Docket: 2011-1424(IT)I

BETWEEN:

JOY MANNING,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on September 28, 2012, at Montreal, Quebec.

Before: The Honourable Justice Johanne D'Auray

Appearances:

For the Appellant:	The Appellant herself
Counsel for the Respondent:	Amelia Fink

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 2006, 2007 and 2008 taxation years is dismissed on the basis that the appellant is not entitled to deduct her rental losses in the amounts of $8,389, $14,044 and $11,606 for the 2006, 2007 and 2008 taxation years respectively pursuant to subsection 9(1) of the Act.

Without costs.

Signed at Montreal, Quebec, this 8th day of February 2013.

"Johanne D' Auray"

D'Auray J.

Citation: 2013 TCC 51
Date: 20130208
Docket: 2011-1424(IT)I

BETWEEN:

JOY MANNING,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

D'Auray J.

[1] The question in this appeal is whether the appellant is entitled to deduct the following rental losses pursuant to subsection 9(1) of the *Income Tax Act* (**Act**):

$8,389 for the 2006 taxation year,

$14,044 for the 2007 taxation year and,

$11,606 for the 2008 taxation year.

[2] At the hearing of the appeal, the appellant testified but did not call any witnesses. The respondent called as witnesses, Mr. George Cooke, the son of the appellant, Mr. Abdelaziz Khadiri, auditor, with the Quebec Revenue Agency (**QRA**) and Mr. Hubert De Groot, appeal officer with the Canada Revenue Agency (**CRA**).

Facts and evidence at trial

[3] The appellant stated that she inherited a house from her mother, Ms. Joan Leach, when her mother passed away in 2000. Her mother had lived in the house along with her husband Mr. James Manning, the appellant's father, since 1962.

[4] Ms. Leach's will gave the appellant's father the right to stay in the house rent free for the rest of his life. However, the will made him responsible for the property expenses, including property taxes, utilities and maintenance costs.

[5] The appellant stated that her father, Mr. Manning, was unable to pay for these expenses due to a stroke that left him disabled. He, nevertheless, continued to live in the house without paying any rent.

[6] The house is located at 51, boulevard de Gaulle in Lorraine, Québec. It is a bungalow with an attached garage.

[7] The appellant testified that, in 2006 she sought advice from two real estate agents and from an evaluator to see if the house could be rented or sold for a profit. According to the appellant, the real estate agents assured her that, if she had the house cleaned and did some repairs on the house, she could sell it or rent it at a profit in the near-term. The evaluator did not either observe any major defects with the house.

[8] As a result, the appellant decided to put the house in a state where she could rent or sell it at a profit. She decided to rent the house to her son, Mr. Cooke, since he had experience in the construction business. He could use his skills to put the house in a state where she could increase the rent or sell it. She added "*there were no family considerations for this [arrangement] at all*".

[9] According to the appellant, Mr. Cooke moved into the house in 2006. The appellant and Mr. Cooke did not have a signed lease. They both testified that they had an oral agreement instead.

[10] Mr. Cooke stated that he and his grandfather had separate bedrooms but shared the rest of the house. He also stated that after moving into the house, he spent about three to four hours a week helping his grandfather with daily tasks.

[11] The appellant stated that in 2006 Mr. Cooke started his own construction business, "Les entreprises Cooke". He ran the business out of the house. She stated

that the rent paid by her son also covered "Les entreprises Cooke", a registered business.

[12] The appellant testified that Mr. Cooke worked on the house mostly in the evenings and on weekends. If his work schedule permitted it, he would work on the house during the day. Mr. Cooke confirmed the appellant's testimony with respect to the timing of the work on the house.

[13] The clean-up and repairs took longer than expected, as certain latent issues with the house were discovered as the repairs progressed. The house was in worse shape that the appellant had anticipated. She stated that, among other things, mould and mildew were discovered, there were carpenter ants and mice, the roof leaked, the kitchen ceiling caved in and the basement had to be gutted. As a result, she testified that many of the repairs undertaken by Mr. Cooke in the years under appeal were required to bring the house into conformity with the building Code.

[14] The appellant explained that she charged Mr. Cooke a monthly rent of $200 in 2006 but decided to reduce the rent to $100 in 2007 and 2008 due to all the work that the house required. She added that, contrary to QRA's position, it would have been impossible to rent the house at the fair market value or to sell the house to a third party due its dilapidated state. She referred the Court to excerpts from a letter that she sent to the QRA where, according to the Canada Mortgage and Housing and la "Société d'habitation du Québec", a reduction of rent can be granted if a property is in a dilapidated state.

[15] The appellant introduced lists showing the work that Mr. Cooke had performed in the years under appeal and the value for such work. According to these lists, Mr. Cooke had performed work worth $3,780 in 2006, $4,245 in 2007 and $8,335 in 2008. The appellant testified that the value was determined by what Mr. Cooke charged his arm's length clients.

[16] According to these lists, Mr. Cooke performed the following tasks: cleared snow, fixed a broken water pipe, cleaned out the garage, removed old appliances, repaired and painted the kitchen ceiling, exterminated mice and carpenter ants, cleaned out an eavestrough, did gardening work, removed mildew and basement floors, installed floors, painted rooms and installed gyprock.

[17] It is unclear as to when the lists were created. The appellant testified in cross-examination that she updated the lists on an ongoing basis as the work was being done. However, Mr. Cooke testified that he had not seen the lists before. Similarly,

the QRA's auditor, Mr. Khadiri, who conducted the audit with respect to the appellant's claim for rental losses, testified that he had never seen the lists during the course of his audit. His first knowledge of the lists came at trial.

[18] I also noticed that in corresponding with the QRA, the appellant never mentioned that Mr. Cooke had performed work on the house in exchange for a rent reduction. In a response dated November 16, 2009 to a question from the QRA as to why the gross income from this building was low, the appellant answered:

> Building is old and dilapidated and needs major repairs and renter is poor and or low income. (cannot rent to anyone else-house is in bad shape)-has mold in ceiling and leaking roof.

[19] There were also several contradictions between the appellant's testimony and Mr. Cooke's testimony. With respect to the rent charged and the timing of the rent payments, the appellant testified that Mr. Cooke paid $200 per month as rent in 2006 and $100 per month in 2007 and 2008. She also stated that Mr. Cook paid several months' rent at a time. However, Mr. Cooke testified that he paid the rent on a monthly basis and that he paid $200 per month throughout the three years.

[20] Another contradiction was with respect to when Mr. Cooke moved into the house and the reasons for this move. The appellant testified that Mr. Cooke moved into the house in 2006 in order to renovate the house. However, Mr. Cooke testified that he moved into the house sometime before 2005. He stated that the reason he moved in was because he had broken up with his girlfriend with whom he had been living. Mr. Cooke also stated that he did not pay any rent to the appellant before 2006.

[21] It is also unclear whether Mr. Cook provided invoices for the work that he did on the house. Mr. Cooke testified that he had while the appellant stated that he had not.

[22] In her income tax returns for her 2006, 2007 and 2008 taxation years, the appellant declared rental income in the amounts of $2,400 for 2006 and $1,200 for 2007 and 2008 taxation years. As expenses from her rental activities, she claimed the amounts of $10,787, $15,244, $12,806 for the 2006, 2007 and 2008 taxation years respectively. She did not include in her rental income the value of the work performed by Mr. Cooke in exchange for the rent reduction. She reported rental losses in each of the years.

[23] The appellant was subsequently audited by the QRA, which denied the rental losses. After receiving information from the QRA, the CRA reassessed the appellant to disallow the rental losses claimed by the appellant in the amounts of $8,389 for the 2006 taxation year, $14,044 for the 2007 taxation year and $11,606 for the 2008 taxation year.

[24] The appellant stated that in addition to the tax reassessment denying her losses, other contractors advised her, that because of the age of the home, more work was required and some work had to be redone. In light of these facts, in 2009 the appellant stopped renovating the house. She also stopped charging rent to Mr. Cooke and stopped deducting losses relating to the house.

[25] At the time of the hearing, Mr. Cooke was still living in the house and he had not paid any rent since 2009. "Les entreprises Cooke" was still using the house' address for its business.

[26] At the time of the hearing, Mr. Manning was also living in the house without paying any rent.

Position of the parties

[27] The appellant relied on the decision of *Stewart v. Canada*, 2002 SCC 46, [2002] 2 SCR 645 (***Stewart***), to submit that her rental activities were purely commercial. She sought to have improvements made to the house in order that she could sell or rent it at a profit. She submitted that the improvements took longer than expected as a result of hidden defects, but that this was not unreasonable as many small businesses take several years to show a profit. With respect to her father, she submitted that he was allowed to stay in the house out of her and Mr. Cooke's goodwill, because of his failure to pay the property expenses. She expected him to leave when the renovations were completed. She submitted that the rent paid by Mr. Cooke, when considered in conjunction with the services provided by Mr. Cooke, reflected fair market value. In addition, she submitted that her son does not have fewer rights merely because he is related to the property owner, and that to hold otherwise might contravene section 15 of the *Canadian Charter of Rights and Freedoms* (the **Charter**).

[28] As a result, the appellant submitted that she should be entitled to deduct her rental losses in computing her income for the 2006, 2007 and 2008 taxation years. In the alternative, she submitted that in computing her rental losses the value of the services provided by Mr. Cooke should be taken into account.

[29] The respondent also relied on *Stewart*. She argued that in light of the facts, there was a personal element with respect to the appellant's rental activities. Her father, Mr. Manning never paid any rent. Her son rent payments were low, and he had only paid rent for a period of three years. He did not pay any rent before 2006 or after 2009. She further argued that the appellant did not meet the test in *Stewart*, as she did not establish that her predominant intention was to make a profit and that she did not carry out her rental activities in accordance with objective standards of business-like behaviour. She also stated that I should take into consideration the contradictions between the appellant's testimony and that of Mr. Cooke. In her view, the appellant's credibility was put in doubt with respect to many issues.

Analysis

[30] With respect to the appellant's Charter argument, I do not agree that section 15 of the Charter applies in this appeal. As explained by Chief Justice Rip of this Court in *Vachon v. The Queen*, 2002 CarswellNat 4659, 2003 DTC 1484 (TCC[IP]), the provisions of the Act with respect to deductibility of expenses do not create a differential treatment on the basis of family status. The test is whether the property was used to make a profit and operated in a business-like behaviour and thus whether a source of income existed. The fact that a family member rented the property does not make the expenses relating to the property non-deductible:

> [30] The constitutional argument raised by the appellants is not valid. The appellants seem to contend that the deductions claimed in respect of the Mississauga property were disallowed because their son was the tenant. They claim that this constitutes discriminatory treatment, which is contrary to the Canadian Charter of Rights and Freedoms.
>
> [31] No ground has been found that would make it possible to conclude that the provisions relevant to the instant appeals are invalid under subsection 15(1) of the Canadian Charter of Rights and Freedoms. […]
>
> [34] The provisions of the Act respecting the deductibility of expenses do not, as the appellants claim, create a differential treatment on the basis of family status, which is discriminatory. The fact that the appellants' son was a tenant of the Mississauga property is considered in the context of determining whether the property was used to make a profit and thus whether it was a source of income earned from a business or property. It is not the fact that the appellants rented the Mississauga property to their son that makes the expenses relating to that property non-deductible but rather the fact that the property was not operated commercially.

[31] In *Sokil v. The Queen*, 2009 CarswellNat 4124, 2009 TCC 601(IP), Justice Favreau of this Court provided a useful overview of the scheme of the Act and an analysis of the *Stewart* decision, in order to determine if a taxpayer was entitled to deduct losses from rental activities. He stated that the question to ask is whether the taxpayer has a source of income from a business or property. He first referred to the provisions of the Act dealing with sources of income. At paragraphs 12 to 14 of his reasons, he stated:

> [12] The basic rules for computing income under the *Act* are found in Division B of Part I, sections 3 and 4. Paragraph 3(*a*) refers to the various sources of a taxpayer's income, as follows:
>
> Section 3: Income for taxation year
>
> The income of a taxpayer for a taxation year for the purposes of this Part is the taxpayer's income for the year determined by the following rules:
>
> (*a*) determine the total of all amounts each of which is the taxpayer's income for the year (other than a taxable capital gain from the disposition of a property) from a source inside or outside Canada, including, without restricting the generality of the foregoing, the taxpayer's income for the year from each office, employment, business and property.
>
> [13] The basic rules for computation of the income or loss from a business are found in section 9 of the *Act*:
>
> Section 9:
>
> (1) Income. Subject to this Part, a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year.
>
> (2) Loss. Subject to section 31, a taxpayer's loss for a taxation year from a business or property is the amount of the taxpayer's loss, if any, for the taxation year from that source computed by applying the provisions of this Act respecting computation of income from that source with such modifications as the circumstances require.
>
> [14] Restrictions concerning the deduction of expenses are found in paragraphs 18(1)(*a*) and 18(1)(*h*) and in section 67 of the *Act*:
>
> Section 18:
>
> (1) General limitations. In computing the income of a taxpayer from a business or property no deduction shall be made in respect of

> (*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property;
>
> (*h*) personal or living expenses of the taxpayer, other than travel expenses incurred by the taxpayer while away from home in the course of carrying on the taxpayer's business;
>
> Section 67: General limitation re expenses
>
> In computing income, no deduction shall be made in respect of an outlay or expense in respect of which any amount is otherwise deductible under this Act, except to the extent that the outlay or expense was reasonable in the circumstances.

[32] Also relevant to determining the application of section 18 is section 248 which provides the definition of personal or living expenses. Section 248 reads:

> Section 248 "personal or living expenses" includes
>
> (*a*) the expenses of properties maintained by any person for the use or benefit of the taxpayer or any person connected with the taxpayer by blood relationship, marriage or common-law partnership or adoption, and not maintained in connection with a business carried on for profit or with a reasonable expectation of profit.

[33] Justice Favreau then referred to the test developed in *Stewart*, to determine "if a taxpayer has a source of income from a business or property". At paragraphs 15 and 16 of his reasons he stated:

> [15] The Supreme Court of Canada developed in *Stewart v. R.*, 2002 D.T.C. 6969 (Eng.) (S.C.C.), a two-stage approach to determining whether a taxpayer has a source of business income such that section 9 of the *Act* applies. In paragraph 50, the two-stage approach is set out as follows:
>
> …
>
> (i) Is the activity of the taxpayer undertaken in pursuit of profit, or is it a personal endeavour?
>
> (ii) If it is not a personal endeavour, is the source of the income a business or property?
>
> The first stage of the test assesses the general question of whether or not a source of income exists; the second stage categorizes the source as either business or property.

> [16] The Supreme Court of Canada provided further explanation concerning the first stage of the test in paragraphs 52, 54 and 55 of the *Stewart* decision:
>
> > [52] The purpose of this first stage of the test is simply to distinguish between commercial and personal activities ... Thus, where the nature of a taxpayer's venture contains elements which suggest that it could be considered a hobby or other personal pursuit, but the venture is undertaken in a sufficiently commercial manner, the venture will be considered a source of income for the purposes of the Act.
> >
> > …
> >
> > [54] ... Thus, in expanded form, the first stage of the above test can be restated as follows: "Does the taxpayer intend to carry on an activity for profit and is there evidence to support that intention?" This requires the taxpayer to establish that his or her predominant intention is to make a profit from the activity and that the activity has been carried out in accordance with objective standards of businesslike behaviour.
> >
> > [55] The objective factors listed by Dickson J. in *Moldowan* at p. 486 were: (1) the profit and loss experience in past years; (2) the taxpayer's training; (3) the taxpayer's intended course of action; and (4) the capability of the venture to show a profit....
>
> [Underlining added.]

[34] In my view, pursuant to the *Stewart* decision, there was a personal element with respect to the appellant's rental activities. Although the appellant stated that her father lost the right under her mother's will to stay in the house rent free because he did not pay the expenses relating to the house, it remained that he continued to live in the house rent free. He also benefited from the presence of Mr. Cooke. Mr. Cooke testified that after moving into the house, he assisted his grandfather for at least three to four hours a week. Notwithstanding the appellant's testimony, it had to be reassuring for the appellant to know that her disabled father was not living alone.

[35] Mr. Cooke also benefited from his rental arrangement. He started sharing the house with his grandfather before 2005. He needed a place to stay following a relationship breakdown. Mr. Cooke benefited from the low rent charged by the appellant, since according to the appellant, one of the considerations taken into account in setting his rent was his low income.

[36] The fact that I find a personal element does not mean that the appellant is not entitled to deduct her rental losses. As was stated in *Stewart*, once a personal element is found, the Court has to do a further analysis to determine if the taxpayer has established:

- an intention to make a profit from the rental activities and if there is evidence in support of that intention; and

- that the rental activities were carried out in accordance with objective standards of business-like behaviour.

[37] I am of the view that the appellant's stated intention to make a profit was not supported by the evidence. In addition, she did not carry out her rental activities in accordance with objective standards of business-like behaviour.

[38] For example, there was no signed lease stating the monthly payment for the rent. No invoices were put in evidence with respect to the work performed by Mr. Cooke. It is also difficult to imagine, in a commercial setting, that a tenant would accept to share a house in a dilapidated state with another person, unless the rent is really low. If the rent is low, then the capability for the appellant to make a profit is nonexistent. On the other hand, if I were to take into account the monetary value of the work performed by Mr. Cooke, the monthly rent fluctuated from $515 in 2006, to $453.75 in 2007 and to $794.58 in 2008. Such fluctuations in monthly rent do not reflect standard business behaviour.

[39] With respect to the capability of the rental activities to show a profit, the appellant would have had to raise the rent by more than five times in 2006 and by more ten times in the 2007 and 2008 taxation years, in order to cover the expenses claimed. Even if I were to take into account the value of the work performed by Mr. Cooke, the appellant still incurred losses from her rental activities. Moreover, in 2009 the appellant decided to stop the renovations, stop charging rent to Mr. Cooke, and stop claiming rental losses.

[40] I find it important to note that there were numerous contradictions as to the rental arrangement between the appellant and Mr. Cooke. I understand the difficulty in remembering precisely events that occurred in 2006, 2007 and 2008 at a Court hearing in 2012. Nevertheless I have difficulty understanding why Mr. Cooke would state that the amount of his rent stayed the same, namely $200 per month for the 2006, 2007 and 2008 years and that it was paid monthly, while the appellant stated that it was $200 per month for the year 2006 and $100 for the years 2007 and 2008

and that it was paid every three or four months. I also have difficulty in understanding why Mr. Cooke stated that he had provided invoices for the work he performed while the appellant stated that he had not.

[41] I also find it difficult to understand why the appellant did not show the lists indicating the work done by Mr. Cooke and the value of such work to the auditor, Mr. Khadiri, and to the appeal officer, Mr. De Groot, if these lists existed at the time of the audit and of the objection. I also do not understand why, in corresponding with the QRA and the CRA, she never mentioned that Mr. Cooke had performed renovations on the house in exchange for a reduced rent. The first time that the appellant mentioned this was in her Notice of Appeal filed on May 5, 2011 with this Court. I also find it difficult to understand why the appellant never mentioned to Mr. Khadiri at the time of the audit, that in addition to Mr. Cooke, her father was also living in the house. Mr. Khadiri only found this out by associating the house phone number to Mr. Manning.

[42] I therefore agree with the respondent that the appellant's credibility has been placed in doubt. It is difficult to understand what really happened. Did Mr. Cooke really pay rent? If so, was the rent low due to the capacity of Mr. Cooke to pay, or was it because Mr. Cooke renovated the house in exchange for a rent reduction?

[43] In tax appeals, the appellant has to establish that the assumptions of the Minister are incorrect. It is clear in this appeal that the appellant did not establish that the assumptions of the Minister were incorrect. She did not make out a *prima facie* case that she carried out her rental activities in accordance with objective standards of businesslike behaviour and her intention to make a profit was not supported by evidence.

[44] In light of the above, the appellant is not entitled to deduct her rental loses pursuant to subsection 9(1) of the Act. The appeal is therefore dismissed without costs.

Signed at Montreal, Quebec, this 8th day of February 2013.

"Johanne D'Auray"

D'Auray J.

CITATION:	2013 TCC 51
COURT FILE NO.:	2011-1424(IT)I
STYLE OF CAUSE:	JOY MANNING v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montreal, Quebec
DATE OF HEARING:	September 28, 2012
REASONS FOR JUDGMENT BY:	The Honourable Justice Johanne D'Auray
DATE OF JUDGMENT:	February 8, 2013

APPEARANCES:

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Counsel for the Respondent:	Amelia Fink

COUNSEL OF RECORD:

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Firm:	
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