Reasonable Expectation of Profit and Input Tax Credits - Sas Ansari

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Gibb v The Queen, 2016 TCC 249

The Court identified two kinds of businesses for purposes of the *Excise Tax Act* and the ability to claim Input Tax Credits (ITCs) - those that are businesses with a reasonable expectation of profit and those without. This distinction only applies to businesses that are carried on by an individual and not by other persons.

The ETA defined "commercial activity" in subsection 123(1) as a business carried on by a person "other than a business carried on without a reasonable expectation of profit by an individual". A business not engaged in commercial activity cannot claim ITCs. The 'reasonable expectation of profit test was set out by the Supreme Court of Canada in *Moldowan v HMTQ*, [1978] 1 SCR 480 (SCC):

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> There is a vast case literature on what reasonable expectation of profit means and it is by no means entirely consistent. In my view, whether a taxpayer has a reasonable expectation of profit is an objective determination to be made from all of the facts. The following criteria should be considered: the profit and loss experience in past years, the taxpayer's training, the taxpayer's intended course of action, the capability of the venture as capitalized to show a profit after charging capital cost allowance. The list is not intended to be exhaustive. The factors will differ with the nature and extent of the undertaking: The Queen v. Matthews. One would not expect a farmer who purchased a productive going [sic] operation to suffer the same start-up losses as the man who begins a tree farm on raw land.

The Court here considered the various factors:

- **Past Profit and Loss -** There was no profit and the court, based on the testimony of the taxpayer, held that "her expectation can best be described as a faint hope, a wish perhaps, but hardly a reasonable expectation of profit based solely on the numbers" (para 6);

- **Training** - The court did not consider the training or knowledge in the particular business alone, but also considered the experience and training that would "equip her to create and manage a profitable business" - noting that although the taxpayer knew the business "though this did not translate into knowing how to effectively run a business" as she "presented no financial statements, no budgets, no formal plan" (para 8);
- **Intended Course of action** - Here some action was taken to improve efficiency and therefore the capacity to produce a profit as capitalized (para 10);
- **Capability of Venture as Capitalized to Show a Profit** - Lack of financial statements did not assist the taxpayer and failed to show that the capitalization was managed to achieve profitability (para 11); and
- **Other factors** - The determination of a reasonable expectation of profit must be objective, divorced from the taxpayer's passionate view of the business - the court must find "sufficient indicia supporting a reasonable expectation of profit" (para 13).

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