

Docket: 2008-1351(IT)I

BETWEEN:

CAROLYNN SOKIL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on September 18, 2009, at Toronto, Ontario.

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the Appellant: Shawn M. Philbert

Counsel for the Respondent: Amit Ummat

JUDGMENT

The appeals from the reassessments made under the *Income Tax Act* for the 2003 and 2004 taxation years are dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 7th day of December 2009.

"Réal Favreau"

Favreau J.

Citation: 2009 TCC 601
Date: 20091207
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Appellant,

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REASONS FOR JUDGMENT

Favreau J.

[1] The appellant, now vice-president, domestic client services and administration, with the MI Group, has appealed the reassessment of her 2003 and 2004 taxation years on the basis that she is entitled to deduct the following disallowed expenses:

	<u>2003</u>	<u>2004</u>
Gross Income as declared	0	0
Expenses		
- Business taxes, fees and licences	\$5,414	\$2,348
- Insurance	-	\$2,102
- Meals & entertainment	\$187	\$633
- Motor vehicle (not including CCA)	\$1,637	\$2,009
- Office	\$5,605	\$4,526
- Supplies	\$398	\$3,662
- Travel	-	\$2,194
- Other (407 ETR)	-	\$820
Total Expenses	<u>\$13,290</u>	<u>\$18,294</u>
Net Business Income (Loss)	(\$13,290)	(\$18,294)

[2] In assessing Mrs. Sokil, the Minister of National Revenue (the "Minister") took the position that the appellant was not carrying on a business operation but

rather was involved in an arrangement to help defray her personal or living expenses. According to the Minister, the appellant's purported business operation was not undertaken in a sufficiently commercial manner to result in the earning of income and therefore would not qualify as a source of income for the purposes of section 3 of the *Income Tax Act*, R.S.C. 1985, c. C-1 (5th Supp.), as amended (the "*Act*").

[3] In the fall of 2003, Mrs. Sokil and her husband, Mr. Walter Sokil (the "Sokils"), were introduced to a web-based network marketing company known as FFL Vacations Ltd. ("FFL") and operating as Fun For Life Club International ("Fun For Life"). The mission of Fun For Life, as described in one of its brochures, was the following:

To put the FUN back into your life!

Fun For Life Club International has created a very exciting, innovative opportunity for you to combine the enjoyment of vacationing with the potential of earning additional income.

Experience life to its fullest – enjoy affordable vacations at four and five star resorts around the world and enrich the quality of your life and those around you with opportunities for more income.

[4] Mrs. Sokil testified at the hearing and explained that she, along with her husband, purchased two vacation packages of three weeks each that gave them an entitlement to two business centres. The initial business centre was purchased in September of 2003. The name of their business was "Here's The Deal" and their web site was registered as www.funforlifeclub.net/htd. The business consisted of selling memberships and vacation packages through their web site. At the beginning, Mrs. Sokil had a 65% interest in the venture, and her husband 35%. At the end of 2004, Mrs. Sokil became pregnant and she ceased to be active in the venture; her husband continued alone throughout 2005.

[5] In a letter dated November 30, 2006, to the Canada Revenue Agency ("CRA"), the appellant provided the following information as to how the system worked and how the business was carried on:

... With Fun For Life Club International, if you choose to purchase a business centre, they provides [*sic*] you with a personally dedicated website, product building seminars and prospecting tools, opportunity and training conferences as well as a tracking function which records any customers who purchase from your website as well as a number of "certificates" which can be used to redeem travel within the club. These certificates can be sold, gifted, donated or used by the business holder.

Initially, income revenue was generated when 14 people joined the club through our dedicated website. We did not generate 14 sales until 2004 so we incurred losses in 2003.

...

In order to run our business, we purchased brochures, business cards, and company CDs to hand out to potential customers.

We run this business out of our home on a part time basis as we both hold day time positions with other firms. We set up one of the bedrooms in our home as an office. This included purchasing a laptop computer, desk, and other office material in order to manage the business from home. This bedroom is a dedicated office and is not utilized for any other means.

Since the business is web based, we had to obtain and maintain internet capabilities and utilized both the phone and computer to contact potential customers. In addition to this, we attended business building meetings on a regular basis to assist us in growing our business centre. My vehicle was used for driving to meetings and going to meet potential customers. Depending on the location of the meeting and/or the client, the 407 ETR was utilized.

[6] In terms of documentary evidence, no signed purchase agreement and no proof of payment for the vacation packages was filed by the appellant, but the following documents were submitted for consideration by the Court:

- a business card showing that Carolynn and Walter Sokil were independent affiliates of Fun For Life;
- a Fun For Life brochure giving general information concerning the bonus system, which generally works as follows: for every three-week vacation package sold, one business centre is activated in the bonus rewards system. Once activated, the business centre is entered into a 2 x 2 bonus structure with six available spots to be filled. Once all 6 positions are filled in the bonus cycle, you are automatically moved into a new bonus cycle and you are entitled to a US\$1,600 bonus as a qualified FunAffiliate;
- the terms and conditions attached as Schedule "A" to the FunPurchaser Subscription Form (this document bears no date, is not addressed to the appellant and is not signed);
- a brochure giving information concerning the business profile of Fun For Life;
- a one-pager entitled "Welcome Aboard!", which explains that the Welcome Kit contains the vacation certificates, along with brochures, a presentation

- CD, an order form and other promotional items (this document bears no date, is not addressed to the appellant and is not signed);
- a document entitled “FunWeek Policies and Procedures”, which appears to be attached as Schedule “A” to the Membership Agreement (this document is version (1) dated April 17, 2006, is not addressed to the appellant and is not signed);
 - a Fun For Life sales support document entitled “6 Step Business Building Process” (this document is not addressed to the appellant and is not signed);
 - a FunPurchaser Entitlement Certificate showing that Here’s The Deal (the business name used by the Sokils) is the owner and person entitled to the use and enjoyment of one FunWeek;
 - an e-mail from Fun For Life to W. Sokil sent on January 20, 2004, which explained the new compensation plan that came into effect on February 1, 2004;
 - a blank Printed Materials Order Form;
 - three FunPurchaser Subscription Forms representing sales of FunPacks, respectively signed by the purchasers on October 25, October 29 and November 26, 2003, together with cheques made payable to Fun For Life Club International;
 - a commission cheque dated April 28, 2004 in the amount of US\$1,600 made payable to Walter and Carolyn Sokil and drawn on a bank account of Fun For Life Club (this income was not reported by the appellant in her 2004 tax return); and
 - a brochure of the Oakville Arts Council providing information for sponsors of the Mayor’s Awards for Business and the Arts for 2004 together with an In Kind Donation Form showing that “Here’s The Deal”, an affiliate of the Fun For Life Club, sponsored a prize consisting of one week’s accommodation for 2 people at a luxury resort valued at approximately \$1,600.

[7] The CRA disallowed as being personal expenses all the expenses claimed by the appellant and determined that they were not incurred for the purpose of earning income from a business. Many discrepancies were noted by the CRA in respect of the claims:

- (a) no gross income from the business was declared by the appellant in her tax returns for the 2003 and 2004 taxation years, although commissions in the amount of US\$1,600 were received in 2004;
- (b) for 2003, the expenses were claimed for the whole year despite the fact that the initial vacation package was bought in September of that year;

- (c) for 2003 and 2004, the appellant claimed 100% of the expenses despite the fact that her husband had a 35% interest in the venture (no allocation of expenses was made);
- (d) in the 2003 tax return, an amount of \$4,171.93 was claimed as the cost of one vacation package while an amount of \$2,348 was claimed for a similar package in 2004 (the difference in the cost of those vacation packages has not been explained);
- (e) insurance expenses in the amount of \$2,102 were claimed for 2004 despite the fact that this cost was attributable to insurance for two cars for the full year; no claim for insurance expenses was made in 2003;
- (f) expenses for meals and entertainment were claimed in 2003 (\$187) and 2004 (\$633) but the names of the persons entertained were not provided by the appellant;
- (g) motor vehicle expenses were claimed for 2003 (\$1,637) and 2004 (\$2,009) but no log of business travel and no names of clients were provided, and receipts for only \$8.50 for 2003 and \$60 for 2004 were provided;
- (h) office expenses in the amounts of \$5,605 were claimed for 2003 and \$4,526 for 2004 and the appellant provided receipts in the amounts of \$5,641.92 for 2003 and \$1,102.01 for 2004. Furthermore, the costs relating to the laptop computer, colour printer, desk and projector should have been capitalized as they were depreciable assets;
- (i) supplies in the amount of \$398 for 2003 and \$3,662 for 2004 were claimed, but the appellant provided receipts for only \$227.44 for 2003 and no receipt at all for the 2004 supplies;
- (j) travel expenses in the amount of \$2,194 were claimed for 2004 for a trip to the Dominican Republic organized for the founding members of Fun For Life; the appellant's spouse was also on that vacation trip;
- (k) with respect to the 407 ETR amount of \$820 claimed for 2004, the appellant provided a statement for \$30.76 addressed to her and another, for \$573.35, addressed to Wolodymyr Sokil.

[8] In summary, the appellant claimed self-employed business losses totalling \$31,584 for 2003 and 2004 but did not report any gross income in her tax returns.

[9] The appellant's counsel acknowledged that receipts were either missing or did not match with the claims made in the tax returns, that certain expenses should have been capitalized as depreciable assets and that the records were badly kept. Despite all that, he argued that the appellant has tried the business side of Fun For Life, that she has acquired the tools necessary to carry on a business, that she did promote her

business and that she did some advertising to recruit members. According to him, the appellant entered into a credible venture with a reasonable expectation of turning a profit.

Analysis

[10] The issue is whether the appellant was entitled to deduct business losses for the 2003 and 2004 taxation years.

[11] The term “business” is defined in subsection 248(1) of the *Act* as follows:

“business” includes a profession, calling, trade, manufacture or undertaking of any kind whatever and, except for the purposes of paragraph 18(2)(c), section 54.2, subsection 95(1) and paragraph 110.6(14)(f), an adventure or concern in the nature of trade but does not include an office or employment.

[12] The basic rules for computing income under the *Act* are found in Division B of Part I, sections 3 and 4. Paragraph 3(a) refers to the various sources of a taxpayer’s income, as follows:

Section 3: Income for taxation year

The income of a taxpayer for a taxation year for the purposes of this Part is the taxpayer’s income for the year determined by the following rules:

- (a) determine the total of all amounts each of which is the taxpayer’s income for the year (other than a taxable capital gain from the disposition of a property) from a source inside or outside Canada, including, without restricting the generality of the foregoing, the taxpayer’s income for the year from each office, employment, business and property.

[13] The basic rules for computation of the income or loss from a business are found in section 9 of the *Act*:

Section 9:

(1) Income. Subject to this Part, a taxpayer’s income for a taxation year from a business or property is the taxpayer’s profit from that business or property for the year.

(2) Loss. Subject to section 31, a taxpayer’s loss for a taxation year from a business or property is the amount of the taxpayer’s loss, if any, for the taxation year from that source computed by applying the provisions of this Act respecting

computation of income from that source with such modifications as the circumstances require.

[14] Restrictions concerning the deduction of expenses are found in paragraphs 18(1)(a) and 18(1)(h) and in section 67 of the *Act*:

Section 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) 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;
- (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;

Section 67: General limitation re expenses

In computing income, no deduction shall be made in respect of an outlay or expense in respect of which any amount is otherwise deductible under this Act, except to the extent that the outlay or expense was reasonable in the circumstances.

[15] The Supreme Court of Canada developed in *Brian J. Stewart v. The Queen*, 2002 DTC 6969, a two-stage approach to determining whether a taxpayer has a source of business income such that section 9 of the Act applies. In paragraph 50, the two-stage approach is set out as follows:

...

- (i) Is the activity of the taxpayer undertaken in pursuit of profit, or is it a personal endeavour?
- (ii) If it is not a personal endeavour, is the source of the income a business or property?

The first stage of the test assesses the general question of whether or not a source of income exists; the second stage categorizes the source as either business or property.

[16] The Supreme Court of Canada provided further explanation concerning the first stage of the test in paragraphs 52, 54 and 55 of the *Stewart* decision:

[52] The purpose of this first stage of the test is simply to distinguish between commercial and personal activities . . . Thus, where the nature of a taxpayer's venture contains elements which suggest that it could be considered a hobby or other personal pursuit, but the venture is undertaken in a sufficiently commercial manner, the venture will be considered a source of income for the purposes of the Act.

. . .

[54] . . . Thus, in expanded form, the first stage of the above test can be restated as follows: "Does the taxpayer intend to carry on an activity for profit and is there evidence to support that intention?" This requires the taxpayer to establish that his or her predominant intention is to make a profit from the activity and that the activity has been carried out in accordance with objective standards of businesslike behaviour.

[55] The objective factors listed by Dickson J. in *Moldowan* at p. 486 were: (1) the profit and loss experience in past years; (2) the taxpayer's training; (3) the taxpayer's intended course of action; and (4) the capability of the venture to show a profit. . . .

[17] In the case at bar, there was clearly an acquisition of a personal or recreational asset, namely the vacation packages, and the appellant took advantage of that asset when she went to the Dominican Republic on a trip organized for the founding members of Fun For Life.

[18] Considering all the facts of the case, I come to the conclusion that the prime intention of the appellant was to obtain a personal benefit, and the possibility of earning income was only accessory thereto.

[19] The evidence submitted by the appellant was not sufficient to establish that a business was carried on with a view to making a profit. The activities conducted by the appellant were not pursued in a commercial manner. Her home-based business activities were conducted as a hobby or as a part-time sideline to augment her employment income.

[20] I do not think that the appellant entered into this venture with a reasonable expectation of making a profit. In 19 months of operation, the venture generated revenue of only US\$1,600, which had to be shared with her husband, and a loss of \$32,000. The changes brought to the commission structure in 2004 made it almost impossible for her to make a profit, and that is one of the reasons why, as stated in paragraph 19 of the Amended Notice of Appeal, the appellant is suing FFL for misrepresentation with regard to her being involved in a business. To break even, 24 sales of vacation packages would have been required while the appellant sold only

six vacation packages. The earning of income in the venture was only incidental and no profit could be generated.

[21] The appellant had no experience in Internet business and her course of conduct was not in accordance with objective standards of businesslike behaviour. No separate bank account was opened for the venture and no adequate books and records were kept. The appellant's course of conduct, in terms of time spent on, and effort devoted to, the development of the venture, was not undertaken in a sufficiently commercial manner to constitute a source of income, even though some advertising was done.

[22] The expenses that were deducted as business expenses were not paid or incurred by the appellant to earn income but were personal or living expenses as defined in subsection 248(1) of the *Act*. The appellant is thus precluded by paragraph 18(1)(h) of the *Act* from deducting those expenses in the computation of her net business loss.

[23] Finally, the amount of expenses claimed as business expenses is clearly not reasonable in the circumstances and, by virtue of section 67 of the *Act*, cannot be deducted.

[24] For these reasons, the appeals from the reassessments made for the 2003 and 2004 taxation years are dismissed.

Signed at Ottawa, Canada, this 7th day of December 2009.

"Réal Favreau"

Favreau J.

CITATION: 2009 TCC 601
COURT FILE NO.: 2008-1351(IT)I
STYLE OF CAUSE: Carolynn Sokil and Her Majesty the Queen
PLACE OF HEARING: Toronto, Ontario
DATE OF HEARING: September 18, 2009
REASONS FOR JUDGMENT BY: The Honourable Justice R al Favreau
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