

Docket: 2011-591(IT)I

BETWEEN:

1259066 ONTARIO LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeals of
Warren Johnson (2011-341(IT)I) on November 17, 2011 and
April 11, 2012, at Ottawa, Ontario.

Before: The Honourable Justice Réal Favreau

Appearances:

Agent for the Appellant: Warren Johnson
Counsel for the Respondent: Mélanie Sauriol

JUDGMENT

The appeals from the reassessments dated February 20, 2009 made under the *Income Tax Act* by the Minister of National Revenue and concerning the 2006 and 2007 taxation years are dismissed in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 29th day of November 2012.

"Réal Favreau"

Favreau J.

Docket: 2011-341(IT)I

BETWEEN:

WARREN JOHNSON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeals of
1259066 Ontario Limited (2011-591(IT)I) on November 17, 2011 and
April 11, 2012, at Ottawa, Ontario.

Before: The Honourable Justice Réal Favreau

Appearances:

For the Appellant: The Appellant himself
Counsel for the Respondent: Mélanie Sauriol

JUDGMENT

The appeals from the reassessments dated February 26, 2009 made under the *Income Tax Act* by the Minister of National Revenue and concerning the 2005, 2006 and 2007 taxation years are dismissed in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 29th day of November 2012.

"Réal Favreau"

Favreau J.

Citation: 2012 TCC 399
Date: 20121129
Dockets: 2011-341(IT)I,
2011-591(IT)I

BETWEEN:

WARREN JOHNSON,
1259066 ONTARIO LIMITED,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Favreau J.

[1] These appeals were heard on common evidence under the informal procedure and concern the 2005, 2006 and 2007 taxation years.

[2] The points at issue are (a) whether the Minister of National Revenue (the “Minister”) properly reduced the expenses claimed by 1259066 Ontario Limited (“1259066”) by the amounts of \$10,153 and \$6,024 for the 2006 and 2007 taxation years and (b) whether the Minister properly assessed Mr. Warren Johnson, as a shareholder of 1259066 (the “Shareholder” or “Mr. Johnson”), for unreported income in the amounts of \$9,655, \$4,881 and \$4,958 for the 2005, 2006 and 2007 taxation years respectively.

[3] By reassessments dated February 20, 2009 made under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), as amended (the “Act”), the Minister adjusted 1259066's net income (loss) for income tax purposes by reducing the expenses claimed by the amounts of \$10,924 and \$7,020 for the 2006 and 2007 taxation years respectively. 1259066 is only appealing the following adjustments made with respect to travel, the Internet and cable, and motor vehicle expenses:

| Expenses | 2006 \$ | 2007 \$ |
|--------------------|-------------------|-------------------|
| Travel | 4,108 | 4,107 |
| Internet and cable | 773 | 851 |
| Motor vehicle | <u>5,272</u> | <u>1,066</u> |
| Total | 10,153 | 6,024 |

[4] By reassessments dated February 26, 2009 made under the *Act*, the Minister increased the Shareholder's other income by \$9,655, \$4,881 and \$4,958 for the 2005, 2006 and 2007 taxation years respectively on the basis that these amounts constituted benefits conferred on the Shareholder by 1259066 and were thus included in the Shareholder's income by virtue of subsection 15(1) of the *Act*. Mr. Johnson is only appealing the following travel and Internet and cable adjustments made to his previously reported income:

| | 2005 \$ | 2006 \$ | 2007 \$ |
|--------------------|-------------------|-------------------|-------------------|
| Travel | 6,301 | 4,108 | 4,107 |
| Internet and cable | <u>737</u> | <u>773</u> | <u>851</u> |
| Total | 7,038 | 4,881 | 4,958 |

[5] In determining 1259066's tax liability for the 2006 and 2007 taxation years, the Minister made the following assumptions of fact set out in paragraph 23 of the amended reply to the notice of appeal:

- a) the appellant was located at 2545 Lookout Drive, Cumberland, Ontario;
- b) Warren Johnson was the President and sole shareholder of the appellant (the "Shareholder"), which [was] incorporated on December 12, 1997;
- c) at all material times the Shareholder's spouse was Alida Johnson (the "Spouse");
- d) the Shareholder and his Spouse resided at 2545 Lookout Drive, Cumberland, ON;
- e) the Shareholder and his Spouse were the only members of the board of directors of the appellant;

- f) the appellant has a fiscal year-end of May 31;
- g) the appellant was in the business of providing consulting services, such as management consulting, public policy, and aboriginal relations;
- h) the Shareholder retired from his employment with the Government of Canada in 2006;

Motor Vehicle

- i) the appellant recorded an expense in the an [sic] amount of \$5,272 in the 2006 taxation year in respect of motor vehicle depreciation for accounting purposes;
- j) the vehicle for which depreciation was expensed by the appellant was owned by the Shareholder;
- k) an amount of \$1,066 claimed as parking expenses by the appellant in the 2007 taxation year were not incurred;

Travel

- l) the appellant's board of directors, consisting of the Shareholder and his Spouse, travel [sic] to Mexico for a period of five-six weeks a year;
- m) meetings [sic] of the board of directors of the appellant were not required to be held in Mexico to earn business income;
- n) the travel to Mexico referenced in paragraphs l) and m) above were [sic] personal expenses;
- o) the appellant did not have a business location or clients in Mexico;
- p) the Shareholder owned a timeshare in Mexico;
- q) the timeshare is located at an all inclusive hotel (the "Timeshare");
- r) while in Mexico, the Shareholder and his Spouse stayed at the Timeshare;
- s) the Shareholder often uses frequent flyer points to cover the cost of airfare to Mexico;

Internet and cable

- t) the appellant claimed expenses for internet and cable in the amounts of \$1,511 and \$1,682 in the 2006 and 2007 taxation years, respectively;

- u) the cost of basic services for cable and internet for the taxation years 2006 and 2007 were [*sic*] \$773 and \$851, respectively;
- v) the cost of basic services for cable and internet were [*sic*] not incurred to earn income from a business;
- w) the cost of basic services for cable and internet were [*sic*] personal expenses of the Shareholder;
- x) the amounts in excess of the basic services were allowed as expenses to the appellant;

Other

- y) in 2006, the Shareholder paid for the following expenditures:
 - i) travel to Mexico in the amount of \$4,108; and
 - ii) internet and cable in the amount of \$773;
- z) in 2007, the Shareholder paid for the following expenditures:
 - i) travel to Mexico in the amount of \$4,107; and
 - ii) internet and cable in the amount of \$851;
- aa) the expenses listed in paragraphs ~~x) and y)~~ y) and z) above were personal expenses of the Shareholder;
- bb) the expenses listed in paragraphs ~~x) and y)~~ y) and z) above were recorded as expenses by the appellant;
- cc) the appellant recorded an increase to the shareholder loan account for the expenses listed in paragraphs ~~x) and y)~~ y) and z) above; and
- dd) the amounts claimed by the appellant as expenses in the amounts of \$4,881 and \$4,958 for the 2006 and 2007 taxation years, respectively, were benefits conferred onto the Shareholder.

[6] In determining Mr. Johnson's tax liability for the 2005, 2006 and 2007 taxation years, the Minister made the following assumptions of fact set out in paragraph 18 of the reply to the notice of appeal:

- a) the appellant resides at 2545 Lookout Drive, Cumberland, ON;
- b) at all material times the appellant's spouse was Alida Johnson (the "Spouse");

- c) the appellant was the sole shareholder of 1259066 Ontario Limited (the “Corporation”), which [was] incorporated on December 12, 1997;
- d) the appellant and his Spouse were the only members of the board of directors of the Corporation;
- e) the Corporation has a year-end of May 31;
- f) the Corporation was in the business of providing consulting services, such as management consulting, public policy, and aboriginal relations;
- g) the appellant retired from his employment with the Government of Canada in 2006;
- h) the Corporation is located at 2545 Lookout Drive, Cumberland, Ontario;

Travel

- i) the board of directors of the corporation, consisting of the appellant and his Spouse, travel [*sic*] to Mexico for a period of five-six weeks a year;
- j) meetings of the board of directors of the Corporation were not required to be held in Mexico to earn business income;
- k) the Corporation did not have a business or clients in Mexico;
- l) the appellant owned a timeshare in Mexico;
- m) the timeshare is located at an all inclusive hotel (the “Timeshare”);
- n) while in Mexico, the appellant and his Spouse stayed at the Timeshare;
- o) the appellant often uses frequent flyer points to cover the cost of airfare to Mexico;

Meals and entertainment

- p) the portion of the benefit assessed of \$2,617 for meals and entertainment in 2005 consisted of one meal;
- q) the amount listed in paragraph p) above was not incurred to earn income from a business;
- r) the amount listed in paragraph p) above was a personal expense of the appellant;

Internet and Cable

- s) the Corporation claimed expenses for internet and cable in the amounts of \$1,487, \$1,511 and \$1,682 in the 2005, 2006 and 2007 taxation years, respectively;
- t) the cost of basic services for cable and internet for the taxation years 2005, 2006 and 2007 were [*sic*] \$737, \$773 and \$851, respectively;
- u) the cost of basic services for cable and internet were [*sic*] not incurred to earn income from a business;
- v) the cost of basic services for cable and internet were [*sic*] personal expenses of the appellant;
- w) the amounts in excess of the basic services were allowed as expenses to the Corporation;
- x) in 2005, the appellant paid for the following expenditures:
 - i) meals and entertainment in the amount of \$2,617;
 - ii) travel to Mexico in the amount of \$6,301; and
 - iii) internet and cable in the amount of \$737;
- y) in 2006, the appellant paid for the following expenditures:
 - i) travel to Mexico in the amount of \$4,108; and
 - ii) internet and cable in the amount of \$773;
- z) in 2007, the appellant paid for the following expenditures:
 - i) travel to Mexico in the amount of \$4,107; and
 - ii) internet and cable in the amount of \$851;
- aa) the expenses listed in paragraphs x), y), and z) above were personal expenses of the appellant;
- bb) the expenses listed in paragraphs x), y), and z) above were recorded as expenses by the Corporation;
- cc) the Corporation recorded an increase to the appellant's shareholder loan account for the expenses listed in paragraphs x), y) and z) above;

- dd) the amounts claimed by the Corporation as expenses in the amounts of \$9,655, \$4,881 and \$4,958 for the 2005, 2006 and 2007 taxation years, respectively, were benefits conferred onto the appellant; and
- ee) the appellant received benefits in the amounts described in paragraphs x), y) and z) above without reporting the income on his personal income tax returns for the 2005, 2006 and 2007 taxation years.

[7] Mr. Johnson was an Assistant Deputy Minister at the Department of Indian Affairs and Northern Development when he retired in 2006. 1259066 was incorporated on December 12, 1997. From the shareholders' ledger of 1259066, it can be seen that Mr. Johnson was the only shareholder holding common shares of the corporation up to April 1, 2010, when his spouse acquired 100 common shares of the corporation. On August 31, 2004, the elected directors of the corporation were Mr. Johnson and his spouse. The fiscal year end of 1259066 was May 31 of each year.

[8] Mr. Johnson testified at the hearing as well as Ms. Victoria De La Ronde, a retired public servant who had been with the Department of Indian Affairs and Northern Development, Mr. Michael Parlato, Chief Executive Officer of Nuromar and of Constructing Green Energy Co., Mr. Alain Mercier, former President of Wrapped Apps Corporation, and Mr. Marc Thibault, the accountant of 1259066.

[9] The testimony of Ms. De La Ronde, Mr. Parlato and Mr. Mercier was intended to demonstrate that Mr. Johnson had carried on some business activities when he was in Puerto Vallarta. Ms. De La Ronde said that she had personal knowledge of Mr. Johnson working in Puerto Vallarta since she had had telephone discussions with him through Skype. She also said that she did not know whether or not Mr. Johnson's spouse was with him as his spouse did not participate in the discussions.

[10] Mr. Parlato, who stayed at the same resort as Mr. Johnson, said that he saw him reading magazines and periodicals at the pool of the resort and that the first time he discussed business opportunities with Mr. Johnson was in the winter of 2008. Mr. Parlato also said that he has since entered into three business ventures with Mr. Johnson. No documentary evidence of these business ventures was filed in court.

[11] Mr. Mercier, as President of Wrapped Apps Corporation, had been a long-time client of 1259066; he made reference to an invoice submitted to Wrapped Apps Corp. on March 10, 2007 for services rendered in February 2007, when Mr. Johnson was in Puerto Vallarta. The invoice was from New Road Strategies, the business

name of 1259066. Mr. Mercier said that he had had, over the years, many conference calls with Mr. Johnson when Mr. Johnson was in Puerto Vallarta.

[12] Mr. Johnson testified at the hearing. He stated that 1259066 had no sales and no income in its 2005 and 2006 taxation years because he underwent major heart surgery in December 2004 and because of the high technology crash. This is why 1259066 was not able to pay its operating expenses, which were therefore paid by him as shareholder. The services offered by 1259066 consisted of providing consulting services with regard to management, public policy and aboriginal relations. Mr. Johnson explained that the business of 1259066 was a one-person operation in which he acted in partnership with his spouse. No documentary evidence of a partnership between Mr. Johnson and his spouse was filed in court.

[13] Mr. Johnson explained that he and his spouse spent two weeks in Puerto Vallarta, Mexico, in 2006 and five weeks in 2007 and that only one week's expenses in each of the 2006 and 2007 taxation years were charged to 1259066, as those were expenses incurred for business purposes. Mr. Johnson described the activities carried on during that week as being a corporate strategic retreat focussing on (i) the building of intellectual capital by reading special studies and reports, (ii) the development of marketing strategies (new website and new brand name), and (iii) the identification of business opportunities.

[14] For each of the two retreat weeks, Mr. Johnson charged 1259066 the amounts of \$4,107.91 (for 2006) and \$4,197.71 (for 2007), which included the following expenses:

| Expenses | 2006 \$ | 2007 \$ |
|------------------------------|-------------------|-------------------|
| Airfare | 1,460.00 | 1,460.00 |
| Hotel in Puerto Vallarta | 1,562.50 | 1,862.50 |
| Hotel in Toronto | 96.98 | 96.98 |
| Taxis (2) in Ottawa | 150.00 | 150.00 |
| Taxis (2) in Puerto Vallarta | 66.25 | 66.25 |
| Taxes and fees | 236.95 | 26.75 |
| Meals | 535.23 | 518.28 |
| Breakfast | <u> </u> | <u>16.95</u> |
| Total | 4,107.91 | 4,197.71 |

[15] Mr. Johnson explained that he paid for his return trips from Ottawa to Puerto Vallarta via Toronto with his Aeroplan miles, except for a small fee of \$104 per ticket. Mr. Johnson determined the commercial value of the airfare by using the cost for standard economy tickets shown on the Air Canada website. Mr. Johnson pointed out that the determination of the commercial value was done either at the time of reservation, which was a year before his departure, or a few months after the trip but before May 31, which was the fiscal year-end of 1259066. Mr. Johnson could not remember the credit card on which the Aeroplan miles were earned, but he was sure that it was a joint personal credit card registered under his and his spouse's names. It was not a corporate credit card of 1259066.

[16] Mr. Johnson also confirmed that he purchased in 1997 timeshare condo # 5007 at the Velas Vallarta Grand Suite Resort (the "Resort"). The purchase price (less discount) for 25 weeks was \$13,132.80, that is, \$525.31 per week. Mr. Johnson charged 1259066 the amount of \$1,562.50 for the week in 2006, which amount exceeded the actual cost of the timeshare of \$1,152.43 (\$525.31 plus the maintenance fee of \$627.12 per week). Mr. Johnson explained that the amount charged to 1259066 was based on the published information available at the time of booking and he recognized that the value claimed was higher than the price actually paid, stating that this was because the timeshare condo increased in value over time. For the 2007 retreat week, Mr. Johnson used the published rate of the Resort (\$1,862.50), which also exceeded his actual cost.

[17] In 2006, Mr. Johnson and his spouse stayed at the Resort for two weeks, from February 9 to 23. In 2007, Mr. Johnson and his spouse stayed for one month, from February 1 to 28, in condo #603 Tower B in Bay View Grand Development Marina Vallarta for \$2,100 USD (\$525 USD per week). They also stayed the week of March 1 to 8, 2007 at the Resort, which was an all-inclusive resort, but Mr. Johnson had asked for a simple plan (breakfast, lunch and pool drinks). At the hearing, Mr. Johnson said that meals were not included in the timeshare cost. The maintenance fee for the week at the Resort in 2007 was \$747.

[18] Concerning the claim for meals, Mr. Johnson explained that the daily cost of food was arrived at by adding the amounts of the receipts for the entire duration of the trip divided by the number of days. According to him, the claims for meals in each of the years 2006 and 2007 represent the actual cost of the food.

[19] Concerning the corporate retreats in 2006 and 2007, Mr. Johnson admitted that there was no PowerPoint presentation, no agenda and no minutes of meetings. He simply stated that the results of the work accomplished during those weeks were published or put on his website.

[20] With respect to the travel expenses claimed by 1259066, Mr. Johnson could not explain why the retreat week in Puerto Vallarta cost \$6,301 in 2005 as opposed to \$4,108 in 2006 and \$4,107 in 2007. No explanations were given by Mr. Johnson concerning the location of the retreat, its duration and the cost of the accommodation. As the 2005 taxation year of 1259066 became statute-barred during the audit, the Minister did not reassess that year but included the travel expenses and Internet and cable expenses claimed by 1259066 in Mr. Johnson's income for his 2005 taxation year.

[21] Concerning the motor vehicle expenses claimed by 1259066, Mr. Johnson explained that the vehicle, a 2001 Volkswagen, was purchased jointly by him and his spouse, that it was registered in his name and that it was used strictly for business purposes. Mr. Johnson explained that what was claimed by 1259066 was not capital cost allowance on the vehicle and that what was charged to 1259066 was the cost of the supply of the vehicle to it, as determined by 1259066's accountant. Mr. Johnson also confirmed that the amount charged to 1259066 in respect of the vehicle was not paid by 1259066 but was instead included in the due to shareholder account. No documentary evidence proving the existence of a contract or arrangement with 1259066 concerning the payment of the operating cost of a vehicle was filed in court by Mr. Johnson.

[22] Mr. Johnson admitted that the amounts disallowed for Internet and cable expenses corresponded to the amounts for basic Internet and cable service.

[23] Mr. Marc Thibault testified at the hearing. He is a sole practitioner who prepared the financial statements and tax returns of 1259066 and who represented 1259066 during the income tax and the goods and services tax audits. Mr. Thibault explained that the full cost of operation of the motor vehicle was charged to 1259066 on the basis that it was used exclusively for business purposes. The depreciation of the vehicle was computed by reference to its purchase price.

[24] Mr. Thibault explained that the expenses charged to 1259066 and not reimbursed to Mr. Johnson were included in a shareholder account. In 2007, the amount of the shareholder account (approximately \$20,000) was transferred to a reserve account pending the results of the income tax audit. This accounting change effectively removed from the books the expense amounts that were owed to Mr. Johnson.

[25] Ms. Karen Turner, the CRA auditor who conducted the audits of 1259066 and Mr. Johnson, testified at the hearing. She explained that when she did her corporate audit, 1259066's taxation year ending May 30, 2004 was statute-barred and that the taxation year ending May 30, 2005 became statute-barred during the audit. Those two taxation years were not reassessed. Ms. Turner could not remember if the operations of 1259066 were financed only by Mr. Johnson, but she pointed out that Mr. Johnson indicated in a letter dated November 30, 2008 that 1259066 reimbursed the president/shareholder for the expenses incurred by him in the carrying on of corporate business, these being eligible expenses for the corporation.

[26] Ms. Turner provided the following explanations concerning the disallowance of the Internet and cable expenses. In her letter of October 31, 2008 to 1259066, the enumeration of proposed disallowed expenses shows only Internet, but the explanatory note regarding the proposed adjustment clearly refers to the amount for Internet and cable and states that the amount for cable TV is a personal expense. In a subsequent letter dated February 3, 2009 to 1259066, the description of the proposed disallowed expenses again refers to Internet only, while the explanatory note refers only to cable. Ms. Turner explained that, in her working paper, the amount for basic Internet and cable was disallowed as those services were available to Mr. Johnson and his spouse 24 hours a day and because it had been established from a conversation with Mr. Johnson that both Mr. Johnson and his spouse watched TV for personal purposes. At the assessment stage, although the disallowed expense was

noted as being for basic cable TV only, the amounts actually disallowed were for both basic Internet and basic cable.

[27] Concerning the disallowed travel expenses, Ms. Turner explained that all such expenses were disallowed and that the amounts used by Mr. Johnson were not considered or examined. Only the purpose of the expenses claimed was considered.

[28] Ms. Turner also pointed out that the amounts included in the shareholder account were amounts owed to Mr. Johnson only.

Analysis

[29] The provisions of the *Act* that are applicable in these appeals are the following:

15(1) **Benefit conferred on shareholder** — Where at any time in a taxation year a benefit is conferred on a shareholder, or on a person in contemplation of the person becoming a shareholder, by a corporation otherwise than by

...

the amount or value thereof shall, except to the extent that it is deemed by section 84 to be a dividend, be included in computing the income of the shareholder for the year.

...

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) **General limitation** — 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) **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;

...

(h) **Personal and living expenses** — 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;

...

20(1) Deductions permitted in computing income from business or property — Notwithstanding paragraphs 18(1)(a), (b) and (h), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto:

(a) **Capital cost property [CCA]** — such part of the capital cost to the taxpayer of property, or such amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by regulation;

...

152(1.1) Determination of losses — Where the Minister ascertains the amount of a taxpayer's non-capital loss, net capital loss, restricted farm loss, farm loss or limited partnership loss for a taxation year and the taxpayer has not reported that amount as such a loss in the taxpayer's return of income for that year, the Minister shall, at the request of the taxpayer, determine, with all due dispatch, the amount of the loss and shall send a notice of determination to the person by whom the return was filed.

...

230(1) Records and books — Every person carrying on business and every person who is required, by or pursuant to this Act, to pay or collect taxes or other amounts shall keep records and books of account (including an annual inventory kept in prescribed manner) at the person's place of business or residence in Canada or at such other place as may be designated by the Minister, in such form and containing such information as will enable the taxes payable under this Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined.

248(1) Definitions — In this Act,

"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,
- (b) the expenses, premiums or other costs of a policy of insurance, annuity contract or other like contract if the proceeds of the policy or contract are payable to or for the benefit of the taxpayer or a person connected with the taxpayer by blood relationship, marriage or common-law partnership or adoption, and

- (c) expenses of properties maintained by an estate or trust for the benefit of the taxpayer as one of the beneficiaries.

[30] An expense is deductible in computing the income of a taxpayer only if it is incurred for the purpose of earning income. Pursuant to the general limitation in paragraph 18(1)(a) of the *Act*, the taxpayer must make the outlay or incur the expense for the purpose of gaining or producing income from the business in which the taxpayer is engaged.

[31] Pursuant to paragraph 18(1)(h) of the *Act*, "personal or living expenses" cannot be deducted by a taxpayer in computing his income from business. The prohibition of paragraph 18(1)(h) does not, however, cover travel expenses incurred by the taxpayer while away from home in the course of carrying on the taxpayer's business.

[32] The purpose of an expense is determined by looking for the predominant reason for which the taxpayer incurs the expense. An important distinction exists between expenses incurred primarily for personal purposes and expenses that are incurred predominantly for the purpose of earning income but which have only incidental and ancillary personal elements.

[33] In *Stewart v. Canada*, 2002 SCC 46, [2002] S.C.R. 645, at paragraphs 56 and 57, the Supreme Court of Canada stated the following in dealing with the personal element of certain activities:

In addition to restricting the source test to activities which contain a personal element, the activity which the taxpayer claims constitutes a source of income must be distinguished from particular deductions that the taxpayer associates with that source. An attempt by the taxpayer to deduct what is essentially a personal expense does not influence the characterization of the source to which that deduction relates. This analytical separation is mandated by the structure of the Act. While, as discussed above, s. 9 is the provision of the Act where the basic distinction is drawn between personal and commercial activity, and then, within the commercial sphere, between business and property sources, the characterization of deductions occurs elsewhere. In particular, s. 18(1)(a) requires that deductions be attributed to a particular business or property source, and s. 18(1)(h) specifically disallows the deduction of personal or living expenses of the taxpayer

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 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.

[Emphasis added].

[34] In these appeals, I have great difficulty accepting that the trips to Puerto Vallarta were predominantly for business reasons. It seems to me that the travel expenses incurred by Mr. Johnson and his spouse were primarily incurred for personal reasons and had only incidental and ancillary business elements.

[35] Mr. Johnson and his spouse have been going to Puerto Vallarta for many years and in 1997 Mr. Johnson purchased a 25-week timeshare condo at the Resort. The week of March 1 to 8, 2007 was the last week covered by the 1997 purchase agreement and a new purchase agreement was negotiated for an additional 25 weeks at the Resort. The main purpose of the trips appears to me to have been to take personal vacations, considering the length of the stays: two weeks in 2006 and five weeks in 2007.

[36] I accept the fact that Mr. Johnson did carry on some business activities while he was there. He probably made calls to clients and received calls from them and read special reports and sought business opportunities, but those activities could have been carried on from anywhere. Mr. Johnson's physical presence in Puerto Vallarta was not required, considering the fact that no local clients were served by 1259066 during Mr. Johnson's stays in Mexico. The trips to Puerto Vallarta resulted from a lifestyle decision by Mr. Johnson, and the cost of those trips may have been incurred in any event. Simply working while on vacation does not make a vacation trip a business trip.

[37] Mr. Johnson admitted that there was no PowerPoint presentation and no agenda for the meetings held during the corporate retreats in 2006 and 2007 and no minutes of those meetings. No details were given by Mr. Johnson concerning the number of days worked, the number of hours spent on each business activity, the dates on which the business meetings took place or the length of those meetings. Mr. Johnson told the auditor that he simply estimated that he spent the equivalent of one week working during his stays in Puerto Vallarta.

[38] Mr. Johnson was generally evasive regarding the role played by his spouse in the operations of 1259066 and, in particular, concerning her involvement in the business activities of 1259066 during her stays in Puerto Vallarta. We know that she did not participate in the various telephone conversations with Ms. De La Ronde and with Mr. Mercier. In fact, there is no evidence that Mr. Johnson's spouse provided any services at all to 1259066 during her stays in Puerto Vallarta, and in that context it is difficult for me to accept that any portion of the expenses attributable to the cost of Mr. Johnson's spouse's trips to Puerto Vallarta was incurred for business purposes. Mr. Johnson's spouse did not testify at the hearing to clarify the nature and extent of the services she performed for the benefit of 1259066 during her stays in Puerto Vallarta.

[39] The expenses charged by Mr. Johnson to 1259066 for airfares and the timeshare did not correspond to their actual cost to him but represented the actual value of those expense items. What was charged to 1259066 for 2006 and 2007 was in excess of the amounts actually paid by Mr. Johnson. For the airfares, there was no cash disbursement except for a small fee of \$104. Mr. Johnson used his Aeroplan miles to pay for the airline tickets. Furthermore, no evidence was provided by Mr. Johnson to explain why the cost of the airfares and of his stay at the timeshare in 2005 was almost double their cost for 2006 and 2007 (\$2,462 for airfare and \$3,325 for the timeshare in 2005).

[40] Since I have concluded that no portion of the expenses claimed in respect of the trips to Puerto Vallarta is deductible by 1259066 as business expenses, no determination of the value and reasonableness of the expenses charged to 1259066 has to be made.

[41] Concerning the motor vehicle expenses, Mr. Johnson stated that he purchased on his own account a previously leased vehicle that was still relatively new and still under warranty and charged to 1259066 the actual costs of operating the vehicle, such as gasoline, repairs and maintenance, licensing, insurance, and an amount for the depreciation of the vehicle that was based on the capital cost allowance prescribed by the *Income Tax Regulations*. The CRA recognized that 1259066 never claimed capital cost allowance in respect of the vehicle and accepted the fact that the vehicle was used exclusively for business purposes. The problem is with respect to the depreciation of the vehicle. According to the CRA, Mr. Johnson has not adduced any evidence establishing the real purchase price of the vehicle, the date it was acquired and the depreciation previously taken on the vehicle.

[42] Mr. Johnson indicated that the vehicle was a three-year old used vehicle probably bought in 2004 and that one year of depreciation was taken in respect of the vehicle. Mr. Johnson did not lead any evidence in court on this point because he thought that the matter had already been dealt with by the CRA's auditor. The accountant of 1259066 testified that he did not remember what the purchase price of the car was.

[43] In the absence of any evidence concerning the real cost of acquisition of the motor vehicle and of the amount of depreciation taken since its acquisition, the amount charged as depreciation to 1259066 for the 2006 taxation year is not a tax-deductible expense. Pursuant to subsection 230(1) of the *Act*, every person carrying on business has the obligation to keep proper books and records to enable the Minister to determine the tax payable under the *Act* or amounts that should have been deducted in computing the person's income.

[44] With respect to the Internet and cable expenses, the CRA disallowed the basic rate amount because no information was available to make it possible to determine the exact percentage of personal use versus business use. Mr. Johnson said that he and the members of his family never use the Internet for personal purposes and that his spouse and he never watch TV for personal purposes although they do watch the news. In this regard, I do not think that the testimony of Mr. Johnson is credible considering that it has not been corroborated by his spouse's testimony and that the reservations at the Resort were made through the Internet. The method used by the CRA was reasonable in the circumstances and Mr. Johnson has the burden of establishing a higher percentage of business use. In this instance, a higher percentage of business use would require exclusive use for business purposes. Despite Mr. Johnson's forceful presentation concerning the business use of the Internet and cable at home, I still consider that a portion of the Internet and cable services was for personal use, as these services were available to Mr. Johnson and his spouse 24 hours a day, seven days a week, and as it has been established that Mr. Johnson and his spouse use the TV for personal viewing. Mr. Johnson was not always in the room when his spouse watched TV.

[45] Concerning the personal reassessments for the 2005, 2006 and 2007 taxation years, Mr. Johnson maintained that, as a result of the reversal of the book entries, he never received the benefit of what was owed to him by 1259066 and that, alternatively, if shareholder benefits are considered to have been received, he should not be taxed on the entire amount but only on 50% as his spouse should be taxed on the other 50%.

[46] The Respondent pointed out that the 2005 taxation year was initially assessed on April 13, 2006 and was reassessed on February 26, 2009, which was within the limitation period and so the reassessment was not statute-barred.

[47] Under subsection 15(1) of the *Act*, the Minister included in Mr. Johnson's income the value of the benefit which corresponded to the amount of the debt due to him that was recorded in his shareholder's loan account in respect of the 2005, 2006 and 2007 taxation years. Mr. Johnson purposely, and on his own initiative, recorded the amounts expended by 1259066 as entries in the shareholder's loan account. This was not done by mistake. Mr. Johnson gave the relevant information to 1259066's accountant in order that he deduct the expenses. Mr. Johnson had both the opportunity and the obligation to accurately record 1259066's debt owed to him.

[48] The Respondent also argued that 1259066 could not transfer the disputed expenses into the reserve account because these expenses were only brought to light after the audit and because, at that point, it was too late, in the absence of any mistake, for 1259066 to reclassify them. I agree with the Respondent and I do not think that it is appropriate to permit a taxpayer to do retroactive tax planning during an audit or after its completion.

[49] I agree with the following comments of Justice McArthur in *Tymchuk v. The Queen*, 2003 TCC 699:

15 To be successful in taking advantage of provisions under the *Income Tax Act*, the form of the transaction between the corporation and its shareholder must be operative. I find as a fact that Donald sought to show the amounts as expenses of the corporation and not declare them as having been received by him. After the audit, it is too late to restructure the transaction. . . .

[50] Mr. Johnson submitted some bank statements for an account jointly held by him and his spouse to establish that his spouse also paid some of the expenses charged to 1259066, so that a portion of the shareholder's benefits should be taxed in her hands. Mr. Johnson has not been able to demonstrate the exact portion of the expenses charged to 1259066 that was paid by his spouse, and the Respondent pointed out that this information was not relevant in any event considering the fact that the amount of the shareholder's loan account was owed only to him.

[51] Mr. Johnson and 1259066 had the onus of establishing that the Minister's assumptions of fact and consequent reassessments were wrong. This they have failed to do here.

[52] Both appellants' appeals are accordingly dismissed.

Signed at Ottawa, Canada, this 29th day of November 2012.

"Réal Favreau"

Favreau J.

CITATION: 2012 TCC 399

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STYLES OF CAUSE: 1259066 Ontario Limited v. Her Majesty the Queen
Warren Johnson v. Her Majesty the Queen

PLACE OF HEARING: Ottawa, Ontario

DATES OF HEARING: November 17, 2011 and April 11, 2012

REASONS FOR JUDGMENT BY: The Honourable Justice Réal Favreau

DATE OF JUDGMENT: November 29, 2012

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