

Docket: 2011-1963(IT)I

BETWEEN:

763993 ALBERTA LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent;

Docket: 2011-2036(IT)I

AND BETWEEN:

1069616 ALBERTA LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence on August 21, 2012 at Grande Prairie, Alberta

Before: The Honourable Justice J.E. Hershfield

Appearances:

Agent for the Appellants: Terry Steinkey

Counsel for the Respondent: Mary Softley

JUDGMENT

The appeal of 763993 Alberta Ltd. from the reassessment made under the *Income Tax Act* for the 2006 taxation year is allowed, without costs, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the sale of the property municipally described as 9301-99 Street, Grande Prairie was the sale of a capital property as reported by the

corporation and for greater certainty the reassessment of 763993 Alberta Ltd.'s 2006 taxation year is, in all other respects, confirmed.

The appeal of 1069616 Alberta Ltd. from the reassessment made under the *Income Tax Act* for the 2007 taxation year is dismissed, without costs.

Signed at Ottawa, Canada this 30th day of August 2012.

"J.E. Hershfield"

Hershfield J.

Citation: 2012 TCC 308
Date: 20120830
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REASONS FOR JUDGMENT

Hershfield J.

[1] The Appellant 1069616 Alberta Ltd. (“106 Ltd.”) was denied the deduction of \$15,730 of expenses claimed in respect of its 2007 taxation year. The Appellant 763993 Alberta Ltd. (“763 Ltd.”) was similarly denied the deduction of \$25,050 of expenses claimed in respect of its 2006 taxation year. Each of 763 Ltd. and 106 Ltd. (the “corporations”) made payments on account of these expenses (collectively referred to as the “subject expenses”) to two of their respective shareholders. The payments by 106 Ltd. that included the subject expenses were to both Mrs. Steinkey and Mr. Steinkey. The payments by 763 Ltd. that included the subject expenses were made to both Mr. Steinkey and another family member. The recipients of the payments are collectively referred to in these Reasons as the “shareholder payees”.

[2] 763 Ltd. was also denied capital gains treatment with respect to the sale in its 2006 taxation year of certain lands municipally described as 9301-99 Street Grande Prairie on the basis that they were inventory of the corporation.

[3] Mrs. Steinkey testified and it was accepted at the hearing that her evidence would be taken to be determinative of the treatment of all of the subject expenses.

[4] Mrs. Steinkey was a shareholder and director and an administrative officer and manager of the corporations. She received employment income from the corporations for services rendered.

[5] In addition, an agreement, labelled as a Private (Free Agent) Agreement, was entered into which provided for the corporations to make payments to Mrs. Steinkey in unspecified amounts for unspecified services. The general tenor of the agreement is that they are agreeing to receive the “quid pro quo” for their knowledge and experience and availability.

[6] The essence of Mrs. Steinkey’s testimony is that as an individual person she could provide subcontracting services to the corporations under such a private arrangement without any intention to profit.

[7] Further, it was asserted that she was entitled to and did perform subcontracting services to the corporations beyond the services for which she was remunerated as an employee. Such other services included, for example, promoting the business of each of the corporations.

[8] The absence of any formulation of an income entitlement for the subcontracting services and her intention not to earn a profit from such services appear to have been regarded by Mrs. Steinkey as meaning that the amounts received by her, namely her receipt of the corporations’ payments of the subject expenses, could not be income for tax purposes but would still be deductible by the corporation. The Respondent argues that the subject expenses were personal expenses of Mrs. Steinkey as a shareholder.

[9] With respect to the subject parcel of land that 763 Ltd. was assessed as having derived ordinary income on its sale, Mrs. Steinkey gave evidence that it was acquired for the business use of the corporation. Before its acquisition, it had been used as a storage yard under an arrangement with the owner of the lands to which 106 Ltd. was providing construction services. No issue was raised by the Crown that this pre-acquisition use of the subject lands was a business use by 763

Ltd.. The lands were well situated for the storage of materials, supplies and equipment of both 106 Ltd. and 763 Ltd.. As a storage facility, it accommodated the business needs of several projects on which the corporations were involved. A worker employed by one of the corporations gave evidence that he had personal knowledge of the storage use of the subject parcel both before and after acquisition.

[10] The Respondent, in part at least, based its position in respect of the subject parcel being inventory on the quick turn-over of the property. The acquisition of the subject lands was completed only six months prior to its disposition. On the other hand, there was evidence that the purchase of the lands had in fact been completed some 14 months before the disposition. The eight month delay was the result of the time it took to sever or subdivide the parcel being acquired from portions not being acquired. Further, as noted, the use of the subject parcel as a storage yard was uninterrupted from the time that it began to be so used (which was well before its purchase) and the time of its disposition.

[11] Returning to the issue of the deductibility of the subject expenses, I note that the corporations kept very good books and records of their expenses. When the payments were made to any of the shareholder payees, there would be a ledger entry noting the nature of the payment and a debit entry to either the shareholder loan account or a suspense account. At the end of the year such items not included in an employee services remuneration category were cleared as offsets to amounts owed for subcontractor services and were treated as deductible expenses for tax purposes. There were no invoices for specific services although the full amount of the subject expenses for 763 Ltd. was invoiced at the end of the year “to clear suspense”. None of the subject expense payments were reported in the income of the shareholder payees. They were, however, assessed as shareholder benefits.

[12] I note, here, as well, that there was a breakdown given at the hearing, taken from the corporations’ books and records, as to the manner of payment of the subject expenses at the time they were first made and booked. They included, for example, payment of the medical expenses of the shareholder payees and expenses relating to their personal residence.

[13] At the hearing, the parties were told that the appeals in respect of the deduction of the subject expenses would be dismissed but that the appeal of 763 Ltd. in respect of the treatment of the subject lands as inventory would be allowed.

[14] Reasons, briefly relayed from the Bench, were that this was a cute and somewhat clever attempt to avoid paying tax either on remuneration received for services or more particularly, in this case, to avoid paying tax on a distribution to shareholders of corporate earnings that simply could not work. Expenses of a corporation that are deductible for tax purposes are expenses incurred to earn income. The essence of the private arrangement was clearly to the effect that the corporations would have no legal obligation to pay any amounts to the payees for any services. That is, the corporations, in this case, had no obligation to pay for any services other than those agreed to be paid as compensation for services rendered as employees. Indeed, I do not accept that there were additional services rendered. Mr. Steinkey's testimony on this point was not credible. Payment of the subject expenses were discretionary payments.

[15] As well, I noted that the argument that the payees had no intention to earn a profit was inconsistent with their clear intention to receive the money that they actually did receive. They relied on the Supreme Court of Canada decision in *Stewart v. Canada*¹ that this was a personal endeavour on their part which was not business income. On the other hand, since the corporations enjoyed the benefit of their services it was argued that they were entitled to deduct the expense.

[16] *Stewart* makes it clear that the intention to earn income is not simply a subjective test. In this case, subjective assertions that there was no intention to earn compensation for services rendered, are not, objectively, very credible assertions but, regardless, in this case, I am satisfied that the payments of the subject expense amounts were wholly discretionary payments made to personally benefit persons in their capacity as shareholders. Such payments are not deductible. The Canada Revenue Agency's assessment of both the corporate and individual parties here strike me as entirely correct.

[17] As well, I suggested at the hearing that in closely held corporations, such as we have here, inevitably, circumstances such as this involving purely discretionary payments, will beg for a finding that matches the corporate treatment of the outlay and the treatment of the receipt for tax purposes.

[18] Further and lastly, I acknowledged the Respondent's reliance on well accepted principles that would disallow expenses where there are no source documents to support book entries. The absence of acceptable invoices in this case for specified or discernable goods or services could, in and by itself, be fatal to a claim for a deduction. Still, the assessments here were not based on the absence of

¹ 2002 SCC 46.

invoices. They were based on the expenses being personal expenses of the shareholders. I concur with that position, although where, in a case like this, the absence of supporting documents indicating a requirement to pay a specific amount for a particular service is intended to be kept private under a private arrangement, such absence seems to doom the deduction of the expense from the start.

[19] Accordingly, for all these reasons, the appeals in respect of the deduction of the subject expenses are dismissed.

[20] With respect to the capital gain versus inventory treatment of the sale of the subject parcel, as I said at the hearing, the appeal is to be allowed. I am satisfied on the evidence that the property was acquired with a view to use it for business purposes. Although the sale of the property reflects a rather quick flip transaction which does raise concerns as to the intention of the parties, I am satisfied that the property was intended to be used for business purposes and that it was sold only because of the receipt of an exceptionally good offer. There is no evidence of a trading history and the independent corroboration of the use of the property satisfies me that the appeal should be allowed in respect of this issue.

Signed at Ottawa, Canada this 30th day of August 2012.

"J.E. Hershfield"

Hershfield J.

CITATION: 2012 TCC 308

COURT FILE NOS.: 2011-1963(IT)I; 2011-2036(IT)I

STYLE OF CAUSE: 763993 ALBERTA LTD. AND THE QUEEN; AND BETWEEN 1069616 ALBERTA LTD. AND THE QUEEN

PLACE OF HEARING: Grande Prairie, Alberta

DATE OF HEARING: August 21, 2012

REASONS FOR JUDGMENT BY: The Honourable Justice J.E. Hershfield

DATE OF JUDGMENT: August 30, 2012

APPEARANCES:

Agent for the Appellants: Terry Steinkey

Counsel for the Respondent: Mary Softley

COUNSEL OF RECORD:

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