Docket: 2009-13(IT)I

BETWEEN:

SUSAN PREISS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on July 6, 2009, at Toronto, Ontario.

Before: The Honourable Justice Steven K. D'Arcy

Appearances:

Agent for the Appellant:	B.C. Chastkofsky, C.A.
Counsel for the Respondent:	Sandra K.S. Tsui

JUDGMENT

The appeals with respect to reassessments made under the *Income Tax Act* for the 2004 and 2005 taxation years are allowed, with costs, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

The appellant's net rental losses for the 2004 and 2005 taxation years in respect of the building located at 37 Ben Machree Drive, Mississauga, Ontario, were $8,196 and $5,492 respectively, determined as follows:

	2004 Taxation Year	2005 Taxation Year

Gross Rental Income	8,724	8,324
Eligible Expenses	30,635	29,104
Less Personal Portion		
11/12 x 1/3	9,361	8,893
1/12 X 2/3	1,702	1,617
Total Personal Portion	11,063	10,510
Deductible Eligible Expenses	19,572	18,594
Deductible Legal Fees	5,543	713
Net rental loss related to property	-16,391	-10,983
Appellant's 50% share of loss	-8,196	-5,492

Signed at Toronto, Ontario, this 1st day of October 2009.

"S. D'Arcy"

D'Arcy J.

Citation: 2009 TCC 488
Date: 20091001
Docket: 2009-13(IT)I

BETWEEN:

SUSAN PREISS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

D'Arcy J.

[1] The Appellant, Susan Preiss, has appealed her income tax reassessments in respect of the 2004 and 2005 taxation years. The appeal concerns rental losses in respect of a building located at 37 Ben Machree Drive, Mississauga, Ontario (referred to during the hearing as the "triplex") that were deducted by her in computing income.

[2] When filing her tax returns for the 2004 and 2005 taxation years, the Appellant claimed rental losses of $21,265 and $21,085 respectively. The reassessments reduced the rental losses to $1,385 and $1,280 respectively.

[3] The parties agreed at the commencement of the hearing that there were two issues to be considered by the Court:

(i) Whether the Appellant was entitled to deduct one-third or two-thirds of the eligible expenses incurred in respect of the triplex; and

(ii) Whether legal fees of $6,256 incurred by the Appellant in the 2004 and 2005 taxation years were deductible by the Appellant for the taxation year in which they were incurred.

[4] Ms. Preiss testified at the hearing. She was a credible witness and I accept her testimony as reliable.

I. Background

[5] The Appellant purchased the triplex in November 2003. The triplex consisted of three units: a basement unit, a unit on the middle floor and a unit on the upper floor.

[6] The Appellant testified that at the time she purchased the triplex she intended to occupy one unit as her principal residence and rent the other two units. Further, the Appellant acknowledged that, when purchasing the triplex, she considered the possibility of her mother renting one of the units. She felt that her mother would consider renting a unit if she became ill and wished to live close to her.

[7] The basement unit (referred to during the hearing as Unit #1) was rented to a third party during the 2004 and 2005 taxation years.

[8] The middle floor unit (referred to during the hearing as Unit #2) was not, except for a two-month period, occupied during the 2004 and 2005 taxation years. It appears from the evidence that Unit #2 was rentable; however, the Appellant elected not to rent the unit while it was undergoing the repairs discussed in subsequent paragraphs.

[9] The Appellant received rental payments of $8,724 in the 2004 taxation year and $8,324 in the 2005 taxation year.

[10] The Appellant's mother moved into Unit #2 in December 2004 for what was referred to as the "trial period". The Appellant noted that her mother wanted to determine if she was comfortable living in Mississauga. As a result, it was agreed that she would not pay rent during the trial period. However, if at the end of the trial period she felt that she was comfortable living in Unit #2, then she would begin to pay rent at $1,100 per month. The trial period lasted two months. In February 2005, the Appellant's mother decided that she did not like living in Mississauga and returned to her home in Windsor.

[11] At the time the Appellant purchased the triplex she concluded that the units required repairs, particularly Unit #2. The Appellant carried out most of the repairs herself. The repairs were delayed in 2004 as a result of a zoning dispute over Unit #1 (which will be discussed shortly) and in 2005 and 2006 as a result of the poor health

of the Appellant's mother, who passed away in February 2006. The repairs were completed in the first quarter of 2007, at which time Unit #2 was immediately rented to a third party.

[12] In April of 2004, a neighbour of the Appellant filed a zoning complaint with the City of Mississauga. The neighbour alleged that Unit #1 did not conform to the City's zoning by-laws. The Appellant retained counsel; however, she spent a considerable amount of her own time fighting the complaint. It appears from the evidence that the matter was resolved in favour of the Appellant in August or September of 2004. Invoices filed by the Appellant evidence payments to her counsel of $5,543 in 2004 and $713 in 2005.

[13] During the cross-examination of the Appellant, it was disclosed that a Mr. James Krystolovich held a 50% legal and beneficial ownership interest in the triplex during the 2004 and 2005 taxation years.

II. Analysis

[14] The first issue before the Court is whether, when calculating her loss under section 9 of the *Income Tax Act* (the "*Act*"), the Appellant was entitled to deduct one-third or two-thirds of eligible expenses incurred in respect of the triplex. In particular, I must determine, in the first instance, whether Unit #2 constituted a source of income. The approach to be taken in making such a determination is mandated by the 2002 decision of the Supreme Court of Canada in *Stewart v. Canada*, 2002 SCC 46, [2002] 2 S.C.R. 645.

[15] The Court noted at paragraphs 52 to 55 of its discussion that where there is some personal or hobby element to the activity in question, one must apply a "pursuit of profit" source test. At paragraph 54, the Court stated the test as follows: "Does the taxpayer intend to carry on an activity for profit and is there evidence to support that intention?"

[16] The following comments of the Supreme Court of Canada in the *Stewart* case are particularly relevant for the purposes of this appeal:

> 63 Even if the appellant had made use of one or more of the properties for his personal benefit, the Minister would not be entitled to conclude that no business existed without further analysis. A taxpayer in such circumstances would have the opportunity to establish that his or her predominant intention was to make a profit from the activity and that the activity was carried out in accordance with objective

> standards of businesslike behaviour. Whether a reasonable expectation of profit existed may be a factor that is taken into consideration in that analysis.

[17] The evidence before the Court in the present case was that the predominant intention of the Appellant was to make a profit from the rental of Unit #1 and Unit #2. During the 2004 and 2005 taxation years, Unit #1 was rented to a third party for a fair market value rent. During this period, the Appellant intended to rent Unit #2 for a fair market value rent. The evidence provided by the Appellant was that the fair market value rent would be provided by either a third person or by her mother (after her two-month trial period ended).

[18] The fact that the repairs took a long time to complete did not change the taxpayer's intention during 2004 and 2005. The fact that she was not inclined to rent Unit #2 until the repairs were completed is further evidence of the businesslike behaviour of the Appellant. She was conscious of the importance of maintaining a reputation as a "good landlord" and maximizing any rents she received from the two units.

[19] As a result, I find that the Appellant's activities with respect to Unit #1 and Unit #2 constituted a source of income.

[20] The next question that must be addressed is the deductibility of expenses. As noted in paragraph 57 of the Supreme Court of Canada decision in the *Stewart* case, whether or not a business exists is a separate question from the deductibility of expenses.

[21] The parties agreed at the commencement of the hearing that the Appellant had incurred eligible expenses in respect of the triplex of $30,635 in the 2004 taxation year and $29,104 in the 2005 taxation year plus any amount that this Court might allow in respect of the legal fees. The details of these expenses are set out in Schedule A of the Respondent's Reply.

[22] While the parties agreed on the quantum of the eligible expenses incurred, they disagreed on the extent to which such expenses were deductible. The Appellant's agent argued that the Appellant was entitled to deduct two-thirds of such expenses when calculating the income or loss from the rental of the units in the triplex. Counsel for the Respondent argued that the Appellant was only entitled to deduct one-third of such expenses. Counsel argued that the deduction of the expenses relating to Unit #2 was prohibited under either paragraph 18(1)*(a)* or 18(1)*(h)* or, alternatively, by subsection 18(3.1).

[23] It is my view that the deduction of eligible expenses relating to Unit #2 during the two-month period the unit was occupied by the Appellant's mother was prohibited by paragraph 18(1)*(h)*.

[24] Paragraph 18(1)*(h)* reads as follows:

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

[25] The term personal and living expenses is defined in subsection 248(1) to include 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.

[26] It is clear from the evidence that for the two-month period commencing in December 2004, Unit #2 was maintained for the benefit of the Appellant's mother. Further, the evidence before the Court was that the Appellant's mother did not pay any rent during this period. This period was referred to as a trial period; its purpose was to allow the Appellant's mother to determine if she was comfortable living in the apartment. If she had decided to stay, she would then have started paying fair market value rent.

[27] However, during the two-month period that the Appellant's mother occupied Unit #2, there was no expectation of profit. As a result, pursuant to paragraph 18(1)*(h)*, the Appellant is not entitled to claim a deduction for expenses incurred during this period in respect of Unit #2.

[28] Counsel for the Respondent argued that subsection 18(3.1) prohibited the Appellant from deducting expenses relating to Unit #2 during the 2004 and 2005 taxation years. I cannot agree with this argument.

[29] One of the conditions for the application of subsection 18(3.1) is that the outlay or expense at issue "can reasonably be regarded as a cost attributable to the period of the construction, renovation or alteration of a building."

[30] Based upon the evidence before the Court, it does not appear that the work carried out by the Appellant during 2004 and 2005 constituted the "construction, renovation or alteration" of a building. The work carried out was more in the nature of repairs to the units than the construction, renovation or alteration of a building. Subsection 18(3.1) is not intended to apply to periods during which general repairs are being undertaken. Rather, subsection 18(3.1) requires more extensive work that constitutes construction, renovation or alteration.

[31] It would be unreasonable to suggest that every time a repair is undertaken the deduction of the related soft costs will be denied under subsection 18(3.1). The issue is one of degree, with general repairs and cosmetic touch-ups at one end of the spectrum and construction, renovation or alteration falling at the other end. Based upon the evidence before the Court, the expenses incurred by the Appellant constituted general repair and cosmetic touch-ups and thus were not subject to the provisions of subsection 18(3.1).

[32] In summary, the Appellant was entitled to deduct two-thirds of the agreed eligible expenses incurred during the 2004 and 2005 taxation years, with the exception of those for the two-month period during which Unit #2 was occupied by the Appellant's mother. For this two-month period, the Appellant was only entitled to deduct one-third of the agreed eligible expenses.

III. Deductibility of Legal Expenses

[33] As noted previously, the Appellant incurred legal fees to defend against a zoning complaint filed by a neighbour with the City of Mississauga. The complaint related to Unit #1 of the triplex.

[34] The agent for the Appellant argued that the legal fees were incurred on account of income, while Counsel for the Respondent argued that they were incurred on account of capital.

[35] In *M.N.R. v. The Dominion Natural Gas Company Limited*, [1941] S.C.R. 19, the Supreme Court of Canada stated at page 31 that legal fees are on account of capital if they are incurred with a view to "preserving an asset or advantage for the enduring benefit of a trade."

[36] In the case of *Kellogg Company of Canada Limited v. M.N.R.*, [1942] C.T.C. 51, the Exchequer Court held that legal fees incurred in the successful defence of an infringement action with respect to a registered trademark involving the use of the words "shredded wheat" were deductible. The Exchequer Court distinguished this from the situation dealt with in the judgment of the Supreme Court of Canada in the *Dominion Natural Gas Company* case by noting that the legal fees were incurred to maintain Kellogg's trading and profit-making position. In confirming the decision of the Exchequer Court, the Supreme Court of Canada noted that the right upon which the Respondent relied was not a right of property or an exclusive right of any description, but the company's right (in common with all other members of the public) to describe its goods in the manner in which it was describing them.

[37] In *Evans v. M.N.R.*, [1960] S.C.R. 391, the Supreme Court of Canada allowed the taxpayer to deduct legal fees which had been incurred to establish her right to an annual income from her father-in-law's estate. Cartwright J., for the majority, said that the payment of the legal fees did not bring this right or any asset or any advantage into existence.

[38] The legal fees at issue in the present case were incurred to allow the Appellant to continue to rent Unit #1. The legal fees were incurred in the process of earning income from the triplex and were not incurred to preserve the Appellant's interests in her capital asset - the triplex. As a result, those fees were incurred on account of income and were fully deductible when determining the income or loss from the rental of the units in the triplex. Further, there was no personal use of the legal services, since the legal services related solely to Unit #1.

IV. Appellant's Financial Interest in the Triplex

[39] As noted previously, during the cross-examination of the witness it was disclosed that a Mr. James Krystolovich held a 50% legal and beneficial interest in the property during the 2004 and 2005 taxation years. As a result, only 50% of the rental loss suffered in respect of the triplex should be deducted by the Appellant when computing her taxable income.

V. Conclusion

[40] The appeals in relation to the reassessments of the Appellant's 2004 and 2005 taxation years are allowed, with costs, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

The appellant's net rental losses for the 2004 and 2005 taxation years in respect of the building located at 37 Ben Machree Drive, Mississauga, Ontario, were $8,196 and $5,492 respectively, determined as follows:

	2004 Taxation Year	2005 Taxation Year
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Signed at Toronto, Ontario, this 1st day of October 2009.

"S. D'Arcy"

D'Arcy J.

CITATION:	2009 TCC 488
COURT FILE NO.:	2009-13(IT)I
STYLE OF CAUSE:	SUSAN PREISS v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	July 6, 2009
REASONS FOR JUDGMENT BY:	The Honourable Justice Steven K. D'Arcy
DATE OF JUDGMENT:	October 1, 2009

APPEARANCES:

Agent for the Appellant:	B.C. Chastkofsky, C.A.
Counsel for the Respondent:	Sandra K.S. Tsui

COUNSEL OF RECORD:

For the Appellant:

Name:	n/a
Firm:	

For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada