Docket: 2014-2465(GST)I

BETWEEN:

L'UNIVERS GYM FITNESS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 29, 2015, at Québec, Quebec.

Before: The Honourable Justice Dominique Lafleur

Appearances:

Agent for the appellant:	Marcel Tremblay
Counsel for the respondent:	Sylvain Lacombe

JUDGMENT

The appeal from the assessment made under the *Excise Tax Act*, notice of which is dated August 29, 2013, for the period from January 1 to March 31, 2013, is dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 1st day of September 2015.

"Dominique Lafleur"

Lafleur J.

Translation certified true
on this 20th day of October 2015
Daniela Guglietta, Translator

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Date: 20150901
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REASONS FOR JUDGMENT

Lafleur J.

[1] This is an appeal filed by L'univers Gym Fitness Inc. (the appellant) from an assessment made under Part IX of the *Excise Tax Act*, R.S.C. 1985, c. E-15 (the Act), notice of which is dated August 29, 2013, covering the period from January 1, 2013, to March 31, 2013, by which the Minister of National Revenue (the Minister) disallowed the deduction of $5,078.15 in the computation of the appellant's net tax for the purpose of the goods and services tax (GST) on account of bad debts for the years 2009 to 2011 under the Act. Following the Notice of Objection filed by the appellant, the Minister confirmed the assessment.

[2] At the hearing, the appellant was represented by Marcel Tremblay, accountant. Mr. Tremblay testified, as did one of his employees, Monique Larouche, accounting technician. No officer of the appellant was present at the hearing.

[3] Émilie Thiffault, auditor with the Agence du revenu du Québec, and Marlène Légaré, objections officer with the Agence du revenu du Québec, testified for the respondent.

I. The facts

[4] The appellant is a company that has been operating a fitness centre since 2004 and is a GST registrant.

[5] Monique Larouche has been employed by Tremblay & Associates, a company owned by Marcel Tremblay, agent for the appellant, since July 2012. She has been doing the appellant's bookkeeping since December 2012. She spends approximately 16 hours per week on the appellant's file. Prior to Ms. Larouche's arrival, there was no accountant on appellant's premises. When she works in the appellant's offices, Ms. Larouche performs the following tasks: reviewing new contracts, recording monthly payments, preparing the payroll, preparing GST and Quebec sales tax (QST) returns and all other accounting tasks. Ms. Larouche confirmed that she spends approximately two hours per week on the appellant's debt recovery.

[6] Ms. Larouche stated that she is also responsible for payments made by clients of the fitness centre operated by the appellant. Thus, she makes ledger entries, opens new accounts, sets up pre-authorized payments and analyzes bank statements indicating the files for which there was a refusal of payment or objection. After receiving the list, Ms. Larouche ensures that clients in default of paying their membership fees are denied access to the fitness centre through the chip eReader. Ms. Larouche has a note placed on the clients' file stating the reason they are being denied access to the fitness centre and the amount they must pay to rectify the situation. She follows up with clients who no longer attend the fitness centre by telephone; Ms. Larouche noted that after the same client fails to pay two or three times the owner of the fitness centre calls the client to try to resolve the matter. Ms. Larouche stated that this procedure has been in place since 2013 but that she could not testify about the procedures in effect from 2009 to 2011. During her cross-examination, Ms. Larouche acknowledged that no letter or notice of default was sent to clients in default of payment. No other measure was put in place owing to the minimal amounts owed by each of the delinquent members.

[7] Ms. Larouche prepared a document filed as Exhibit A-1 entitled [TRANSLATION] "Recovery statistics for the 2013-2014 period." This document explains the percentage of the appellant's recovery of accounts for that period.

[8] The agent for the appellant then filed in a bundle, as Exhibit A-2, documents from 2010, 2011 and 2012 showing the follow-ups with clients. Ms. Larouche explained to the Court that these documents come from boxes that were kept on the

appellant's premises. She did not know the identity of the persons who prepared these documents. Counsel for the respondent objected to the introduction of the documents on the basis that the follow-ups concerned actions by the appellant prior to Ms. Larouche's arrival. In addition, counsel for the respondent indicated that the rules against hearsay must be applied to refuse the production of these documents. Indeed, counsel for the respondent cannot cross-examine the persons who prepared these documents. At the hearing, I took the documents under advisement. I will discuss the objection of counsel for the respondent further below.

[9] Mr. Tremblay noted that the appellant's shareholders, directors or officers were not here to testify today because they were unaware of the debt recovery methods during the years 2009 to 2011 and that, according to him, their testimonies would have served no useful purpose.

[10] Ms. Larouche then noted that the invoicing method changed in 2012. Previously, the contract was invoiced in full, regardless of the method of payment chosen by the member. Since 2012, payments are made monthly and the GST is also collected monthly and remitted thereafter.

[11] Mr. Tremblay filed in a bundle as Exhibit A-3 the list of unpaid contracts for each of the years 2009, 2010 and 2011. Said document was prepared by a computer specialist hired by the appellant. This person was not present at the hearing. Counsel for the respondent objected to the production of the document for the same reasons set out above regarding the evidence filed as Exhibit A-2. At the hearing, I took the document under advisement. I will discuss the objection of counsel for the respondent further below.

[12] Ms. Larouche confirmed in her testimony that all the unpaid invoices pertaining to the contracts are indicated in the computer system. I must note, however, that none of those invoices was adduced at the hearing.

[13] Finally, Ms. Larouche confirmed that it was in reviewing Exhibit A-3 that she determined in 2013 that the debts under review were bad. She however agreed that she did not review all the contracts from 2009 to 2011 to determine the amount of the bad debts.

[14] On her cross-examination, Ms. Larouche agreed that she did not work on calculating the amount of the bad debts, she did not file the GST return (as Mr. Tremblay took care of it) and she does not know whether the GST amounts pertaining to the so-called irrecoverable accounts were remitted to the Minister.

Moreover, Ms. Larouche agreed that she had no knowledge of the appellant's financial statements and cannot testify as to the deferred income of $152,103 shown on the financial statements of December 31, 2012. I will address that amount below.

[15] Marcel Tremblay also testified at the hearing. He mentioned to the Court that, when he accepted the appellant's mandate in 2013 or late 2012, the appellant did not have an internal accountant. According to him, the sales management system was acceptable and no changes were made in that regard.

[16] He stated to the Court that, as indicated in the document filed as Exhibit A-3, the total of the amounts listed under the heading [TRANSLATION] "Accounts Receivable" of $17,964.08 for 2009, $17,142.16 for 2010 and 40% of that amount ($80,272) for 2010 is considered bad debt. Thus, that is the amount he used to claim the tax deduction for bad debts at issue in this appeal. He confirmed to the Court that the amounts entered as bad debts were never recovered by the appellant. However, on cross-examination, Mr. Tremblay stated that he relied on the figures provided by the computer specialist, as indicated on document A-3, to determine the amount of the bad debts; he used the figures as indicated and prepared the claim for a GST deduction at issue based on those figures. He also agreed that he is unaware whether those amounts were recovered; he assumed that none of those amounts was paid and that the debts were all outstanding.

[17] Mr. Tremblay stated that he did not carry out a comprehensive review of the invoices; he added that, according to him, amounts outstanding in 2013 dating from 2009 can be considered uncollectible.

[18] Mr. Tremblay added that, because the invoicing method was changed for 2012 and subsequent years, the appellant will no longer have bad debts as amounts owing are paid monthly and GST is collected monthly also.

[19] Mr. Tremblay indicated that the write-off of bad debts was accounted for in the accounting books. He produced a document as Exhibit A-4 at the hearing entitled [TRANSLATION] "List of accounts with transactions" for the periods ending March 31, 2013. On this document, there are three entries entitled [TRANSLATION] "doubtful debts" (with reference codes) and the amounts indicated beside the entries are $795.75, $759.34 and $3,523.06, respectively, for a total of $5,078.15. It should be noted that these amounts represent the GST and not the amount of the bad debts. Mr. Tremblay explained to the Court that this is only one page of the 37 page document and that the full document was sent to the auditor of the file.

The document filed as Exhibit A-4 is the GST account recorded in the general ledger.

[20] Mr. Tremblay explained to the Court that the recovery procedures put in place by the appellant are standard procedures in this type of industry. He added that no further action will be taken to collect the amounts owing.

[21] Mr. Tremblay added that, because he performed a review engagement and did not prepare audited financial statements, he did not ask to review the general ledgers kept by the appellant's former accountants. He confirmed to the Court that he never reviewed the accounting books from the years 2009 to 2011 kept by the appellant's former accountants. He assumed that the appellant had a debt of approximately $52,000 on account of services not rendered.

[22] In that regard, paragraph 3 of the Notice of Appeal prepared by Mr. Tremblay indicates as follows:

> [TRANSLATION]
>
> 3. In January 2013 the appellant changed accounting firms and the new firm noticed $152,103 in deferred income recorded in the financial statements as at December 31, 2012. That amount represented the invoiced contracts deducted from the sales year after year for which services had not been rendered and for which payments had not been collected. In 2012, the deferred income increased to $55,139 from the previous year, as appears from a copy of the financial statements produced by the firm Groupe Profisc as at December 31, 2012, filed in support of this Notice of Appeal as Exhibit R-2.

[23] Mr. Tremblay explained to the Court that the deferred income ($152,103) was added to the appellant's income and it was determined that a portion of it, approximately $52,000, was a bad debt. The $52,000 represents services not rendered and for which payments were not collected by the appellant.

[24] Émilie Thiffault stated to the Court that she audited the appellant's tax return for the period from January 1, 2013, to March 31, 2013, in which a deduction in determining the amount of net tax for bad debts was claimed and which is at issue. She asked Mr. Tremblay to explain the entries entitled [TRANSLATION] "doubtful debts". Mr. Tremblay did not provide the auditor with any documents to show that the debt was bad. Furthermore, Mr. Tremblay was unable to show that the GST had been remitted and paid in respect of the bad debts. Mr. Tremblay rather stated to Ms. Thiffault that after 12 months of default, an overdue account could be

considered a bad debt. Mr. Tremblay also stated to Ms. Thiffault that, since the appellant had changed accountants in 2012, he could not give her any information for the years prior to 2013. Also, Mr. Tremblay confirmed to Ms. Thiffault that the appellant's only method of recovering unpaid debts was via telephone.

[25] The last witness to take the witness stand was Ms. Légaré, objections officer. Ms. Légaré dealt with Mr. Tremblay regarding the claim for a deduction in respect of bad debts for the purpose of calculating the GST at issue. Mr. Tremblay did not provide her with any copies of the financial statements, accounting ledgers, tax returns for 2009 to 2011, or membership contracts. Mr. Tremblay did not provide her with any documents to support his calculations. He only provided her with a very brief document accounting for the bad debts. As for the recovery measures taken by the appellant, Mr. Tremblay stated that the appellant claims its debts by telephone and that a person spends about 30 hours per week attempting to recover the amounts owing. Furthermore, Mr. Tremblay did not provide Ms. Légaré with any evidence as to the debt write-off in the books of account.

II. Issue

[26] Was the appellant justified in claiming a deduction in determining the amount of its net tax under subsection 231(1) of the Act in respect of the bad debts for the 2009, 2010 and 2011 taxation years in its GST return covering the period from January 1, 2013, to March 31, 2013?

III. Position of the parties

[27] The appellant submits that it is entitled to the deduction in respect of the bad debts under subsection 231(1) of the Act given that the debts from 2009 to 2011 are bad debts and that is wrote off the debts in its books of account in 2013.

[28] According to the respondent, the conditions for the application of subsection 231(1) of the Act are not met in this case, as the debts from 2009 to 2011 are not bad debts under the Act and there is no evidence of the amount of such debts.

IV. Preliminary issue: rules of evidence

[29] Before turning to the issue in this case, I must respond to the objections raised by counsel for the respondent to the documents produced as Exhibits A-1, A-2 and A-3.

[30] The rule of evidence in informal procedure cases is set out at subsection 18.15(3) of the *Tax Court of Canada Act*:

> 18.15(3) Notwithstanding the provisions of the Act under which the appeal arises, the Court is not bound by any legal or technical rules of evidence in conducting a hearing and the appeal shall be dealt with by the Court as informally and expeditiously as the circumstances and considerations of fairness permit.

[31] The Federal Court of Appeal considered this provision in *Selmeci v. R.*, 2002 FCA 293. It concluded that this provision of the *Tax Court of Canada* does not mean that no rules of evidence apply in informal procedure cases, but that the judge "has judicial discretion to disregard the rules of evidence when an appeal is heard under the Informal Procedure, in order to hear the appeal as informally and expeditiously as the circumstances and considerations of fairness permit" (para. 4).

[32] The Federal Court of Appeal also discussed the importance of the hearsay rule in informal procedure matters before the Tax Court of Canada:

> [6] The hearsay rule is of special prominence in our legal system and the problems that hearsay evidence creates, whether in a criminal or civil setting, are constantly being reviewed (see, for example, *R. v. B (K.G.)*, [1993] 1 S.C.R. 740, at 763; *R. v. Starr*, [2000] 2 S.C.R. 144, at 228, at para. 159). These problems include the absence of an oath or solemn affirmation, the inability of the trier of fact to assess the demeanour and credibility of the declarant or the accuracy of the purported statement and the lack of contemporaneous cross-examination by the opposing party. The fundamental reason for the exclusion of hearsay documents is the lack of an adequate opportunity to test the reliability of a witness's statement. Hence, in *R. v. Khan*, [1990] 2 S.C.R. 531 and *R. v. Smith*, [1992] 2 S.C.R. 915 it was held that, if satisfied that evidence is both necessary and reliable, a trial judge may admit it notwithstanding that it is hearsay evidence and inadmissible under one of the exceptions to the exclusionary hearsay rule.
>
> [7] One of the difficulties facing a party in responding to adverse evidence is that the *Tax Court of Canada Rules (Informal Procedure)* appear not to require the parties to disclose their documentary evidence in advance of trial by using the normal document discovery process. At a trial conducted under the Informal Procedure, a party may attempt to introduce a written statement by an individual not present in court. The party opposite, confronted for the first time with this document, is then deprived of the right to cross-examine the author and, without an adjournment, may be denied as adequate opportunity to present independent evidence to contradict or explain the statement or put it in its proper context. Consequently, the absolute abolition of the hearsay rule under the Informal Procedure could lead to serious injustice as any findings by the Tax Court Judge

> as to the reliability or weight of the statement in such circumstances would be based on speculation; the statement being untested.
>
> [8] The Tax Court Judge may not, however, reject evidence simply on the basis that it is hearsay and would not be admissible under one of the "exceptions", including Khan, supra. Under subsection 18.15(4), however, the Tax Court Judge has a broader discretion and may admit hearsay evidence even though it would not, for example, be sufficiently necessary to satisfy Khan, supra, but is nonetheless relevant and reliable. As Sharlow J.A. recently noted in Suchon v. The Queen, [2002] F.C.J. No. 972, 2002 FCA 282 at para. 32:
>
> > That is not to say that a Tax Court Judge in an informal proceeding is obliged to accept all evidence that is tendered. There is no such requirement. However, it is an error for a Tax Court Judge in an informal proceeding to reject evidence on technical legal grounds without considering whether, despite the ordinary rules of evidence or the provisions of the *Canada Evidence Act*, the evidence is sufficiently reliable and probative to justify its admission. In considering that question, the Tax Court Judge should consider a number of factors, including the amount of money at stake in the case and the probable cost to the parties of obtaining more formal proof of the facts in issue.
>
> At the core of this exercise of discretion is the facilitation of a fair and expeditious hearing.
>
> [9] By enacting subsection 18.15(4),[1] Parliament did not intend to eradicate the normal rules of evidence under the Informal Procedure. Rather, the provision was intended to provide Tax Court Judges with the necessary flexibility to enable them to deal as informally and expeditiously with an appeal as the circumstances of the case and considerations of fairness allow (see, for example, *Ainsley v. Canada* [1997] F.C.J. No. 701). However, it is open to judges to refuse to admit hearsay evidence where, in their opinion, its admission would not advance the statutory objectives prescribed in subsection 18.15(4).

[33] The Federal Court of Appeal considered subsection 18.15(3) more recently in *Madison v. The Queen*, 2012 FCA 80. In that case, the taxpayer appealed the decision of the Tax Court judge of the to refuse to admit the file notes the taxpayer took out of a conversation of a telephone call. The Tax Court judge did not admit the document as evidence on the basis that it was hearsay. The Federal Court of Appeal came to the following conclusion:

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[1] Subsection 18.15(3) of the *Tax Court of Canada Act* replaced subsection 18.15(4) referred to in this quotation.

> [11] It is an error of law to exclude evidence solely on the basis that it is hearsay without first considering whether it is necessary and reliable (see *R. v. Khan*, [1990] 2 S.C.R. 531 and *R. v. Smith*, [1992] 2 S.C.R. 915). More importantly in the present context, it is an error of law to exclude hearsay evidence in a Tax Court proceeding conducted under the informal procedure rules without first considering whether it is sufficiently reliable and probative to justify its admission, taking into account the need for a fair and expeditious hearing (*Selmeci v. Canada*, 2002 FCA 293, at paragraph 8).

[34] Of course, if the judge decides to admit hearsay evidence, he will then have to assess its probative value.

[35] The parties provided me with written submissions as to the admissibility of the documents produced as Exhibits A-1, A-2 and A-3.

[36] According to counsel for the respondent, the element of necessity is not present here as the witnesses' absence is not the result of a death, serious illness or the fact that it would be too onerous to have witnesses summoned.

[37] However, as noted by the Federal Court of Appeal in *Selmeci* and *Madison*, *supra*, the Tax Court judge dealing with an informal procedure case can accept hearsay evidence even if the criteria of necessity in *Khan*, *supra*, are not present if such evidence is nonetheless reliable and probative (or relevant) to facilitate a fair and expeditious hearing.

[38] Thus, even if the element of necessity is not present here, I can accept the filing of documents even if such evidence is reliable and probative (or relevant).

[39] More particularly, with respect to the documents produced as Exhibit A-2, counsel for the respondent submits that to allow the filing of said documents to prove the debts or the recovery measures taken cannot be considered without causing serious prejudice to the respondent; also, in his view, said documents do not meet the degree of reliability required by the case law.

[40] I must therefore determine whether the documents filed in a bundle as Exhibit A-2 are reliable and probative (or relevant). In my view, the criterion of reliability is not met in this case. According to Mr. Tremblay, these documents come from boxes that were kept on the appellant's premises; as mentioned above, no one from the appellant testified at the hearing to explain the contents of such documents. Even in an informal procedure case, I cannot accept the filing in evidence of such documents.

[41] As for the documents produced as Exhibit A-3, counsel for the respondent is of the view that, because he cannot cross-examine the computer specialist or any one from the appellant about the origins of these documents, it is impossible to verify the reliability and validity of the information they contain. In addition, in his view, the value of the information is limited because the documents are not dated and no contract or invoice was filed at the hearing.

[42] At the hearing, Mr. Tremblay explained that he used the amounts indicated in the documents to claim the tax deduction at issue; however, he did not thoroughly examine the contracts and used the figures as such. He even agreed on cross-examination that he does not know whether the debts were paid and assumed that none of these debts was paid to the appellant during the subsequent years and that they were still all outstanding.

[43] I must determine whether the documents filed as Exhibit A-3 are reliable and probative (or relevant). In my view, the documents are reliable and probative. The documents consist of three separate documents, one document for each of the 2009, 2010 and 2011 taxation years. Said documents indicate in table form, for each of the years, the details of the contracts for which amounts are outstanding, namely, the name of the client and the invoice number, the details of the taxes in respect of each of the contracts as well as the outstanding amounts for each of the contracts. Under each of the tables prepared for each of the years, a summary is given of the total sales, the GST and the QST received, the amounts owing and the accounts receivable. While the computer specialist who prepared said documents did not testify at the hearing, I will accept the filing of these documents with a view to a fair and expeditious hearing. However, in my analysis, I must assess the probative value to be assigned to the documents produced as Exhibit A-3.

[44] Finally, counsel for the respondent submitted that the document produced as Exhibit A-1 was irrelevant as it covers a period after the period in issue and that the document is hearsay as the figures used were collected from documents that were not filed in evidence. Said document was prepared by Ms. Larouche and indicates the recovery statistics for the appellant’s accounts for the period from 2013 to 2014. In my view, said document is irrelevant as it only shows the recovery rate for the appellant’s accounts for a period subsequent to the dispute. I would therefore not allow said document to be filed as evidence.

V. Legislation and analysis

[45] Under subsection 231(1) of the Act, a supplier can claim a deduction, in determining the supplier's net tax, for bad debts:

> 231. (1) If a supplier has made a taxable supply (other than a zero-rated supply) for consideration to a recipient with whom the supplier was dealing at arm's length, it is established that all or a part of the total of the consideration and tax payable in respect of the supply has become a bad debt and the supplier at any time writes off the bad debt in the supplier's books of account, the reporting entity for the supply may, in determining the reporting entity's net tax for the reporting period that includes that time or for a subsequent reporting period, deduct the amount determined by the formula
>
> A × B/C
>
> where
>
> A is the tax in respect of the supply;
>
> B is the total of the consideration, tax and applicable provincial tax remaining unpaid in respect of the supply that was written off at that time as a bad debt; and
>
> C is the total of the consideration, tax and applicable provincial tax in respect of the supply.
>
> (1.1) A reporting entity is not entitled to deduct an amount under subsection (1) in respect of a supply unless
>
> (*a*) the tax collectible in respect of the supply is included in determining the amount of net tax reported in the reporting entity's return under this Division for the reporting period in which the tax became collectible; and
>
> (*b*) all net tax remittable, if any, as reported in that return is remitted.
>
> (3) If all or part of a bad debt in respect of which a person has made a deduction under this section is recovered at any time, the person shall, in determining the person's net tax for the reporting period that includes that time, add the amount determined by the formula
>
> A × B/C
>
> where

> A is the amount of the bad debt recovered at that time;
>
> B is the tax in respect of the supply to which the bad debt relates; and
>
> C is the total of the consideration, tax and applicable provincial tax in respect of the supply.
>
> (4) A person may not claim a deduction under this section in respect of a bad debt relating to a supply unless the deduction is claimed in a return under this Division filed within four years after the day on or before which a return of the person was required to be filed for the reporting period in which the supplier has written off the bad debt in its books of account.

. . .

[46] Subsection 231(1) of the Act imposes a number of conditions before a person (the supplier) can claim a deduction under this subsection:

1- The supplier must have made a taxable supply for consideration.

2- The recipient of the supply must have been dealing with the supplier at arm's length.

3- All or a part of the total of the consideration AND tax payable in respect of the supply has become a bad debt.

4- The supplier at any time writes off the bad debt in the supplier's books of account (that time must be included in the reporting period or for a subsequent reporting period in which the deduction is claimed or be prior to the reporting period).

5- The tax collectible in respect of the supply is included in determining the amount of net tax reported in the reporting entity's return under this Act for the reporting period in which the tax became collectible.

6- The net tax remittable as reported in the return referred to in item 5 above is remitted in full to the Minister.

[47] The grounds raised by the respondent in disallowing the tax deduction under subsection 231(1) of the Act are that the amount of the debts has not been established by the appellant and that, in addition, these debts are not bad debts within the meaning of the Act.

Taxable supply for a consideration or amount of the debts

[48] As mentioned by Mr. Tremblay and as indicated in paragraph 3 of the Notice of Appeal, the amount showing in the appellant's financial statements as of December 31, 2012, as deferred income is $152,103. According to Mr. Tremblay's testimony, that amount represents the invoiced contracts deducted from the sales year after year for which services have not been rendered and for which payments have not been collected. Again, according to Mr. Tremblay, that amount of deferred income was added to the appellant's income and it was determined that part of that amount, approximately $52,000, represented bad debts.

[49] Thus, according to the appellant's submissions, that amount represents the amounts owing under contracts for which services have not been rendered by the appellant; moreover, that amount is equal to the debts not collected by the appellant.

[50] According to the evidence adduced by the appellant, when clients do not pay, the appellant's services are not provided; indeed, the magnetic chip allowing access to the appellant's premises is deactivated. Thus, the appellant does not provide services during that time. I have difficulty reconciling the fact that the appellant made a taxable supply in these specific cases.

[51] However, that is a question that I need not answer in this case, as I am of the view that the appellant failed to prove the amount of the debts on a balance of probabilities.

[52] Mr. Tremblay attempted to demonstrate at the hearing the amount of the debts, which, based on his assessment, are bad. To demonstrate this, at the hearing he filed the documents as Exhibit A-3. As previously mentioned, said documents were prepared by a computer specialist hired by the appellant. The documents consist of three separate documents, one document for each of the 2009, 2010 and 2011 taxation years. Said documents indicate in table form, for each of the years, the details of the contracts for which amounts are outstanding, namely, the name of the client and the invoice number, the details of the taxes in respect of each of the contracts as well as the outstanding amounts for each of the contracts. Under each of the tables prepared for each of the years, a summary is given of the total sales, the GST and the QST received, the amounts owing and the accounts receivable.

[53] At the hearing, Mr. Tremblay explained to the Court that he used the amounts indicated in the documents to claim the tax deduction at issue; however,

he agreed that he did not thoroughly examine the contracts and used the figures as such. He even admitted on cross-examination that he does not know whether the debts were subsequently paid and assumed that none of these debts was paid to the appellant during the subsequent years and that they were still all outstanding.

[54] Mr. Tremblay used the figures of the previous accountants without verifying them, assuming that those figures were accurate.

[55] In my view, there are too many unanswered questions about the documents produced as Exhibit A-3 for me to accept these documents as evidence of the amount of the so-called bad debts. I have no proof that the debts appearing in the documents produced as Exhibit A-3 were not paid during a subsequent year. Even Mr. Tremblay agreed that he does not know whether those amounts were paid in a subsequent year; Mr. Tremblay stated moreover that he relied on these documents without asking any questions; he also agreed that he did not thoroughly examine the invoices.

[56] Mr. Tremblay repeatedly stated that the auditor did not ask him to provide specific documents. It is the responsibility of taxpayers to prove that they are entitled to a deduction. They must provide tax authorities with documents that will allow them to ensure that the conditions for entitlement to a deduction are met.

<u>All or a part of the total of the consideration AND tax payable in respect of the supply has become a bad debt</u>

[57] Another condition provided for in subsection 231(1) of the Act that is at issue is whether all or a part of the total of the consideration and tax payable in respect of the supply has become a bad debt.

[58] This issue has been repeatedly addressed by the case law.

[59] In *Rich v. R.*, 2003 FCA 38, 2003 CarswellNat 635, the Federal Court of Appeal provided a summary of the generally applicable criteria for making this determination:

> [13] I would summarize factors that I think usually should be taken into account in determining whether a debt has become bad as:
>
> 1. the history and age of the debt;

> 2. the financial position of the debtor, its revenues and expenses, whether it is earning income or incurring losses, its cash flow and its assets, liabilities and liquidity;
>
> 3. changes in total sales as compared with prior years;
>
> 4. the debtor's cash, accounts receivable and other current assets at the relevant time and as compared with prior years;
>
> 5. the debtor's accounts payable and other current liabilities at the relevant time and as compared with prior years;
>
> 6. the general business conditions in the country, the community of the debtor, and in the debtor's line of business; and
>
> 7. the past experience of the taxpayer with writing off bad debts..
>
> This list is not exhaustive and, in different circumstances, one factor or another may be more important.
>
> [14] While future prospects of the debtor company may be relevant in some cases, the predominant considerations would normally be past and present. If there is some evidence of an event that will probably occur in the future that would suggest that the debt is collectible on the happening of the event, the future event should be considered. If future considerations are only speculative, they would not be material in an assessment of whether a past due debt is collectible.
>
> [15] Nor is it necessary for a creditor to exhaust all possible recourses of collection. All that is required is an honest and reasonable assessment. Indeed, should a bad debt subsequently be collected in whole or in part, the amount collected is taken into income in the year it is received.
>
> . . .
>
> [23] However, there is no legal requirement that proactive steps be taken in all cases. The obligation to take such steps will only arise where there is some evidence to show that collection on the loan is reasonably possible. This, of course, would include cases in which the Minister has assumed that collection was reasonably possible and the taxpayer has failed to address or has inadequately addressed that assumption.

[60] In *Davies v. R.*, [1998] G.S.T.C. 58 (T.C.C.), Judge Hamlyn of this Court denied an input tax credit in respect of a bad debt, particularly because the appellant did not take the appropriate steps to recover the amount of the debt:

> [13] The test of whether a debt is bad is essentially a subjective determination, that is, did the Appellant find the debt to be bad. As in all cases, the determination must not be contrived and the finding must be reasonable on the facts. Towards this end, the Appellant must show the Court whether he considered the amount to be uncollectible and unrecoverable.
>
> . . .
>
> [18] In particular, the Appellant did little to attempt to collect the debt. He made a few phone calls and wrote letters while at the same time the Appellant carried on his franchise operation and recorded his liabilities (royalties) owed to the franchisor as they were incurred on the books of his business. He made no attempt to take legal redress action nor did he seek settlement from those monies owed to him by the franchisor against those monies owed by him to the franchisor. I find the evidence is weak, that the Appellant took no reasonable steps to determine if the debts were uncollectible and unrecoverable, and as such has not met the onus the debts were bad.

[61] This case was cited with approval in *Paquin v. R.*, 2004 CarswellNat 3006, 2004 TCC 597.

[62] Finally, in *Ministic Air Ltd. v. R.*, 2008 TCC 296, 2008 CarswellNat 3271, Justice Bowie of this Court stated:

> [12] It is a question of fact whether a debt has been established to be uncollectible. It is not sufficient that the debt has been outstanding for a long period of time. The taxpayer must have taken reasonable measures to collect the debt, without success, and have concluded that it is unlikely that it will be paid. In the present case, there is little evidence as to the actual measures taken by the appellant to collect any specific debt. The appellant's evidence was general as to the unwillingness of its debtors to pay their accounts, particularly those who were owed money by Garden Hill. They, perhaps understandably, were unwilling to pay their accounts to a corporation whose shares were almost all owned by Garden Hill. I do not consider the generalizations that made up the evidence of Ms. Fraser and Mr. Brotherston on this issue to be sufficient. The debts must be considered and found to be uncollectible on an individual basis, and the evidence simply did not demonstrate that that had ever been done. Instead, Ms. Fraser simply decided at some time after the company ceased operating that all its receivables should be written off.

[63] In the appellant's case, the criteria set out in *Rich*, *supra*, apart from the history and age of the debt, are difficult to apply given the large number of debts and the relatively small amounts of each of the debts taken in isolation.

[64] In order to conclude that a debt is bad, I must determine whether the creditor took reasonable measures, without success, to collect the debt. In my view, the appellant did not adduce sufficient evidence, on a balance of probabilities, that could permit me to find that it took such measures in this case.

[65] Mr. Tremblay repeatedly noted that the passage of time alone justified considering a debt as being bad. I cannot agree with that proposition. Indeed, it is clear that this alone is not sufficient to conclude that a debt is bad.

[66] Mr. Tremblay added that the recovery procedure used was a standard procedure used in this type of industry. Again, Mr. Tremblay's assertion alone does not allow me to conclude that the debts are bad.

[67] Ms. Larouche explained to the Court the procedure she has been using since late 2012 to collect monies owing to the appellant. Ms. Larouche spends approximately two hours of work per week trying to collect payments from clients in default. First, she deactivates the magnetic chip that allows access to the appellant's premises and, then, she calls the client who owes the debt. After more than two unsuccessful attempts, the boss places the call. Ms. Larouche admitted that this procedure has been in place since 2013 and she was unable to testify regarding the procedures in place from 2009 to 2011. Did she attempt to collect the debts from 2009, 2010 and 2011? No evidence was provided to me in that regard. During her cross-examination, Ms. Larouche acknowledged that no letter or notice of default was sent to clients in default of payment, whereas at paragraph 5 of the Notice of Appeal, the appellant indicated that letters were sent to debtors to claim the amounts owing. No officer of the appellant testified at the hearing. No evidence was provided about the procedures followed to recover the debts from 2009, 2010 and 2011.

[68] In my view, the evidence adduced by the appellant does not allow me to conclude that the debts of 2009, 2010 and 2011 are bad.

[69] The appeal is therefore dismissed, without costs.

Signed at Ottawa, Canada, this 1st day of September 2015.

"Dominique Lafleur"

Lafleur J.

Translation certified true
on this 20th day of October 2015
Daniela Guglietta, Translator

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