Professional Advice Capital v Income - Sas Ansari

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Rio Tinto Alcan Inc v Canada, 2016 TCC 172

At issue was whether legal fees, investment banking fees, fees in respect of government representations, and other matters incurred at a time where take-overs and spin-offs were being conducted were on account of capital (and added to the ACB of the shares) or income.

ANALYSIS

Although ITA subsection 9(1) allows for the deduction of expenses from revenue in determining profit, paragraphs 18(1)(a) and (b) limit deductions that may be claimed. The outlay or expense must have been incurred for the purpose of gaining or producing income from a business (s 18(1)(a)), and cannot be an outlay or expense that is of a capital nature (s 18(1)(b)).

The respondent argued that the expenses were current expenses as they relate to the cost of professional advice relied on by the board of directors in deciding whether or not to approve the transactions - "oversight expenses" rather than "execution costs".

What is meant by "on account of capital" as used in 18(1)(b) is not defined in the ITA. No rigid or single test applies and the courts must draw the distinction on the facts of a particular case - *Johns?Manville Canada Inc. v. The Queen*,[16]:

- The matter turns on how the expenditure is calculated to effect from a practical and business point of view rather than based on juristic classification of the legal rights secured, employed or exhausted in the process (para 73);
- The distinction draws a line between: (i) the acquisition of the means of production and the use of such means; (ii) establishing or extending a business organization and carrying on business; (iii) implements employed in work and the regular performance of work; (iv) the enterprise itself and the sustained effort of those engaged in the enterprise;
- Other considerations include: (i) the character of the advantage sought and its lasting qualities; (ii) the recurrence of the expense; (iii) the manner in which the advantage is to be used or enjoyed; (iv) the means adopted to obtain the advantage;
- The expense is on income account where the purpose of the expense which would fall into the class of thing that in aggregate are in constant demand;

The Court identified the three tests developed by the courts in distinguishing between capital and income:

1. ***The recurring expense test*** - though just because an expense is made once and for all does not mean it is of capital nature (para 75);
2. ***Enduring benefit or asset test*** - looks to whether the expenditure creates a lasting benefit for the business (para 76);
3. ***Underlying Purpose or*** Rationale ***Test*** - if an expense is incurred to a matter related to the income earning process, it is likely current, while an expense incurred as part of the implementation of a transaction resulting in the creation or acquisition of a capital asset, or expansion of business, is likely on capital account (para 77) analyzed in the context of the taxpayer's business with a view to the commercial purpose of the payment- *Ikea Ltd. v. Canada,* [1998] 1 S.C.R. 196; *Morguard Corp. v. The Queen,* 2012 FCA 306.

The tests above must be applied on a case-by-case basis and none alone provides a definitive answer in all circumstances (para 79).

Just because an expenditure was made as part of the decision-making process or oversight process of determining whether or not to bring about a capital asset does not make the expense one of capital nature. These expenses may still result from the current operations of the business and part of the concern of directors and officers for conducting the daily operations in a business-like manner (para 80) - *Bowater Power Co. Ltd. v. M.N.R.*, 71 DTC 5469; *Wacky Wheatley's TV & Stereo Ltd. v. M.N.R.*, 87 DTC 576; see also IT?475 "Expenditures on Research and for Business Expansion".

The court noted that the current business environment demands greater oversight over activities of the corporation, with the board challenging and testing proposals by managers by, in part, seeking independent professional advice to guide their decision-making process (para 87). The court held at paragraph 88:

> Simply put, Oversight Expenses are current expenses because they relate to the management of a corporation's income?earning process. Proper management includes the judicious allocation or reallocation of capital for the purpose of maximizing the income earned by the corporation. Ineffective oversight over the capital allocation process is a formula for disaster that often leads to a decline in earnings and cash flow and, as a result, the destruction of shareholder value. In this context, Oversight Expenses serve an income?earning purpose. Oversight Expenses per se do not create enduring benefits for taxpayers. Rather, it is the actual implementation of an approved capital transaction that creates the enduring benefit. In this context, the Court must carefully scrutinize the evidence, with proper regard to the applicable evidentiary burden, in order to ensure that the expenses that are treated by a taxpayer as current expenses actually pertain to advice given to the board of directors to assist it in the decision?making process undertaken as part of the exercise of the board's oversight function. This is to be contrasted with expenses incurred as part of the implementation

of a transaction leading to the acquisition of capital property. In that context, the Court must look at the primary purpose of the work performed. **Was the work commissioned primarily to assist in the oversight or management process, or was it primarily linked to the implementation of a transaction carried out on capital account?**

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