

Docket: 2009-2545(IT)G

BETWEEN:

MICHAEL F.G. NOEL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on November 25, 2010, at Miramichi, New Brunswick.

Before: The Honourable Justice Robert J. Hogan

Appearances:

For the Appellant: The Appellant himself

Counsel for the Respondent: Sheherazade Ghorashy

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**JUDGMENT**

The appeal from the reassessments made under the *Income Tax Act* for the 2004 and 2005 taxation years is allowed, with costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 14th day of January 2011.

"Robert J. Hogan"

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Hogan J.

Citation: 2011 TCC 27  
Date: 20110114  
Docket: 2009-2545(IT)G

BETWEEN:

MICHAEL F.G. NOEL,

Appellant,

and

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Respondent.

### **REASONS FOR JUDGMENT**

#### **Hogan J.**

[1] This is an appeal from reassessments by the Minister of National Revenue (the “Minister”) disallowing pursuant to paragraphs 18(1)(a) and (h) and section 67 of the *Income Tax Act* (the “ITA”) business expenses incurred by the Appellant for the 2004 and 2005 taxation years.

#### **Factual Background**

[2] The Appellant testified that he formed the law firm Noel, Urquhart and Associates with three colleagues in 1994. The law firm had two offices, one located in Miramichi East (formerly Chatham) and the other located in Miramichi West (formerly Newcastle). The firm had four partners, who shared the profits equally.

[3] The Appellant worked out of the Miramichi East office. According to the Appellant, he generated more revenue than his partners. This led to discord regarding the fairness of the partners’ profit-sharing arrangement. The partners agreed to terminate their partnership arrangement in 2002 and agreed instead to share a limited amount of common expenses. The Appellant became responsible for the operation of the Miramichi East office.

[4] Connie Noel, the Appellant’s wife, testified that she had worked for the Royal Bank of Canada in a career spanning approximately 25 years. She had held various administrative and secretarial positions at the bank. In early 2000, the bank

reorganized its business operations and centralized a number of branch functions in a regional office. Ms. Noel's branch position was eliminated following the reorganization.

[5] Ms. Noel had a young daughter and decided to work on a part-time basis for the law firm starting in 2000. She worked in the Miramichi West office where she was being trained to take over from the firm's bookkeeper. Following the restructuring of the law firm in 2002, Ms. Noel found herself in an untenable position at the Miramichi West office. She decided to work instead for her husband in the Miramichi East office. The plan was for Ms. Noel to continue to work as a bookkeeper on a part-time basis only. In 2002, the Appellant's two senior legal assistants decided not to return to work upon termination of their maternity leave. Their temporary leave of absence thus became permanent. The Appellant was unable to hire senior legal assistants. He had to settle for hiring two junior legal assistants directly out of secretarial school. Ms. Noel agreed to fill the void by working full-time in the Appellant's law practice. She oversaw the handling of all of the law firm's financial matters, including billing and collection, payroll deduction remittances and management of the law firm's trust account. Ms. Noel stepped into the role of office manager. She became responsible for the oversight of the administrative staff. This allowed the Appellant to focus his attention on the practice of law.

[6] The Appellant and his wife testified that they would work long hours together, working many evenings and on weekends. The couple would bring their daughter to the office in the evening and on weekends.

[7] I found both witnesses to be credible. Their testimony was not challenged by the Respondent.

[8] The Appellant explained that he increased his wife's salary to take into account her significant new duties. Instead of the part-time salary of \$10,000, the couple agreed on a salary in the \$40,000 to \$45,000 range for full-time employment with the law firm.

[9] Ms. Noel received fixed draws of \$200 per week for an amount totalling \$8,200 in 2004. The balance of her remuneration was paid on a sporadic basis when the law firm's cash flow permitted. In 2004, Ms. Noel received additional cheques totalling \$34,005.

[10] In 2005, the arrangement changed slightly. This change was made following a CRA payroll audit. The CRA determined that all of the wages payable to Ms. Noel constituted insurable earnings. The Appellant had remitted employment insurance premiums on the \$200 weekly payments made to his wife, but not on the additional payments. The couple decided to end the weekly payments knowing that, if they did so, Ms. Noel's employment would be excluded employment under the *Employment Insurance Act*. That statute provides that non-arm's length employment is excluded unless the terms and conditions of the employment are substantially similar to those that would exist in an arm's length arrangement. According to the Appellant, it was a relatively safe bet that he could avoid the cost of premiums if he paid his wife on an entirely sporadic basis. An arm's length employee would not accept being paid irregularly.

[11] Ms. M.L. Muir appeared as a witness for the Respondent. She is the auditor for the Canada Revenue Agency (the "CRA") who concluded that the Appellant could deduct only the weekly \$200 payments made to his wife. She denied the Appellant a deduction for the sporadic payments he made to his wife for the following reason:

To clarify the Agency's position, this audit is not an examination of the employer/employee relationship between you and your spouse. The salary indicated to have been paid to her as per your payroll records has been allowed as an expense. The amounts that are disallowed are the payments made in addition to Mrs. Noel's salary in each of the above noted years. Our review indicates these additional payments have not been incurred to earn income from your professional practice. In part, this is supported by the fact that they were not based on a particular contract or employment rate of pay, hours expended or completion of particular tasks. Arrangements regarding her time of work and authorization to execute cheques from the general account are not factors that have contributed to the determination that the payments outside her basic pay were not incurred to earn your professional income.<sup>1</sup>

[Emphasis added.]

## Analysis

[12] The Respondent relies on three provisions of the *ITA* to justify its decision to deny the Appellant a deduction for the full amount paid to his wife. First, the Respondent points out that paragraph 18(1)(a) provides that, in computing business income, a deduction can be claimed for an expense only "to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income". Second, paragraph 18(1)(h) denies a deduction for "personal or living expenses". Finally, section 67 prohibits the deduction of an expense otherwise deductible under

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<sup>1</sup> Exhibit AR-1, Tab 21.

the *ITA* if the expense is unreasonable. According to the Respondent, the Appellant has failed to establish that the additional amount paid to his wife does not run afoul of these provisions.

[13] I do not agree with the Respondent's interpretation of the evidence. In her Report on Objection, the appeals officer acknowledges that Ms. Noel had the skills to perform the duties for which she was responsible. Her conclusions are as follows:

- The taxpayer's wife, Connie Noel, was on the payroll.
- The taxpayer's wife received a salary of \$200 per week for 41 weeks in 2004 and for 17 weeks in 2005.
- Other employees with less responsibility were paid more than the taxpayer's wife.
- The taxpayer's wife was paid every Friday.
- The taxpayer's wife received her last payroll cheque on May 12, 2005.
- The taxpayer's wife maintains that her work is now done on contract.
- The taxpayer's wife maintains that there is no record of her hours and that she was not paid any particular amount per hour.
- The taxpayer's wife maintains that she was paid what the taxpayer thought her contribution was worth.
- The taxpayer's wife does not have her own bank account. Her cheques are deposited in a joint account.

The taxpayer's wife, Connie Noel, previously worked for the Royal Bank of Canada for 24 years. It appears obvious that she had the background and skills to perform the duties that the taxpayer has attributed to her. Why was her actual salary less than other employees who had less responsibility? The additional cheques paid to Connie Noel, or paid on behalf of Connie Noel, were made while she was on the payroll. The amounts were paid at random and at times there was more than one cheque issued on the same day. There is no doubt but that these amounts were in addition to her salary. The cheques made out to the Receiver General for Canada in both years were credited directly to Connie Noel's tax liability. The total of the additional cheques issued to Connie Noel, or issued on behalf of Connie Noel, were reported on Connie Noel's tax returns as income. The objective appears to be income-splitting; a means of diverting a portion of the taxpayer's income to his wife.

In 2004, 41 payroll cheques were issued to Connie Noel and another 48 cheques were issued to Connie Noel, or were issued on her behalf. With the exception of 5 cheques, the amounts were multiples of \$100. 6 cheques totaling \$8,500 were issued to the Receiver General for Canada and were applied against Connie Noel's personal tax liability. 1 cheque in the amount of \$444.43 was issued to Options Mastercard and 1 cheque in the amount of \$549.32 was issued to NB Power. Of the 43 cheques issued to Connie Noel personally, 3 cheques in the amounts of \$950.91, \$642.78, and \$748.02 were noted as being for "Bills".

In 2005, 17 payroll cheques were issued to Connie Noel and another 67 cheques were issued to Connie Noel, or were issued on her behalf. With the exception of 1 cheque, the amounts were multiples of \$100. 9 cheques totaling \$12,000 were issued to the Receiver General for Canada and were applied against Connie Noel's personal tax liability. Of the 58 cheques issued to Connie Noel personally, 1 cheque in the amount of \$667.22 was noted as being for "NB Power & Phone \$ Cell Phone".

The taxpayer has not responded to my request to substantiate the amounts paid to his wife as being paid to earn income from his legal practice. There is no doubt that the taxpayer's wife provided services to the taxpayer's law practice. However, the taxpayer has not provided evidence that the amounts paid to his wife were for services rendered as opposed to splitting income between himself and his wife.<sup>2</sup>

[Emphasis added.]

[14] It appears that the CRA's decision was influenced by the fact that Ms. Noel agreed to draw her remuneration at times when it was financially beneficial to the law firm for her to do so. The *ITA* does not require that a salary be paid on a regular basis. The appeals officer appears to have concluded that only the \$200 weekly payments to Ms. Noel were salary. In point of fact, Ms. Noel's salary was the full amount she received in the year for her services. A spouse may agree to be paid on an irregular basis because she has a greater interest in the family-owned business than an unrelated employee. This does not mean that the amount she receives is not salary. Salary is the amount paid to an employee under a contract of employment for that employee's services. Whose interest would have been served if Ms. Noel had demanded to be paid on a regular basis like the other employees? Presumably the Appellant would have been required to use his line of credit more often to meet such a demand. The couple's arrangement avoided unnecessary interest charges.

[15] The only question at issue here is whether Ms. Noel worked at the law firm and was paid a reasonable wage for her services. Both of the CRA officials agreed that she worked in the business. The appeals officer acknowledges in her report that Ms. Noel was qualified to perform the duties that were entrusted to her. The Respondent did not dispute the fact that the Appellant's two senior legal assistants had suddenly left. The Respondent did not dispute the fact that Ms. Noel became the senior administrative employee of the law firm. The Respondent did not attempt to refute the Appellant's claim that he hired two junior legal assistants straight out of secretarial school to replace his senior legal assistants because he could not find more senior personnel. In these circumstances, it is reasonable to infer that Ms. Noel was required to play an important role in the operation of the law firm. The evidence does

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<sup>2</sup> *Ibid.*, Tab 24.

not show that the couple was involved in an income-splitting arrangement as suggested by the appeals officer in her Report on Objection.

[16] The Appellant testified that a bookkeeper could earn up to \$30,000 a year and that legal assistants were paid from \$18,000 to \$40,000 a year depending on their level of experience. Ms. Noel was much more than a bookkeeper or legal assistant. In addition to performing the duties of those positions, she was the law firm's office manager. She ran the administrative side of the law practice. I am comforted in my conclusion by Ms. Muir's admission that Ms. Noel handled the income tax audit for the law firm. According to Ms. Muir, Ms. Noel was quite knowledgeable about the administrative and financial workings of the law firm.

[17] The appeal is allowed, with costs to the Appellant, and the reassessments are referred back to the Minister for reconsideration and reassessment in accordance with these reasons for judgment.

Signed at Ottawa, Canada, this 14th day of January 2011.

"Robert J. Hogan"

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Hogan J.

CITATION: 2011 TCC 27

COURT FILE NO.: 2009-2545(IT)G

STYLE OF CAUSE: MICHAEL F.G. NOEL v. HER MAJESTY  
THE QUEEN

PLACE OF HEARING: Miramichi, New Brunswick

DATE OF HEARING: November 25, 2010

REASONS FOR JUDGMENT BY: The Honourable Justice Robert J. Hogan

DATE OF JUDGMENT: January 14, 2011

APPEARANCES:

For the Appellant: The Appellant himself

Counsel for the Respondent: Sheherazade Ghorashy

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

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