Docket: 2011-3058(IT)G,

BETWEEN:

LISE LAVOIE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on common evidence with the appeal of Jean-Yves Côté, 2012-382(IT)G, on December 12, 2013, at Montréal, Quebec.

Before: The Honourable Justice Gaston Jorré

Judgment rendered by the Honourable Justice Pierre Archambault

Appearances:

Counsel for the appellant:	Claude Germain
Counsel for the respondent:	Simon Vincent

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* (Act) for the 2008 taxation year is allowed with costs, and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the penalty assessed under subsection 163(2) of the Act is cancelled.

Signed at Vancouver, British Columbia, this 24th day of September 2015.

"Pierre Archambault"

Archambault J.

Translation certified true
on this 25th day of May 2016.

François Brunet, Revisor

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BETWEEN:

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Appellant,

and

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Citation: 2015 TCC 228
Date: 20150924
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REASONS FOR JUDGMENT

Archambault J.

[1] Jean-Yves Côté and Lise Lavoie (the **Côté-Lavoie couple,**[1] **the couple** or **the two taxpayers**) are appealing[2] from an assessment made by the Minister of National Revenue (**Minister**) for the 2008 taxation year. The issue is the same in both appeals, namely, whether the Minister was justified in assessing the penalty

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1 The two taxpayers are spouses.

2 Class A appeal for Ms. Lavoie and Class B appeal for Mr. Côté, according to the admissions of the parties at the hearing. See p. 4 of the transcript.

provided for in subsection 163(2) of the *Income Tax Act* (Act).[3] Only the amount in issue is different.

[2] In his income tax return for 2008, Mr. Côté reported a business loss of $919,440.31 listed in a "Statement of Agent Activities For: JEAN-YVES COTE."[4] In that statement, a gross income of $342,717.31 was reported as "Money Collected as Agent for Principal and reported by third parties." Added to that amount was an additional amount of $61,689.12 representing "Additional Money Collected as Agent for Principal and not reported by third parties" for a total of $404,406.43. From that amount $981,129.43 was deducted, described as an "Amount to principal in exchange for labour," for a net loss of $576,723. Also deducted from that amount were the amounts collected that were reported by third parties totalling $342,717.31, amounting to a net loss of $919,440.31. Said loss cancelled the inclusion in the income of $200,275.35 received from employment and a taxable dividend amount of $161,332.80, resulting in negative income of $557,523.[5] The significance of the loss generated in 2008 also allowed Mr. Côté to claim a loss carryback for the previous three years, 2005, 2006 and 2007 in the amounts of $138,425, $262,097 and $176,201, respectively.[6]

[3] On October 7, 2010, the Minister issued an assessment for the 2008 taxation year whereby he increased the income of Mr. Côté by $919,440. In addition to the income adjustment, he assessed a penalty of $93,820.97 under subsection 163(2) of the Act. Added to that penalty is a penalty of $455.42 for late filing.[7]

[4] As a result of the notice of objection filed by Mr. Côté, the Minister confirmed the assessment, and Mr. Côté appealed to the Tax Court of Canada. The sole issue is whether the penalty assessed under subsection 163(2) of the Act was justified. Mr. Côté acknowledged that he was not entitled to the loss of $919,440.31.[8]

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3 See pp. 4 and 5 of the transcript.
4 See Exhibit I-1, Tab 1, p. 7.
5 See Exhibit I-1, Tab 1, p. 8.
6 See Exhibit I-1, Tab 5, p. 2.
7 See Exhibit I-1, Tab 2.
8 See p. 15 of the transcript.

[5] Ms. Lavoie took a similar approach. The amount of the business loss that she reported was $418,185.58,[9] which also resulted in a loss carryback for 2005 to 2007 in the amounts of $72,178, $112,796 and $303,302, respectively.[10] In his initial assessment, the Minister allowed the business loss and loss carryback. Subsequently, in the reassessment dated October 13, 2010, he also disallowed the loss of $418,185.58. The amount of the penalty assessed under subsection 163(2) was $45,906.06, and the sole issue is whether this penalty was justified.[11]

[6] With the agreement of the parties, the Chief Justice of this Court requested that the undersigned judge render the decision based on the transcript (**transcript**) of the testimony given at the hearing of December 12, 2013, and the documents submitted in evidence at the time before Justice Jorré, including the transcript (**discovery transcript**) of the testimony given by the couple on an examination for discovery.

[7] As the statement of evidence will show in greater detail, this is another one of those cases where taxpayers abused trust and were lured into a scheme (**preposterous scheme**) put in place by unscrupulous promoters who led a number of Canadian taxpayers to believe that they could essentially claim losses for the maintenance of individuals, who, based on this scheme, have a dual personality. Therefore, taxpayers believed that they created losses that reduced their tax obligation to zero and entitled them to a loss carryback for previous years. The exact role of the promoters in this case is not very clear as the Minister, who had the burden of proof, did not call them to testify to provide further details about this preposterous scheme. Indeed, only the two taxpayers and the appeals officer testified at the hearing.

[8] Armed with case law that has on numerous occasions confirmed the penalties assessed by the Minister in cases similar to this one—numerous decisions of this nature were reproduced in the respondent's book of authorities—the Minister attempted to justify the assessment of the 50% penalty. This action of the Minister is understandable given the abusive and preposterous nature of the scheme put in place by the promoters. The names Fiscal Arbitrators and

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9 See Exhibit I-2, Tab 1, p. 3.

10 See Exhibit I-2, Tab 5, p. 2.

11 See Exhibit I-2, Tab 2, p. 1. The Minister also made reassessments for 2005 to 2007, to deny the loss carrybacks.

Frieslander Financial Inc. constantly appear in the documentation submitted in evidence in these two appeals.

[9] The specific issue is whether the Minister was able to justify the assessment of the penalty under subsection 163(2) of the Act, that is to say, whether the two taxpayers "knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form. . . filed or made in respect of a taxation year for the purposes of this Act."

[10] It is important to note the applicable general principles for resolving the issue raised by the two appeals. First, as stated in subsection 163(3) of the Act, the burden of establishing the facts justifying the assessment of the penalty is on the Minister.

[11] It is also recognized that each case must be considered on its own merits and that the facts must be given careful consideration by the Court to determine whether the Minister was able to meet his burden of proof.

[12] During oral argument, counsel for the Minister did not argue that the two taxpayers knowingly made a false statement or omission in their returns. The sole issue before the Court is whether there were "circumstances amounting to gross negligence." The leading case defining what constitutes such circumstances is *Venne v. Canada (Minister of National Revenue)*, [1984] F.C.J. No. 314 (QL), [1984] C.T.C. 223, 84 DTC 6247. In that decision, Judge Strayer wrote the following:

> (4) Imposition of penalties - As noted earlier, in order for the defendant to levy penalties under subsection 163(2) of the *Income Tax Act* it is necessary that the taxpayer have "knowingly, or under circumstances amounting to gross negligence . . . participated in, assented to or acquiesced in the making of" a false statement in a return, etc. The similar language of sub-section 56(2) of the former *Income Tax Act* was interpreted by Cattanach, J. in *Udell v. Minister of National Revenue* (1969) 70 DTC 6019 (Ex.Ct.). In that case a farmer had retained a certified public accountant to prepare his income tax returns. The accountant made several errors in different taxation years in the process of transposing figures from the taxpayer's account books to his working papers. In some of the years in question the accountant signed the returns on behalf of the taxpayer before they were seen by the latter and in other years the taxpayer reviewed them first and then signed

them. He apparently did not notice any errors. The Minister of National Revenue assessed penalties with respect to these errors. In interpreting the language now found in sub-section 16 3(2) of the present *Income Tax Act*, Cattanach, J. said, at pages 6025-26:

> Accordingly there remains the question of whether or not section 56(2) contemplates that the gross negligence of the appellant's agent, the professional accountant, can be attributed to the appellant. Each of the verbs in the language "participated in, assented to or acquiesced in" connotes an element of knowledge on the part of the principal and that there must be concurrence of the principal's will to the act or omission of his agent, or a tacit and silent concurrence therein. The other verb used in section 56(2) is "has made". The question, therefore, is whether the ordinary principles of agency would apply, that is, that what one does by an agent, one does by himself, and the principal is liable for the actions of his agent purporting to act in the scope of his authority even though no express command or privity of the principal be proved.
>
> In my view the use of the verb "made" in the context in which it is used also involves a deliberate and intentional consciousness on the part of the principal to the act done which on the facts of this case was lacking in the appellant. He was not privy to the gross negligence of his accountant. This is most certainly a reasonable interpretation.
>
> I take it to be a clear rule of construction that in the imposition of a tax or a duty, and still more of a penalty if there be any fair and reasonable doubt the statute is to be construed so as to give the party sought to be charged the benefit of the doubt.

In coming to this interpretation the learned judge had regard to the fact that the sub-section in question is a penal provision and it must be interpreted restrictively so that if there is a reasonable interpretation which will avoid the penalty in a particular case that construction should be adopted. He concluded that the erroneous information in the returns was not included with the knowledge of the taxpayer nor could the gross negligence of the accountant be attributed to him.

It is also important to keep in mind in applying this sub-section that by sub-section 163(3) the burden of proof is on the defendant in justifying the assessment of a penalty.

I have come to the conclusion that the defendant has not sufficiently proven that the misstatements were made "knowingly" by the plaintiff in his tax returns for the years in question. I should note here, as it is relevant to the whole question of the application of penalties under sub-section 163(2), that there seems to be a certain element of subjectivity recognized in the case law with respect to assessing the knowledge or gross negligence of a taxpayer with respect to misstatements in his returns: see, e.g., *Howell v. Minister of National Revenue* (1981) 81 DTC 230 at 234 (T.R.B.); *Joris v. Minister of National Revenue* (1981) 81 DTC 470 at 472 (T.R.B.). The taxpayer here is a man with a grade five education, working and paying taxes in a language which is not his first language nor that in which he was educated, a man who is more at ease in a garage than in an office. Not only do these factors militate against a finding that the misstatements in his returns were made knowingly by him, but also his entire course of conduct is not consistent with that of a person who had deliberately set out to conceal large amounts of taxable income. He kept what appear to be quite complete records of sales in his business, then turned these over to his bookkeeper. As far as one can judge from the evidence, all or most of the revenues from the business were deposited in the bank where the monies could readily be traced. He also lodged all but one or two of the mortgages on which he lent money with banks and trust companies which kept careful records of the income earned from these "escrow mortgages". It is unlikely that a person planning to conceal income would have handled his affairs in this manner. Further it is hard to believe that he was consciously and effectively supervising his bookkeepers since a number of the errors made in his returns were to his disadvantage, even though more or them were to his advantage. I am therefore not able to conclude that the misstatements in the returns were made "knowingly" by the plaintiff.

With respect to the possibility of gross negligence, I have with some difficulty come to the conclusion that this has not been established either. "Gross negligence" must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not. I do not find that high degree of negligence in connection with the misstatements of business income. To be sure, the plaintiff did not exercise the care of a reasonable man and, as I have noted earlier, should have at least reviewed his tax returns before signing them. A reasonable man in doing so, having regard to other information available to him, would have been led to believe that something was amiss and would have pursued the matter further with his bookkeeper.

With respect to business income, I can more readily recognize that effective surveillance would have been difficult for the plaintiff and would have involved his making and reviewing numerous computations of revenues, expenditures, assets, and liabilities. In other words the errors in business income, small in some

years but very substantial in others, would not necessarily have "sprung out" at a person of the taxpayer's background and abilities. While it may have been naive for him to trust his bookkeeper as knowing more about such matters than he did, I do not think it was gross negligence for them to fail to challenge the bookkeeper with respect to the business computations. However egregious the errors committed by the bookkeepers in this respect, it is quite conceivable that they were not in fact noticed by the plaintiff and his neglect in not noticing them fell short of constituting gross negligence.[12] For other examples of such a situation see *Minister of National Revenue v. Weeks* [1972] C.T.C. 60 (F.C.T.D.); *Mark v. Minister of National Revenue* [1978] D.T.C. 2262 (T.R.B.); *Morgan et al v. Minister of National Revenue* (1973) D.T.C. 146 (T.R.B.).

With respect to most of the unreported interest income, however, I have more difficulty avoiding the conclusion that the plaintiff was grossly negligent. . . . I can only conclude that the plaintiff knew, or was readily able to ascertain, how much interest income he was earning year by year from mortgages and from bank accounts, trust company accounts, certificates of deposit and like instruments. This was not a difficult concept and well within the plaintiff's abilities which, the evidence demonstrates, easily included the addition of sums and the calculation of interest. His explanation for not reporting all his interest income, however, is that he was not concerned about possible discrepancies between the amount of interest he knew, or could ascertain, that he was earning, and the amount reported in his income tax returns, because he thought the T-5 issued by the banks and trust companies was the governing instrument indicating how much of the interest was taxable. That he might have reached such conclusion is not completely improbable because taxpayers have long been confused by a complex system of

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[12] The previous paragraph and this paragraph up to the reference to this footnote were cited as consistent with the case law and adopted by the Federal Court of Appeal in *Findlay v. Canada*, 2000 CanLII 15344, at paragraph 21. The approach described in *Venne* was also adopted in another Federal Court of Appeal decision, *Zsoldos v. Canada (Attorney General)*, 2004 FCA 338, 2004 CarswellNat 4958, 2004 DTC 6672, [2005] 1 C.T.C. 11, as reflected in these words by Justice Malone at para. 21:

> 21 It is clear under subsection 163(2). . . . In assessing the penalties for gross negligence, the Minister must prove a high degree of negligence, one that is tantamount to intentional acting or an indifference as to whether the law is complied with or not. (See *Venne v. Her Majesty The Queen* (1984), 84 D.T.C. 6247 at 6256 (F.C.T.D.).) A taxpayer may avoid these penalty provisions where he or she has relied on the erroneous advice of a tax advisor and has not knowingly failed to report income or a capital gain. (See *Findlay v. Her Majesty the Queen*, 2000 D.T.C. 6345 (FCA).) However, that is not our case. . . .

> taxation in which the taxable amount from certain sources does not always correspond to the amount actually received.
>
> It is difficult to decide whether a mistake such as this is one of fact or of law. . . . After reviewing a number of previous decisions on sub-section 163(2) or its predecessors I have been unable to find any clear authority on whether a mistake of law is a defense to the application of penalties thereunder. I am inclined to think that it can be, depending on the circumstances and the state of understanding of the taxpayer. One must keep in mind, as Cattanach, J. said in the Udell case supra that this is a penal provision and it must be construed strictly. The sub-section obviously does not seek to impose absolute liability but instead only authorizes penalties where there is a high degree of blameworthiness involving knowing or reckless misconduct. The section has in the past been applied subjectively to taxpayers, taking into account their intelligence, education, experience, etc., and I believe this implies that an ignorance of the law which is not unreasonable for the particular taxpayer in question and the particular circumstances may be acceptable as a defence to the application of penalties. On this basis, and having regard to the fact that the onus is on the Minister to prove that the penalty should be applied, I find the evidence ambiguous and therefore conclude that the penalty should not be applied even in respect of the unreported income from interest.
>
> I have therefore reached the conclusion that penalties under sub-section 163(2) may not be assessed on the unreported amounts of income arising during the years 1972 to 1978 inclusively.
>
> [Emphasis added.]

[13] It should be added that subsection 163(2) of the Act provided for a 25% penalty with respect to the relevant taxation year in *Venne*. If great care is necessary when the courts must interpret a penal provision, as suggested by Judge Cattanach in *Udell*, cited earlier in the passage from *Venne*, this is even more true and important when the penalty is 50%!

[14] It should also be noted that, in this last decision, Judge Strayer had to deal with not only the penalty under subsection 163(2) but also the application of subsection 152(4) of the Act, which allows the Minister to reopen previous assessments going back more than four years (at the time). Judge Strayer said: "It will be noted that for the penalty to be applicable there appears to be a higher degree of culpability required, involving either actual knowledge or gross negligence, than is the case under sub-section 152(4) for reopening assessments more than four years old where mere negligence seems to be sufficient."

[15] Although it is certainly useful to cite case law pertaining to Canadian taxpayers who used a scheme similar to the preposterous scheme, it is necessary to carefully apply the principles propounded by the case law, notably *Venne*, to determine whether the penalty is justified, even if the scheme is abusive and far-fetched. A meticulous analysis of the facts found at the hearing must be carried out in the light of these principles.

[16] As will be evident from the factual analysis in these two appeals, the Minister failed to establish that the two taxpayers made a false statement under circumstances amounting to gross negligence. I have not been persuaded here that the degree of culpability was sufficiently high for me to conclude that the penalty was applicable. In my view, this is not a case involving greater neglect than simply a failure to use reasonable care. There is no such high degree of negligence tantamount to intentional acting and an indifference as to whether the law is complied with or not.

[17] This case involves taxpayers with little education and little experience in taxation matters. On his examination for discovery, Mr. Côté indicated that he only had a Grade 6 education. At page 52 of the transcript, Mr. Côté described himself as being [TRANSLATION] "uneducated." Ms. Lavoie completed Secondary 1.[13] In addition, neither of them was knowledgeable enough to read and understand an English text, except for Ms. Lavoie in the limited context of her work. Mr. Côté's low level of education became evident in his examination for discovery when his lawyer asked him to address counsel for the Minister using the French "vous," and he did not know what that meant. (See Exhibit I-3, page 33.)

[18] It is true that Mr. Côté and Ms. Lavoie were involved in the management of their corporations. Indeed, Mr. Côté had two, as did Ms. Lavoie. The corporations had significant sales figures (approximately 10 million dollars[14]) for the type of business they ran, namely, the transportation of bulk material.[15] However, for the corporations to be successful, Mr. Côté had to invest a huge amount of time.[16] The

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13 See p. 113 of the transcript.

14 The corporations have 70 employees (p. 60 of the transcript).

15 Particularly concrete, gravel. See pp. 23 and 24 of the transcript.

16 MR. CÔTÉ: On Monday mornings, I start at 2:00. I'm there.
MS. GERMAIN: When you say 2:00, ---
MR. CÔTÉ: Two in the morning (2:00 a.m.). On Mondays, I finish around – when the garage is good to go, as there are four mechanics and one welder. Once everything is

evidence shows that Mr. Côté had to devote all his energy to ensuring the business success of his corporations.[17] It should also be borne in mind that Ms. Lavoie, who, essentially, assisted her husband[18] in the operation of their corporations, had previously acted as a representative for companies distributing hazardous materials used in welding, notably at GM plants.[19]

[19] Counsel for the respondent attempted to increase Ms. Lavoie's level of contribution to that of an accountant who was capable of understanding accounting concepts and appreciating the importance of numbers. However, her work entailed data entry, including data from invoices. She was also responsible for sending submissions and managing contracts.[20]

[20] The two taxpayers had to use the services of professionals, especially individuals with proficiency in accounting, to assist them with filing their income tax returns[21] and managing the business of their corporations. In particular, the two used the services of a bookkeeper.

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good to go, around 7:30-8:00 a.m., because my guys on the floor start at 5:00 a.m., and all the trucks have arrived.

On Tuesdays, I start later. I arrive at 3:15-3:30 a.m. From Tuesday to Thursday, I start at 3:00 or 3:15 a.m. I finish around 7:30 a.m. I finish when I have to.

On Fridays, I work longer. I never leave before 9:30-10:00 a.m.

On Saturdays, I prepare everything for the coming week, all follow-ups. Tire measurements and all that. I have over 900. I do what I can on Saturdays, I get there around 5:00 a.m. And on Saturdays I finish around noon.

On Sunday mornings, I check to make sure everything is there, and after that, I look at my receivables, my payables and everything that goes with that.

(See p. 61 of the transcript.)

(See also p. 48 of the discovery transcript, Exhibit I-3.)

(See also p. 114 of the transcript for corroboration by Ms. Lavoie.)

17 He is responsible for opening fence gates and preparing trucks to be driven by the employees of his corporations; he also looks after the trucks and breakdowns, and deals with obtaining transportation contracts. (See pp. 25, 62-63 of the transcript.)

18 Here is what she says about her work:

[TRANSLATION] "But everything, the trucks, the invoicing, billing, I hate all this, I hate it, working in offices. But for my husband, trucks and running all this, it's his passion, but for me, my passion is him." (p. 115 of the transcript.)

19 See pp. 112-113 of the transcript.

20 See p. 102 of the transcript.

21 See p. 26 of the transcript.

[21] In legal matters, Mr. Côté had been using, for him or his corporations, the services of a lawyer, Ferdinand Roy, for about thirty years. That lawyer had expertise in transportation law and made a significant contribution to the business operations of the corporations.

[22] He is also the same lawyer who convinced Mr. Côté to participate in the preposterous scheme. He began to raise doubts in Mr. Côté's mind by insinuating that he was paying too much tax. He convinced him to provide him with his income tax returns to be able to, in all likelihood, persuade Mr. Côté. That lawyer advised him to use the services of tax specialists (also known as the promoters in these reasons) who could advise him on how to reduce his taxes. This was not about evading the payment of taxes illegally.

[23] Since he was overly involved in the business operations of his corporations, Mr. Côté asked his wife, Ms. Lavoie, to attend an information meeting during which the representatives of the promoters likely explained the preposterous scheme. I say "likely" because it is not known exactly what was discussed at that meeting. It should also be noted that most of the meeting was conducted in English and that Ms. Lavoie did not understand English. She was accompanied by Mr. Roy, who provided her with the highlights of what was said. They described a way of paying lower taxes that was unknown to many accountants!

[24] Because he had been using the services of Mr. Roy, not only as his lawyer, but also as a lawyer for his corporations, for about thirty years and considered him a friend and honest man, Mr. Côté relied on the advice of that lawyer. Since the preposterous scheme was proposed by tax specialists based in either Toronto or Ottawa and everything was conducted in English, the two taxpayers, on the advice of their lawyer, agreed to sign income tax returns in which they indicated English as the language of correspondence and in which the aforementioned *Statement of Agent Activitie*s was inserted.

[25] Furthermore, the two taxpayers signed their income tax returns without reviewing the content thereof. The following is an excerpt from the testimony of Mr. Côté, at pages 27 to 29, which describes his approach:

> [TRANSLATION]

MR. VINCENT: Have you seen this document before? Have you gone through it, have you looked at it?

MR. CÔTÉ: Well, I signed it. I've seen it of course.

MR. VINCENT: Did you read it before you signed it?

MR. CÔTÉ: I couldn't read it, it's entirely in English. Besides, I've never filed income tax returns in my life.

MR. VINCENT: So, what you are saying to us is that you don't read English?

MR. CÔTÉ: Me, I don't speak English.

MR. VINCENT: So, you signed the income tax return despite the fact that it was in English and that you didn't understand it?

MR. CÔTÉ: That's right. We, when it comes to machinery, we buy machinery in Toronto, in Ontario, call it whatever you want, sign below and make arrangements to take care of your payments.

We can't speak with them, we don't speak English. Now, I'm equipped. I have lots of people who speak English at our work. I have two people.

MR. VINCENT: So you don't speak English, but did you at least go through it to see what the numbers looked like, because numbers, you can visibly understand them?

MR. CÔTÉ: Yes, numbers, I understand them.

What happened is that, Ms. Juneau has always filed my income tax returns. I have a lawyer who handles transportation matters, a very good lawyer who is recognized by the ACQ, Commission des transports. A man in his sixties, who – at one point told me, maybe a year ago, he said "Who does your income tax returns?" He said, "Is it Diane, upstairs here?"

He said, "Let me take a look at it." He said, "I'm sure, you have corporations and staff, you're going to look for money."

I don't handle that stuff.

At one point, he insisted. He looked at it and said "Leave it with me."

I said, "I don't have time for this."

I'm the guilty one. I sent my wife who is Lise Lavoie, I sent her to a session here in town. She came back with this and – my wife didn't even want to go. I'm the one who got her –excuse the expression – in deep trouble.

She went. She signed below too. That's why we're here.

MR. VINCENT: I'm going to ask the same question again.

MR. CÔTÉ: Yes.

> MR. VINCENT: Did you go through your income tax return?
>
> MR. CÔTÉ: Listen, sir, you know, he told me to sign there. He could have told me to go to the slaughterhouse and I would have signed there. It's lack of skill and ignorance.
>
> MR. VINCENT: I'm going to ask you my question for a third time. Did you go through your income tax return?
>
> MR. CÔTÉ: No. Where he told me to sign, like I told you maybe for the second or third time, I signed. I didn't know what I was signing. I relied on Ferdinand Roy.

[Emphasis added.]

[26] To not read an income tax return when signing it is not appropriate conduct and constitutes negligence.[22] Does this, however, represent a high degree of negligence constituting a type of wilful blindness and constituting a high degree of negligence amounting to gross negligence? I do not believe that to be the case here. First, it should be noted that the document is in English, a language Mr. Côté does not understand. Because of this, Mr. Côté normally signs important contracts in English, such as when purchasing machinery, without reading them: he only signs below. It is Mr. Roy who made him sign his tax return prepared by Ontario tax specialists, and he relied on his lawyer. He was negligent, but this conduct does not suggest wilful blindness regarding the fact that he was evading his taxes. As in *Venne*, even if he had read his income tax return, chances are that this would not have changed anything because his lawyer, in whom he had complete trust,[23] had already advised him on the preposterous scheme and had convinced him of its legality. The following is the testimony that Mr. Côté gave at the hearing on this issue, at pages 31 and 33 of the transcript:

> [TRANSLATION]
>
> MR. VINCENT: I'll be more specific, Mr. Côté. Did you know in signing your income tax return that what you were essentially asking was not to pay tax for 2008 and to recover all the taxes you paid for the three previous years. Were you aware of this when you signed the income tax return?

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[22] Mr. Côté himself acknowledged this at the hearing, thus indicating, in my view, his good faith in this matter. He stated the following at page 36 of the transcript [TRANSLATION]: "It's not right that I signed papers and that I didn't know what I was signing. It's my fault."

[23] See pp. 10, 16, 19 of the discovery transcript (Exhibit I-3).

MR. CÔTÉ: Yes.

MR. VINCENT: You knew?

MR. CÔTÉ: Yes.

MR. VINCENT: So what justified him, in your view, in making such a request?

MR. CÔTÉ: **Ferdinand told me that because I operated a business I was entitled to do so**.

MR. VINCENT: So Ferdinand Roy comes to see you and tells you that you are entitled to recover the taxes you paid for the last three years and that as for the tax that you would have had to pay for that year, you would not pay anything. That's what he told you?

MR. CÔTÉ: Yes, **and he said that I was within my rights to do so,** but I said – I didn't want to. I didn't have time for this.

. . .

MR. VINCENT: I'm going to ask my question again; did you have any doubts?

MR. CÔTÉ: **No, because these days, there are laws that come out that we don't know about.**

[Underlining and boldface added.]

[27] Ms. Lavoie stated the same thing at page 101 of the transcript:

[TRANSLATION]

MS. LAVOIE: Well, he's my lawyer. I trust him, and if it's not right, he knows what to do. I never imagined he would be involved in something like that. From where I stood, all of this was legal.[24]

[28] During the examination for discovery, at page 18 of his transcript, Mr. Côté's response to counsel for the respondent was as follows:

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[24] Ms. Lavoie also confirmed her husband's trust in the legality of the preposterous scheme, at p.116 of the transcript.
[TRANSLATION] Jean-Yves said: "It sounds super legal and Ferdinand, there's an information day and an information session or whatever the term is," he said: "I want you to go for me, you're my eyes, you're my ears and you'll report back to me."

> [TRANSLATION]
>
> [MR. VINCENT:] Didn't you find that a little odd?
>
> [MR. CÔTÉ] Well, I think he went back four years, something like that. And he said: there were things you were entitled to, I forget now, you never got that, you pay far too much tax. But I said: it seems to me that all of this doesn't make any sense. **But he said: look, just trust me.**[25]

[Underlining and boldface added.]

[29] And Mr. Côté trusted Mr. Roy, a man he described as honest, who worked for the government: [TRANSLATION] "But he has the reputation of an honest man. I listened to him, and I signed documents that were—and I didn't know what I was signing. It's like a finance contract, you know." (See pages 36 and 37 of the transcript. See also pages 64-68 of the transcript and page 16 of the discovery transcript (Exhibit I-3).) Even Mr. Côté's accountant trusted Mr. Roy. Mr. Côté's response to counsel for the respondent, who asked him whether he had consulted his accountant was as follows: [TRANSLATION] "She [Diane Juneau] said, 'I find this a little odd.' But she added, 'Ferdinand Roy, he knows where he's going. I'll wait and see.'"[26] Ms. Lavoie confirmed Mr. Roy's good reputation at page 115 of the transcript.

[30] It is also important to note that the couple did not fail to report all of its income. It is all there. This was even acknowledged by the auditor in his report recommending the penalty (Exhibit I-1, Tab 7, p. 5). The false statement in the return is the loss concocted by the alleged tax specialists that the couple's lawyer bonded. As seen in the passage quoted above, Mr. Côté was not looking for a scheme to evade his taxes at all costs. At page 57 of the discovery transcript, he made a statement that clearly describes, in my opinion, his good faith: [TRANSLATION] ". . . I don't want any trouble with the government. I said: I pay my bills, I pay my taxes. . . . " He did not have time for this because his work for his corporations kept him very busy. A legal professional told him he could report the loss and he did so based on that advice. The words of Judge Strayer in *Venne* are

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[25] Also see the following passages in which it is indicated that Mr. Roy told the two taxpayers to trust him or in which they themselves stated that they trusted him: pp. 35, 36, 56, 66, 67, 68, 69, 70, 102, 115.

[26] Pages 51-52 of the transcript.

entirely appropriate and applicable here. For ease of reference, I reproduce them again:

> . . . The taxpayer here is a man with a grade five education, working and paying taxes in a language which is not his first language nor that in which he was educated, a man who is more at ease in a garage than in an office. Not only do these factors militate against a finding that the misstatements in his returns were made knowingly by him, but also his entire course of conduct is not consistent with that of a person who had deliberately set out to conceal large amounts of taxable income. . . .

[Emphasis added.]

[31] The evidence amply shows that the subsequent correspondence between the tax authorities and the Côté-Lavoie couple was in English. With no knowledge of the English language, the couple submitted it to Mr. Roy, whom the two completely trusted. Even if they had been able to understand the scope of the documentation, their knowledge in tax matters was so limited that they would have, in any event, acted in the same manner because they placed all their trust in Mr. Roy regarding all legal matters.

[32] The email exchange between Ms. Lavoie and Mr. Roy can be found at Exhibit A-1, Tab 8. The exchange is from October 19, 2009, to December 24, 2011, as is clear from the table at the beginning of Tab 8. As shown in the analysis of this extensive documentation (about 130 pages long), the Côté-Lavoie couple relied entirely on the legal advice given to them by their lawyer, and there is no evidence in the email exchange of bad faith, such as an intention by the couple to evade payment of its taxes, for instance, by claiming a deduction in respect of losses to which it was not entitled.

[33] On the contrary, what can be seen from the evidence is that the two taxpayers are fair-minded people who kept their lawyer informed of any communication from the tax authorities and who were constantly told that their lawyer and the tax specialists in Ontario were handling the situation and they had to trust them! Rather, the testimonies provided above reveal taxpayers concerned about paying any amounts owing to the tax authorities. If the two taxpayers claimed the deduction of an alleged loss, it is because their lawyer made them believe that they were entitled to it.

[34] As evidenced by a number of excerpts taken from the email exchange between the couple and Mr. Roy, Mr. Roy either deliberately misguided his clients and friends or was so gullible that he believed in the preposterous scheme and convinced the couple to get involved.

[35] Such trust can be seen not only before the adoption of the preposterous scheme, but also after, in the conduct of the opposition that followed the issuance of the assessments by the Minister. The Minister did not accept the income tax return filed by Mr. Côté for 2008 or the loss carryback claimed in respect of 2005 to 2007, because, from the outset, he disallowed the taxpayer's repayment claim.

[36] It is clear from the description of the Statement of Agent Activities provided above that it was a preposterous claim. First, the amounts claimed were enormous for taxpayers who did not operate any businesses in the previous years. The income reported by Mr. Côté for 2008 is essentially income from employment and dividend income from his corporations. The only amount indicated as a business loss by Mr. Côté is the loss of $919,440. The evidence does not reveal the nature of the income claimed for 2005 to 2007. However, it is plausible that the only businesses operated were those of the corporations.

[37] Moreover, a mere reading of the Statement of Agent Activities by the Minister was very telling of the preposterous nature of the losses reported by the Côté-Lavoie couple. It is not at all surprising that the Minister disallowed a loss as high as $919,440 in such circumstances. What is rather surprising is that the Minister allowed the loss of $418,185.58 claimed by Ms. Lavoie in her 2008 income tax return, when she only reported primarily income of $118,213 from employment and interest income of $11,878. It should be said that it seems that the initial assessment was made expeditiously without a thorough review of the return filed with the Minister. As soon as a thorough review was initiated, the Minister determined, of course, that the loss of $418,185 claimed by Ms. Lavoie should be disallowed.

[38] It should be noted that the return at Tab 1 of the respondent's Exhibit I-2 does not include the income statement known as the Statement of Agent Activities. For affirmation that the statement was included in Ms. Lavoie's return, one must refer to the report entitled "Office Audit - Shawinigan Tax Centre Penalty Recommendation Report" at Tab 7 of Exhibit I-2. The second paragraph of that report reads as follows:

> The file was identified following her spouse's file that shows an important business loss related to "questionable business loss" (it was intercepted before assessment). Therefore we found important to question madam's business loss. This taxpayer included a "Statement of AGENT activities" and therefore shows the particular words used by these people involved in this scheme. The business loss was allowed at initial assessing without audit.

[39] As mentioned earlier, no one came to the hearing to provide details of the preposterous scheme proposed by the promoters. However, it can be understood by inference, on the basis of the documentation filed with the income tax return, notably the *Statement of Agent Activities* and the comments in the reports of the Minister's auditors, and given that the scheme was amply described in other decisions regarding the same promoters, that this is a scheme based on the concept of the dual personality of individuals and that, as part of this scheme, the expenses incurred by said individuals for the benefit of a fictional person, who is the individual represented by a social insurance number,[27] can be deducted when they are expenses that would be described by tax specialists as clearly personal expenses and, thus, non-deductible.

[40] There are other mitigating circumstances that militate against the Minister's position. First, it should be recalled that Mr. Côté did not attend the meeting with the promoters and that he only obtained information about its scope through what Ms. Lavoie or Mr. Roy told him. Second, the session was conducted in English and, therefore, neither of the two taxpayers was able to appreciate the nuances. Third, even if the meeting had been held in French, these people did not have the necessary tax knowledge to make a judgment on the preposterous nature of the scheme.

[41] The Court takes some comfort in the fact that even the Minister's officials, including his own lawyer, became confused by the dual personality of the shareholders and their corporations. If such competent people can confuse these legal concepts, it is easy to see why people with low education levels and no legal or tax knowledge would become lost!

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[27] Here is the explanation in the words of Mr. Côté [TRANSLATION]: "'Well,' he said, "your social insurance number [number omitted for reasons of confidentiality]," he said, "it's a company and that's why you're entitled to'---" (p. 40 of the transcript).

[42] There is at least one passage in the transcript of the testimony given at the hearing and in the transcripts of the examination for discovery where it is clear that counsel for the respondent confused the business of the corporations and the two taxpayers' business.[28] That confusion is also present in the penalty reports when the auditor states that he informed the two taxpayers that they had experience operating their business when it was the business of their corporations.[29]

[43] In some decisions cited by counsel for the respondent involving taxpayers who used schemes similar to the preposterous scheme, a finding of wilful blindness was made when the taxpayers believed the information provided by the promoters to explain to them, in all likelihood, the basis of the scheme. As for the two taxpayers in these appeals, a finding of wilful blindness on their part cannot be made as they always sought advice from their legal counsel, Ferdinand Roy, a lawyer who was a member of a reputable professional association, the Bar, at the relevant time, that is, the period leading up to and including the date their 2008 income tax returns were filed.

[44] It should be noted that, during the examination for discovery, counsel for the respondent sought permission from both taxpayers to question Mr. Roy on the events surrounding their participation in the preposterous scheme. It is apparent from the examination for discovery of Ms. Lavoie that she gave said permission to counsel for the respondent. However, counsel for the respondent did not deem it appropriate to have him testify at the hearing as to the legality or illegality of the scheme. As a result, I draw a negative inference against the respondent, as was done in *Huneault v. The Queen*, 98 DTC 1488 (T.C.C.) by my colleague Judge Lamarre (as she then was) who, at page 1491, referred to some of the observations made by Sopinka and Lederman in their treaty *The Law of Evidence in Civil Cases*, cited by Judge Sarchuk of this Court in the following passage from *Enns v. Minister of National Revenue*, T.C.C. File No. APP-1992(IT), February 17, 1987, at pages 3 and 4, 87 DTC 208 at page 210:

> In *The Law of Evidence in Civil Cases*, by Sopinka and Lederman, the authors comment on the effect of failure to call a witness and I quote:
>
> > In *Blatch v. Archer*, (1774), 1 Cowp. 63, at p. 65, Lord Mansfield stated:

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28 See, in particular, Question 17 at p. 6 of the discovery transcript (Exhibit I-3).

29 See Exhibit I-1, Tab 6, p. 3/3, Tab 7, p. 4, Tab 10, p. 1; Exhibit I-2, Tab 7, p. 4.

> "It is certainly a maxim that all evidence is to be weighed according to the proof which it was in the power of one side to have produced, and in the power of the other to have contradicted."
>
> The application of this maxim has led to a well-recognized rule that the failure of a party or a witness to give evidence, which it was in the power of the party or witness to give and by which the facts might have been elucidated, justifies the court in drawing the inference that the evidence of the party or witness would have been unfavourable to the party to whom the failure was attributed.
>
> In the case of a plaintiff who has the evidentiary burden of establishing an issue, the effect of such an inference may be that the evidence led will be insufficient to discharge the burden. (*Lévesque et al. v. Comeau et al.* [1970] S.C.R. 1010, (1971), 16 D.L.R. (3d) 425))

[45] As a result, one cannot find on the basis of those facts that the couple acted with a high degree of culpability that could justify the application of the 50% penalty provided for in subsection 163(2) of the Act.

[46] In his questioning and oral argument, counsel for the respondent attempted to cast doubt on the reasonableness of the conduct of the Côté-Lavoie couple in relying on the advice of their legal counsel, Mr. Roy, as, in the words of counsel for the respondent, he placed himself in a conflict of interest by providing advice on a scheme in which he himself may have had a financial interest.

[47] First, evidence of Mr. Roy's compensation was never established with sufficient certainty since the Côté-Lavoie couple was unable to determine what Mr. Roy's compensation from the promoters was.[30] All Mr. Côté and Ms. Lavoie stated was that they believed their lawyer must have been compensated by the promoters as they themselves did not pay any fees for the legal advice provided by Mr. Roy.[31] The respondent should have had Mr. Roy testify.

[48] However, while it is entirely plausible that Mr. Roy was indeed compensated by the promoters and that he had a financial interest in the scheme, I do not believe

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30 See, in particular, p. 97 of the transcript and pp. 36 and 37 of the discovery transcript (Exhibit I-3).

31 See pp. 38 and 39 of the transcript.

that it was unreasonable for the Côté-Lavoie couple to believe in their lawyer's professionalism and not to have doubted the value and quality of the legal advice he provided. It is important to remember that a thirty-year relationship existed between Mr. Roy and Mr. Côté. Mr. Côté considered him his friend, as Mr. Roy attended his mother's funeral, and there was no reason to believe he was dishonest. He did business with a lawyer who had been giving him advice, seemingly effectively, for such a long time on transportation matters, and therefore, it is entirely unreasonable to submit, as counsel for the respondent does, that the couple demonstrated a high degree of culpability as required by the doctrine of gross negligence propounded in *Venne* or to conclude that they demonstrated wilful blindness by relying on the advice of their lawyer. Here, I accept the approach adopted by the Federal Court of Appeal in *Zsoldos*, cited above in footnote 12: "A taxpayer may avoid these penalty provisions where he or she has relied on the erroneous advice of a tax advisor" (para. 21).

[49] During oral argument, counsel for the respondent impugned the couple's credibility by submitting as follows (transcript, pages 163 and 164):

> [TRANSLATION]
>
> They did not trust those people to give them money, to manage their money, but they were willing to trust them to prepare their income tax return. And not only the 2008 return, if we rely on what Ms. Lavoie told us at the very end of her testimony, but also the subsequent income tax returns.
>
> And speaking of the income tax returns after for 2009, for instance, the preparation continued until 2010. At that point, they already had enough doubt not to trust him, Mr. Joanisse, with their money. I think that these are clear indications, Your Honour, that the penalty was fully justified in this case.
>
> [Emphasis added.]

[50] This is the passage on which he relies to support his allegation (transcript, pages 128 and 129):

> [TRANSLATION]

> MR. VINCENT: I have one last question for you, Ms. Lavoie, is it accurate that after the 2008 income tax return, you did not use those people for the 2009, 2010, 2011 returns? For the subsequent returns ---
>
> MS. LAVOIE: Yes.
>
> MR. VINCENT: --- did you go back to see them, Mr. Joanisse, Mr. Roy?
>
> MS. LAVOIE: Yes, they sent them.
>
> MR. VINCENT: So they prepared 2009, 2010, 2011?
>
> MS. LAVOIE: They sent them but we did not get anything.
>
> MR. VINCENT: So what happened with that?
>
> MS. LAVOIE: Well, I don't know. They had them.

[Emphasis added.]

[51] That passage reveals much confusion. Ms. Lavoie confirms that it is accurate that the couple did not use the promoters for their 2009 to 2011 returns. Thereafter, counsel forgets the scope of his question and believes he understands the opposite of what Ms. Lavoie said. He asks her to confirm that the couple used the promoters for 2009 to 2011. I believe she only confirmed that she used the promoters for the 2008 taxation year, as was indeed the case, and that she did not say that the couple used the preposterous scheme for the subsequent years, as counsel for the respondent believed. If he had seen in the Minister's records that the two taxpayers filed returns for subsequent years, it would have been in his interest to adduce them in evidence to show the taxpayers' bad faith. However, he did not do so. The best evidence would have been the returns received by the Minister for the subsequent years. If said evidence had been presented, there would not have been any ambiguity. The respondent's argument is without merit, in my opinion.

[52] I believe the two taxpayers were egregiously manipulated by Mr. Roy and the promoters in this preposterous scheme and that they were actually victims of that scheme as they spent significant amounts of money. When the two taxpayers realized that they had been ill-advised by their lawyer and that he had lured them into a sleazy business, they cut all ties with him. Mr. Côté stated as follows:

[TRANSLATION]: "Never in my life do I want to speak with that guy again."[32] It would be entirely unfair to uphold a 50% penalty in such circumstances.

[53] For all these reasons, I conclude that the Minister failed to justify the application of the penalty, as required by subsections 163(2) and 163(3) of the Act and, therefore, the appeals of both taxpayers are allowed with costs. Thus, the assessments are referred back to the Minister for reconsideration and reassessment on the basis that the penalties assessed under subsection 163(2) of the Act are cancelled.

Signed at Vancouver, British Columbia, this 24th day of September 2015.

"Pierre Archambault"

Archambault J.

Translation certified true
on this 25th day of May 2016.

François Brunet, Revisor

[32] See, in particular, p.74 of the transcript and p. 49 of the discovery transcript, Exhibit I-3.

CITATION:	2015 TCC 228
COURT FILE NOS.:	2011-3058(IT)G 2012-382(IT)G
STYLE OF CAUSE:	LISE LAVOIE v. HER MAJESTY THE QUEEN JEAN-YVES CÔTÉ v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	December 12, 2013
REASONS FOR JUDGMENT BY:	The Honourable Justice Pierre Archambault
DATE OF JUDGMENT:	September 24, 2015

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