Robertson v. The Queen

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Judges and Taxing Officers: Valerie A. Miller
Subjects: Income Tax Act

Docket: 2007-95(IT)G

BETWEEN:

RICK ROBERTSON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 6, 2008, at Edmonton, Alberta

Before: The Honourable Justice Valerie Miller

Appearances:

Counsel for the Appellant:	Gordon D. Beck
Counsel for the Respondent:	Margaret M. McCabe

JUDGMENT

The appeals from the reassessments made under the *Income Tax Act* for the 2000, 2001 and 2002 taxation years are allowed with costs and the reassessments are 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 3rd day of April 2009.

"V.A. Miller"

V.A. Miller, J.

Citation: 2009TCC183
Date: 20090403
Docket: 2007-95(IT)G

BETWEEN:

RICK ROBERTSON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2007-271(IT)G

AND BETWEEN:

RICK ROBERTSON ENGINEERING LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

V.A. Miller, J.

[1] These appeals were heard on common evidence and are with respect to the 2000, 2001 and 2002 taxation years of Rick Robertson and the March 31, 2001 and March 31, 2002 taxation years of Rick Robertson Engineering Ltd. ("RREL"). The issues in these appeals are numerous and are as follows:

a) Whether RREL was a personal services business;
b) Whether the following amounts were correctly included in Rick Robertson's income:

	2000	2001	2002
Unreported income	$ 963.00	$	$
Interest benefit on shareholder loan	9,123.23	14,160.06	8,624.69
Shareholder benefit, promotions		8,206.00	4,546.00
Shareholder benefit, travel		26,068.00 **P**	32,232.00 **P**
Shareholder benefit, personal memberships		3,580.00 **P**	1,163.00 **P**

c) Whether RREL was properly reassessed as follows:

	2001	2002
Promotion expenses disallowed	$ 6,028.00	$ 2,820.00
Travel expenses disallowed	23,665.30 **P**	32,515,58 **P**
Memberships and dues disallowed		1,163.00 **P**
Horseracing revenue overstated		-759.00
Small business deduction disallowed	6,396.00	6,814.00

d) Whether penalties pursuant to subsection 163(2) of the Income Tax Act (the "Act") were properly imposed on the amounts marked with a **P** in the above charts.

[2] At the hearing, evidence was given by Rick Robertson and Patricia McCulloch, an appeals officer with the Canada Revenue Agency ("CRA").

[3] Rick Robertson ("Robertson") graduated as an electrical engineer in 1984 and received his professional status in 1987. He worked for the City of Calgary and then as a partner with a company called A & W Associates. It was Robertson's evidence that by 1992 he was looking to broaden his business. He met with Gerry Stebnicki, another professional electrical engineer, and they, along with Ron Skene, decided to work together through a corporation owned by Stebnicki which he renamed Stebnicki, Robertson & Assoc. Ltd. ("SRAL"). Robertson was advised by his accountant that he should incorporate his own company. Thus, in 1992, RREL was incorporated.

[4] Throughout the hearing Robertson referred to SRAL as a partnership and he referred to his associates as his partners. However, section 3 of the Alberta *Partnership Act* provides that the relationship of the members of SRAL is not a partnership:

> Body corporate not partnership
> 3 The relationship between members of any company or association who constitute a corporation under any law in force in Alberta is not a partnership within the meaning of this Act.[1]

[5] Rick Robertson is the sole shareholder and director of RREL. In the years under appeal he was a director of SRAL and RREL owned between 25 to 30% of the shares of SRAL. Each associate in SRAL held shares in SRAL through their own company.

[6] In 2001 and 2002, RREL earned its income from providing electrical engineering services and horse racing. In 2001 and 2002, all income from engineering services was received from SRAL. It was Robertson's evidence that in years prior to the years in issue, RREL received income from small projects that did not involve SRAL (transcript p.95). In prior years RREL had also earned revenue from its investments in a small printing company and in real estate. Sometime after 2002, RREL purchased shares in and provided services to RSR Engineering Services which provided commissioning services (transcript p.94).

[7] RREL had two employees: Robertson who provided the engineer services and his spouse, Brenda Robertson ("Brenda"), who provided secretarial services for the engineering business, and management of the horse racing operation. Brenda was paid $30,000 each year for the services she performed and this was accepted by the Minister of National Revenue (the "Minister") as reasonable in the circumstances (exhibit AR-1, tab 22).

[8] Robertson explained that each of the shareholders in SRAL was responsible for obtaining its own contracts. He stated that when he started to work in SRAL, he brought his clients with him and they remained his clients. Robertson stated that he has since left SRAL and he has the same major clients that he had prior to and during his time with SRAL.

[9] One of Robertson's long term clients was the Calgary Exhibition and Stampede (the "Exhibition"). Some of the other types of projects that he worked on were tenant improvements in office buildings and schools. The other engineers in SRAL mainly acquired contracts for new developments such as hospitals.

[10] Robertson stated that the benefit of working through SRAL was that he could take on larger projects. As his clients grew, he could still provide services to them. SRAL employed the secretaries, clerks, contract administrators, certified engineer technologists and drafting designers who assisted him with his projects.

[11] When any of his clients were planning a project they advised him to submit a Request for a Proposal ("RFP"). As an example, he stated that when the Exhibition decided to have the Calgary Stampede Roundup Center Expansion constructed, they contacted him. He, in turn, contacted various architects who were planning to present an RFP on the project to ensure that he could align himself with them and be on their team. He then prepared his RFP and gave it to the architect who submitted it as part of a package. His team was chosen as the one that would design the building.

[12] Robertson attended all meetings to develop the design. He decided how the building would look from an electrical point of view; that is, he designed the power, fire alarm and security systems. Once he reached the electrical design stage, he stated that he enlisted the help of the electronic engineering technologists and the computer-aided drafting designers who actually produced the drawings. When construction started, Robertson assigned a contract administrator to the project. This individual went to

all further meetings and actually watched the project being built to ensure that all was in accordance with the design and the codes.

[13] Robertson indicated that anyone for whom he worked was RREL's client and not that of SRAL. No other engineer at SRAL worked on any of his contracts nor did he work on any contracts that they obtained.

[14] All contracts, invoices, letters, etc. to RREL's clients were on SRAL's letterhead. All project expenses incurred by RREL were billed to the clients by SRAL who then reimbursed RREL. Robertson's liability insurance was in the name of SRAL and not RREL. He said that all associates carried their liability insurance under the name of SRAL as they were able to get a better rate if their insurance was combined.

[15] There was no written agreement between SRAL and RREL. Likewise there was no written agreement between Robertson and RREL.

[16] RREL invoiced SRAL every two weeks for the amount of $3,750 for Robertson's services. At its year end, the directors of SRAL declared bonuses or dividends to its shareholders so that its revenue was written down to zero. The amount that each shareholder received was calculated according to the percentage of shares owned and that percentage changed each year in accordance with the revenue generated by the shareholder. The bonuses paid to RREL were $175,000 and $207,000 in 2001 and 2002.

Personal Services Business

[17] A personal services business is defined in subsection 125(7) of the *Income Tax Act* (the "Act") as follows:

> **"personal services business"** carried on by a corporation in a taxation year means a business of providing services where
>
> (a) an individual who performs services on behalf of the corporation (in this definition and paragraph 18(1)(*p*) referred to as an "incorporated employee"), or
>
> (b) any person related to the incorporated employee
>
> is a specified shareholder of the corporation and the incorporated employee would reasonably be regarded as an officer or employee of the person or partnership to whom or to which the services were provided but for the existence of the corporation, unless
>
> (c) the corporation employs in the business throughout the year more than five full-time employees, or
>
> (d) the amount paid or payable to the corporation in the year for the services is received or receivable by it from a corporation with which it was associated in the year;

[18] In these appeals, Rick Robertson can be viewed as the incorporated employee. Counsel for the Appellants has argued that RREL is not a personal services business and if I find that it is, then paragraph (d) of the definition is applicable.

[19] To determine if RREL carried on a personal services business requires an answer to the question: Can Robertson reasonably be regarded as an officer or employee of SRAL but for the existence of RREL? The answer to this question requires a consideration of the factors that are used to determine

whether a worker is an employee or an independent contractor. The leading decision in this area is that of the Supreme Court of Canada in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc*[2]. In *Sagaz*, Major J. reviewed the four-prong test from *Wiebe Door Services Ltd. v. M.N.R.*[3] and in paragraphs 47 and 48 he stated:

> 47 Although there is no universal test to determine whether a person is an employee or an independent contractor, I agree with MacGuigan J.A. that a persuasive approach to the issue is that taken by Cooke J. in *Market Investigations, supra* . The central question is whether the person who has been engaged to perform the services is performing them as a person in business on his own account. In making this determination, the level of control the employer has over the worker's activities will always be a factor. However, other factors to consider include whether the worker provides his or her own equipment, whether the worker hires his or her own helpers, the degree of financial risk taken by the worker, the degree of responsibility for investment and management held by the worker, and the worker's opportunity for profit in the performance of his or her tasks. *(emphasis added)*
>
> 48 It bears repeating that the above factors constitute a non-exhaustive list, and there is no set formula as to their application. The relative weight of each will depend on the particular facts and circumstances of the case.

[20] Considering all of the circumstances in these appeals, it is my opinion that Robertson performed the engineering services as a person in business on his own account. He had his own clients; he had to procure his own contracts; and, his ultimate earnings were determined by his efforts. SRAL only became involved in a proposal after Robertson had acquired the contract. Robertson worked only on the contracts that he acquired; he did not work on the contracts obtained by the other associates. SRAL did the paperwork for Robertson; its staff worked on his projects; and, he ultimately paid SRAL for these services.

[21] He possessed the opportunity for profit and ran the risk of loss in the performance of his engineering services. His share of the profits in SRAL was determined by the amount of money that he brought into SRAL. He was not compensated for the time spent working on a proposal if the proposal did not result in a contract. He only received a reimbursement from SRAL for those expenses that could be billed to a client. When he incurred an expense to obtain a contract and his proposal was unsuccessful, that expense was borne by him.

[22] The contract between RREL and SRAL did not require Robertson to work any particular number of hours. His evidence was that his hours varied; it depended on the demands of the project and his client. Some weeks he could work 20 hours whereas other weeks he might work as many as 70 hours. He decided when he would take vacation and the length of that vacation.

[23] The evidence disclosed that Robertson was independent. He made the decisions about which projects he would pursue and how he would perform his engineering services. He decided who would be on the team that worked on his contracts. SRAL did not control nor did it have the right to control the manner in which Robertson performed his engineering services.

[24] It was conceded by Robertson that SRAL owned many of the tools that allowed him to perform his engineering services. Those tools were used by the staff of SRAL. Robertson stated that he owned the computer, code books, theory books, lighting design books, calculators, pen and paper that he used. Counsel for the Appellants submitted that the most significant tools that any professional has, is his

education, experience and insight, and certainly the ownership of those tools rested with Robertson. I agree.

[25] Counsel for the Respondent argued that the evidence which I have listed in paragraph 14 above, indicate that there was a contract of service between Robertson and SRAL. It is my opinion that when I weigh all the factors, it would not be reasonable to conclude that, but for the existence of RREL, Robertson would be considered as an employee or officer of SRAL in 2000, 2001 and 2002.

[26] I find that RREL was not a personal services business.

RREL
Travel Expenses

[27] The travel expenses disallowed for the taxation year ending March 31, 2001 consisted of the following amounts:

Cheque #457 to Travel Masters	$ 2,500.00
Travel	12,103.80
Travel – US	4,689.79
Automobile	2,871.71
Accrued cash expenses paid by shareholder	1,500.00
Total	$23,665.30

The travel expenses disallowed for the taxation year ending March 31, 2002 consisted of the following amounts:

Expense form not reimbursed by SRAL	$ 1,354.11
Travel Masters	15,393.00
Travel- credit card expenses	8,984.56
Automobile	6,313.51
US Travel	470.40
Total	$32,515.58

[28] Robertson gave evidence with respect to the expenses incurred by RREL. I found that he was credible and I accept his evidence. In this regard I have relied on the decision of the Supreme Court of Canada in *Hickman Motors Limited v. The Queen*[4] where L'Heureux-Dube J. stated at page 5376:

> Furthermore, where the ITA does not require supporting documentation, credible oral evidence from a taxpayer is sufficient notwithstanding the absence of records: *Weinberger v. M.N.R.*, 64 DTC 5060 (Ex. Ct.); *Naka v. The Queen*, 95 DTC 407 (T.C.C.); *Page v. The Queen*, 95 DTC 373 (T.C.C.)

[29] Robertson stated that the amounts of $2500 paid to Travel Masters and $1500 claimed as accrued cash expenses in 2001 were business expenses. He was not able to give any explanation or details concerning the amount of $2500 and I find that it was not a business expense. He stated that he did pay cash for some of RREL's expenses. He did not keep a record of these expenses but he and his accountant

estimated that such cash payments were $1500. Without more than this as an explanation, I have not accepted that the amount of $1500 is a business expense of RREL.

[30] It was Robertson's evidence that RREL did not have an automobile or a credit card. He used his personal truck and his personal credit card for the business activities of RREL. Each month he reviewed his credit card statements and marked those expenses that were incurred on behalf of RREL. He stated that he reviewed these items with his accountant and he claimed only those expenses with which his accountant agreed.

[31] With respect to his truck, Robertson stated the amounts of $2,871.71 and $6,313.51 were the total expenses that he incurred for his truck for gas, insurance and oil changes in 2001 and 2002. He stated that he claimed these amounts as he thought that they were less than claiming $0.35 per km. In the Notices of Objection, Robertson stated that he did a significant amount of travelling to Edmonton to review potential and owned thoroughbred horses; to do banking; to purchase supplies; and to attend meetings. He also stated that he did not keep a log but "could go back through his records and make a proper travel log with mileage". He did not present a log at the hearing, instead he estimated that he drove approximately 50,000 kilometers per year and 60 to 70% of this would have been for business.

[32] It is obvious from the revenue earned by RREL from both its engineering business and its horse racing business that it had to incur expenses. I accept that Robertson used his truck for the businesses of RREL and that the amount of use was 60%. Rather than use an estimate of the kilometres travelled each year, I think that it is preferable to use the expenses submitted by Robertson. RREL is allowed to deduct as an automobile expense the amounts of $1,723.03 and $3,788.11 in 2001 and 2002 respectively.

[33] Robertson did give details of most of the travel expenses which were disallowed. Some of those explanations were as follows:

a) The majority of the travel expenses that were disallowed pertained to the horse racing business of RREL. In its 2002 taxation year, RREL earned revenue in the amount of $35,841.49 from its horse racing activities.

b) When he travelled to Vancouver in 2000, 2001 and 2002, it always involved either the horse racing business or the engineering services. He travelled to Vancouver to meet with various people about investing in horses, to acquaint himself with Hastings Park or to obtain stalls for his horses. It was his evidence that one didn't just show up at a racetrack with a horse. You first have to meet people who will help you to get a stall, an exercise rider and a jockey if you don't already have one. When he went to Vancouver it was to review the barns, meet the trainers, review the track, meet the race secretary, to make sure that he did everything correctly that he had to do prior to transporting his horses. He stated that when you are going to check out a race track, you do not make appointments; you just show up as the people you want to meet are always there.

c) Robertson explained that in 2000 he was working on a project called Arctic Shores for the Calgary Zoo. He and his team had already travelled to Chicago and Omaha to look at their zoos and were planning to travel to Orlando to look at the Discovery Reserve. Instead of going to Orlando with his team, he travelled with his family as he had already planned a family vacation to Florida. He claimed as a business expense only his cost of visiting the Discovery Reserve.

d) Robertson learned that there was a proposal to build a race track, grandstand, hotel and casino in the Calgary area. It was estimated that this construction would cost $200 million. In March 2002, he assembled a team to travel to Dallas and then to Alabama to look at different race tracks, casinos and hotels. His team consisted of an architect, an interior designer, an electrical contractor, a UPS manufacturing representative, and a distribution manufacturing representative. The race track in Dallas was the only new one that had been built in North America in the previous ten years. He and his team were able to "look at the infrastructure and how things were built and designed and how it worked". Robertson paid for the trip which cost $15,393. His team was successful in obtaining the contract and the project advanced to the design development stage when the investors stopped the project. RREL was not able to recoup the expense that it had incurred.

e) Robertson testified that he travelled to Phoenix in February 2002 for the horse racing business. He testified that this was not a family holiday as was assumed by the CRA auditor. He had to take his children with him as they were very young at this time; and neither he nor his wife had family in Calgary who could take care of his children. He inadvertently deducted the children's airfare and room. He stated that the amount of $ 1,403.20 and $235.20 should not have been claimed as a business expense.

f) In April 2001, RREL submitted an invoice to SRAL for a travel expense of $3,020.46 that it incurred. SRAL only reimbursed $1,666.35 as that was the only amount that could be billed to a project. The remainder, $1,354.11 had to be borne by RREL.

g) In May 2001, he travelled to Birmingham for the horse racing business and he incurred an expense of $365.88 for a car rental.

h) In July 2001 he travelled to Penticton. There were two reasons for the trip; one was to look into the development of a hotel and the other was so that his son could attend hockey school. He stated that he spent the entire week either with realtors or at the Chamber of Commerce to get background information on land that was for sale. He claimed the hotel cost of this trip as a business expense but not the meals or travel costs.

[34] As stated earlier, I found Robertson to be credible. When he made an error in claiming an expense he readily admitted it. He was able to recall specific details of most of his trips. I find that RREL incurred travel expenses in the following amounts:

March 31, 2001		March 31, 2002	
Travel	$12,103.80	Expense form not reimbursed	$ 1,354.11
Travel-US	4,689.79	Travel Masters	15,393.00
Automobile	1,723.03	Travel-credit card	7,346.16
Total	$18,516.62	Automobile	3,788.11
		US Travel	470.40
		Total	$28,351.78

Promotion Expenses

[35] The promotion expenses disallowed in 2001 and 2002 were $6,028 and $2,820 respectively. Robertson gave evidence with respect to one of the expenses disallowed. He stated that in 2002, the expense of $1,025 was incorrectly labelled as a family reunion. It was actually a promotional function held in Medicine Hat at his parents' ranch. The purpose of the expense was to find investors for RREL's horse racing business and to find investors to start accumulating real estate in the commercial sector. The "cost of the function was a success" as RREL now has thirteen investors in various thoroughbred horses. It has also acquired commercial real estate with eight investors.

[36] Included in the promotion expenses are the costs of meals that Robertson paid for while he was travelling. As I have allowed the travel expenses as a business expense, the costs of the meals so incurred are also allowed.

[37] I find that RREL incurred promotion expenses of $4,608.92 and $2,820 in 2001 and 2002 respectively.

Memberships

[38] It was Robertson's evidence that each year RREL purchased golf balls, shirts and gloves which it gave to its clients for their golf tournaments. In 2002 these items cost RREL $1,115 and it is allowed as a business expense.

Rick Robertson

[39] Counsel for the Appellants conceded that Robertson failed to include the amount of $963 in his income in 2000.

Interest Benefit

[40] Robertson has been assessed an interest benefit pursuant to subsection 80.4(2). This subsection deems a benefit to a taxpayer who becomes indebted to a company of which he is a shareholder. It reads as follows:

> **(2) Idem [loan to shareholders -- deemed interest]** -- Where a person (other than a corporation resident in Canada) or a partnership (other than a partnership each member of which is a corporation resident in Canada) was
>
> (a) a shareholder of a corporation,
>
> (b) connected with a shareholder of a corporation, or
>
> (c) a member of a partnership, or a beneficiary of a trust, that was a shareholder of a corporation,
>
> and by virtue of such shareholding that person or partnership received a loan from, or otherwise incurred a debt to, that corporation, any other corporation related thereto or a partnership of which that corporation or any corporation related thereto was a member, the person or partnership shall be deemed to have received a benefit in a taxation year equal to the amount, if any, by which
>
> (d) all interest on all such loans and debts computed at the prescribed rate on each such loan and debt for the period in the year during which it was outstanding

exceeds

(e) the amount of interest for the year paid on all such loans and debts not later than 30 days after the later of the end of the year and December 31, 1982.

(3) Where subsecs. (1) and (2) do not apply -- Subsections (1) and (2) do not apply in respect of any loan or debt, or any part thereof,

(b) that was included in computing the income of a person or partnership under this Part.

[41] The evidence was that Robertson did not receive a regular salary from RREL; instead he took draws throughout the year. The December 31 closing debit balances for Robertson's shareholder loan account were $169,238.56, $449,138.30 and $255,831.66 in 2000, 2001 and 2002. There was no interest paid on these amounts. The balances were reduced to zero by March 31 of the following year when Robertson received his bonus or dividends.

[42] It was Robertson's evidence that he did not think there was ever an occasion that he owed money to RREL. It was his understanding that it was RREL who owed him money. The recording of the draws that he received from RREL was performed by his accountants at year end. He stated that he didn't have the accounting background to appreciate the entries in the shareholder account.

[43] Counsel for the Appellants submitted that Robertson did not intend to be indebted to RREL. That may be so. However, intent is not an element of subsection 80.4(2). There was no evidence to show that the balances in this account were incorrect. There was no evidence that there was a posting error.

[44] Counsel for the Appellants also argued that subsection 80.4(3) applied to the circumstances of these appeals as Robertson included "an amount equivalent to the amount of the loan" in income. I assume that counsel is referring to the bonus or dividends which were declared and credited to Robertson's shareholder account on March 31, 2001 and March 31, 2002.

[45] This argument cannot be sustained. Subsection 80.4(2) speaks to the period in the year in which the loan or debts were outstanding. Judge Bonner's words in *Wood v. M.N.R.*[5] are applicable to the facts in these appeals:

> The statutory language is quite plain. At the end of any day during the year the test can be applied and the quantum of the benefit can be determined to that time subject only to reduction in respect of interest actually paid by the debtor as required by paragraph 80.4(1)(c). The length of a period during which a loan is outstanding is not affected either by the formation of an intention to cause sufficient dividends to be declared to permit a set-off or by what might have been done.

[46] Accordingly, in the circumstances, I think that an interest benefit was properly assessed to Robertson.

Shareholder Benefits

[47] As I have concluded that many of the amounts that were included in Robertson's income were properly business expenses of RREL, those same amounts should be deducted from the benefits which were included in Robertson's income pursuant to subsection 15(1).

Gross Negligence Penalties

[48] The penalties were imposed on the premise that Robertson as the sole shareholder of RREL directed the corporation to make numerous payments which were not laid out to earn income. The Appellants were largely successful in these appeals. I have concluded that the majority of the payments were in fact business expenses. As a result, the penalties for both RREL and Robertson are to be deleted.

[49] The appeals are allowed with costs.

Signed at Ottawa, Canada this 3rd day of April 2009.

"V.A. Miller"

V.A. Miller, J.

CITATION: 2009TCC183

COURT FILE NO.: 2007-95(IT)G

STYLE OF CAUSE: RICK ROBERTSON AND HER MAJESTY THE QUEEN

PLACE OF HEARING: Edmonton, Alberta

DATE OF HEARING: October 6, 2008

REASONS FOR JUDGMENT BY: The Honourable Justice Valerie Miller

DATE OF JUDGMENT: April 3, 2009

APPEARANCES:

Counsel for the Appellant:	Gordon D. Beck
Counsel for the Respondent:	Margaret M. McCabe

COUNSEL OF RECORD:

For the Appellant:

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[1] RSA 2000 c. P-3, s. 3

[2] [2001] 2 S.C.R. 983

[3] [1986] 3 F.C. 553

[4] 97 DTC 5363 (SCC)

[5] 88 DTC 1180 (TCC) at para. 12