Citation: 2013 TCC 65
Date: 2013**0614**
Docket: 2009-3477(IT)G

BETWEEN:

RICHARD ALLAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

AMENDED REASONS FOR JUDGMENT

Pizzitelli J.

[1] The parties acknowledged that this appeal is only in respect of the 2001 taxation year notwithstanding that the Notice of Appeal refers to an appeal from the confirmation of the Minister of National Revenue (the "Minister") in respect of the taxation years 2000 and 2001.

[2] The Appellant appeals from an assessment for his 2001 taxation year that denied the deduction of legal fees totalling $48,164 and a sum of $70,000 surrendered to Her Majesty the Queen in right of Ontario with respect to an agreement reached in the context of criminal proceedings against the Appellant for charges of living off the avails of prostitution.

[3] The evidence not in dispute is that the Appellant managed the escort business carried on mainly in Toronto by two corporations; namely Nu-Deal Holdings Inc.("Nu-Deal") and D.J.A. Holdings Inc ("DJA") (together the "Corporations"); which were jointly owned by the Appellant and his brother in 2001 until the

Appellant sold his shares to his brother in January, 2001. The Appellant admitted he owned 50% of such shares as assumed by the Minister.

[4] As part of the sale transaction, the Appellant entered into an Employment Agreement with DJA, dated August 1, 2001 (the "Employment Agreement") that specified he was to be employed until July 31, 2004, a period of three years, unless terminated earlier, and pursuant to paragraph 2.1 thereof, in the position of "Supervisor" to "perform such duties and exercise such powers pertaining to the management and operation of the Corporation as may be determined from time to time by the board of directors of the Corporation consistent with the office of the Executive" and pursuant to paragraph 3.1 thereof "to report to the person holding the office of President of the Corporation", for remuneration pursuant to paragraph 4.1 of "$96,000.00 per annum payable in monthly installments of $8,000 in arrears less all required employee source deductions".

[5] Notwithstanding that the Employment Agreement required him to devote his full time and attention to the Corporation or its Affiliates, the Appellant described his role in such Corporation as that of a consultant after the sale of his shares to his brother, who would step in and replace his brother and "take care of things" in his absence from time to time even though the Appellant acknowledged that he never billed the Corporations for any consulting fees, only received the remuneration agreed to in the Employment Agreement until April of 2009 when operations ceased and is never referred to as a consultant or independent contractor in the Employment Agreement. The Appellant's role prior to the sale of shares had been that he effectively managed the Corporations including handling the books, making bank deposits, paying bills and setting escort schedules but all this changed when he sold his shares and as he testified "got out of the business".

[6] Shortly after his sale of shares, the Appellant and his brother were criminally charged as aforesaid and the Appellant spent at least about 30 days in jail until he was released on bail in a Toronto courtroom and for the next 18 months while awaiting trial was required as a condition of bail to report in once weekly or bi-weekly and thus was unable to otherwise work and did not. The evidence is that he had no other source of income in 2002 or 2003, other than about $24,000 in 2002 representing the amounts earned under the Employment Agreement for the first three months of that year. It should be noted that the business of the two Corporations effectively ceased operating because of criminal charges against the Appellant and his brother. The Appellant testified the delays in getting to trial and his inability to work were among the reasons he agreed to execute an agreement titled "Surrender" pursuant to which he surrendered any interest in various properties including $70,000

he held in a bank account, all of which he admitted in such Surrender were derived from his criminal activities and which his counsel described as a settlement with the Crown.

[7] The Appellant arranged to file his tax returns for the 2001 and 2002 taxation years only in 2007 because his records had been seized from him, his accountant and his brother by the Canada Revenue Agency ("CRA") and not returned until some years later and because after the return of the seized materials his accountant, who first indicated would prepare and file his returns, changed his mind and the Appellant was forced to retain the services of a new accountant, a Mr. L., sometime in 2006.

[8] With the assistance of Mr. L., to whom he had brought all the documents and met with, his 2001 T1 General Return was prepared, reviewed by the Appellant and executed by the Appellant showing employment income of $98,000 from DJA, other employment income of $12,666 from Nu-Deal and other taxable dividends and taxable capital gains, but no self-employment income. In fact, the evidence adduced by the Respondent and admitted by the Appellant was that the Appellant had not had self-employment income or income from a business for the years since 1998 until the present as earlier discussed.

Position of the Parties

[9] The Appellant takes the position that he can be considered to have been in the business of running an escort service due to his role in the Corporations and that the legal fees and surrender fees in issue are expenses directly relating to that business. The Appellant also argues that at the least the Appellant is an employee and that such expenses were incurred in order to protect and preserve his source of income, notwithstanding that they were both incurred in 2003 but were claimed with respect to the 2001 taxation year. The Appellant argues that notwithstanding when the expenses were incurred, they were in relation to the process which started shortly after his arrest in relation to the business and were funded from the income he received from the Corporations' business and hence under accounting principles the deduction should be matched to the income that supported them.

[10] The Respondent takes the position that the Appellant was not engaged in any business but was just an employee and thus cannot claim deductions for the items in dispute as they were not expended for the purpose of gaining or producing income, nor deductible as expenses from employment. The Respondent basically argues these were personal expenses incurred to defend himself from criminal charges or settle his affairs with the Crown pertaining to his criminal activities and are not deductible.

The Law

[11] The relevant provision of the *Income Tax Act* (the "*Act*") are set out below:

> **8.**(1) In computing a taxpayer's income for a taxation year from an office or employment, 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
>
> …
>
> **Legal expenses of employee**
>
> (*b*) amounts paid by the taxpayer in the year as or on account of legal expenses incurred by the taxpayer to collect or establish a right to salary or wages owed to the taxpayer by the employer or former employer of the taxpayer;
>
> …
>
> **Sales expenses**
>
> (*f*) where the taxpayer was employed in the year in connection with the selling of property or negotiating of contracts for the taxpayer's employer, and
>
> (i) under the contract of employment was required to pay the taxpayer's own expenses,
>
> (ii) was ordinarily required to carry on the duties of the employment away from the employer's place of business,
>
> (iii) was remunerated in whole or part by commissions or other similar amounts fixed by reference to the volume of the sales made or the contracts negotiated, and
>
> (iv) was not in receipt of an allowance for travel expenses in respect of the taxation year that was, by virtue of subparagraph 6(1)(*b*)(v), not included in computing the taxpayer's income,
>
> amounts expended by the taxpayer in the year for the purpose of earning the income from the employment (not exceeding the commissions or other similar amounts referred to in subparagraph 8(1)(*f*)(iii) and received by the taxpayer in the year) to the extent that those amounts were not

(v) outlays, losses or replacements of capital or payments on account of capital, except as described in paragraph 8(1)(*j*),

(vi) outlays or expenses that would, by virtue of paragraph 18(1)(*l*), not be deductible in computing the taxpayer's income for the year if the employment were a business carried on by the taxpayer, or

(vii) amounts the payment of which reduced the amount that would otherwise be included in computing the taxpayer's income for the year because of paragraph 6(1)(*e*);

…

General limitation

(2) Except as permitted by this section, no deductions shall be made in computing a taxpayer's income for a taxation year from an office or employment.

…

18.(1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of

General limitation

(*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;

…

Personal and living expenses

(*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;

Analyses

[12] I will first deal with the issue as to whether the Appellant can deduct the claimed expenses as expensed incurred to gain or produce income from a business or property pursuant to paragraph 18(1)(*a*).

1. Deduction of expenses to gain or produce income from a business

[13] The Appellant agrees that although he was not a shareholder of the Corporations after the sale of his shares to his brother in January of 2001, his duties were basically running the companies when his brother was not there and hence he should be treated as running a business. Frankly, I find this argument totally unconvincing.

[14] Firstly, the Appellant was not directly operating the escort business he purported to run, the Corporations were. It is trite law in this country that corporations are considered a separate legal entity from their shareholders or employees and the *Act* acknowledges this by defining a "person" in subsection 248(1) as including a corporation.

[15] Secondly, the Appellant himself admitted that after he sold his shares he effectively got out of the business and his duties changed and went from managing and running the businesses to entering into an Employment Agreement pursuant to which he himself suggested only required him "to take care of things" in his brother's absence when his brother needed him, which he suggested was infrequently. By his own evidence, he cannot be said to have carried such an important role as to suggest he personally should be considered to be operating the business even if that argument was feasible.

[16] Thirdly, even if the Appellant had continued to manage the business of the Corporations on a full-time basis after the sale of his shares, I cannot find any basis in law to suggest a manager or executive is deemed to operate the business of the corporation he works for.

[17] There is absolutely no evidence in this matter that the Appellant operated any business in 2001, nor at any time from 1998 to 2003, in effect since he and his brother incorporated the business sometime in 1997 as per his own testimony. He admits he reported no income from self-employment in 2001 nor since 1997 and earned income from employment from the Corporations in 2001. The Appellant not having carried on a business he cannot then claim to deduct expenses for the purpose of gaining or producing income therefrom under paragraph 18(1)(*a*) of the *Act*, whether it be for legal fees or a forfeiture of assets.

[18] The Appellant relied on the case of *Partykan v. The Minister of National Revenue*, 80 DTC 1475, a 1980 decision of the Tax Review Board that allowed a taxpayer to deduct the legal fees and value of shares relinquished in favour of his former employer in settlement of a claim for misuse of confidential information

being client lists on the basis such payment allowed the taxpayer to use such information in his own business and thus compete for the business of clients. The Appellant suggests that this supports his position that expenses that allow him to work are deductible.

[19] With respect to the Appellant, there was no dispute that the taxpayer in that case was found to be in business and funds were expended to allow him to compete and produce income from business or property. In the Appellant's case, he has no source of business income from which to claim his deductions as he has no business.

[20] The Appellant also argued that the legal fees were necessary to preserve the business in order to protect his source of income but frankly, the evidence of the Appellant himself is that the business of the Corporations was finished once he and his brother were arrested and nothing in the invoice refers to any action taken by the solicitors with a view to allowing the Corporations to continue the escort business. The invoice for legal services references only the criminal charges in relation to the Appellant as indicated above.

[21] The Appellant relied on the Tax Review Board's decision in *St-Germain v. The Minister of National Revenue*, 83 DTC 36, which found that pursuant to paragraph 18(1)(*a*), a medical doctor could deduct his legal expenses in defending himself from a criminal negligence charge where a conviction would effectively prohibit him from practising as a medical doctor and thus from carrying on his business. Again, in the case at hand, the Appellant was not carrying on any business prior or after the expenses incurred so that case is clearly distinguishable and of no assistance to the Appellant.

2. Deductions from Employment

[22] The Appellant also argues that he is entitled to deduct such expenses from his employment. There is no argument the Appellant was an employee of the Corporations during the 2001 taxation year. He admitted it. The evidence shows he was issued T4 income slips from the Corporations and the Corporations filed payroll returns evidencing them. While the Appellant attempted to suggest the CRA issued those returns, there is no evidence of that and frankly the evidence of the Respondent clearly suggests the CRA processed such corporate returns within a reasonable time after filing for 2001 and I accept the evidence of the CRA as more credible on this matter. No other evidence was tendered by the Appellant to suggest otherwise.

[23] There is no dispute the Appellant was an employee of the Corporations in 2001 and that the Appellant earned income from such employment. The evidence is clear that he was an employee prior to the sale of his shares and afterwards where the Employment Agreement clearly describes his relationship as that of an employee paid a monthly amount subject to "required employee source deductions" as set out in paragraph 4.1 of such agreement. Moreover, there is evidence that DJA issued a T4 Statement of Remuneration to the Appellant evidencing income from employment while Nu-Deal issued a T4A Statement of Pension, Retirement, Annuity or other income to the Appellant. The Appellant admitted he received no commission income from the Corporations nor reported or earned any income from self employment as earlier alluded to.

[24] The Appellant argues that the legal fees incurred in 2003 were incurred to resolve the matter and protect his source of income and dignity and should be deductible. With respect to the Appellant, subsection 8(2) of the *Act* is clear in that it limits deductions from employment only to those deductions enumerated in subsection 8(1). The only relevant paragraph of subsection 8(1) relating to any of the two deductions taken is paragraph 8(1)(*b*) which explicitly requires that amounts paid by the taxpayer must be "paid" in the year as well as "incurred by the taxpayer to collect or establish a right to salary or wages owed to the taxpayer by the employer or former employer".

[25] The invoice for legal services claimed was clearly issued on July 24, 2003 and was paid by the Appellant in that year according to his testimony. Accordingly, it is clear that if such amount was deductible it is only deductible in the year it is paid. Here the Appellant paid the account in 2003 and claimed a deduction in 2001 while late filing that return and accordingly such legal fees are not deductible in 2001

pursuant to the specific wording of paragraph 8(1)(*b*). This clearly puts to rest the Appellant's argument on the timing of the deduction.

[26] Aside from the timing issue, the other requirement of the paragraph is that the expense must be incurred to collect or establish a right to a salary or wages owed to the taxpayer by the employer or former employer. There is nothing in the invoice from the Appellant's solicitors referencing any action or discussions with any of the Corporations to collect salary or remuneration due. The invoice references only matters pertaining to such lawyer's representation of the Appellant in the criminal matter and includes references to attendance at bail hearing, a pre-trial, attempts to obtain access to funds seized, dealing with police, and discussions regarding suspended jail sentences and probation for the Appellant. There is absolutely nothing in my opinion that relates to any claim by the Appellant for wages or salaries due under the Employment Agreement or otherwise and I am of the view such legal fees were incurred only in relation to the criminal charges against the Appellant, which have nothing directly to do with salary or wages owed. Accordingly, the other requirement of subparagraph 8(1)(*b*) are not met either.

[27] In *Wilson v. Canada*, 90 DTC 6382, the Federal Court - Trial Division, which at the time heard appeals from decisions of the Tax Court of Canada, found that a salaried school teacher could not deduct legal expenses incurred in defending charges of rape and unlawful confinement. Addy J. stated on page two thereof:

> I agree also with the finding of His Honour Judge Sarchuk to the effect that the words in that section [referring to paragraph 8(1)(*b*)] are clear and unambiguous and that the taxpayer must establish that the expenses were incurred in the collection of salary or wages and, therefore, they must be incurred in some sort of proceeding against the employer or the person who owes the salary or wages.

[28] The Appellant's argument is more remote. He is in fact saying that it was essential to resolve the criminal matter in order to enable him to preserve his dignity and reputation and continue to work.

[29] In *Esposito v. Canada*, 2004 TCC 102, [2004] 2 C.T.C. 2840, a police officer attempted to claim legal fees incurred in defending himself against charges of assaulting a prisoner and was acquitted of such charges, yet nevertheless was denied the right to deduct such legal fees. The police officer had argued that a defence of such charges was necessary to enable him to continue to work as a police officer. Woods J. of this Court stated at paragraph 7:

> … Based on the evidence presented at the hearing, the legal fees incurred in defence of the criminal charges were incurred to protect a future source of income. They were not incurred to collect salary that was owed.

[30] In my opinion, the Appellant is in the most general sense trying to protect future income in this case as well.

[31] The Appellant also relies on the decision in *Raphael v. Canada*, 2008 TCC 202, 2008 DTC 3559, wherein McArthur J. allowed a taxpayer who was an investment broker to deduct the award granted by a court of $49,759 in favour of his former **employer** for breach of employment contract plus court costs and legal fees incurred by the Appellant. However in that case, the taxpayer was a commissioned salesperson who switched employers and the basis for deductibility was under paragraph 8(1)(*f*) of the *Act* and not paragraph 8(1)(*b*) of the *Act*. The same can be said for the taxpayer in *Douthwright v. Canada*, 2007 TCC 560, 2007 DTC 1614, also relied upon by the Appellant, who was therein allowed to deduct legal fees and settlement costs for breach of employment contract incurred to enable him to take a higher paying job. The taxpayers in those cases were able to rely on a specific other deduction from employment income provided under subsection 8(1) as commissioned salespersons.

[32] The Appellant in this case admitted he received no commissions and accordingly could not fall under the provisions of paragraph 8(1)(*f*) of the *Act* as did the taxpayers in the above-mentioned cases.

[33] I also take note that in respect of the Appellant's claim to deduct the $70,000 he surrendered to the Crown above as expenses from employment, I can find no provision in subsection 8(1) that would otherwise specifically permit it and the Appellant has not pleaded any. Subsection 8(2) is clear that there shall be no deductions from employment unless specifically permitted under subsection 8(1).

[34] The Appellant has not demonstrated any basis for claiming these deductions from salary or wages pursuant to section 8 of the *Act*.

Fairness Arguments

[35] I should like to address the other basis for relief sought by the Appellant as expressed in his Notice of Appeal and in argument for fairness and justice in light of the hardships the Appellant has had to endure from the loss of employment and in respect to the processes involving the criminal charges he dealt with. The Appellant also complained in his pleadings about the conduct of the CRA and suggests, *inter alia*, that with respect to the Surrender of the bank account item at least, that the Minister was not clear as to the basis for its position throughout the objection stage. This Court is empowered pursuant to section 171 of the *Act* to deal with the assessment only and not the conduct of the CRA or questions of fairness outside the scope of the *Act*. This Court cannot grant the equitable relief sought by the Appellant as it has no jurisdiction to ignore its findings relevant to the assessment and otherwise come to the assistance of the Appellant on grounds of hardship or fairness. As for the Appellant's suggestion the Minister was inconsistent in its reasons for disallowing some of the expenses, I simply do not agree that suggesting he was not carrying on a business and then suggesting there is no provision of the *Act* that allows such deduction to be inconsistent as I have come to just that conclusion.

Conclusion

[36] Based on the above, I must find that the Appellant has no legal basis for the deduction of either the legal fees or the value of his bank account balance surrendered to Her Majesty the Queen in right of Ontario as claimed either under subsection 18(1) or section 8. Accordingly, the appeal for 2001 is dismissed. In addition, as the parties agreed, this appeal was not in respect of the 2000 taxation year so the appeal with respect to such year is also dismissed. The Respondent shall be entitled to costs.

This Amended Reasons for Judgment is issued in substitution of the Reasons for Judgment dated February 22, 2013.

Signed at Ottawa, Canada, this **14th** day of **June** 2013.

"F.J. Pizzitelli"

Pizzitelli J.

CITATION:	2013 TCC 65
COURT FILE NO.:	2009-3477(IT)G
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REASONS FOR JUDGMENT BY:	The Honourable Justice F.J. Pizzitelli
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