Docket: 2010-282(IT)I

BETWEEN:

MARC PILON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on November 26, 2010, at Montréal, Quebec.
Before: The Honourable Justice Brent Paris

Appearances:

Agents for the appellant:	Christina Meunier-Cyr (Student-at-law) and Frédérick Houle (Student-at-law)
Counsel for the respondent:	Marc André Rouet

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2005 taxation year is allowed, without costs, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that $15,363.46 was deductible as a current expense for the 2005 taxation year.

The appeals from the reassessments made under the *Income Tax Act* for the 2004, 2006 and 2007 taxation years are dismissed.

Signed at Ottawa, Canada, this 4th day of February 2011.

"B. Paris"

Paris J.

Translation certified true
on this 14th day of March 2014
Daniela Guglietta, Translator

Citation: 2011 TCC 67
Date: 20110204
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BETWEEN:

MARC PILON,

Appellant,

and

HER MAJESTY THE QUEEN,

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REASONS FOR JUDGMENT

Paris J.

[1] This is an appeal under the informal procedure from reassessments of the appellant's 2004 to 2007 taxation years inclusive. The Minister of National Revenue (the Minister) reassessed the appellant to reduce the $67,541 rental loss claimed by him in the 2005 taxation year to $4,233, and to disallow a non-capital loss carry-back of $27,993 from 2005 to the 2004 taxation year and $3,300 non-capital loss carry-forward from 2005 to the 2006 taxation year. The Minister also disallowed certain tuition and education credits which are not in issue.

[2] In addition to contesting the reduction of the rental loss and the resulting disallowance of non-capital losses, the appellant is also seeking to increase his rental loss from what he originally claimed for the 2005 taxation year, and to increase his non-capital loss carry-forward and carry-back.

[3] The issue in this appeal is whether expenditures of $89,758 for work done on a duplex owned by the appellant at 7655/7657 Broadway, LaSalle, Quebec (the

Property) were deductible as repair and maintenance expenses in the calculation of his income from property in 2005.

[4] In his 2005 income tax return, the appellant sought to deduct repair and maintenance expenses of $55,627 in relation to the Property. He indicated that he spent a total of $85,580 for repairs and maintenance of the Property, of which he claimed 65% as a rental expense. The remaining 35% was treated as a personal expense, because the appellant lived in the upper unit from July 2005 through the end of the year.

[5] The appellant was initially assessed for the 2005 taxation year to allow a greater rental loss ($63,308) than what had been claimed ($60,010). It appears that the amount that was allowed in excess of what had been claimed was allowed in error, and nothing turns on it. In 2008, the appellant revised his rental loss claim for the 2005 taxation year. He claimed an additional $1,167 for repairs and maintenance in respect of the Property, for a total of $86,747.37, and deleted the 35% adjustment for personal use.

[6] The Canada Revenue Agency reviewed the revised claim, and disallowed the entire amount claimed for repairs and maintenance on the basis that the amounts had not been incurred to earn income because the Property became the appellant's principal residence and because the expenditures were capital in nature.

[7] In appealing the reassessments in issue, the appellant is also seeking to increase the deduction for repairs and maintenance for the Property to $89,758 from $86,747 in his revised claim and from $85,580 in his original filing.

[8] The appellant purchased the Property in 2001 for $117,000. Both units were rented at the time of purchase, and the existing tenants stayed on. The upper unit measured approximately 1,000 sq. ft. while the bottom unit had about 1,800 sq. ft. spread over the main floor and basement.

[9] In April 2005, the tenant in the upper unit moved out without notice. Upon inspecting the apartment, the appellant said the unit was, in his opinion, in "disastrous" condition. There was damage to some interior doors, certain walls had many small holes from pictures that had been taped or hung on them, an exterior door had a broken window pane and was difficult to open, the linoleum floor in the dining

room was worn and torn in spots, a living room light fixture was missing and the carpet was torn and dirty, and there was mould and water damage in the back room due to a water leak from a blocked roof drain. In the kitchen, a cupboard door and some drawers were missing, as well as one cupboard doorknob, and the corner of another door was broken off.

[10] At that point, the appellant decided to carry out work on the upper unit rather than attempt to rent it out. Over the next three months, he replaced the kitchen cupboards and counters, relocated and replaced the kitchen sink and added a dishwasher, replaced the linoleum kitchen floor with ceramic tile replaced a large part of the electrical wiring, added electrical outlets, replaced or added electrical heating apparatus and at least several circuit breakers. He refinished the wood floors in the living room, dining room, hall, three bedrooms and closets and replaced exterior doors. The walls were repaired, some windows and some door trim were replaced and the apartment was painted. It also appears that a portion of the kitchen plumbing and bathroom vanity and fan were replaced. This work was completed in June 2005.

[11] The appellant testified that at around this time the tenant in the lower unit decided to move out. The appellant determined that that unit as well required work, although it was not in as "disastrous" condition as the upper unit had been. He, therefore, decided to move into the upstairs newly finished apartment to enable him to be more available to work on the lower unit.

[12] According to the appellant's testimony, there had been water leaking into the basement through cracks in the foundation and water leaking into the back room on the main floor from the same roof drain leak that had caused damage upstairs. The appellant had the exterior drainage redone and ripped out and replaced all of the basement finishing. He also replaced the damaged portion of the back room on the main floor. He said he was also required to change the existing oil heating system to an electric one because his insurer had advised him that it would no longer insure premises which used oil as the heating fuel. This led him to upgrade the electrical service from 100 amps to 200 amps. There was also an extensive amount of rewiring done throughout the unit.

[13] The appellant also said that in the past the floors in the kitchen had been repaired a number of times to counteract the settling of the house and that as a result, the counter height had been effectively lowered. The kitchen itself was dated and the

cabinets were worn, so he decided to redo the kitchen. He also had insulation blown into the ceiling to soundproof between the two units and the exterior walls were insulated on the main floor.

[14] The appellant said that the tub in the main floor bathroom needed to be replaced because it was stained, and in order to do so, the ceramic tile around the tub had to be redone. The hot water tanks for both units were replaced, and the apartment was repainted and the driveway resealed. The appellant did almost all the work himself, with some unpaid help from friends and relatives.

[15] The agent for the appellant maintained that the expenditures that were incurred by the appellant for work and material to the property were current expenses and should be deductible in the calculation of the appellant's income from property in 2005. He said that the determination of whether a particular expense is capital or current in nature must be made upon a consideration of all of the surrounding circumstances, including the taxpayer's purpose in making the expenditures and whether the expenditures resulted in the creation of a new property.

[16] He submitted that the appellant did not carry out the work to increase the value of the property, but simply to repair damage and wear and tear and to avoid future repairs. The units were not enlarged and there was no proof that the work increased their value. The agent for the appellant said that the appellant sought to perform the work in the most economical manner possible using replacement materials that were comparable in quality to the original.

[17] With respect to the personal use of the property, the agent for the appellant argued that the appellant had not claimed any expenses for the unit he occupied in 2005 for work done while he occupied the unit. He also argued that the expenses for work done to the units while they were vacant were deductible because the units were still considered property for the purpose of earning income during those periods.

Analysis

[18] I will deal firstly with the deductibility of the expenses incurred after July 1, 2005, for work on the lower unit.

[19] After considering all of the evidence, I find that the appellant carried out the work on that unit with the intention of occupying it as his personal residence, and therefore, that the expenses were not incurred to earn income from property.

[20] The nature and scope of the work satisfy me that they were not carried out as repairs of the unit to enable it to be rented out. I am satisfied that the work done went far beyond what was necessary to repair any deficiencies in the unit to enable it to be rented out. Despite the unit having been continuously occupied from the time the appellant purchased the building, and despite there having been no complaints about the condition of the Property by the tenant, the appellant chose to rip out most of the existing finishing and redesign most of the main floor. The kitchen was replaced, many of the interior walls were either removed or moved, an open plan living room, dining room and kitchen was created from what had been three separate rooms. The bathroom was moved to a new location where there had previously been a bedroom; the staircase to the basement was moved as well. The doors to the bedrooms were changed from swing doors to pocket doors, new closets were installed, a kitchen window was replaced with a new sliding patio door. Part of a veranda was enclosed to use as a laundry room, and the basement door to the outside was reconfigured.

[21] In his direct testimony, the appellant made no mention of most of the changes I described above and gave the impression that the work that was done was simply to repair wear and tear and damage to the unit. The full extent of the work only became apparent by reviewing the plans of the work that the appellant submitted to the City at the request of the building inspector.

[22] My conclusion that these renovations were done for personal purposes is reinforced by the costs of certain parts of the work which seem excessive in comparison to the amounts expended on the upper unit. For instance, the appellant spent $14,000 on kitchen cabinets and $2,300 on a bathroom vanity, almost $1,000 on a bathtub, and $450 on a Roman bath faucet set. He also installed one-piece toilets, a garbage disposal in the kitchen sink, and a central vacuum system, and soundproofed the ceiling above the main floor.

[23] By contrast, the appellant spent $4,900 on new kitchen cabinets for the upper unit, for a kitchen of approximately the same size. He did not move any walls or install any pocket doors, did not insulate the exterior walls or add a central vacuum or garbage disposal and only changed the medicine cabinet in the bathroom. The

appellant also chose to have foam insulation sprayed into the exterior walls on the main floor whereas no insulation was added to the upper unit.

[24] The appellant said that the high cost of the kitchen cabinets for the lower unit was due to the ceiling being higher. He said that the ceiling in the downstairs kitchen was 10 feet high whereas the upstairs kitchen had 8 foot ceilings. He said that it cost more to have the cupboards downstairs go all the way to the ceiling.

[25] I do not accept this explanation. Firstly, there is no corroboration of a need for the cupboards to go all the way to the ceiling, and I can think of no reason why this should be the case. Furthermore, I find it hard to believe that the much higher cost of cupboards for the lower unit was only due to their height. The kitchens in both units were approximately the same size and had the same layout, yet the cost of the downstairs cupboards was almost three times higher. I also do not accept that the new "thermoplastic" cupboards in the lower unit were inferior in quality to the old cupboards, as claimed by the appellant. Pictures of the upstairs cupboards prior to their replacement show what appear to be very basic built-in plywood cabinets, and the appellant testified that the existing cupboards in the lower unit were similar. The statement that the new $14,000 cupboards were of lesser quality than the original ones is very difficult to believe.

[26] I also note that the appellant testified that the lower unit was in better condition than the upper unit when the tenants left. The appellant did not provide any reason for the more expensive finishings and significant redesign of the lower unit, and given that he moved into it once the work was substantially completed and continues to live there, I infer that it was his intention from the outset to renovate the unit for his own use. Furthermore, if the appellant had intended to maximize his rental income, he would have remained in the upper unit and rented out the larger, completely renovated lower unit. Although he said he moved into the lower unit because the upper unit could be rented out immediately and the lower unit was not finished, at another point in his testimony he said that most of the work on the lower unit had been completed by the end of 2005. It appears to me that when he moved downstairs in April 2006, there was relatively little work left to finish the lower unit and that his explanation for moving downstairs is not borne out by the facts.

[27] The appellant also said that he decided to move into the lower unit after his mother passed away in March 2006. Prior to her becoming ill, the appellant said he planned to move into a house he owned in St. Basile Le Grand near his mother's

house. However, this appeared to be a long-term plan. Earlier in his testimony, the appellant said that he intended to move to St. Basile Le Grand only after he was married and had children. On his 2005 and 2006 tax returns, he listed his marital status as single and did not claim any dependents.

[28] Even if I had found that the appellant had intended to rent out the lower unit after the renovations, I would have found that the expenditures for that unit were capital in nature. While certain parts of the work may have been necessitated by wear and tear or damage that had occurred, the work went far beyond simply returning those aspects of the unit to their original condition or to an equivalent condition. This has been held to be an important factor in cases of this kind.

[29] In *Chambers v. Canada*,[1] in deciding whether certain expenditures in relation to a rental property were capital or current expenses, Brulé J. said:

> 14 It would seem that if the repairs resulted in virtually the same old building as before the repairs were undertaken then such should be properly expensed, but if on finishing the repairs a virtually new building or at least quite a different building results then the repairs should be on capital account.

[30] In *Gold Bar Developments Ltd. v. Canada*,[2] Jérome A.C.J. wrote:

> 8. An expenditure which is in the nature of a repair will not be allowed as a deduction from income if it becomes so substantial as to constitute a replacement of the asset. *See Canada Steamship Lines Limited v. Minister of National Revenue*, [1966] C.T.C. 255, 66 D.T.C. 5205; *M.N.R. v. Haddon Hall Realty Inc.*, [1961] C.T.C. 509, 62 D.T.C. 1001; and *Minister of National Revenue v. Vancouver Tugboat Company, Limited*, [1957] C.T.C. 178, 57 D.T.C. 1126.

[31] From the description of the work which I have set out above, it appears to me that the lower unit was substantially transformed by the renovations, and that something quite different from the original unit was created.

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1 [1997] T.C.J. No. 1244.

2 [1987] F.C.J. No. 219.

[32] I also find that it was the appellant's intention to improve the unit, to make it better and that this factor supports the conclusion that these were capital expenditures: see *Gold Bar Developments Ltd. v. Canada* at paragraph 5.

[33] Finally, the amount spent on the renovation—about $70,000—was substantial in comparison to the original acquisition cost of the property. The portion of the total acquisition cost of the Property which was attributable to the lower unit would have been 65% x $117,000 (the appellant's cost of the entire Property, including the land) which equals $76,500, or only slightly more than the total spent by the appellant on the renovation.

[34] With respect to the amounts spent on the upper unit, I am satisfied that the majority were spent to repair damage or wear and tear. I am also satisfied that the appellant did not undertake the repairs with the intention of occupying the unit, other than temporarily while he renovated the lower unit as his personal residence. For the most part, the work appears limited to the repair of damage or worn out elements, and was consistent with an intention to rent out the premises. However, I find that the amount spent on electrical work was a capital expenditure. There was no evidence of any problem with the electrical system, except that the use of a window air conditioner would sometimes trip a breaker. The work done, though, went well beyond adding a separate circuit for an air conditioner. The materials alone for the electrical work cost over $4,400. While the appellant said he was concerned about the state of the wiring, he did not obtain a professional opinion on the point. Furthermore, he admitted that he had added extra outlets to accommodate the greater number of electrical appliances and devices that are used now compared to when the unit was built. These factors lead me to conclude that at least 80% of the electrical work was intended to be, and was in fact improvement to the unit, rather than a repair intended to return it to an original condition.

[35] According to Exhibit A-1, the amounts spent for work on the upper unit in 2005 was $19,812.86, but the appellant acknowledged that the stated amount of $875 for [TRANSLATION] "asphalt repairs" had to be deducted because it was an expense incurred for work on the lower unit. The total is, therefore, $18,937.86. The amount spent on electricity was $4,468.01, 80% of which is $3,574.40. The total amount of deductible expenses would be $15,363.46.

[36] For these reasons, the appeal is allowed in part, and the matter is referred back to the Minister for reconsideration and reassessment on the basis that the $15,363.46

(the amount spent on the upstairs unit, excluding 80% of the electrical work expenditures) was deductible as a current expense in the 2005 taxation year.

Signed at Ottawa, Canada, this 4th day of February 2011.

"B. Paris"

Paris J.

Translation certified true
on this 14th day of March 2014
Daniela Guglietta, Translator

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APPEARANCES:

Agents for the appellant:	Christina Meunier-Cyr (Student-at-law) and Frédérick Houle (Student-at-law)
Counsel for the respondent:	Marc André Rouet

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