TAX FOR THE Owner-Manager

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DiCaita v. The Queen: When Are Repairs and Maintenance Expenses Currently Deductible?

Although *DiCaita v. The Queen* (2021 TCC 5) was heard under the informal procedure and thus has no precedential value, it illustrates the law regarding two fundamental issues that arise under the Act—namely, whether a taxpayer has a source of income and whether an expense is on income or capital account. In this article, we deal only with those issues, which were relevant to one of the two properties that were the subject of the appeal.

The appellant owned one unit in a condominium complex in Vancouver. The unit was always a rental property of the appellant, and it always enjoyed a high occupancy rate. In April 2010, the board that managed the complex undertook a major remediation to deal with multiple issues that involved only the complex's exterior common elements and did not affect any of the units' interiors.

During the remediation work, the complex became an active construction site, which was very disruptive for the occupants of the complex. The appellant's tenant was unhappy with the disruption and asked for a significant rent reduction, which the appellant refused to grant. As a result, the tenant vacated the unit in November 2010. The appellant attempted to rent the unit out but was unable to do so because of the remediation project.

During the period when the appellant was unable to rent the unit, he decided to undertake needed repairs to address problems caused by wear and tear and to replace some fixtures and appliances that had reached the end of their useful lives. In January 2012, he hired a contractor to make the necessary repairs—among other things, replacing some bathroom fixtures, kitchen cabinetry, countertops, appliances, flooring, and baseboards. Those repairs were completed in May 2012.

The work cost about $24,000, which the appellant estimated to be 5 percent of the unit's FMV. No construction permits were required, and the existing items were replaced with items of similar quality and value. The repairs were not intended to have a material effect on the value of the unit.

The building's exterior remediation work fell behind schedule and affected the appellant's ability to rent out his unit even after the interior repairs were completed. The unit remained vacant until November 2012. It was rented out in December 2012 for $2,200 per month, an increase of $700 per month, which was in line with rents charged for comparable units.

The appellant deducted $22,483 for repairs and maintenance in his 2012 taxation year. The minister disallowed the expenses on the basis that the unit was not available to be rented out, and therefore the appellant did not have a source of income. Alternatively, the minister claimed that the expenses were capital expenditures and thus not deductible under paragraph 18(1)(b).

The TCC first addressed the source-of-income issue. Relying on *Stewart v. Canada* (2002 SCC 46), Masse DJ said that

> [a] property does not need to be generating income at every stage of operation in order to be considered a source of income. What is required . . . is the predominant intention to make a profit in accordance with objective standards of businesslike behaviour. That has been clearly established. The fact that the unit was vacant from January through to November of 2012 means only that it was not earning income during that time—it does not mean that it was not a source of income.

He noted that the unit had been continuously rented out for the years prior to the repairs and was rented out after the exterior remediation and interior repairs were completed.

In the absence of legislation or binding case law otherwise, the TCC held that a property did not have to be generating income at every stage of operation in order to be considered a source of income; the unit did not lose its character as a source of income while the repairs were being conducted simply because it was vacant or not available to be rented for an interval of time. The court thus concluded that the unit was a source of income before, during, and after the renovations.

Next, the court addressed the question whether the impugned expenses were capital expenditures or current operating expenses. Relying on *Rainbow Pipe Line Co. Ltd. v. Canada* (2002 FCA 259), the court said that whether a particular outlay should be capitalized or treated as a current expense is a determination that must be made in accordance with GAAP and is not dealt with by any specific provision of the Act. (We note that the FCA phrased this point somewhat differently at paragraph 12 of its reasons: "On the basis of the expert evidence, Mogan T.C.J. found that well-accepted business principles, including GAAP, ran against the appellant and, in particular, that there is much stronger support in GAAP in the circumstances of this case for capitalizing the replacement cost than expensing it." The important point is that the determination does not depend on GAAP. Rather, well-accepted business principles, including GAAP, are determinative.)

The TCC cited *Minister of National Revenue v. Algoma Central Railway* (1968 CanLII 774 (SCC)) for the proposition that "[t]he classic definition of a capital expenditure is one incurred for

procuring 'the advantage of an enduring benefit,' and includes 'preserving an asset,' but not an expense that creates no identifiable asset." The court also referred to *Hare v. The Queen* (2011 TCC 294) and *Hare v. Canada* (2013 FCA 80) for guidance. Masse DJ quoted the court in *Cousineau v. The Queen* (2013 TCC 375) for its "thorough analysis" of the multiple considerations that go into determining this question of fact.

The TCC then considered six factors to be weighed in determining whether an expenditure was current or capital in nature:

1) betterment and enduring benefit,
2) typical repairs,
3) timing of the repairs,
4) vacancy of the property during repairs,
5) cost of repairs relative to the value of the property, and
6) increase in rent following the repairs.

The court stated that the overarching test was the purpose and nature of the expenditure. It held that although the repairs were of enduring benefit, they were not significant enough "to bring into existence a different capital asset than what was there before"; they merely updated what was already in existence. In reaching this conclusion, the court referred to the cost of the repairs relative to the value of the unit, the lack of a need for building permits, the absence of building code issues, and the fact that the materials and items purchased were "like for like" replacements of existing materials.

Masse DJ found that the repairs were typical of current expenses. With respect to the timing of the repairs, he rejected the minister's assertion that the lumping together of multiple repairs must have resulted in the creation of a new asset, and he held instead that the "the timing of the repairs was somewhat serendipitous in that the hiatus in tenancies provided [the appellant] with an opportunity to effect the needed repairs all at once." In the court's view, therefore, the timing of the repairs was merely fortuitous and not a significant factor in the case.

The court also rejected the minister's argument that the fact that the unit needed to be vacant so that the repairs could be made resulted in the repair expenses being capital in nature. The court held that the unit's vacancy during the repairs did not mean that it had to be vacant: "Although it is true that the unit was vacant between tenancies, it does not follow that it had to be vacant in order to effect the repairs. It was simply easier to effect the repairs if the unit was vacant." The court also found that the cost of the repairs was small in relation to the value of the unit, which supported a finding that the expenses were current.

Finally, the court found that "[t]he increase in rent is just as likely attributable to the exterior remediation [as] it is to the interior repairs," and held that the rent increase was not a significant factor in the determination. Accordingly, the TCC held that the repairs were current in nature.

DiCaita serves as a welcome reminder of the often complex analysis that goes into distinguishing a current expense from a capital expense. It is also a reminder that the question whether a property or a business is a source of income involves complex issues of intention and manifestations of objectively businesslike behaviour; mechanistic points of timing of receipts of income are a poor basis for determining whether at a particular time there is a source of income.

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