
PERSONAL TAX PLANNING

Co-Editors: T.R. Burpee* and P.E. Schusheim**

WORKING WITH THE SOURCE TEST: THE SUPREME COURT'S REPLACEMENT FOR THE REASONABLE EXPECTATION OF PROFIT TEST

*Rayna F. Laiken*** and Stanley N. Laiken*****

The application of the “reasonable expectation of profit” test to activities that have generated losses has resulted in considerable litigation and some uncertainty. The scope of the test seems to have expanded well beyond a simple prohibition of the deduction of “personal or living expenses.” The recent decision of the Supreme Court of Canada in *Stewart v. Canada* has provided a replacement test, termed “the source test,” which is clearly stated and simpler and more objective to apply. This article outlines the source test and reviews the legislative and common law context in which it was developed. The requirement to show evidence of an intention to pursue profit, where there is a personal-benefit element to an activity, is assisted by a consideration of the objectively observable factors that have been suggested in common law. These factors, together with factors specified in us legislation with a similar objective, are compiled in a planning and documentation checklist. This checklist can be used by individuals and their advisers, at the planning and the operating stages of a commercial activity, to help establish, in a thorough and systematic manner, support for the required pursuit-of-profit intention.

KEYWORDS: BUSINESS ■ INCOME ■ INDIVIDUALS ■ LOSSES ■ PROFITS ■ TAX DEDUCTIONS

* Of Ernst & Young LLP, Montreal (retired).

** Of Ernst & Young LLP, Toronto.

*** Of Ernst & Young LLP, Toronto. This article is based on this author's initial research for a paper entitled “Reasonable Expectation of Profit: A Legislated Alternative,” a tax research paper, supervised by Robin MacKnight, in partial fulfillment of the requirements for the Master of Taxation degree in the School of Accountancy, University of Waterloo, winter 2001.

**** Of the School of Accountancy, University of Waterloo.