

Accounting for Gains

TAX COURT

BY JAMIE GOLOMBEK



The issue of taxing profits from stock market trading, as either income or capital gains, pops up regularly in the courts. A Quebec tax case decided last year, *Thibault v The Queen* (2007 TCC 515) but just released in its English translation last month, sheds some light on the issues a court examines to determine what tax treatment will prevail.

Yvon Thibault is an agronomist and vice-president with Shur-Gain Quebec, a division of Maple Leaf, where he earned annual income that ranged from \$210,000 to \$240,000.

Thibault began personally investing in securities in 1986 and spends "a large portion of his time in it." In 2003, he reported nearly \$140,000 of profits from his stock market transactions as a capital gain, taxable at 50%. He sheltered those capital gains from tax by using a capital loss carried forward from 1995.

The Canada Revenue Agency reassessed him, saying that the \$140,000 of profits should be taxed as business income, which therefore precluded him from offsetting this amount with a capital loss carry-forward.

The CRA also charged Thibault with a gross negligence penalty under the *Income Tax Act* on the 50% portion of the profits that he failed to include in his income.

Thibault objected to both the penalty and the classification of his trading profits as business income.

As it turns out, Thibault was no stranger to the CRA. From 1987 to 1997, he suffered losses from various stock transactions totalling \$738,550 and claimed these losses as business losses as opposed to capital losses.

The CRA first reassessed him for the 1987 taxation year but he was able to convince the CRA that the losses were not capital losses and thus should be tax-deductible as business losses against his salary income from Shur-Gain.

Since Thibault continued to incur and report losses from his trading activities as business losses, he was reassessed again for the 1995, 1996 and 1997 taxation years. Again the CRA objected and claimed that since Thibault "had not demonstrated that he

had a reasonable hope of profit," the losses should be treated as capital losses.

Thibault objected and ultimately settled with the CRA, agreeing to consider his 1995 loss as a capital loss but his 1996 and 1997 losses as business losses since Mr. Thibault declared the profits on his stock transactions in the 1998 (\$78,372) and 1999 (\$84,023) tax years as business income as opposed to a capital gain.

Subsequently, in 2000, 2001 and 2002, Thibault also incurred

nearly \$500,000 of losses which he claimed as business losses in those years and offset these against his other income.

It was therefore surprising to the CRA that the \$140,000 of profits realized in 2003 would be suddenly claimed as a capital gain and not as business income. The CRA argued that Thibault was simply "trying to take advantage by declaring this profit as a capital gain taxed at 50% when he had always declared his losses as non-capital losses deductible at 100% against any other in-

come."

The CRA further claimed that Thibault should be charged with a gross negligence penalty.

The judge reviewed the history of Thibault's trading activities, discovering that in 1989 he had registered with the office of the Prothonotary for the district of Longueuil, Quebec as "doing business in the field of stock transactions."

Over the years, Thibault had a significant number of high-value stock transactions, often invested on margin, in highly speculative stocks, often with short holding periods (2 to 37 days).

All this evidence demonstrated

that Thibault was actively trading as a business activity.

The judge also concluded that the penalty was justified since Thibault took advantage of his losses over the years to reduce the tax burden on his employment income, yet, when he made profits, he tried to claim them as capital gains. Thus, by declaring his 2003 trading income as a capital gain, he knowingly made a "false statement" on his return. **AER**

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