

Reasonableness of Business Expenses

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Peach v The Queen, [2017 TCC 40](#)

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There are a number of hurdles to overcome before an expense is deductible for income tax purposes when determining profits of a business under the *Income Tax Act*. One hurdle is the limitation imposed by section 67 of the Act, requiring that the expense be reasonable.

In this case, the TCC issued a Redetermination Order after the taxpayer had partial success at the Federal Court of Appeal. The FCA sent the matter back to the TCC to identify what particular expenses were unreasonable and to what extent, as under section 67 the court can reduce or eliminate an expense to make it reasonable. The TCC reviewed each category of expense, the evidence and testimony in relation to each category, as well as submissions by counsel.

ANALYSIS

The Court referred to the Supreme Court of Canada decision in *Stewart v. The Queen*, [2002 SCC 46](#), where the SCC at paragraph 57 addressed how a court should approach the reasonableness inquiry:

57 It is clear from these provisions that the deductibility of expenses presupposes the existence of a source of income, and thus should not be confused with the preliminary source inquiry. If the deductibility of a particular expense is in question, then it is not the existence of a source of income which ought to be questioned, but the relationship between that expense and the source to which it is purported to relate. The fact that an expense is found to be a personal or living expense does not affect the characterization of the source of income to which the taxpayer attempts to allocate the expense, it simply means that the expense cannot be attributed to the source of income in question. As well, if, in the circumstances, the expense is unreasonable in relation to the source of

income, then s. 67 of the Act provides a mechanism to reduce or eliminate the amount of the expense. Again, however, excessive or unreasonable expenses have no bearing on the characterization of a particular activity as a source of income.

There are certain things that a court is not entitled to consider, including second guessing the business decisions of a taxpayer by asking:

- whether the expense is the result of poor business judgment - *Ankrah v. R.*, [2003 TCC 413](#) at paragraph 4, citing *Gabco Limited v. MNR*, (1968), 68 DTC 5210 (Ex. CF) at page 5216. The primary basis for denial is that no person of business would pay such an amount given the circumstances of the particular taxpayer; and
- whether expenses exceed revenues as business expenses are incurred before profitability can be determined and for the purpose to gain business income, and cannot be part of the reasonableness inquiry - *Williams v. R.*, [2009 TCC 93](#) at paragraphs 16 and 17.

The Court considered the following categories of expenses:

- **Meals and Entertainment**
 - the court stated that anything beyond \$20.00 a day for lunch, when no client meetings are involved, is unreasonable.
 - ***NOTE - the court considered travel meals under meals and entertainment - not the appropriate category of expenses, and also did not consider the particular circumstances (location, average meal, dietary needs) in setting out a hard line number.***
- **Business Tax, Fees and Licenses**
 - these are costs that must be incurred to operate a business and as such are reasonable.
- **Office Expenses**
 - the Court determined that absent an explanation for an increase in the subsequent year, the amount in excess of the year previous was unreasonable.
- **Capital Cost Allowance**
 - The court determined that without a travel log the expenses were unreasonable
 - The Court also determined that give vehicles were unreasonable
- **Motor Vehicle Expenses**
 - The Court held that the operation of five motor vehicles over two years for one person was unreasonable without a justification

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