

Training For Trading

Deductibility of costs

TAX COURT

BY JAMIE GOLOMBEK



A recent case (*Douthwright v. the Queen*, 2007 TCC 560) deals with Kevin Douthwright who joined BMO Nesbitt Burns as an advisor in February 2001. When he joined, he had to enrol in an 18-month training program. He signed Nesbitt's

"Investment Advisor Trainee Agreement" which acknowledged that the training course "entails a substantial expenditure by BMO Nesbitt." Douthwright agreed that should he resign from Nesbitt within two years, he would be required to pay \$25,000 to cover the firm's cost.

Douthwright resigned from Nesbitt in June 2002 and began working as an investment advisor with TD Waterhouse. Not sur-

prisingly, Nesbitt sued him for the \$25,000 under the terms of his signed trainee agreement.

In August 2003, Douthwright settled the lawsuit with Nesbitt by agreeing to pay a total of \$11,125 in five monthly instalments of \$2,225 each, from August 2003 through December 2003.

So, how did the matter end up in Tax Court? Douthwright claimed the \$11,125 of settlement costs along with nearly \$4,000 in legal fees as

tax-deductible expenses on his 2003 personal income tax return.

The CRA objected, saying that these were properly regarded as capital expenses, and therefore, specifically disallowed under the *Income Tax Act* as a deduction for employees. The CRA's secondary argument was that even if the court found that the expenses were not capital expenses, they should

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not be deductible since they were not incurred for the purpose of earning income from either Nesbitt or TD Waterhouse.

The judge boiled the case down to whether the "training costs" that were required to be paid back to Nesbitt were tax-deductible.

According to the CRA's Interpretation Bulletin IT-357R2, "training costs are not deductible as current expenses if they are capital expenditures. They are considered to be capital in nature where the training results in a lasting benefit to the taxpayer, i.e., where a new skill or qualification is acquired. Where, on the other hand, the training is taken merely to maintain, update or upgrade an already existing skill or qualification, the related costs are not considered to be capital in nature."

The judge found that the training (which was in relation to investment products and training on portfolio and management techniques) were related to maintaining, updating or upgrading an already existing skill or qualification. While some of the training may well have been "capital" in nature, the judge concluded that since no breakdown was provided, either by Nesbitt or by the CRA in its arguments, the entire amount can be considered a current, deductible training expense.

The judge then turned to CRA's secondary argument – that the amounts paid were not incurred by Douthwright for the purpose of earning income.

The judge disagreed and applied a logical, legalistic reasoning, starting with Douthwright's pre-existing training agreement with Nesbitt. The judge found that since Douthwright could not have earned commission income from TD Waterhouse without first resigning from Nesbitt and that since resigning from Nesbitt directly resulted in his obligation to pay for the training costs that Nesbitt incurred, then the amount that Douthwright paid to Nesbitt in respect of the training cost was made for the purpose of earning income from TD Waterhouse.

Similarly, the judge allowed Douthwright to deduct his \$4,000 of legal fees which were incurred to reduce the amount of the payment to Nesbitt and thus can be considered to have been made for the purpose of earning commission income from TD Waterhouse. **AER**

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