

# Focus

BUSINESS LAW



## The connectivity requirement

A pair of Tax Court cases rule against taxpayers deducting legal fees



**Peter Aprile**

Late last year, the Tax Court of Canada released its reasons for judgment in *Ironside v. Canada* [2013] T.C.J. No. 298, and *Gouveia v. Canada* [2013] T.C.J. No. 353. In *Ironside* and *Gouveia*, the Tax Court considered the deductibility of legal fees the taxpayers incurred to defend against charges the Alberta Securities Commission and Ontario Securities Commission, respectively, brought against them. The facts and primary arguments in *Ironside* and *Gouveia* were similar and, therefore, we will highlight the salient facts for brevity.

In *Ironside*, the taxpayer, an accountant, earned business income as officer and director of a corporation in the oil and gas industry (BRRC). How-

ever, at the time he was BRRC's officer and director he was not practising as an accountant. He earned income through his BRRC roles.

BRRC was victim to a hostile takeover and *Ironside* was forced to resign. After the takeover, *Ironside* earned business income from his new chartered accounting practice. The ASC subsequently opened an investigation to determine whether he acted contrary to the securities legislation in his role as BRRC's officer and director. *Ironside* incurred legal fees to defend against the charges and deducted these legal fees from the income he earned from his chartered accounting practice on the basis that the ASC charge would lead the Institute of Chartered Accountants to take disciplinary action, cancel his registration as a chartered accountant, and prohibit him from gaining or producing income in this capacity.

In *Gouveia*, *Gouveia* was employed as a freezer company's director and officer (Atlas). In 2002 and 2003, *Gouveia* reported the employment income he earned from Atlas along with business income earned from a sole proprietorship management consultancy business. In 2003, *Gouveia* resigned from Atlas. The

OSC brought charges against *Gouveia* related to his conduct while working for Atlas, and a class action lawsuit was initiated against Atlas as well. He incurred legal fees to defend against the charges and deducted these legal fees from the income he earned from his consultancy practice on the basis that the OSC charges, and the lawsuit, would impact the income he could earn from his consultancy practice.

Stated simply, the taxpayers' primary submissions in *Ironside* and *Gouveia* were that the subject legal fees were incurred to protect their new businesses and preserve their ability to earn income from these businesses.

The Tax Court considered whether the legal fees were incurred for the purpose of earning business income. The Tax Court reviewed the factors that the Supreme Court of Canada considered in *Symes v. The Queen* [1993] S.C.J. No. 131, to determine whether the legal fees were incurred for the purpose of earning business income:

■ First, whether the expense was the type that similar businesses would normally incur, and

**Hypothetical, Page 12**

