Docket: 2009-2180(IT)G

BETWEEN:

TIMOTHY H. MAGNUS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on July 18 and 19, 2011 at Calgary, Alberta
By: The Honourable Justice Judith Woods

Appearances:

For the Appellant: The Appellant himself

Counsel for the Respondent: Robert Neilson

AMENDED JUDGMENT

The appeal with respect to assessments made under the *Income Tax Act* for the 2004 and 2005 taxation years is allowed, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the appellant is entitled to deductions for interest and carrying charges in the amounts of $127,272.23 and $**74,306.71** for the 2004 and 2005 taxation years, respectively.

This Amended Judgment is issued in substitution for the Judgment dated August 26, 2011.

Signed at **Toronto**, Ontario this **9th** day of **November** 2011.

"J. M. Woods"

Woods J.

Citation: 2011 TCC 404
Date: 2011**1109**
Docket: 2009-2180(IT)G

BETWEEN:

TIMOTHY H. MAGNUS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

AMENDED REASONS FOR JUDGMENT

Woods J.

[1] The appellant, Timothy Magnus, has claimed deductions for interest and carrying charges relating to real property for the 2004 and 2005 taxation years. In reassessments for these years, the amounts claimed in the tax returns, $190,600 and $87,200, respectively, were disallowed in their entirety.

[2] The main reason that the deductions were disallowed was the failure of the appellant to provide any supporting documentation during the audit or objection stages. The appellant blames this on the Canada Revenue Agency. Apparently, the CRA refused to review documentation at the appellant's premises and insisted that the appellant bring the documentation to its offices.

[3] This standoff about production of documents was resolved during discoveries, when extensive documentation was provided by the appellant.

[4] Based on its review of documentation produced during discoveries, the respondent made certain concessions at the opening of trial. It is conceded that $77,173.14 is deductible for the 2004 taxation year and $32,196.61 is deductible for the 2005 taxation year. These amounts generally represent interest and carrying charges that are supported by documentation and which relate to properties on which

rental income was reported by the appellant in his tax returns for the relevant taxation years.

[5] Before discussing whether further deductions should be allowed, I would comment concerning a notice of motion sent to the Court by the appellant just one business day prior to the hearing.

[6] The motion sought to have the assessments vacated for reasons related to the conduct of the CRA during the audit process. The conduct of the CRA is not a sufficient reason to vacate the assessments. For this reason, and since the motion material was filed very late, I declined to hear the motion.

Issues and burden of proof

[7] In the Reply, the respondent referred to paragraph 18(1)(*a*) of the *Income Tax Act* in support of the assessments. There was no description of the provision in the Reply, but a description was provided by the CRA in the Confirmation. The provision is reproduced below.

> **18.(1)** 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;

[8] At the opening of the hearing, I suggested to counsel for the respondent that it should bear the burden to establish that there was no income-earning purpose for purposes of para 18(1)(*a*) because the assumptions stated in the Reply do not deal with it.

[9] The relevant assumption as stated in the Reply reads:

> f) The Appellant did not incur interest or carrying charges of $190,600 in the 2004 taxation year and $87,200 in the 2005 taxation year.

[10] There is no reference at all to the purpose of the expenses in the above assumption. It is well-established that a taxpayer's burden is only to disprove the assumptions as set out in the Reply: *LeCaine v The Queen*, 2009 TCC 382, 2009 DTC 1246.

[11] The respondent strongly objects to assuming this burden, and submits that several of the properties were not being used to earn income. He submits that the assumption in (f) is broad enough to extend to the income-earning purpose test and that it would be unfair to impose the burden on the respondent in circumstances where the appellant did not provide any supporting material during the audit process.

[12] I disagree with these submissions.

[13] First, assumption (f) is not broad enough to encompass the facts supporting the application of s. 18(1)(*a*). The respondent could have avoided the unfairness of having to assume the burden by making appropriate assumptions and stating them in the reply.

[14] Second, the rules relating to assumptions and burden of proof are well-established and are designed to enable taxpayers to know the case that they have to meet in order to be successful at trial. The ultimate question is one of fairness. It would be unfair for the appellant to bear the burden of disproving this when it is not mentioned in the Reply.

[15] Third, there is nothing unusual in this case. The Minister often has to make assumptions regarding business expenses which have not been substantiated during the audit process. In these cases, the Minister often makes multiple assumptions: that the purported expenses were not incurred, that they were not incurred for the purpose of earning income, and perhaps that they were not reasonable.

[16] I see no reason to make an exception in the burden of proof in this case.

[17] I have concluded that the burden of proof rests with the respondent with respect to facts to support the income-earning requirement in para 18(1)(*a*).

Discussion

[18] Testimony was provided at the hearing by the appellant on his own behalf. As a general comment, I did not find the testimony to be convincing overall. It was not sufficiently detailed or cogent to be reliable and it appeared to be inconsistent with some of the facts set out in the Notice of Appeal.

[19] In addition to his oral testimony, however, the appellant introduced a large number of source documents that clearly establish that interest and carrying charges were incurred either by the appellant or his wholly-owned corporation.

[20] I would first make a preliminary comment concerning expenses that may have been incurred by the corporation. The appellant submits that this should not be a bar to his claiming the deductions. There were two reasons offered for this, first, that the appellant became the beneficial owner of all the real estate in 2003, and second that the appellant earned income from the corporation in return for paying these expenses.

[21] As it turns out, it is not necessary that I consider whether the appellant became the beneficial owner of all the properties. The reason for this is that none of the expenses which have been allowed appear to relate to properties which the corporation may have owned.

[22] I will begin the discussion by reproducing a portion of the appellant's written statement, which he read during his testimony (Ex. A-1). The extract below describes the real estate properties that the deductions relate to.

> Investment Properties
>
> 4) Real property included 4 units at 610-17th Ave SW [units 302, 502, 600 & 602], 3 units at 317-14th Ave SW [units 701, 702 & 706], unit 601, 111-14th Ave SE. and 2 detached homes [2925 Signal Hill Hts and 434070 2nd St. E].
>
> 5) Condominium properties were acquired for rental and/or personal use. Over the years, rental income has been generated by each and every condominium property, even if no rental income was generated in 2004 and/or 2005. [see 2002/2003 rental revenue].
>
> 6) 434070 is a detached home that has been offered for rental but we discovered that the market for this type of property is not viable. The Corporation was been domiciled at 434070 in 2004 and 2005 and as such qualifies as a business investment where 'rental' is a portion of the Schedule 4 income.
>
> 7) 2925 is a detached home that was purchased with the intent of providing 'rooms' for rent. Though no rental income for this property was generated in 2005 (the year of acquisition) it is currently a going concern with rental income.

[23] Before considering these properties in more detail, I would make a few general observations.

[24] First, according to the appellant's statement the condominiums were acquired for rental and/or personal use. This statement is too vague to be useful and oral testimony did not provide sufficient clarity. In addition, during discovery the appellant stated that he had lived at the 2985 property from "2005, 2006 through

current." This is not reflected in the above statement.

[25] Second, the statement mentions that rental revenue was earned for each condominium property. However, the notice of appeal states:

> Rental income claimed by Tim Magnus is for the rent of personal property, not related to the properties managed by the Corporation.

Although it may be possible to reconcile these statements, the evidence did not satisfactorily do so.

[26] Further, the statement refers to 2002 and 2003 rental revenues in support. However, the only documentation provided for this was an untitled document which seems to list purported rental revenue in 2002 and 2003 (Ex. A-2). I have not given this document any weight as I do not view it to be reliable. In particular, the document was not in the appellant's list of documents and the respondent has not had sufficient opportunity to consider its reliability.

[27] Similarly, the above statement mentions that the 2925 property is currently a going concern with rental income. No supporting documentation for this assertion was provided.

[28] I now turn to consider specific groups of properties.

[29] The first group mentioned in the appellant's statement is four condominium units at 610-17th Ave SW (the "610 properties"). The respondent has conceded interest, condo fees and taxes for three of these properties. It is not clear to me why expenses were not also conceded for the fourth property, Unit 502. This unit was sold early in the relevant period and the interest and carrying charges are modest.

[30] I propose to allow interest and carrying charges for all four units of the 610 properties.

[31] The second group is three condominium units at 317-14th Ave SW (the "317 properties"). Expenditures with respect to these properties were not conceded by the respondent because there was no rental income reported in the relevant tax years with respect to these properties. In other words, the respondent suggests that the properties were not used for the purpose of earning income.

[32] The fact that rental income was not reported in 2004 or 2005 is not a sufficient

basis for denying the interest and carrying charges. According to the respondent's own witness, rental income was reported by the appellant in 2002 and 2003. Unless the respondent led evidence to show that this income did not relate to these properties, I would conclude that the respondent has not satisfied the burden to establish facts to support the application of s. 18(1)(*a*) with respect to this group of properties.

[33] It is also relevant to consider that having a portfolio of a relatively large number of properties strongly suggests commercial use. The respondent referred to evidence that the business was in the course of liquidation and it was suggested that the source of income had disappeared. I do not agree with this. If properties were originally acquired for purposes of earning income, the use does not change during the period of liquidation.

[34] I propose to allow interest and carrying charges relating to these properties, except for expenses related to Unit 701 which the appellant himself has listed in Ex. A-3 as personal expenditures.

[35] The next group is a single property, condominium unit 601 at 111-14th Ave SE (the "601 property").

[36] The respondent has conceded interest, condo fees and taxes relating to this property for 2004 and 2005 even though the appellant submits that expenses after February 2005 are personal.

[37] I propose to allow interest and carrying charges related to the 601 property for 2004 and 2005. For expenses after February 2005, the amount allowed will be the amount conceded by the respondent.

[38] The next group of properties to be considered is also a single property, a detached home at 2925 Signal Hill Heights. (the "2925 property"). This property has a much greater value than the condominium units and greater expenses were incurred with respect to it.

[39] As mentioned above, the appellant stated during discoveries that he has lived at this property since "2005, 2006" and that he still lives there.

[40] This evidence, which was introduced by the respondent, is sufficient in my view for the respondent to establish a *prima facie* case that the 2925 property was a personal use property and was not acquired for the purpose of earning income.

[41] The appellant stated in Ex. A-1 that this property was purchased in 2005 with the intent of providing "rooms" for rent and that rental income is now being earned. It should not have been difficult for the appellant to provide supporting evidence of this, for example from his tax returns. In the absence of any supporting documentation, I do not accept the self-serving evidence that this property was acquired for an income-earning purpose.

[42] The expenses relating to the 2925 property will be disallowed.

[43] The final property to be considered is identified as 434070 2nd St. E (the "Oka Toks property").

[44] There is very little reliable evidence relating to this property. According to the appellant's statement in Ex. A-1, he tried to rent the property but was unsuccessful. I have given this testimony little weight as it was too brief to be convincing.

[45] The statement goes on to mention that the appellant's corporation was domiciled there in 2004 and 2005. However, on cross-examination the appellant implied that no one actually occupied the premises and they were used only to hold furniture and equipment.

[46] Although there is no reliable evidence from the appellant relating specifically to this property, I have concluded that the interest and carrying charges should be allowed because the burden was on the respondent to establish that there was no income-earning purpose. Overall, the evidence led by the respondent, either in chief or in cross-examination, was not sufficiently detailed for me to have any idea what the Oka Toks property was intended to be used for, or what in fact it was used for.

[47] I would conclude that interest and carrying charges with respect to the Oka Toks property should be allowed.

[48] To summarize, interest and carrying charges will be allowed with respect to all of the properties, except Unit 701 of the 317 properties and the 2925 property ("Qualifying Properties").

[49] It remains to be determined the appropriate amount of the interest and carrying charges. It is very difficult to determine appropriate figures from the source documentation and from the list of expenses Ex. A-3. As an example, the expenses in Ex. A-3 includes principal repayments and no detailed calculation of these has been

provided.

[50] According to the appellant's statement (Ex. A-1), the following types of expenditures are being claimed as deductions:

1) mortgage interest and banking charges,

2) fees charged by condominium corporations,

3) municipal taxes and charges,

4) closing costs for sales (broker fees, legal fees, title insurance, banking fees, etc.), and

5) legal expenses relating to lawsuits concerning the properties and a computer business that had been conducted by his corporation.

[51] The first three items qualify as interest or carrying charges and should be allowed with respect to the Qualifying Properties.

[52] These amounts should be determined based on the list of expenses that was prepared by the appellant in the course of the litigation and introduced into evidence as Exhibit A-3 (the "Ledger").

[53] I reviewed a relatively large number of source documents to verify this list. Although I found the Ledger to correspond quite closely to the source documents, I also found discrepancies that I could not reconcile. Just to take an example, the appellant claimed mortgage payments for the 2925 property for ten months whereas the mortgage source document only lists nine monthly payments. I have decided that it is appropriate to discount the otherwise allowable amounts by an arbitrary ten percent on account of potential discrepancies.

[54] Subject to the discount for discrepancies, interest and carrying charges for the Qualifying Properties should be determined based on expenses itemized in A-3 for mortgage payments (less principal), condo payments and taxes.

[55] The appellant also seeks to deduct selling expenses. These expenses are neither interest nor carrying charges and I do not propose to allow them.

[56] The appellant submitted that these expenses are ordinary deductible expenses.

I disagree. These properties were reported and accepted as capital property. Selling expenses are should be deducted in computing capital gains and are not incurred in the regular course of earning income. Subsection 9(3) of the *Act* makes this clear.

[57] In deciding to disallow selling expenses, I have also taken into account written agreements (Ex. A-4) which state that the corporation will increase interest payments to the appellant in return for his assuming obligations with respect to the properties (including "legal/sales expenditures").

[58] These agreements suggest that the selling expenses were incurred in order to earn interest income. However, I am not satisfied as to the reliability of these agreements. There is no execution date on the agreements and they appear to contradict the following statement in the notice of appeal:

> 5. Each year, the Corporation pays to Tim Magnus a return on the total shareholder loan and reports tax deductible carrying charges claimable, ensuring that there will be no "double deduction" for the carrying charges. These carrying charges are limited to the interest and condominium fees paid by Tim Magnus.
>
> (Emphasis added.)

[59] I would also comment that the agreements are self-serving documents and they have not been supported by up to date financial records of the corporation. The corporation has not filed tax returns since about 2001.

[60] Finally, I am troubled that the issue of selling expenses was not properly raised in the notice of appeal. It would be unfair to the respondent for the appellant to now seek relief with respect to these expenses.

[61] The next category of expenditures is legal fees. As far as I can determine, none of the legal expenses were supported by invoices. It would not be appropriate to allow any of these expenses without proper supporting documentation as to the amounts incurred.

[62] Finally, I have rejected a deduction claimed in the amount of $40,000 for two cheques paid to a corporation identified as Rock Solid Investors Group. There is insufficient supporting documentation to establish what these amounts relate to. The appellant listed them in Ex. A-3 as broker fees and they are mentioned obliquely in legal reporting letters as consultancy fees. I am not satisfied as to what these items represent.

[63] Where does that leave us? I have attempted to compute the amounts that are

deductible in accordance with the above reasons. These amounts, which are based on the figures in the Ledger, are set out below:

2004 taxation year

Interest and carrying charges

Total expenses	$252,268.23
Less - personal use	18,112.64
- principal repayments	36,303.92
- selling expenses	16,436.97
- Rock Solid payments	40,000.00
Subtotal	$141,414.70
Less - 10 percent discount	14,141.47
Final total	$127,273.23

2005 taxation year

Interest and carrying charges

Total expenses	$188,785.25
Less - personal use	17,151.26
- principal repayments	23,783.15
- selling expenses	58,331.29
- 2925 property mort interest and taxes	16,262.46
Add - 601 property concession in excess of amount claimed in Ledger (assumes one-third of mort payment is principal)	9,305.92
Subtotal	$ **82,563.01**
Less – 10 percent discount	**8,256.30**
Final total	$ **74,306.71**

[64] The appeal will accordingly be allowed in accordance with these reasons.

[65] I would like to give an opportunity for submissions on costs. Such submissions, if any, should be sent to the Court, by letter in writing addressed to the Hearings Coordinator, with a copy to the opposing party. Appellant's submissions to be received within two weeks of the release of this decision, from the respondent within a further two weeks and with a five-day right of reply.

These Amended Reasons for Judgment are issued in substitution for the Reasons for Judgment dated August 26, 2011.

Signed at **Toronto**, Ontario this **9th** day of **November** 2011.

"J. M. Woods"

Woods J.

CITATION:	2011 TCC 404
COURT FILE NO.:	2009-2180(IT)G
STYLE OF CAUSE:	TIMOTHY H. MAGNUS and HER MAJESTY THE QUEEN
PLACE OF HEARING:	Calgary, Alberta
DATES OF HEARING:	July 18 and 19, 2011
REASONS FOR JUDGMENT BY:	Hon. J.M. Woods
DATE OF **AMENDED JUDGMENT**:	**November 9, 2011**
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APPEARANCES:

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