

# Allowable deductions for businesses in the wind up phase

September 12, 2019

## Summary

The taxpayer practiced as a lawyer for 27 years before ultimately retiring from the profession in 2013. In preparation for retirement, the taxpayer moved the records of her client files from her traditional business office into a storage facility and incurred monthly storage fees. During the 2015 taxation year, the taxpayer deducted storage fees as a business expense by virtue of article 18(1)(a) of the *Income Tax Act* (Act). The Minister of National Revenue (CRA) disallowed the deduction, claiming that the taxpayer did not incur these expenses in the course of earning business income.

## Arguments

Only expenses incurred for the purposes of earning income are deductible under the Act. Furthermore, the CRA states that “being a lawyer is not, in and of itself, a business”<sup>1</sup> and that expenses incurred by a lawyer not engaged in private practice, but rather as in-house corporate counsel, are therefore not deductible as business expenses.

In rebuttal, the taxpayer argued that the requirement to maintain records of her closed files is necessary to comply with the standard and acceptable business practice laid out by her profession, which recommend that client records be kept for a period of 3 to 25 years post-closing. Furthermore, the taxpayer argues that file maintenance or storage “is an inherent risk of the profession” and is necessary to the practice of law. She claims that failing to properly store files would have resulted in sanctions and may have led to her possible disbarment.

## Analysis and Decision

The court sided with the taxpayer, who was accruing “run off” expenses relating to file retention, accessibility and future storage obligations, which were necessary in the context of winding up her professional practice. In other words, the continuing services of record keeping and file storage provided by the taxpayer in 2015 were connected to the income she earned in previous years and is consistent with the notion of

“unavoidable expenses necessarily expended in future years referable to previous income” as discussed in *Poulin*<sup>2</sup>.

## Takeaway:

CRA denies a deduction pursuant to subsection 18(1)(a) of the Act based on the premise that no income was being generated from these storage costs. The court rightfully disagreed, as costs incurred as a consequence of carrying on a business are deductible even if they are in the wind-up phase, as these costs accrued as a result of the income earning process.

<sup>1</sup>*Jamieson* (1996), 96 D.T.C 6477

<sup>2</sup>*Langille v. R.* (2009), 2009 TCC 398 and *Raegele v. R.* (2002), [2002] 2 C.T.C. 2955

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