Docket: 2009-26(IT)I

BETWEEN:

LINDA RUTH KELSO PATRY,

appellant,

and

HER MAJESTY THE QUEEN,

respondent.

Appeal heard on June 18, 2012, at Victoria, British Columbia.

Before: The Honourable Justice Robert J. Hogan

Appearances:

For the appellant:	The appellant herself
Counsel for the respondent:	Holly Popenia

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 2003 and 2004 taxation years is dismissed in accordance with the attached reasons for judgment.

Signed at Ottawa, Ontario, this 27th day of May 2013.

"Robert J. Hogan"

Hogan J.

Citation: 2013 TCC 107
Date: 20130527
Docket: 2009-26(IT)I

BETWEEN:

LINDA RUTH KELSO PATRY,

appellant,

and

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respondent.

REASONS FOR JUDGMENT

Hogan J.

I. INTRODUCTION

[1] Dr. Linda Ruth Kelso Patry (the "appellant") has appealed reassessments issued by the Minister of National Revenue (the "Minister") denying deductions that she claimed in respect of certain legal expenses incurred in the 2003 and 2004 taxation years. The legal expenses in question arose after she became involved in a dispute with Barrie Neff, who had formerly acted as an arbitrator in a tenancy dispute relating to the appellant's rental activities.

II. FACTUAL BACKGROUND

[2] The appellant is a medical doctor (although she has recently given an undertaking to refrain from practising medicine). During the years in question, she earned business income from the practice of medicine. In addition, she earned income from her rental activities.

[3] Beginning in 1992, the appellant was involved in a dispute with one of her tenants. She testified that this dispute related to damage to one of her rental

properties. Eventually, the dispute resulted in arbitration hearings before the Residential Tenancy Branch of British Columbia. The arbitrator at those hearings was Mr. Neff. He ruled against the appellant, who was upset by Mr. Neff's conduct in relation to those arbitration proceedings.

[4] A major dispute ensued between the appellant and Mr. Neff. The appellant applied for judicial review of Mr. Neff's decision and, in her application, apparently criticized Mr. Neff for being biased and unfair. The appellant testified that she also contacted a member of the Law Society of British Columbia regarding her concerns about Mr. Neff, who was arrested and detained by the police on the basis of, *inter alia*, actions taken by the appellant.

[5] Mr. Neff sued the appellant (along with a third party) for, among other things, malicious prosecution, abuse of process and intentional infliction of mental suffering.[1] This action resulted in several motions and a trial (together, the "Neff Lawsuit").

[6] Mr. Neff was ultimately awarded damages by the British Columbia Supreme Court in respect of the Neff Lawsuit, including punitive damages against the appellant.[2] In its reasons for judgment the Court stated:

> 153 The defendant Patry formed an intense dislike of the plaintiff and a desire for revenge for his finding against her in the Arbitration, which grew and expanded beyond her properly seeking redress of a legal wrong into a vendetta to strip him of his job, professional standing, and finally to have him subjected to criminal prosecution.

[7] According to the appellant, Mr. Neff also made various complaints about her to the College of Physicians & Surgeons of British Columbia (the "College of Physicians"), which investigated the appellant and stripped her of her licence to practise medicine for a brief period during the 1990's. The appellant testified that Mr. Neff regularly made complaints to the College of Physicians, including during 2003 and 2004.

[8] In her 2003 and 2004 tax returns, the appellant claimed deductions in respect of legal expenses. The Minister reassessed the appellant, disallowing the deduction of

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[1] *Neff v. Patry*, [2008] B.C.J. No. 209 (QL).
[2] *Ibid*.

$11,000 of those legal expenses for her 2003 taxation year and $10,000 of those expenses for her 2004 taxation year.

[9] There is some uncertainty regarding the quantum of the legal expenses that the appellant actually incurred in 2003 and 2004 in respect of the Neff Lawsuit.

[10] In general, the appellant's testimony was that the legal expenses in issue relate only to the Neff Lawsuit. However, at other times, she appeared to be testifying that some of those expenses might relate to her defence against Mr. Neff's complaints to the College of Physicians, although she also suggested that part of the expenses for that defence might have been borne by the Canadian Medical Protective Association. Her written submissions in the present appeal appears to indicate that the legal expenses in issue relate only to the Neff Lawsuit.[3] In addition, letters from each of the lawyers who represented the appellant during the years in question clearly describe the legal fees as relating only to the Neff Lawsuit.[4]

III. POSITIONS OF THE PARTIES

A. Appellant's Position

[11] The appellant relies on subsection 8(1) and paragraph 18(1)(*a*) of the *Income Tax Act* (Canada) (the "*ITA*"). She submits that the legal expenses were

> [F]or the purpose of gaining or producing income from her rental properties plus for the purpose of maintaining her license to practice medicine that grants her the ability to produce and earn income from the practice of medicine.[5]

[12] The appellant's position is that the Neff Lawsuit resulted from things that she had said at the arbitration hearings and in the consequential judicial review proceeding that took place with regard to her rental operations. Accordingly, the appellant submits that the legal expenses in issue were deductible as having been incurred in connection with the earning of rental income.

[13] The appellant also argues that she was compelled to defend herself against the Neff Lawsuit because, if she had not done so, the College of Physicians might have made an adverse finding against her on the basis of those proceedings, and might

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[3] Appellant's Written Submissions, at Tab 3, first page to third page.

[4] Copies of letters from these two lawyers are contained in the Appellant's Written Submissions, at Tabs 10(A), (B) and (C).

[5] Appellant's Written Submissions, at Tab 3, first page. See also Appellant's Written Submissions, at Tab 5, first page; Tab 5, third page, to Tab 6, first page; Tab 7, first page to third page.

have taken away her licence to practise medicine. She submits that her dealings with Mr. Neff were for the purpose of

> . . . maintaining my license to practice medicine and allowing me to produce and earn income from the practice of medicine. . . .[6]

In other words, the appellant is arguing that the legal expenses in issue were deductible as having been incurred in connection with her practice of medicine.

[14] The appellant also cites subparagraph 18(*a*)(i) of the *ITA* in support of her claim for deductions in respect of certain legal expenses that she paid in advance.[7]

[15] The appellant cites *Mercille v. The Queen*,[8] She submits that the facts in her case are distinguishable from the facts in *Leduc v. The Queen*[9] and more closely resemble those in *Vango v. Canada*[10] and *Mercille*. Finally, she cites *65302 British Columbia Ltd. v. Canada*[11] for the proposition that outlays and expenses will be deductible if made or incurred for the purpose of earning income, unless the *ITA* itself provides otherwise.

B. Respondent's Position

[16] The respondent submits that the legal expenses in issue were incurred in respect of the appellant's personal actions and are not business expenses but, rather, personal expenses.

[17] The respondent submits that, to the extent that the appellant incurred the legal fees in issue in order to defend her professional reputation, those fees were on account of capital and, pursuant to paragraph 18(1)(*b*) of the *ITA* are not deductible.
[18] In the alternative, the respondent submits that, if the legal expenses in issue are deductible as current expenses, the quantum of such expenses is only $19,190.94.

IV. ISSUE TO BE DECIDED

[19] The main issue to be decided in this appeal is whether the legal expenses in question are deductible as current business or property expenses. If those legal

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[6] Appellant's Written Submissions, at Tab 5, first page.
[7] Appellant's Written Submissions, at Tab 7, second page to third page.
[8] [1999] TCJ No. 941 (QL).
[9] 2005 TCC 96.
[10] [1995] T.C.J. No. 659 (QL).
[11] [1999] 3 S.C.R. 804.

expenses are deductible, their quantum is also an issue, along with the question whether they are deductible on income or capital account.

V. ANALYSIS

[20] Under subsection 9(1) of the *ITA*, a taxpayer's income from a business or property for a year is "the taxpayer's profit from that business or property for the year". Iacobucci J., in *Symes v. Canada*, [12] explained:

> . . . the "profit" concept in s.9(1) is inherently a net concept which presupposes business expense deductions. It is now generally accepted that it is s.9(1) which authorizes the deduction of business expenses. . . .[13]

Thus the *ITA*, generally speaking, allows the deduction of expenses that are incurred in a year for the purpose of earning income from a business or property.

[21] However, the *ITA* contains provisions that limit the deductibility of certain expenses:

> 18. (1) 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;
>
> (*b*) 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;
> . . .
>
> (*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;
> . . .

[22] When determining the purpose underlying expenses, the taxpayer's subjective intention in incurring the expenses is not determinative. Instead, the Court must examine the objective manifestations of purpose, taking into account all of the circumstances.[14]

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[12] [1993] 4 S.C.R. 695.
[13] *Ibid*., at page 722.
[14] *Supra*, note 12, at paragraph 68.

[23] In her written submissions, the appellant relied on subsection 8(1) of the *ITA*, which relates to the deductibility of certain amounts from a taxpayer's income from an office or employment. Her reliance on that provision was clearly an error – her submissions were generally directed toward the matter of the deductibility of the legal expenses at issue from her income from a business or property, and she apparently filed her tax returns on the basis of such deductibility. Moreover, only certain enumerated classes of expenses are deductible from employment income (whereas business expenses are, in general, deductible unless otherwise provided for in the *ITA*, as discussed above). The appellant is not assisted by subsection 8(1).

[24] The appellant also cites paragraph 18(9)(*a*) of the *ITA* in relation to certain amounts that she prepaid to one of her lawyers during the relevant period. Paragraph 18(9)(*a*) generally serves to deny the deductibility of certain prepaid amounts that are otherwise deductible. As a result, paragraph 18(9)(*a*) is not relevant to the appellant's appeal unless the amounts in issue are established to be otherwise deductible.

[25] By virtue of subsection 9(1) and paragraphs 18(1)(*a*), (*b*) and (*h*), the legal expenses in issue in this appeal are deductible only if they: (1) were incurred by the appellant for the purpose of gaining or producing income from a business or property, (ii) were not an outlay of capital, and (iii) were not personal expenses of the appellant.

[26] In *Leduc*,[15] this Court held that the legal expenses of a lawyer, which were incurred to defend himself against charges of various sexual offences, were not deductible. The lawyer's position was that, if he had been convicted, he might have lost his ability to practise law. In finding that the expenses were not deductible, Lamarre J. wrote:

> 21 . . . in the absence of evidence to the contrary, it would appear that, had he not practiced law, the appellant would nonetheless still have incurred the legal expenses to defend himself before the courts against the criminal charges. Therefore, those expenses are not deductible pursuant to paragraph 18(1)(*h*) of the *ITA*. . . .
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> 22 Second, I am not even convinced that one purpose of incurring these legal expenses was to earn income. [. . .] Indeed, the appellant testified that during the period when the legal expenses were incurred his earning capacity from the law profession was not affected at all. On the contrary, his legal practice has continued to thrive. There was no need to incur the legal expenses in order to have an expectation of income, as income was already flowing from the appellant's legal practice.

[15] *Supra*, note 10.

[27] Lamarre J. went on to describe the connection that must exist, in such circumstances, between the business and the legal fees before the fees can be deductible:

> 26 One may conclude from the above-cited case law that if the activities that led to the charges were carried on in the normal course of the income-earning operations, then an expense incurred to defend those activities is a direct result of the activities themselves, and hence may be deductible under paragraph 18(1)(*a*) of the *ITA*. Consequently, it is the activity that resulted in the charges and its connection to the business that determine the deductibility of the legal expenses associated with the defence.

[28] *Poulin v. Canada*[16] involved a real estate agent whose clients brought proceedings against him alleging fraud and false representation. These proceedings resulted in a judgment awarding damages, interest and costs against the real estate agent. The real estate agent sought to deduct various expenses relating to the proceedings, including the amount of the award of damages and his legal fees. The Federal Court of Appeal ruled that the expenses were non-deductible. Marceau J.A. held that:

> 8 . . . In order for such a payment, which in itself, of course, is not made for the purpose of earning a profit, to be nonetheless considered to meet the requirement in paragraph 18(1)(*a*) of the Act, it must be seen as the unfortunate consequence of a risk that the taxpayer had to take and assume in order to carry on his trade or profession. And in order for the payment to be seen as such, it is an essential condition, I believe, that it be directly related to an act that was necessary in order to carry on the trade or profession and that it could potentially have been considered to have been performed improperly.

[29] In *Doiron v. Canada*,[17] a lawyer was charged with criminal offences after allegedly paying bribes to prevent a client from testifying against another person. After three trials (the first of which occurred in 2003), the lawyer was convicted of attempted obstruction of justice and was sentenced to four and a half years in prison. Mr. Doiron's licence to practise law was suspended in 2003. In his 2004 and 2005 tax returns, Mr. Doiron claimed deductions in respect of the legal expenses incurred to defend himself, together with associated interest expenses. These deductions were subsequently denied by the Minister. McArthur J. of the Tax Court of Canada allowed Mr. Doiron's appeal on the following basis:

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[16] [1996] F.C.J. No. 960 (QL).
[17] 2010 TCC 519, rev'd. 2012 FCA 71.

> 19 The present situation is close to the line. Balancing both well presented arguments I find in favor of the Appellant giving the taxpayers the benefit of the doubt. . . . The legal expenses in Doiron arose directly from the Appellant's law practise and his acting on behalf of Lefebvre and no doubt Cormier.

[30] The Federal Court of Appeal reversed this decision. Noël J.A. agreed with McArthur J. that the legal expenses would not have been incurred if not for the fact that the respondent was practising law. However, he cited *Symes* for the proposition that this is not a relevant factor in determining the deductibility of the expenses.[18] Noël J.A. held that:

> 48 Given the extremely serious nature of the impugned act from the perspective of someone who was acting as an officer of the court, the intercepted conversations adduced in evidence against the respondent, and the arguments he used to counter this evidence, Mr. Doiron has not shown how he could hope to regain his licence to practice even if he had succeeded in having that evidence excluded so that "the ... case would fall apart and [he] would be acquitted of a most serious offence" (*R. v. Doiron*, at paragraph 112). In my humble opinion, if the TCC judge had considered the evidence from the criminal proceedings, he would have had no choice but to conclude that the respondent had not discharged his burden of proving the connection between the legal fees and his business.

[31] In her submissions, the appellant relies on the *Mercille* case. That case involved a stockbroker who claimed deductions from his employment income in respect of certain legal fees which he had incurred when defending himself in proceedings before the Montreal Exchange's Disciplinary Committee, the Montreal Exchange's Governing Committee and the Commission des valeurs mobilières du Québec, and in criminal proceedings before the Court of Quebec. These proceedings all involved certain acts that the taxpayer had allegedly committed in relation to his employment.[19] The taxpayer testified that, if he had failed in defending himself in those proceedings, he would have temporarily or permanently lost his right to carry on his profession. Ultimately, Judge Archambault held that the legal fees were incurred for the purpose of earning employment income and allowed their deduction pursuant to paragraph 8(1)(*f*) of the *ITA*.

[32] The appellant also referred the Court to *Vango*. In *Vango*, the taxpayer was an investment advisor and stockbroker who had been accused by the Toronto Stock Exchange of removing shares from a client's account without having authority to do so. The taxpayer's employer informed him that he would lose his job – and the taxpayer realized that he could lose his licence – unless the wording of the infraction

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[18] 2012 FCA 71, at paragraph 32.
[19] *Supra*, note 8, at paragraphs 6 to 9.

of which he stood accused could be modified to something less serious.[20] As a result, he incurred legal expenses to have the wording of the infraction modified. He was ultimately successful. The Tax Court of Canada, per Judge Bowman (as he then was), accepted the legal expenses as deductible under paragraph 8(1)(*f*).

[33] In *Leduc*, Lamarre J. distinguished the facts before her from the facts in *Mercille* and *Vango*:

> 24 This case is distinguishable from this Court's decisions in *Vango v. Canada.*, [1995] T.C.J. No. 659 (QL) and *Mercille v. Canada.*, [1999] T.C.J. No. 941 (QL), referred to by counsel for the appellant. In those cases, the charges faced by the taxpayers were directly related to their work, as an investment advisor in one case and as a stockbroker in the other. The charges with respect to which they incurred the legal fees were directly related to their functions. In *Vango*, the taxpayer was directly faced with the loss of his licence. It was decided in both cases that the legal fees were deductible as employment expenses pursuant to section 8 of the *ITA*. In the present case, the criminal offences with which the appellant is charged have nothing to do with his legal practice. The legal expenses paid to defend himself against several sexual offence charges did not arise out of his law practice. The acts regarding which a defence is being mounted do not relate to his business.

[34] In my opinion these decisions are reconcilable. *Mercille* and *Vango* suggest that legal expenses relating to actions allegedly committed during the course of business activities can be deductible in certain circumstances. However, the Federal Court of Appeal's decision in *Poulin* suggests that such expenses must also be "the unfortunate consequence of a risk that the taxpayer had to take and assume in order to carry on his trade or profession". Similarly, in *Leduc*, the Tax Court suggests that for such legal expenses to be deductible they must have arisen in the normal course of the taxpayer's income-earning operations, and must have been "directly related" to those operations. In *Mercille* and *Vango* the taxpayers succeeded in showing that the expenses were related to their income-earning activities because the disciplinary actions against which they defended themselves were directly related to their work.

[35] *Leduc* and *Doiron* both suggest that there must be real evidence establishing the connection between the relevant legal expenses and the business. In *Leduc*, the Court declined to find that the relevant legal expenses were deductible, in part because the taxpayer's legal practice had continued to thrive. In *Doiron*, the Federal Court of Appeal ruled that the taxpayer had not established the connection between his legal expenses and his law practice because, on the evidence before the Court, he could not have hoped to regain his licence.

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[20] *Supra*, note 9, at paragraph 9.

[36] In the present case, the British Columbia Supreme Court's decision in *Neff v. Patry* suggests that the Neff Lawsuit bore only an incidental relationship to the appellant's rental operations. The appellant first encountered Mr. Neff as part of an arbitration proceeding in relation to her rental operations. However, the Court found that the dispute had expanded into a personal vendetta. It would be inappropriate for me to contradict that finding because, in particular, the evidentiary record before this Court, in relation to the appellant's dispute with Mr. Neff is comparatively sparse. Therefore, I am of the opinion that the appellant has failed to establish that the Neff Lawsuit was directly related to her rental operations.

[37] Similarly, I am of the opinion that the appellant failed to establish that the Neff Lawsuit bore anything more than an incidental relationship to her medical practice. It is reasonable to infer that the appellant would have defended herself against the Neff Lawsuit even if there had been no consequential threat to her ability to practice medicine. Moreover, the appellant has failed to provide sufficient evidence to establish that her medical practice was truly threatened as a result of the Neff Lawsuit. The Neff Lawsuit could not have turned out worse for the appellant with regard to her ability to continue practising medicine. Yet she continued to practise. Therefore, following *Leduc* and *Doiron*, I conclude that the legal expenses in issue are not deductible as having been incurred in connection with her medical practice.

[38] The appellant argues that her case resembles the facts in *Mercille* and *Vango* more closely than the facts in *Leduc*. However, the evidence shows that the appellant did not become involved in the Neff Lawsuit as a result of actions committed in the normal course of her medical practice. Mr. Neff was not a patient of the appellant's. He sued the appellant because of actions taken against him by her in her personal capacity.

[39] In light of the foregoing, the legal expenses in issue were not incurred by the appellant for the purpose of gaining or producing income from a business or property. Instead, the evidence shows that those expenses were personal expenses of the appellant. Therefore, they are not deductible. For all of these reasons, the appellant's appeal is dismissed.

Signed at Ottawa, Ontario, this 27th day of May 2013.

"Robert J. Hogan"

Hogan J.

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APPEARANCES:

For the appellant:	The appellant herself
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