

BETWEEN:

JEAN DRAGO,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on July 19, 2013, at Québec, Quebec.

Before: The Honourable Justice Gaston Jorré

Appearances:

Agent for the appellant: Marcel Tremblay
Counsel for the respondent: Martin Lamoureux

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeal from the assessment made under the *Income Tax Act* for the 2007 taxation year is allowed, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the following basis:

- (a) \$6,000 of the \$36,939 at issue are current expenses,
- (b) \$30,939, the balance of the amount at issue, are capital expenses and the appellant may claim, if he chooses to, a capital cost allowance in accordance with the *Income Tax Act* and the *Income Tax Regulations*.

Signed at Calgary, Alberta, this 21st day of August 2013.

"Gaston Jorré"

Jorré J.

Citation: 2013 TCC 257
Date: 20130821
Docket: 2012-3070(IT)I

BETWEEN:

JEAN DRAGO,

Appellant,

and

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Respondent.

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REASONS FOR JUDGMENT

Jorré J.

Facts

[1] The appellant is appealing an assessment for the 2007 taxation year during which he bought a rental property and deducted some renovation expenses as current expenses. He elected the informal procedure.

[2] The respondent does not dispute the amount of these expenses nor the fact that they are related to a rental property. However, the respondent argues that they are capital expenses.

[3] In 2006, the appellant's mother received a notice informing her that the owner of her apartment intended to take it back and move into it. His mother knew that there was a vacant unit in the building at issue; a building that was close to her home.

[4] On June 22, 2007, the appellant bought an undivided half of the building at issue for \$150,000. His undivided half contained two units. Consequently, each unit cost the appellant \$75,000. The building was built in 1910.¹

[5] The appellant paid \$15,000 in cash. The appellant agreed to pay the balance of \$135,000 over a 20-year period at a 7% interest rate in monthly instalments of \$1,046, that is \$523 per unit. The debt is secured by a hypothec.²

¹ Exhibit I-2, page 1.

² Exhibit A-1, pages 4 and 5.

[6] I would note that at a 7% interest rate, the appellant paid about \$9,450 in interest over the first 12 months or about \$787 per month, \$393 per unit.

[7] One of the units had a tenant and the appellant intended to continue renting it out.

[8] The other unit had not been rented for a long time.³ The appellant intended to rent the second unit to his mother.

[9] The appellant did a lot of work on the unit rented to his mother. This work was done not only before his mother moved into the unit, but before he bought the property.

[10] No renovations were made to the unit that was already rented.

[11] The renovations at issue cost \$36,939. Almost all of these expenses were for the purchase of materials. Only \$4,360 was spent on demolition work.⁴ The proportion of expenses for the purchase of materials is so high because the appellant did almost all the work himself; he worked between 30 and 40 hours a week over a four-month period.

[12] The appellant testified that he could have rented the second unit as is and I accept his testimony on this issue.

[13] Among other things, the appellant carried out the following work: the appellant replaced three of the windows; he removed five or six layers of wallpaper from the walls; he removed the drywall; he put insulation in the walls to replace the paper that was there; he rebuilt the walls; he also replaced the wiring; he replaced the sinks; he changed the kitchen cupboards.

[14] According to the appellant, the renovated unit would be good for 8 to 10 years.

[15] The appellant wanted the unit to be nice for his mother.

[16] The appellant testified that he replaced more or less what was there. For the following reasons, I do not accept the appellant's testimony on this particular point.

³ At one time, the former owner had kept the undivided half bought by the appellant for his daughter's use in the summer because she would come with her child. However, after a certain point, his daughter could no longer come and the unit remained empty. The former owner divided this unit in two, one unit was rented the other was vacant.

⁴ Exhibit I-1, third page, last line.

[17] The appellant rented the renovated unit to his mother for \$625 per month.

[18] The evidence does not contain any detailed description of the work nor a detailed outline of the expenses by the type of work carried out.⁵

Analysis

[19] There is a substantial body of case law on whether an expense that is otherwise deductible is a current expense, that is, an expense may be deducted during the year in which it is incurred, or a depreciable capital expense that must be deducted over a period of several years.⁶

[20] Although the mechanics of accounting and the *Income Tax Act* may be different and the details may be different, overall, with depreciation, both try to give a better idea of profit when an expense will last a certain amount of time by spreading out the expense over a given period.

[21] The general idea behind all that is that a routine and repetitive expense that does not last a long time is deducted in the year when the expense was incurred, whereas an expense that should last a certain amount of time will be spread out over a number of years.

[22] Various factors must be considered, including the following:

- (a) the nature of the expense
- (b) the amount of time the result will last (the longer the duration, the more likely that the expense is a capital expense).
- (c) whether the expense has the effect of restoring what already existed, without improvement, or whether it is an improvement (if it is a simple repair or restoration, it is more likely that it will be deemed a current expense; if it is an improvement, it is more likely to be deemed a capital expense).
- (d) whether the effect of the expense increases the value of a property (an indication that it is a capital expense).
- (e) when there is a lot of work, in reviewing it as a whole, whether it can be described more as an improvement than a simple restoration (however, it is

⁵ See Exhibit A-1. Only a long list of purchases prepared by the auditor was put in evidence; this list does not indicate what specific project the purchase was made for.

⁶ See, for example, the article by Professor John W. Durnford, "The Deductibility of Building Repair and Renovation Costs" (1997), 45 *Canadian Tax Journal* 395-416.

possible, even where there is a lot of work, that certain projects should be reviewed separately from the others).

[23] Although the quantum of expenses in itself does not prove anything, it could, for example, in comparison with a recent purchase price, be an indication that it was an improvement.

[24] All the factors must be considered when assessing the matter.

[25] In this case, these are more than simple routine repairs. For example, removing wallpaper and drywall, putting in modern insulation when there was paper before and redoing the interior walls are improvements.

[26] The fact that the appellant wanted a nice apartment for his mother combined with the fact that he spent almost \$37,000 in addition to having worked between 30 and 40 hours a week for four months, a very large investment when compared with the purchase price of \$75,000, is also an indication of improvements rather than mere repairs.

[27] Moreover, the fact that the appellant had indicated that this work would avoid the need to do significant work on his mother's unit for 8 to 10 years is also an indication of capital expenses.

[28] Thus, I find that, overall, the outlays were capital expenses.

[29] I reviewed the evidence to determine whether part of the work could be considered a current expense.

[30] As I have already noted, the evidence does not provide many details about the work nor the expenses linked to specific work. Thus, it is impossible for me to systematically review whether some of the work should be treated individually as a current expense.

[31] The only indication that there are current expenses is the fact that the list of purchases includes small expenses. I also noticed that it includes the purchase of paint, which is typically considered a current expense. Because of this and the fact that it is quite likely that at least a small part of the work is routine, I find that \$6,000 of the total \$36,939 at issue represent current expenses. The rest, i.e. \$30,939, represents capital expenses for which the appellant may claim a capital cost allowance.

[32] The appeal is allowed, but only to allow the limited changes related to \$6,000 as current expenses discussed above and to enable the appellant, if he so wishes, to claim a capital cost allowance.

[33] Accordingly, the appeal is allowed, and the matter is referred back to the Minister for reconsideration and reassessment, on the basis of the following:

- (a) \$6,000 of the \$36,939 at issue are current expenses,
- (b) \$30,939, the balance of the amount at issue, are capital expenses and the appellant may claim, if he chooses to, a capital cost allowance in accordance with the *Income Tax Act* and the *Income Tax Regulations*.

[34] Given the appellant's limited success, no costs will be awarded.

Signed at Calgary, Alberta, this 21st day of August 2013.

"Gaston Jorré"

Jorré J.

Translation certified true
On this 16th day of September 2013
Monica F. Chamberlain, Translator

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APPEARANCES:

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