Docket: 2011-1673(IT)I

BETWEEN:

SÉBASTIEN AUDET,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on May 1, 2012, at Montréal, Quebec

Before: The Honourable Justice Lucie Lamarre

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Marie-France Camiré

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2008 taxation year is dismissed.

Signed at Ottawa, Canada, this 10th day of May 2012.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 27th day of June 2012.
Daniela Possamai, Reviser

Citation: 2012 TCC 162
Date: 20120510
Docket: 2011-1673(IT)I

BETWEEN:

SÉBASTIEN AUDET,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Lamarre J.

[1] The appellant is appealing from a reassessment made by the Minister of National Revenue (**the Minister**) under the *Income Tax Act* (**ITA**) for the 2008 taxation year. The Minister disallowed the appellant's deduction of $3,000 on account of legal expenses, and disallowed his claim of an allowable business investment loss (**ABIL**) in the amount of $4,120 ($8,240 X 50%). The appellant has now reduced his ABIL claim from $4,120 to $2,584.23 ($5,168.46 X 50%).

Facts

[2] The appellant is a certified general accountant (**CGA**). He was a shareholder of three corporations, two of which, 9145-0411 Québec Inc. and 9153-1772 Québec Inc., were in the business of selling kitchenware. The appellant guaranteed several loans granted to these corporations by various financial institutions. One of those institutions made a claim against him in May 2007, and, on August 20, 2007, the appellant sold the shares of 9145-0411 Québec Inc. for $300,000, of which $150,000 was payable the same day and the remaining $150,000 was payable on February 20, 2008 (see Exhibit I-1, tab 6). Only $25,000 of the total

amount was ever paid to the appellant; this occurred on August 20, 2007. The remaining $275,000 was never paid to him.

[3] The appellant also worked for a corporation called Cuisine Gourmet. He tendered in evidence (Exhibit A-1) its interim financial statements as at February 28, 2006, which he claims to have prepared. He signed an accounting mandate with Cuisine Gourmet on December 3, 2007. He was retained to provide consulting services in relation to its operating structure and its accounting, for which he received professional fees (Exhibit I-1, tab 9). The mandate contract appears to show that the appellant had already started providing these services on January 1, 2007, and that his mandate was renewed (page 2, paragraph B under the heading [TRANSLATION] "Purpose") Under the heading [TRANSLATION] "Other Consideration," the appellant, on December 3, 2007, was granted an option to purchase 25% of the voting shares of the corporation for a price of $25,000, during a term of one year. The appellant never exercised the option. In fact, he quickly realized that he did not have the same business philosophy as the director of Cuisine Gourmet and did not want to make any further investments. He had already guaranteed a loan of $148,032 granted on May 3, 2007, to the corporation by the Business Development Bank of Canada (**BDC**) (see subparagraph 6(i) of the Amended Reply to the Notice of Appeal). According to his testimony, his objective in accepting the mandate with Cuisine Gourmet was to form a group of corporations, which would include the corporations he already held in the same field of endeavour. In his Notice of Appeal, he states that, under the plan, Cuisine Gourmet, as a parent corporation, acquired the two corporations whose shares he held. This never transpired. In court, the appellant made reference to the business risk associated with this plan to form a group of corporations. He said the decision to defer the acquisition of his two corporations by Cuisine Gourmet was a strategic one: if business did not go well, it would be easier to close Cuisine Gourmet alone, without the involvement of any of the group of other corporations. The appellant stresses that business ultimately plummeted, and that they were never able to get to the second phase, in which all the corporations would become a group.

[4] On January 9, 2008, having noticed that he was unable to meet his meet his obligations as they generally became due, the appellant filed a notice of intention to make a proposal to his creditors (see Exhibit I-1, tab 8, the appointed trustee's statement of the affairs and property of the debtor under subsection 50(5) of the *Bankruptcy and Insolvency Act* (**the trustee's report**)). On February 5, 2008, Michel Charbonneau, of the law firm of Charbonneau, Gauthier & Associés, notified the trustee responsible for the appellant's file that he was willing to take the matter involving the sale of the shares of 9145-0411 Québec Inc. (discussed above) for

$3,000, including taxes, plus 30% of the amounts collected (Exhibit I-1, tab 3). At the hearing, the appellant explained he was not the one who personally retained Mr. Charbonneau to represent him in order to recover the unpaid balance from the sale of his shares. Rather, when he met the trustee, the trustee proposed to include the recovery of this amount in the proposal to the creditors. The appellant said he wanted to avoid bankruptcy so he could keep his professional title and thereby preserve his source of income. He said he had $40,000 at his disposal. Apparently, the trustee suggested he allocate $30,000 to the creditors as a dividend, and the remaining $10,000 to the trustee's fees and the fee of the lawyer tasked with recovering the amount due. That amount would be distributed to the creditors as well, after the fees were paid. The appellant explains that $7,000 was then paid to the trustee, and that he personally paid the lawyer $3,000.

[5] On February 8, 2008, the appellant filed a proposal with the official receiver, which was recommended for acceptance by the trustee on February 29, 2008 (trustee's report) and then approved by a majority of the creditors on March 14, 2008, and ratified by the Quebec Superior Court, Commercial Division, on April 8, 2008 (Exhibit I-1, tabs 7 and 8). Paragraph 5 of the trustee's report states that the debtor (the appellant) negotiated a mandate with a lawyer to take charge of the collection measures in exchange for $3,000, including taxes, plus 30% of the amounts collected, and that the debtor would advance the $3,000 if the inspectors to be appointed accepted Mr. Charbonneau's mandate. In addition, the trustee's report allocates a total of $10,000 to the trustee's fees and disbursements (Exhibit I-1, tab 8, paragraph 5). On May 11, 2009, in an interim statement of receipts and disbursements, the trustee stated that the debtor had completed the performance of his proposal on June 16, 2008, and had advanced $3,000 to Michel Charbonneau so that he would commence collection of the amount owed by the purchaser of the shares of 9145-0411 Québec Inc. (Exhibit I-1, tab 2, second page). This is the $3,000 which the appellant is seeking to deduct from his income as legal expenses, and which the Minister disallowed on the basis that it was a capital outlay.

[6] In addition, after completing the performance of the proposal on June 16, 2008, the appellant, in computing his taxable income, claimed a deduction of $28,180 on account of personal guarantees paid on commercial loans (see 2008 income tax return, Exhibit I-1, tab 1, [TRANSLATION] "Other income, deductions and credits"). This amount included his payment of $5,168.46 on the $148,032 BDC loan to Cuisine Gourmet which he had guaranteed (see subparagraphs 6(i), (o) and (p) of the Amended Reply to the Notice of Appeal). The Minister disallowed the amount of $5,168.48 on the basis that it could not be an ABIL, because the appellant was not a shareholder of Cuisine Gourmet, and did not show that he had guaranteed the loan

for the purpose of gaining or producing income from a business or property. It is this second amount that is at issue before me.

Analysis

Legal fees

[7] The respondent argues that the legal fees in this case are a capital outlay and are therefore not deductible under paragraph 18(1)(*b*) of the ITA, which reads as follows:

> **Deductions**
>
> **SECTION 18: General limitations**
>
> **18.** (1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of
>
> . . .
>
> (*b*) **Capital outlay or loss** - an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part;

[8] The respondent submits that the purpose of incurring the legal fees was to recover the capital gain realized from the sale of shares, and that this makes the outlay capital in nature. In addition, she submits that even if, as the appellant argues, the legal fees are part of the fees payable to the trustee, they are still a capital outlay, because, as the appellant explained, he went to see the trustee to make a proposal that would avoid bankruptcy so that he could continue to practice the profession of CGA. In this regard, the respondent relies on *Canada v. Doiron*, [2012] F.C.J. No. 316 (QL), 2012 FCA 71, which reiterates that the right to practise a profession governed by a professional body is an asset of an enduring nature, and that expenses claimed for the purpose of acquiring, preserving or regaining such a right to practice are capital outlays that are not deductible under the terms of paragraph 18(1)(*b*) of the ITA (see *Doiron* at paragraphs 34, 35 and 42).

[9] The appellant, for his part, submits that he was not the person who retained the lawyer, and that he remitted the $3,000 to the lawyer on the advice of the trustee. Moreover, he does not understand why the Minister drew a distinction between the $7,000 in fees paid to the trustee and allowed as deductible expenses, and the amount

of $3,000 paid to the lawyer, which is somehow not deductible. He cites *Renaud v. The Queen*, 2006 CarswellNat 1654, 2006 TCC 354, where our Court held that a trustee's fees were deductible because the proposal to the creditors was made for business reasons.

[10] I need not make any pronouncement on the deductibility of the $7,000 in fees paid to the trustee, because the Minister, rightly or wrongly, allowed the appellant's claim in that regard. This amount is not in issue before me.

[11] As for the amount of $3,000 which the appellant paid directly to the lawyer, it is clear that the amount was paid to recover the proceeds of the sale of the shares of 9145-0411 Québec Inc. The profit realized from the sale of the shares is a capital gain, only 50% of which is taxable because, in this instance, it constitutes profit on an investment. It is not business income or income from property, the full amount of which would be taxable. The result is that any expense incurred to recover the proceeds of a disposition that gives rise to a capital gain is also capital in nature. Such an expense is not deductible under the terms of paragraph 18(1)(*b*) of the ITA. And even if the trustee retained the lawyer to recover this amount, the decision to include this receivable in the proposal to the creditors was made under an agreement with the appellant. The appellant not only agreed to this approach, but also paid the lawyer himself, with a view to collecting the debt owed to him. Under the circumstances, the legal fees in question cannot be included in the same class as the fees paid to the trustee.

[12] In conclusion on this point, the appellant could not deduct the $3,000 in legal fees from his income for the 2008 taxation year.

ABIL

[13] The respondent disallowed the deduction of an allowable business investment loss on the $5,168.46 paid by the appellant to BDC under his guarantee of a loan to Cuisine Gourmet. The Minister argues that the appellant is not entitled to this loss because he was not a shareholder of Cuisine Gourmet and did not establish that he gave the guarantee for the purpose of gaining or producing income from a business or property. In paying this amount to BDC, the appellant paid part of the debt owed by Cuisine Gourmet, and Cuisine Gourmet thereby became his debtor.

[14] The provisions of the ITA that are relevant in determining entitlement to an ABIL are reproduced below:

Subdivision c - Taxable Capital Gains and Allowable Capital Losses

SECTION 38: Taxable capital gain and allowable capital loss

For the purposes of this Act,

. . .

(*c*) a taxpayer's allowable business investment loss for a taxation year from the disposition of any property is 1/2 of the taxpayer's business investment loss for the year from the disposition of that property.

SECTION 39: Meaning of capital gain and capital loss

(1) For the purposes of this Act:

. . .

(*c*) a taxpayer's business investment loss for a taxation year from the disposition of any property is the amount, if any, by which the taxpayer's capital loss for the year from a disposition after 1977

(i) to which subsection 50(1) applies, or

(ii) to a person with whom the taxpayer was dealing at arm's length

of any property that is

(iii) a share of the capital stock of a small business corporation, or

(iv) a debt owing to the taxpayer by a Canadian-controlled private corporation (other than, where the taxpayer is a corporation, a debt owing to it by a corporation with which it does not deal at arm's length) that is

(A) a small business corporation,

(B) a bankrupt (within the meaning assigned by subsection 128(3)) that was a small business corporation at the time it last became a bankrupt, or

(C) a corporation referred to in section 6 of the *Winding-up Act* that was insolvent (within the meaning of that Act) and was a small business corporation at the time a winding-up order under that Act was made in respect of the corporation,

exceeds the total of

. . .

SECTION 40: General rules

(2) Limitations Notwithstanding subsection (1),

. . .

(*g*) a taxpayer's loss, if any, from the disposition of a property, to the extent that it is

. . .

(ii) a loss from the disposition of a debt or other right to receive an amount, unless the debt or right, as the case may be, was acquired by the taxpayer for the purpose of gaining or producing income from a business or property (other than exempt income) or as consideration for the disposition of capital property to a person with whom the taxpayer was dealing at arm's length,

is nil;

SECTION 50: Debts established to be bad debts and shares of a bankrupt corporation

50. (1) For the purposes of this subdivision, where

(*a*) debt owing to a taxpayer at the end of a taxation year (other than a debt owing to the taxpayer in respect of the disposition of personal-use property) is established by the taxpayer to have become a bad debt in the year, or

(*b*) a share (other than a share received by a taxpayer as consideration in respect of the disposition of personal-use property) of the capital stock of a corporation is owned by the taxpayer at the end of a taxation year and:

(i) the corporation has during the year become a bankrupt (within the meaning of subsection 128(3)),

(ii) the corporation is a corporation referred to in section 6 of the *Winding-up Act* that is insolvent (within the meaning of that Act) and in respect of which a winding-up order under that Act has been made in the year, or

(iii) at the end of the year,

(A) the corporation is insolvent,

> (B) neither the corporation nor a corporation controlled by it carries on business,
>
> (C) the fair market value of the share is nil, and,
>
> (D) it is reasonable to expect that the corporation will be dissolved or wound up and will not commence to carry on business,

> and the taxpayer elects in the taxpayer's return of income for the year to have this subsection apply in respect of the debt or the share, as the case may be, the taxpayer shall be deemed to have disposed of the debt or the share, as the case may be, at the end of the year for proceeds equal to nil and to have reacquired it immediately after the end of the year at a cost equal to nil.

[15] Thus, to deduct an ABIL under sections 38 and 39 of the ITA, the appellant must show that he incurred a capital loss from the disposition of property. Under section 50 of the ITA, the taxpayer is deemed to have disposed of a debt owing to him at the end of the year for proceeds equal to nil, if the debt is established to have become bad during the year. If the taxpayer holds shares in a corporation that becomes bankrupt or insolvent during the year, he will be deemed to have disposed of the shares at the end of the year for proceeds equal to nil.

[16] In the present case, it is clear that the appellant was never a shareholder of Cuisine Gourmet. As for the debt owed to him by Cuisine Gourmet following his payment under the guarantee, the Minister, relying on subparagraph 40(2)(*g*)(ii) of the ITA, states that the appellant's loss on the debt owed to him was nil because he did not acquire the debt for the purpose of gaining or producing income from a business or property. The Minister argues that since the appellant was not a shareholder, he could not expect any dividend income. Moreover, the giving of a guarantee did not entitle him to any interest income, because he was not the one who advanced the interest-bearing loan. The income that the appellant obtained from Cuisine Gourmet consisted in professional fees under his accounting mandate from the corporation, and those fees were obtained in exchange for rendering specific services. This income was in no way tied to the guarantee given to BDC on its loan to Cuisine Gourmet.

[17] For his part, the appellant argues that although he held no shares in Cuisine Gourmet, he was closely involved in it from a financial point of view, because he personally guaranteed the $148,000 BDC loan and devoted 100% of his work to Cuisine Gourmet with a view to creating a single group out of it and his other two corporations. In his view, it is clear that his loan guarantee was an investment in a business for the purpose of gaining income.

[18] Only subparagraph 40(2)(*g*)(ii) of the ITA is in play here. The decision in *Byram v. Canada*, 1999 CanLII 7428 (FCA) deals specifically with its application. It instructs us that the only purpose that the analysis under the subparagraph is concerned with is the purpose for which the debt was acquired. In the case of a guarantee, one must refer to the point in time when the guarantee was given and determine the purpose for which the guarantee was originally given (see *Cadillac-Fairview Corp. v. Canada*, [1996] T.C.J. No. 209 (QL) at paragraphs 10-11, 97 DTC 405 at pages 407-8). In this instance, that point in time was May 3, 2007.

[19] In addition, subparagraph 40(2)(*g*)(ii) requires a linkage between the taxpayer (the guarantor in this instance) and the income. However, there is no need for the income to flow directly to the taxpayer from the loan (*Byram*, at paragraph 16). Therefore, a shareholder may make an interest-free loan to his or her corporation for the purpose of obtaining income, because the loan thereby made can facilitate the performance of the corporation, which will ultimately pay the shareholder dividends. (*Byram*, at paragraphs 17-18).

[20] Also, current commercial reality is increasingly considered sufficient to demonstrate that the expectation of dividend income justifies a capital loss deduction under subparagraph 40(2)(*g*)(ii) (*Byram*, at paragraph 19). However, if the taxpayer does not hold shares in the corporate debtor, proof of a sufficient linkage between the taxpayer and the anticipated income from the corporate debtor is much more demanding. Accordingly, a deduction cannot be so far removed from its corresponding income stream as to render its connection to the anticipated income tenuous at best (*Byram*, at paragraphs 21 and 23). In other words, if the connection between the anticipated income and the expense is too tenuous or remote, it cannot be argued that the expense was incurred to gain or produce income from the business or property.

[21] In the present case, the appellant was never a shareholder of the Gourmet Corporation, and his own corporations never became affiliated with it. The appellant himself admits that these facts resulted from his own decision, which was based on the riskiness of the venture. Therefore, it was legally impossible for the appellant to derive any income from the Gourmet Corporation from the loan that he agreed to guarantee.

[22] In *Toews v. The Queen*, 2005 TCC 597, 2005 CarswellNat 5836, the taxpayer made an interest-free loan to a corporation. He was not a shareholder of the corporation, but was one of the beneficiaries of a trust that was. Under the trust deed, the trustees (one of whom was the taxpayer) had the discretion to pay one beneficiary to the exclusion of the others. Justice Bowie of this Court held that the necessary nexus between the taxpayer and the income flowing from the loan was lacking. The reason was that, given the structure selected, the taxpayer might never obtain income from the operating company that acquired the loan, since the trust deed allowed him to be excluded as a beneficiary by a decision that the trustees had the discretion to make. Accordingly, the taxpayer was not permitted to deduct an ABIL. It is worth noting that Justice Bowie relied on the decision in *Service v. The Queen*, 2004 TCC 592, 2004 DTC 3317, affirmed 2005 FCA 163, where the Court held that a loan made by a taxpayer at no interest to a holding company whose shares were all held by his wife had not been made for the purpose of gaining or producing income, there being no nexus between the taxpayer and the operating company.

[23] In the instant case, the appellant was paid professional fees for the services that he rendered to the corporation, and the professional services contract in question was legally formalized when the accounting mandate was signed in December 2007. Only then was the appellant granted an option to purchase shares in the corporation. Upon guaranteeing the loan in May 2007, the appellant could not even claim to have the right to exercise that option. Moreover, at the time that he made good on his guarantee, he had still not exercised his purchase option, and was therefore still not a shareholder of the corporation. The appellant's position is that he agreed to guarantee the loan to Cuisine Gourmet for an investment purpose, namely, in order to increase, in a sense, the income-earning potential of his own businesses. However, nothing was put in place at that time to ensure a return on this investment. This alleged purpose is too indirect and too far removed to conclude that the appellant could expect to obtain income from the loan he guaranteed (see *Byram*, at paragraph 20, citing *Mark Resources Inc. v. Canada*, [1993] T.C.J. No. 265 (QL)).

[24] For these reasons, the appellant is not entitled to an ABIL on the $5,168.46 that he paid to BDC as that loss is deemed to be nil under the terms of subparagraph 40(2)(*g*)(ii) of the ITA.

[25] The appeal is dismissed.

Signed at Ottawa, Canada, this 10th day of May 2012.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 27th day of June 2012.
Daniela Possamai, Reviser

CITATION:	2012 TCC 162
COURT FILE NO.:	2011-1673(IT)I
STYLE OF CAUSE:	SÉBASTIEN AUDET v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	May 1, 2012
REASONS FOR JUDGMENT BY:	The Honourable Justice Lucie Lamarre
DATE OF JUDGMENT:	May 10, 2012

APPEARANCES:

For the Appellant:	The Appellant himself
For the Respondent:	Marie-France Camiré

COUNSEL OF RECORD

For the Appellant:

Name:

Firm:

For the Respondent:	Myles J. Kirvan Deputy Attorney General of Canada Ottawa, Canada