of one company, that relate more directly to producing income of an investee company, deductible on the basis that increased income of the

investee company could lead to the production of income from property, being dividends (or even interest) to the investing company.

[2] The Respondent also denied input tax credits pursuant to the *Excise Tax Act* ("*ETA*") on the basis the flight expenses were not incurred in the course of the Appellant's commercial activities.

Facts

[3] While the issue is relatively straightforward, the facts are anything but. Mr. Mullen testified for a day explaining in some detail the various commercial enterprises in which he was involved. I do not intend to get into such great detail, but rather intend to limit my review of the facts to the commercial enterprises, which Mr. Mullen maintains justified the flights, as well as a review of his personal circumstances, including his full-time employment.

[4] In 2002 and 2003, Mr. Mullen was an executive with Mullen Transportation Inc. and Mullen Trucking Inc.. Mr. Mullen's father started a trucking company many years previously which has grown into an enterprise with 16 to 18 subsidiary companies with 5,000 employees. I will simply refer to this trucking enterprise as the "Mullen Group". Mr. Mullen appears to have worked his way up through the organization, having started as a driver. There is no doubt he was devoted to the family firm. His timesheets from the years in question showed a minimum of approximately 2,200 to 2,400 hours a year, which if calculated on a five-day week would work out to an average of regular 10-hour days. Mr. Mullen was adamant, however, that these were minimum hours. All to say, he worked hard at his day job. I will have more to say on his timesheets when discussing particular flights.

[5] Mr. Mullen was also interested in business generally: in fact, I would describe him as being passionate about being an entrepreneur.

[6] Mr. Mullen incorporated the Appellant in 1993 as an active company, though he was somewhat unclear as to exactly what it was active in, but ultimately he used it to pursue investments in other active companies, which he referred to as "business ventures". The Appellant would invest either by buying shares or lending money to the business ventures. For Mr. Mullen to consider an investment a business venture, not only did Lyncorp have to hold shares or debt in the venture, but Mr. Mullen personally would have to play an active role in the venture in providing support services. By support services, he meant formulating business plans and advising on financial matters, developing marketing strategies, helping overcome technical

operational challenges and investigating business expansion opportunities. He relied on aircraft fractionally owned by the Appellant to attend to these business ventures. Neither Lyncorp, nor the business ventures, which I will describe shortly, ever paid Mr. Mullen for these actual services. There was no written agreement between either Mr. Mullen or the Appellant and the business ventures. My impression was that Mr. Mullen saw a business need for these ventures to survive and thrive and, because of the Appellant's interest, he filled that need. It was also clear that Mr. Mullen viewed himself and the Appellant as one and the same, as he stated "Lyncorp is David Mullen".

[7] Starting in June 2001, Mr. Mullen undertook a major reorganization of his business affairs by moving his personal investments into the Appellant. His explanation for this move was rather sketchy, claiming the businesses had become too complicated for him to fund personally. By far the major assets transferred into the Appellant were Mr. Mullen's interests in the Mullen Group. It was clear, looking at the Appellant's revenue in subsequent years, that wealth in the Appellant was generated primarily from the Mullen Group investment (well over $8 million between 2005 and 2007 alone).

[8] Mr. Mullen noted that one of his business ventures, Shulin Lake Mining Co. Inc. ("Shulin Mining"), should have been transferred into the Appellant at the time of the reorganization but, for whatever reason, was not. He personally remained a shareholder.

[9] For the first four months of 2002, the Appellant had a fractional interest in a turbo prop airplane, but in March of 2002 it traded it in for a similar interest in a jet.

[10] The reasons given by Mr. Mullen as to why the Appellant would buy a plane rather than rely on commercially scheduled flights was that his windows of opportunity for working on the Appellant's business was very limited, given his huge time commitment to the Mullen Group. As he put it, his work for Lyncorp only started late on Friday afternoon. The ownership of the plane guaranteed availability of transport and it was reliable. In representations from his accounting agent, KPMG, to the Canada Revenue Agency ("CRA") in March 2008, KPMG described the reasons for the acquisition of the plane as follows:

…

- Absolute time savings by spending less time at airports checking-in, going through long security line-ups, making connections, risking potential commercial flight delays, waiting for luggage, clearing US Customs, etc.

- Ability to respond quickly to urgent matters that required David's personal attention and intervention. There were instances where return trips were required that could not have been accommodated commercially. Since David also had responsibilities that required him to be back in Calgary, he needed to adhere to a very strict travel schedule.

- The ability to conduct business meetings and discuss confidential business matters on route with others and, conversely, the ability for David to have uninterrupted quiet time to spend this time strategizing business plans on the many flights he took alone.

- An effective and more convenient way to transport Lyncorp's potential suppliers, other investors and consultants to business sites by eliminating time spent making alternate travel arrangements on commercial flights and then coordinating their arrival with David's.

- There are times when the nature of the information and goods that David travels with, such as drilling and core samples, would be too sensitive, confidential and difficult to check in personal baggage and too large for carryon on a commercial flight.

- The timing and often short notice period made the use of scheduled commercial flights unfeasible. Airsprint was able to accommodate David to get him to his destinations quickly and on short notice.

- Reduced and better control over exposure to air-borne sickness so prevalent on commercial flights. David was very busy and couldn't afford to increase his chances of becoming ill and missing time and opportunities.

[11] Mr. Mullen handled the aircraft invoices from Airsprint by identifying on the invoice itself whether the flights referred to in the invoice were personal, for a third party account (e.g. for the Mullen Group), in which case costs would be invoiced to that third party, or for the Appellant's own account. The Appellant in fact earned $121,000 and $54,000 respectively from third parties' use of the aircraft in the years in question. Mr. Mullen acknowledged that this system of allocating costs was imperfect and that he might occasionally mischaracterize a flight.

[12] Before turning to a review of the business ventures in which the Appellant had an equity or debt interest, that specifically relate to the disputed flight expenses, I

want to provide a brief review of any direct business activity carried on by the Appellant, in particular mining exploration and drilling services.

[13] With respect to mining exploration, Mr. Mullen testified that Lyncorp held some mining interests in Saskatchewan and incurred some exploration expenses there as well as in southern British Columbia. The Appellant's financial statements, however, show no expenses, salary or otherwise that might relate to exploration in 2002 or 2003. Certainly, there was no such activity in Alaska. Apart from holding some claims, I find there was little, if any, direct exploration activity in 2002 or 2003 by the Appellant, though there was some evidence of some future activity.

[14] With respect to a drilling services business, the Appellant did acquire a drilling rig for $35,000 USD in July 2002. The rig was located at Shulin Lake, Alaska. The Appellant made the rig available to Shulin Mining for no charge, to continue drilling in the area. Mr. Mullen explained that having the rig operating there allowed him to learn a lot about the drilling business. Although the rig was acquired by the Appellant, it was accounted for in the books of Shulin Mining, rather than in the books of the Appellant. The rig was moved to Saskatchewan in the fall of 2003. There was correspondence in 2004 from Golconda Resources Ltd. ("Golconda") to Mr. Mullen at Mullen Transportation, as well as a mineral sample submittal form from ALS Chemex ("ALS") indicating samples were submitted by the Appellant from Saskatchewan in 2004.

[15] Mr. Mullen testified that the Appellant continuously carried on a drilling business up to 2007. From a review of the Appellant's financial information, it is clear it was, in the latter years (2004 to 2007), incurring costs, and in 2006, 2007 and 2008 it was actually earning some income from drilling. In 2007, a new drilling company, Lyncorp Drilling Services Inc. commenced operations and carried on the drilling services.

[16] I will now turn to a review of the following business ventures associated with many of the disputed flight expenses:

a) Shulin Lake Mining Co. Inc., Golconda Resources Ltd. and Shear Minerals Ltd. ("Shear");

b) Shulin Lake Lodge Inc. ("Shulin Lake Lodge");

c) Campbell River Boatland (1982) Ltd. ("C.R. Boatland")

Shulin Mining, Golconda and Shear

[17] Shulin Mining was an Alaskan company incorporated in 1997 with David Mullen and his father owning two-thirds of the shares: the remaining one-third of the shares were held by Carl and Mike Tatlow. Shulin Mining had 152 claims. It granted Shear, a public company, an option in 1999 to acquire a 50% interest in the claims, that was later reduced to 24% interest. Mr. Mullen was a director of Shear. The Appellant held approximately 2.7 million shares in Shear representing a seven to ten percent interest. In 2005, Shear spun out shares in Kaminak Gold Corporation ("Kaminak") worth $50,000 which the Appellant later sold for $230,000.

[18] In February 2001, Shulin Mining granted an option to 885301 Alberta Ltd. ("885301") for a 40% interest in the claims. In May 2001, the Appellant transferred its shares in 885301 to Golconda for shares in Golconda. The Appellant already owned substantial shares in Golconda, and by the end of 2003 owned close to 1.7 million shares at a cost of approximately $700,000. Golconda was engaged in the drilling services business.

[19] In February 2002, Shulin Mining bought some more claims from a third party for $36,500. Mr. Mullen maintains this purchase was financed by the Appellant. By December 31, 2002 the Appellant had outstanding advances to Shulin Mining of $255,110 which increased to $442,000 by the end of December 2003. Such loans were demand non-interest bearing loans.

[20] So what were these companies doing in Shulin Lake? A newspaper article of August 1, 2002 described activity as follows:

> …
>
> Tatlow switched his focus, and he and Shulin Lake Mining Inc. partners Dave and Rowland Mullen found Canadian backers.
>
> Alberta-based Golconda Resources Ltd. holds 51 percent of the project and Shear Minerals Ltd. of Edmonton holds about 14 percent.
>
> The team began using airborne geophysical technology and samples of deposits from streams and glaciers to narrow the search.
>
> They began drilling last February, to the scepticism of some geologists.
>
> …

> To many, Tatlow busy camp of ATCO trailers caterpillars tractors, a lumber mill and miscellaneous heavy equipment must seem out of place.
>
> …

[21] A release from Golconda dated January 3, 2002 referred to a 2002 drilling program at a cost of $200,000, $43,000 of which was for Shulin Mining's account. In summary, some drilling was taking place on some form of joint venture basis amongst Shulin Mining, Golconda and Shear in the relevant years. Lyncorp held an equity interest in Shear and Golconda and a debt interest in Shulin Mining.

Shulin Lake Lodge

[22] Shulin Lake Lodge was incorporated in 2001 with the Appellant owning 50% of the shares and Carl Tatlow owning 50%. Mr. Mullen testified that it was his idea for the lodge to evolve from a trailer used as accommodation for those working on a well site to accommodation for workers in a mining camp, and if no mining was going on, then to a permanent lodge for fishing and hunting. Construction commenced in August 2002. It was necessary to rely on a winter road to get materials in during the winter of 2002 – 2003. Mr. Mullen anticipated guests in June 2004. The company had income of $40,203 in 2003 being the charge to Shulin Mining for accommodation, while in 2004 the income of $164,000 was mainly attributable to fishing guests.

[23] By the end of 2003, the Appellant had advanced approximately $1.5 million to Shulin Lake Lodge, again on a demand non-interest bearing basis.

C.R. Boatland

[24] C. R. Boatland was in the business of the sales and servicing of boats, ATV's etc. in Campbell River, B.C.. The Appellant and Daniel Telosky acquired the shares of C.R. Boatland and assigned them to 622535 BC Ltd. ("622535"), a company in which the Appellant and Mr. Telosky had a 50/50 interest. In November 2003, Mr. Telosky transferred his interest to the Appellant. Mr. Telosky was to serve as manager of C.R. Boatland, though Mr. Mullen testified that he provided the ideas to take the company from a losing position to a profitable one, by adding some new businesses to the company, properly capitalizing it and generally cleaning up the operations. As he put it, he made the important decisions, though, similar to Shulin Mining and Shulin Lake Lodge, he was not paid by C.R. Boatland for any of these services. He was also a director of C.R. Boatland.

[25] Mr. Mullen owned a home 40 kilometres outside of Campbell River since 1996.

Flights

[26] The deductibility of about $400,000 in flight costs, representing about 40 round trip flights, is in dispute. Attached as Appendix A to these Reasons is a list of the disputed aircraft expenses. There is no question that it was Lyncorp who paid for the cost of all these flights and that Mr. Mullen was the primary passenger on all flights. Mr. Mullen, in examination-in-chief and on cross-examination went through all the flights indicating, as best as he could remember, for what purpose he took the flight, and what he did at his destination.

[27] Over half of the flights involved travel to Campbell River, in connection with C.R. Boatland, somewhat less number of flights to Alaska, in connection with Shulin Mining or Shulin Lake Lodge and a few flights to other destinations (Cranbrook, Rankin Inlet, Vancouver and Kelowna).

[28] With respect to trips to Campbell River, Mr. Mullen described them as being for the purpose of working on C.R. Boatland business. His typical trip would be to leave Calgary Friday afternoon, meet with Mr. Telosky Friday evening, review the condition of the operations, attend the business Saturday morning to either serve customers or simply help out, spend Saturday afternoon with the family, have a Sunday morning breakfast meeting with Mr. Telosky and have the rest of the day with the family. Often, his wife and daughter would travel with him to their home in Campbell River for these weekends.

[29] On one such trip to Campbell River (April 25 to 28, 2002), Mr. Mullen returned via Vancouver to attend a mining trade show. On another (November 17 to 20, 2002) he travelled through Vancouver to meet representatives from Yamaha to discuss the possibility of C.R. Boatland picking up the Yamaha line. Mr. Mullen indicated several of the Campbell River trips involved working on the Yamaha file in 2002 and 2003.

[30] Mr. Mullen also described one trip to Campbell River due to problems with the boiler on the premises.

[31] Finally, in connection with the C.R. Boatland business, Mr. Mullen had a trip to Vancouver in late 2001 for the purposes of securing containers for ice machines, a

new business he was introducing to C.R. Boatland. On the same trip, he checked into the availability and suitability of ocean containers. It was unclear to me whether this was intended to be a business for C.R. Boatland or for the Appellant directly.

[32] To reiterate, Mr. Mullen held no paid position with C.R. Boatland, though he was a director.

[33] Several of the flights were to Alaska, where Mr. Mullen attended to both the business of Shulin Mining (including Shear and Golconda) and Shulin Lake Lodge. Exactly what he did could have been made clearer. For example, he would indicate that he would be in Shulin Lake because Shulin Mining was putting in drill sites, or because Shulin Mining required ice roads and he needed to know how to build ice bridges. This type of response did not elaborate in any great detail on his personal involvement. He said he would check the hauling of loads (materials for building the lodge) on the ice roads, or check on the drill sites. I was not clear exactly what this all meant. With respect to the lodge, he would get as involved as tapping trees in readying the site for construction. He also stated there would be some helicopter work and he would look into getting helicopter transportation information.

[34] On one trip to Shulin Lake in late August 2002, he wanted to ensure everything in connection with the drilling operation was safe due to some recent flooding problems. He would occasionally bring back core samples with him from Shulin Mining's drilling. He described another trip in his written summary as follows: "travel to site to assess equipment and needs".

[35] One trip (June 16 to 19, 2003) appeared to be primarily to attend the cleanup and landscaping of the lodge. Mr. Mullen did acknowledge that after work, he may go fishing until late in the evening.

[36] Mr. Mullen also described another trip to Shulin Lake (September 2 to 5, 2003) as a networking trip, connecting with future employees, business associates and partners. This is the trip on which he stopped in Kelowna to drop off a couple of business associates.

[37] In May 2002, Mr. Mullen had a one-day trip to Cranbrook to check out potential mine sites for the Appellant.

[38] In June 2003, Mr. Mullen travelled to Rankin Inlet to visit a site where Shear was drilling. He returned with some core samples.

[39] Mr. Mullen maintained that all the disputed flights were for commercial purposes tied in with either the Appellant's direct business activity or in connection with the business ventures, Shulin Mining, Shulin Lake Lodge, C.R. Boatland or Shear. The Crown took Mr. Mullen through some of his timesheets from the Mullen Group, which suggested that on days where he was shown to be in Campbell River or Alaska on the Appellant's or its' business ventures' businesses, he was recording eight or 10 hours towards his full-time employment with the Mullen Group. Mr. Mullen explained that his timesheets only represented minimum hours actively worked. He left the impression that if he put in a 14-hour day, he might only record 10 and reflect the extra hours on another day – the timesheets were imperfect. He admitted that they were not completed daily but only every month or two. Asked directly how he would account for 10 hours to the Mullen Group on a day that his flight data showed he was in Alaska purportedly on the Appellant's, Shulin Mining's or Shulin Lake Lodge's business, he answered: "I can't tell you".

[40] A review of Lyncorp's revenue from 2002 forward shows some aircraft charter income from 2002 to 2005 and some drilling income from 2006 to 2008, with little other active income. With respect to investment income, it shows no investment income in 2002, dividend income from the Mullen Group in 2003, dividend income of $168,000 in 2004, $165,000 of which was from the Mullen Group and $5.9 million of dividend income in 2005, all from the Mullen Group.

Issues

[41] The income tax issue is whether the disputed flight expenses were incurred, in accordance with paragraph 18(1)(*a*) of the *Act*, for the purpose of earning or producing income from Lyncorp's business or property. Specifically, the following questions need to be answered:

a) did the Appellant incur the expenses?

b) were the expenses of a personal nature?

c) if not, were they incurred for the purposes of earning or producing income from a business or property of the Appellant?

[42] The Goods and Services Tax ("GST") issue is whether the Appellant was entitled to claim Input Tax Credits of $11,396 in 2002 and $21,499 in 2003, arising from the disputed flight expenses. The question to be answered specifically is

whether the disputed flight expenses were incurred by the Appellant in the course of the Appellant's commercial activities.

Parties' Positions

[43] The Appellant's position is that the Appellant was directly engaged in carrying on active businesses, thereby having a source of income from business, as well as having a source of income (dividends or interest) from property (shares and debt in other companies). The Appellant's strategy was to provide support services to all of the business ventures, without adding to their cost, for the purpose of ultimately benefiting the Appellant in the form of future dividend income. The Appellant argues that it also held debt in the business ventures as a source of interest income, as, if the business ventures proved successful, the Appellant could then charge interest.

[44] The Appellant further argues that access to the airplane allowed Mr. Mullen the flexibility to devote valuable limited time to the Appellant's direct business activities, as well as to providing the support services to the business ventures. The Appellant points to the turnaround in C.R. Boatland's profits as due to Mr. Mullen's, and therefore the Appellant's, involvement, thus creating an "opportunity" to pay dividends at some point. Finally, the Appellant maintains that it made a business decision to use the airplane and it is not for the Government to substitute its business judgment for that of the Appellant's.

[45] The Respondent's position is simply that the flight expenses were incurred solely for the benefit of Mr. Mullen, not for the Appellant. It was a convenience to Mr. Mullen personally. To the extent there was any commercial purpose, it was the business of the business ventures, not the Appellant and, therefore, flight costs are not deductible to the Appellant.

Analysis (*Income Tax Act*)

[46] This is a unique case in that a company, Lyncorp, incurs costs (ignoring any personal element for the time being) that I would describe as operational expenses for the operations of other companies (Shulin Mining, Shulin Lake Lodge, C.R. Boatland, Shear), in which it has a debt or equity interest, without passing those costs onto those operating companies. The Appellant can rightfully declare that its equity interest could yield income from property; that is, there is a source of income. Yet, equally clear is that Shulin Mining, Shulin Lake Lodge, C.R. Boatland and Shear, had they been charged for these operational expenses, could have and should have claimed them, as they would have gone to producing income from their

operations; that is, they had a business source of income. The fact is, only one company incurred the costs, Lyncorp. I will return to this.

a) Did Lyncorp incur the costs?

Yes.

b) Were the costs of a personal nature?

[47] Paragraph 18(1)(*h*) of the *Act* prohibits a deduction for personal or living expenses. The Respondent argues that the flight expenses are commuting expenses and, therefore, personal and not deductible. Further, she argues that the flights were simply for Mr. Mullen's convenience to take him wherever he wanted to go, whenever he wanted to go to increase his own efficiency in dealing with his many companies.

[48] Dealing with the commute argument first, while it is certainly recognized that commuting to work is a personal expense, I would not describe Mr. Mullen's flights as simply commuting to work. Is a business person, with several business interests across Canada, to be denied the cost of getting to those interests as that is simply commuting to work? No, there must be a recognition that some businesses are located in multiple locations, though there would most likely be one predominant place of business. The further twist in this case is that Mr. Mullen's flights can, for the most part, be viewed as costs incurred in connection with the property source of income, as opposed to business income. It is too broad a view of "commute" to suggest that in the context of holding properties, travelling to check on those properties in several locations is commuting to work. No, I do not accept the argument that Mr. Mullen was simply commuting to his place of business. He, and therefore the Appellant, were incurring costs to check on far flung investments, as well as carrying on some direct business activity.

[49] With respect to the trips to Campbell River, however, Mr. Mullen had the added attraction of having a home there; very much a personal reason for taking the plane to Campbell River. His family would often accompany him. This creates a chicken and egg scenario: which came first; the Appellant's decision to check on their investment in Campbell River, so let's have some personal time while we are there anyway or, the decision to spend a family weekend at the Vancouver island property, so let's check on our investment while we are there anyway. I conclude from Mr. Mullen's description, that the time in Campbell River was quite evenly

split, so too then should the cost of any flights to and from Campbell River, between personal and commercial.

[50] This only addresses one element of the Respondent's concern as to the personal nature of the flights; the other element is an overriding concern that these were simply flights of personal convenience. The Respondent points to the list of reasons cited by KPMG (see paragraph 10 of these Reasons) for support of the position that the flights were personal to Mr. Mullen and not for the benefit of the Appellant. This is a difficult concept to grapple with when the corporate Appellant and Mr. Mullen are, as he put it, one and the same. Legally, of course, the Appellant is a separate entity, but practically it is people who conduct that separate entity's affairs; and where the corporate entity has effectively only one person serving as shareholder, director, officer and employee, one must closely scrutinize the nature of the activities before too hastily suggesting those activities are only to the personal benefit of the individual. If Mr. Mullen, as director of Lyncorp, determines it is in the best interest of Lyncorp to actively oversee its' business ventures' activities, and to do so in a time effective manner, knowing the Appellant has only the resources of one person, whose time is limited, is the Government simply second guessing that business decision by suggesting this can only be interpreted as a personal convenience to Mr. Mullen? I believe that is exactly what the Government is doing. Former Chief Justice Bowman addressed this matter of second guessing the taxpayer's business judgment in the case of *Podlesny v. R.*[1] where he stated:

> [15] There is also the question of reasonableness which was not pleaded but which appears to have been an important consideration in the making of the assessments. It is obvious to me that Mr. Podlesny was rather aggressive in claiming the cost of two cars in computing his employment income. It is equally obvious that he liked cars. That, however, is his choice. It is not for me or the Minister to second-guess his business judgement and say that he cannot use two cars for business purposes even though he might have been able to make do with only one, and a cheaper one at that. His work is important and at times urgent. His decision to have two well maintained automobiles is not so patently absurd that I would be justified in setting it aside as irrational or capricious. (See, for example, *Gabco Ltd. v. M.N.R.*, [1968] DTC 5210). To do so would require me to substitute my business judgement for that of the taxpayer and that is not something that I am entitled or prepared to do. Moreover, I would be to some extent usurping the role of Parliament. If Parliament wants to say that you can only use one car

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[1] 2005 TCC 97.

> in your business it knows how to say so, just as it has put a limit on how much CCA you can claim on a luxury car. I do not think that one can, under the guise of "reasonableness" substitute the court's judgement for that of the taxpayer. …

[51] The fact that Mr. Mullen was convenienced by having a plane at the ready, does not make the cost of flights on that plane personal, if the purpose of the flight was commercial and the actions of Mr. Mullen fulfill that purpose. It seems the Respondent is suggesting that if commercial flights were cheaper, though the schedules were awkward for Mr. Mullen, causing considerable inconvenience, that such costs may more likely not be considered to be of a personal nature. Or perhaps the Respondent is suggesting that Mr. Mullen, as the moving force of Lyncorp, should have decided that Lyncorp should hire a third party consultant to check on the business ventures, rather than Mr. Mullen himself, as again it might have been cheaper. These are business decisions. I realize it is difficult when dealing with a one person company to readily determine when the individual is conducting personal matters versus corporate business, but the facts in this case support the conclusion that it was Lyncorp who was both in some active business and also held investments. Mr. Mullen was Lyncorp's sole mover and shaker to get things done.

[52] The Respondent did not plead that the expenses were unreasonable, but simply that they were personal to Mr. Mullen and did not produce income from the Appellant's business or property. I need not, therefore, address the question of reasonableness.

c) Were the costs incurred for the purpose of gaining or producing income from business or property?

[53] Having carved out 50% of the disputed flight costs to Campbell River as being personal, were the remaining disputed flight costs incurred for the purpose of earning or producing income from business or property of the Appellant as required by paragraph 18(1)(*a*) of the *Act*.

<u>Business source</u>

[54] I will first address whether any of the disputed flight expenses were incurred for purpose of gaining or producing income from the Appellant's business, as opposed to the Appellant's property.

[55] The Appellant argues that it was directly engaged in several businesses: active mining exploration, drilling services, aircraft charters and, interestingly, the business of providing a variety of technical, management and executive type services of Mr. Mullen. I find that none of the disputed flight expenses were incurred in pursuit of the Appellant's mining exploration business. That business was not carried on in any of the locations connected to the disputed flights. Also, the aircraft charter business was not engaged in the disputed flights.

[56] I will address first then the notion put forth by the Appellant that it was in the business of providing support services to the business ventures. If it was, then the evidence is clear that it was engaged in a not-for-profit business. Mr. Mullen was straightforward in his testimony that the Appellant simply did not charge the business ventures for the support services he provided. The Appellant did not even charge Shulin Mining for the use of the rig. There is a commercial flavour to Mr. Mullen's work with the business ventures, but the Appellant cannot rely on this consulting business for the purpose of claiming a deduction for the distributed flight expenses as this "business" did not produce revenue nor was it intended to produce revenue. According to Mr. Mullen, the business ventures could not afford to pay for these services. I do not see how the Appellant can now turn around and argue the costs were incurred for the purposes of producing income from that business. This is not a matter of reincarnating any "reasonable expectation of profit" test: this is a matter of the facts clearly establishing this was an intentional non-income producing activity.

[57] The Appellant also cannot point to the possibility of dividend income as being income produced from this consulting business. Dividend income is derived from the source of income being property, and although neither party mentioned it, if the dividend income is the income to be gained from the Appellant's efforts, it would necessarily be a specified investment business, with the result the income is still to be considered income from property, not income from business. All to say, I find the Appellant's argument non-persuasive that this consulting business justifies any deduction of the disputed flight expenses: if it is a business, there is no income; if the Appellant points to the dividend income as the income being produced, it is not income from business but income from property.

[58] With respect to the Appellant's drilling services business, that needs further review. I find the flights to Alaska to check on the operations of Shulin Mining had a twofold purpose. First and foremost, it was to assist Shulin Mining (and also Shear and Golconda) with its operations. But second, it was for the Appellant, through Mr. Mullen, to see firsthand how the Appellant's drilling rig, being used at no charge by Shulin Mining, was being operated. Mr. Mullen acknowledged it provided a learning

experience on which the Appellant could rely for its ongoing and future drilling services. I am satisfied the Appellant owned the rig and I am further convinced it was a legitimate business reason to send its representative to check on the rig and to, more importantly, determine how to best use the rig in its future drilling business. The rig was later moved by the Appellant to work in Saskatchewan.

[59] There is little evidence to effectively determine how much of Mr. Mullen's time and effort, when visiting drill sites at Shulin Lake, was overseeing the activities of one of its business ventures (Shulin Mining, Shear or Golconda) versus checking on the Appellant's rig and learning, from the use of the rig, the effective operation of a drilling business. The flight costs of the Appellant for the latter direct business activity are legitimate deductible business expenses as they relate directly to the development of Lyncorp's active business. The cost incurred for the former, I will deal with when reviewing income from property.

[60] From Mr. Mullen's description of his involvement with Shulin Mining, I find that he was there more to oversee the work of Shulin Mining, Shear and Golconda in connection with the claims, than to check on Lyncorp's rig and basically learn the ropes for Lyncorp's own drilling business. I considered sending this point back to the Parties for further submission but instead have determined that a 75% - 25% allocation is appropriate. Therefore, one-quarter of the flight costs to Alaska that relate to drilling should be deductible. It is then necessary to allocate flights to Alaska between flights to check on the lodge versus flights to check on the drilling versus flights where Mr. Mullen did both. I find the following flights related only to drilling and, therefore, one-quarter of the cost is deductible, as it pertains to Lyncorp's direct business activity:

a) February 7 to 11, 2002 - $9,677

b) April 2 to 4, 2002 - $19,404

c) August 3 to 6, 2002 - $13,776 ($6,450 was already deducted as pertaining to the Campbell River portion of the trip)

d) August 14 to 19, 2002 - $15,943

e) August 30 to September 3, 2002 - $16,472

f) September 22 to 23, 2002 - $20,649

Total for 2002 - $95,921, 25% being $23,980.

g) February 5 to 7, 2003 - $16,314

h) March 14, 2003 - $16,445

Total for 2003 - $32,759, one-quarter of which is $8,189.

[61] I find the following flights related to both Shulin Lake Lodge and to the drilling. I have no conclusive evidence as to how Mr. Mullen divided his time between the two, and again am going to presume an equal split, which means one-quarter of one-half of the costs related to Lyncorp's direct business activity of developing a drilling business:

a) March 15 to 19, 2002 - $11,281

b) June 17 to 20, 2002 - $18,254

Total for 2002 - $29,535, of which $3,692 is deductible.

c) April 23 to 27, 2003 - $18,081

d) June 16 to 19, 2003 - $16,657

e) August 13 to 17, 2003 - $15,569

f) September 2 to 5, 2003 - $25,061

Total for 2003 - $75,368, of which $9,421 is deductible.

[62] All other flights to Alaska, I conclude were non-drilling related, such as work in connection with the lodge.

[63] The only other flight that I find relates directly to the Appellant's business activity is the May 2002 flight to Cranbrook at a cost of $1,440.

Property source

[64] I turn now to consider whether any of the remaining disputed flight expenses were incurred for the purpose of gaining or producing income from property. In this regard, the Appellant argues it has two sources of property income – shares and debt.

[65] I will first deal with the issue of debt as a source of property income. The Appellant did indeed lend considerable amounts to its business ventures in 2002 and 2003. It argues it could benefit from such loans in two ways: first, if the ventures became profitable enough, the Appellant could charge interest on the loans; second, even if it chose not to charge interest on the loans, they could be viewed as enhancing the business ventures' ability to pay dividends.

[66] The evidence was clear that the loans were non-interest bearing. The Appellant's position that it could decide to charge interest at a point it believed the business ventures could afford to pay it, is just not sufficient to find the existing contractual debts owed to it were income producing. They were not. The disputed flight costs were not incurred for the purpose of producing interest income, given the debts were non-interest bearing. It is too remote a link to suggest that, because the Appellant could have or perhaps should have charged interest, there is a property source of income. Could haves or should haves, speculation generally, is not enough.

[67] The Appellant's argument that the loans are a source of income from property as they would allow the debtors to ultimately pay dividends is imaginative, bold even, but it too must fail. The property itself, the debt, produces no income. The debtor is obliged to repay the principal: it has no contractual obligation to pay interest. It may become profitable in the future, allowing it to repay that debt. It may then be in a position to pay dividends. I fail though to see any link, direct or otherwise, between the debt and the possibility of payment of dividends, let alone any actual payment of dividend. The dividend income does not arise from the debt. Put in tax terms, the debt is not the source of dividend income.

[68] This leads, finally, to perhaps the most interesting issue: does the Appellant's investment in shares of the business ventures, with the possibility of dividends being declared on those shares, support the deduction of the disputed flight expenses, claimed to have been incurred for the purpose of producing that dividend income?

[69] To recap, it was the Appellant's strategy to provide the support services of Mr. Mullen to the business ventures at no charge, to help them succeed with an expectation of future dividends. Therefore, the Appellant argues, the flight costs incurred in enabling Mr. Mullen to provide those support services fits squarely within paragraph 18(1)(*a*) of the *Act*, as they were incurred for the purpose of producing

income from a property, being the shares in the business ventures. I note at this point that it was Mr. Mullen, not the Appellant, who owned shares in Shulin Mining, notwithstanding Mr. Mullen's view that those shares should have been transferred to the Appellant. They were not. However, the Appellant did own shares in both Shear and Golconda, which were intimately involved with Shulin Mining in the work in Alaska.

[70] The Respondent relies on the recent decision of *SLX Management Inc. v. R.*[2] to support the proposition that expenses incurred to produce income from a subsidiary company, are not deductible on the basis of being incurred for the purpose of producing income from property (dividends). To be fair, *SLX Management* does not appear to address this issue head on, but simply stated:

> [55] Second, the aircraft was used in relation to a business other than Management, SLX Aviation, which is a subsidiary of Management. A distribution agreement being negotiated with Socata by Miller anticipated that this other entity and not Management would be the distributor. Miller stated that Management itself would never be the owner of anything in terms of this venture with Socata. According to the principles enunciated in *Stewart, supra,* any aircraft expenses incurred for the purpose of gaining income for SLX Aviation are not deductible by Management.

[71] It is not clear whether the Appellant in *SLX Management* even argued for the deductibility based on income from property. No, I am not prepared to attribute as broad an interpretation to *SLX Management* as the Respondent suggests. The issue requires further scrutiny.

[72] In *Stewart v. Canada*,[3] the Supreme Court of Canada stated:

> [57] It is clear from these provisions that the deductibility of expenses presupposes the existence of a source of income, and thus should not be confused with the preliminary source inquiry. If the deductibility of a particular expense is in question, then it is not the existence of a source of income which ought to be questioned, but the relationship between that expense and the source to which it is purported to relate. The fact that an expense is found to be a personal or living expense does not affect the characterization of the source of income to which the taxpayer attempts to

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[2] 2010 TCC 148.

[3] [2002] 2 SCR 645.

> allocate the expense, it simply means that the expense cannot be attributed to the source of income in question. As well, if, in the circumstances, the expense is unreasonable in relation to the source of income, then s. 67 of the *Act* provides a mechanism to reduce or eliminate the amount of the expense. Again, however, excessive or unreasonable expenses have no bearing on the characterization of a particular activity as a source of income.

[73] The dilemma before me is which relationship triggers a possible deductible expense: the relationship between the expense, being the disputed flight costs, and the business income of the particular business ventures, or the relationship between the expense and the property income (dividends) of the parent company incurring the expense? I attempted to address the dilemma in argument by asking the parties about a direct or indirect relationship. They did not appear enthusiastic to take the bait. Yet, that is where, I believe, the resolution lies. To which source of income does the expense purportedly relate? The fact the Appellant incurred the expense has little impact on the answer to that question. The Appellant argues the expense relates to the property source of income. Indirectly, perhaps. But clearly, the remaining disputed flight expenses relate directly to the business income of the business ventures. The expenses were incurred to make the business ventures profitable. Yes, that might yield at some future point dividend income, but the direct cause and effect link is between the expenses and the business income of the business ventures, not the relationship with any property source of income.

[74] To allow the Appellant's deductibility of such expenses invites shareholders and corporate taxpayers to effectively choose from which source of income (property or business) to deduct expenses as best suits their purposes. I do not believe the *Act* contemplates such an election.

[75] The Appellant was, in effect, giving its business ventures several hundred thousand dollars, neither by way of debt or equity but simply by providing free services toward the operation of the business ventures' businesses, with the hope that this generosity would help them get on their feet and maybe some day, in some manner, repay them. This generosity was neither a loan nor an equity investment by the Appellant. It might best be described as an agreement to pay someone else's expenses. Equity investments yield dividend income. Debt investments yield interest income. Free services, with no obligation to repay, yield only hope. This is not a deductible expense.

[76] In summary, on the income tax appeal, the appeal is allowed and referred back to the Minister for National Revenue for reconsideration and reassessment on the

basis the Appellant is entitled to deduct flight expenses of $29,112 in the 2002 taxation year and $17,610 in the 2003 taxation year.

GST

[77] Generally, the entitlement to Input Tax Credits (ITC's) under the *ETA* arises when GST was paid "for consumption, use or supply in the course of commercial activity". Subsection 123(1) of the *ETA* defines commercial activity generally, as "a business carried on by the person…except to the extent to which the business involves the making of exempt supplies by the person". From this definition, it is inferred that exempt supplies will not qualify as commercial activities, as well as non-business activities, or activities of a personal nature. Further, what is key from this description of commercial activity is that it is not enough the activity be simply commercial in nature, but that it is a business carried on by the taxpayer. This is the Appellant's hurdle, as apart from the direct flight expenses that I have found relate to the Appellant's direct business activity, the rest of the disputed flight expenses simply do not relate to a business carried on by the Appellant.

[78] In *B.J. Services Company Canada, the Successor to Nowsco Well Service Ltd., v. Her Majesty the Queen*[4], I determined the Court should look to the following factors in determining the commerciality of the inputs:

a) the purpose for the input;

b) for whose benefit was the input incurred;

c) the context within which the input was incurred; and

d) caselaw dealing with what constitutes commercial activity.

[79] In *Sclerie St.-Elzear Inc. v. Her Majesty the Queen* the Court considered whether the Appellant could claim ITC's in relation to fees paid for the preparation of financial statements of five related companies owned by the Registrant's members. The Tax Court upheld the Minister's decision that the ITC's were not an integral part of the Registrant's commercial activities, stating, as follows:

> …in the case at bar, the professional services do not fulfil the Appellant's obligations, but, rather, the five management companies' obligations to

4 [2002] G.S.T.C. 124.

> file tax returns and financial statements. The five management companies are the ones that need professional services like those rendered in the instant case, and, in my opinion, they are the ones that should pay for them. The fact that the Appellant has agreed to foot the bill for these services attests to its economic interest in maintaining the management companies in existence, as opposed to pointing to a need or legal duty on its part to ensure that its business operates soundly, which need or duty would compel a finding that the payment is an integral part of the Appellant's commercial activities. The purpose and context of the input are not related to the Appellant's commercial activities, any more than the fact that the Cooperative and its members are the ones that benefit from the input by reason of the profit that will be distributed to the members at age 60.

[80] I conclude that the purpose for, and the benefit of, the remaining disputed flight expenses (other than the $29,112 in 2002 and $17,610 in 2003) relate to the businesses of the business ventures and not any commercial activity of the Appellant. Likewise, the context of the remaining disputed flight expenses was services provided in the business ventures' businesses, in their commercial activity, not any commercial activity of the Appellant.

[81] This is a unique situation of a company incurring costs (inputs) to provide free services to its business ventures. In such circumstances, the company can best be viewed as the ultimate consumer – the end of the line: no ITC's are available, as there is no further commercial activity of the company.

[82] In summary, the GST Appeal for the period January 1, 2002 to December 31, 2003 by Notice of Assessment No. 10CT0700344 dated July 26, 2006 is allowed and referred back to the Minister of National Revenue for reconsideration and reassessment on the basis the Appellant is entitled to ITC's in connection with the flight expenses of $29,112 in the 2002 taxation year and $17,610 in the 2003 taxation year.

[83] Given the limited success of the Appellant, I award one set of costs to the Respondent in accordance with the tariff.

Signed at Ottawa, Canada, this 19th day of October 2010.

"Campbell J. Miller"

C. Miller J.

Appendix A

Lyncorp International Ltd.
Aircraft Expenses

Flight Date	From	To		Amount
29-Nov-01	Calgary	Vancouver	$	2,869.97
1-Dec-01	Vancouver	Calgary		
2-Jan-02	Calgary	Campbell River	$	3,077.00
6-Jan-02	Campbell River	Calgary		
7-Feb-02	Calgary	Edmonton	$	9,676.93
7-Feb-02	Edmonton	Whitehorse		
7-Feb-02	Whitehorse	Anchorage		
11-Feb-02	Anchorage	Edmonton		
11-Feb-02	Edmonton	Calgary		
15-Mar-02	Calgary	Prince George	$	11,261.82
15-Mar-02	Prince George	Anchorage		
19-Mar-02	Anchorage	Edmonton		
19-Mar-02	Edmonton	Calgary		
2-Apr-02	Calgary	Anchorage	$	19,403.72
4-Apr-02	Anchorage	Calgary		
25-Apr-02	Calgary	Campbell River	$	3,505.61
28-Apr-02	Campbell River	Vancouver		
28-Apr-02	Vancouver	Calgary		
16-May-02	Calgary	Campbell River	$	960.00
20-May-02	Campbell River	Calgary	$	1,820.00
26-May-02	Calgary	Cranbrook	$	1,440.00
26-May-02	Cranbrook	Calgary		
17-Jun-02	Calgary	Anchorage	$	18,254.03
20-Jun-02	Anchorage	Calgary		
26-Jun-02	Calgary	Campbell River	$	2,895.00
1-Jul-02	Campbell River	Calgary	$	1,820.00
20-Jul-02	Calgary	Campbell River	$	2,250.00
28-Jul-02	Campbell River	Calgary	$	3,058.45
3-Aug-02	Calgary	Campbell River	$	20,226.75
3-Aug-02	Campbell River	Anchorage		
6-Aug-02	Anchorage	Campbell River		

Flight Date	From	To	Amount
6-Aug-02	Campbell River	Calgary	
10-Aug-02	Campbell River	Calgary	$ 1,605.00
14-Aug-02	Campbell River	Anchorage	$ 8,068.22
18-Aug-02	Anchorage	Campbell River	$ 7,875.00
30-Aug-02	Calgary	Anchorage	$ 16,472.34
3-Sep-02	Anchorage	Calgary	
20-Sep-02	Calgary	Campbell River	$ 3,855.00
22-Sep-02	Campbell River	Calgary	
22-Sep-02	Calgary	Anchorage	$ 20,649.58
23-Sep-02	Anchorage	Calgary	
18-Oct-02	Calgary	Campbell River	$ 3,855.00
20-Oct-02	Campbell River	Calgary	
17-Nov-02	Calgary	Vancouver	$ 4,912.00
20-Nov-02	Vancouver	Campbell River	
20-Nov-02	Campbell River	Calgary	
16-Dec-02	Calgary	Campbell River	$ 3,862.00
17-Dec-02	Campbell River	Calgary	
2-Jan-03	Calgary	Campbell River	$ 2,257.00
5-Jan-03	Campbell River	Calgary	$ 1,820.00
5-Feb-03	Calgary	Anchorage	$ 16,313.95
5-Feb-03	Anchorage	Calgary	
14-Mar-03	Calgary	Anchorage	$ 16,445.91
9-Apr-03	Calgary	Vancouver	$ 2,086.45
11-Apr-03	Calgary	Vancouver	$ 4,608.80
11-Apr-03	Vancouver	Campbell River	
13-Apr-03	Campbell River	Calgary	
23-Apr-03	Calgary	Edmonton	$ 18,081.08
23-Apr-03	Edmonton	Anchorage	
27-Apr-03	Anchorage	Edmonton	

Flight Date	From	To		Amount
27-Apr-03	Edmonton	Calgary		
2-May-03	Calgary	Campbell River	$	6,795.86
4-May-03	Campbell River	Calgary		
8-May-03	Calgary	Vancouver	$	4,658.80
9-May-03	Vancouver	Campbell River		
10-May-03	Campbell River	Calgary		
2-Jun-03	Campbell River	Vancouver	$	16,719.78
2-Jun-03	Vancouver	Anchorage		
4-Jun-03	Anchorage	Calgary		
8-Jun-03	Calgary	Campbell River	$	15,229.48
8-Jun-03	Campbell River	Kamloops		
8-Jun-03	Kamloops	Calgary		
13-Jun-03	Calgary	Edmonton	$	14,663.52
13-Jun-03	Edmonton	Rankin Inlet		
13-Jun-03	Rankin Inlet	Edmonton		
13-Jun-03	Edmonton	Calgary		
16-Jun-03	Calgary	Anchorage	$	16,657.72
19-Jun-03	Anchorage	Calgary		
28-Jun-03	Calgary	Campbell River	$	3,509.11
1-Jul-03	Campbell River	Calgary	$	3,335.21
17-Jul-03	Calgary	Anchorage	$	20,062.22
19-Jul-03	Anchorage	Campbell River		
20-Jul-03	Campbell River	Calgary		
26-Jul-03	Calgary	Campbell River	$	3,804.61
3-Aug-03	Calgary	Campbell River	$	7,157.48
3-Aug-03	Campbell River	Calgary		
7-Aug-03	Campbell River	Calgary	$	1,984.95
8-Aug-03	Calgary	Campbell River	$	2,219.65
13-Aug-03	Campbell River	Anchorage	$	15,569.68
17-Aug-03	Anchorage	Campbell River		
2-Sep-03	Calgary	Whitehorse	$	25,061.61
2-Sep-03	Whitehorse	Anchorage		
5-Sep-03	Anchorage	Campbell River		
5-Sep-03	Campbell River	Kelowna		
8-Sep-03	Kelowna	Calgary		
3-Oct-03	Calgary	Campbell River	$	7,164.83
5-Oct-03	Campbell River	Calgary		
Total Flights for 2002			$	173,693.42
Total Flights for 2003			$	226,207.70
Total Flights in Issue			$	399,901.12

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COURT FILE NO.:	2008-2977(IT)G and 2008-2710(GST)G
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