Docket: 2015-710(GST)I

BETWEEN:

9091-2239 QUÉBEC INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on April 25 and 26, 2016, at Montreal, Quebec, and June 23, 2016 by teleconference at Ottawa, Canada

Before: The Honourable Justice Dominique Lafleur

Appearances:

Counsel for the Appellant:	Patrick E. Farley
Counsel for the Respondent:	Nicolas C. Ammerlaan

JUDGMENT

The appeal from the assessment made pursuant to Part IX of the *Excise Tax Act*, the notice of which is dated July 15, 2013 and covers the 16 quarterly reporting periods between January 1, 2009 and December 31, 2012 (the "period"), is allowed, without costs, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment to reduce from $23,768.85 to $12,802.35 the amount added in the calculation of the appellant's net tax for the period and the interest and penalties shall be adjusted accordingly, all in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 14th day of September 2016.

"Dominique Lafleur"

Lafleur J.

Citation: 2016 TCC 198
Date: 20160914
Docket: 2015-710(GST)I

BETWEEN:

9091-2239 QUÉBEC INC.,

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and

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REASONS FOR JUDGMENT

Lafleur J.

A. OVERVIEW

[1] The corporation 9091–2239 Québec Inc. (the "appellant") is appealing from an assessment, the notice of which is dated July 15, 2013, made pursuant to the *Excise Tax Act*, R.S.C. 1985, c. E-15 (the "ETA"), by the Agence du revenu du Québec acting on behalf of the Minister of National Revenue (the "Minister"). This assessment covers the quarterly reporting periods from January 1, 2009 to December 31, 2012 (the "period") for the pizzeria (the "restaurant") the appellant has operated since 2000 in the east of Montreal. A copy of the notice of assessment was filed at hearing as Exhibit I–3.

[2] In the assessment, the Minister claimed an additional net tax amount of $23,768.85, penalties of $5,942.23 under section 285 of the ETA, and interest. These amounts result from the addition to the appellant's sales from the operation of the restaurant for the 2009, 2010, 2011 and 2012 taxation years of the amounts of $107,816, $115,233, $125,430 and $126,870 respectively. In order to determine the amount of unreported sales, the Minister used an alternative method that consisted in comparing reported sales and the quantity of pizza boxes purchased during the period.

B. THE FACTS

(1) Testimony – General

[3] At the hearing, Jamal Hamade, one of the appellant's two shareholders (the other being his spouse), testified, as did Salim Jabbour, the appellant's accountant from the time it was constituted.

[4] The only witness for the respondent was Catherine Massey, the auditor from the Agence du revenu du Québec in charge of the audit of the appellant. Ms. Massey is an individual and corporate income tax auditor; she also conducts audits relating to taxes payable by restaurants and is a team leader at the Agence du revenu du Québec, where she has been working since June 2003.

[5] When the audit of the appellant began, Mr. Hamade referred the auditor to Mr. Jabbour, who was his contact person for this audit.

[6] From 1995 to 2000, Mr. Hamade worked at the restaurant as an employee. The appellant purchased the restaurant in 2000. In 2013, the appellant sold the restaurant to an employee or to a corporation owned by the said employee.

[7] The restaurant had a surface area of 500 square feet, could seat 18, and had 7 or 8 tables. According to the menu (Exhibit I–1, Tab 14), the restaurant sold pizzas of various sizes, French fries, poutine, chicken wings, submarines, chicken pita sandwiches, pasta and onion rings. It was possible to order takeout and delivery was also available. The menu, as well as the specials, remained unchanged throughout the period. Moreover, it was admitted that there were no renovations or additions to the space occupied by the restaurant during the period.

[8] The appellant's financial statements for the fiscal year ending December 31, 2013 were produced by the appellant as Exhibit A–4. Since the restaurant was sold on April 1, 2013, the restaurant was only operated for three months in the 2013 fiscal year. According to those documents, the total sales for that short period amounted to $53,524; for the 12-month period ending December 31, 2012, total sales were $159,464.

[9] Counsel for the appellant also filed, as Exhibits A-5 and A-6, the financial statements of the new owner of the restaurant to show the total sales for 2014 and 2015 from the operation of the restaurant by the new owner. Counsel for the respondent objected on the grounds that these documents constituted hearsay.

I allowed the documents to be entered, subject to my decision on the hearsay objection.

[10] During his testimony, Mr. Jabbour explained to the Court that at the end of each month he analyzed the cash register Z-tapes, the bank statements and the purchases in order to do the restaurant's accounting. After the installation of the sales recording module (the "SRM"),[1] he used the information from the SRM. He also prepared the paycheques and the income tax and other tax returns. According to him, 90% of the purchases were made from Les Distributions Giu-Setti Inc. ("Giu-Setti"). He was not very familiar with the restaurant's operations before the audit started. The auditor went to his office to look at all the invoices. There were missing invoices for vegetable and submarine bun purchases; however, according to him, submarines were not popular — in 14 days, only one submarine was sold. In 2012, he conducted an audit of the appellant; his audit showed that all the invoices Mr. Hamade provided were confirmed by those Giu-Setti provided to the auditor.

[11] Mr. Jabbour confirmed that there was no limit to the number of hours Mr. Hamade worked at the restaurant. Mr. Jabbour also stated that the auditor never asked him for ~~a~~ confirmation of the number of pizza boxes the appellant purchased.

[12] In cross-examination, Mr. Jabbour admitted that he had prepared the financial statements on the basis of the information Mr. Hamade provided and that he had never dealt directly with the restaurant's suppliers or with its employees. Mr. Jabbour is also the accountant for the new owner of the restaurant and it was he who prepared the documents filed as Exhibits A-5 and A-6.

[13] Mr. Hamade testified that the majority of the restaurant's sales were takeout orders; there were not many deliveries.

[14] According to Mr. Hamade, there were always two people on the premises, an employee and he himself. He stated that he never did much advertising. The restaurant offered a special two or three days a week, namely, a 14-inch pizza for $7.99. According to Mr. Hamade, this item was the most popular. Pizza slices also constituted a large portion of the restaurant's sales.

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[1] Since November 1, 2011, restaurant owners must use an SRM to record data relating to the commercial activities of their establishments (section 350.52 of the *Act respecting the Québec sales tax).* Restaurant owners are required to provide an invoice with a bar code from the SRM. It should also be noted that restaurant owners have access to the information recorded in the SRM.

[15] Mr. Hamade agreed that there was not much food loss from the restaurant operation: around one large pizza was lost every two days and there was a loss of around 20% for the vegetables.

[16] In cross-examination, Mr. Hamade agreed that some 40 or 50 clients would visit the restaurant daily. He also acknowledged that he did not know the names of the mobile vendors from whom he bought the vegetables used in the restaurant's operations. These vendors did not give him invoices, or if they did, the invoices were incomplete, in particular because they did not identify the vendor. He also had no invoices for the purchases of submarine buns or pita bread.

[17] According to Ms. Massey, the decision was made to conduct a tax audit of Mr. Hamade and his spouse because of the household income they declared (between $25,000 and $30,000 in total per year during the period) and the assets they held, namely, a residence with a municipal assessment value of $336,000 and a vehicle with a purchase price corresponding to Mr. Hamade's annual salary. In 2009, Mr. Hamade purchased a small Pontiac car, paying $171.90 per month (Exhibit A-1, instalment sale agreement). In 2004, he and his spouse purchased a $190,000 house (Exhibit A-2). He has three children. He and his spouse do not have any other assets.

[18] In addition, according to Ms. Massey, the restaurant's sales figures were low considering the type and size of the restaurant; moreover, the ratio of utilities charges to reported sales was twice the usual ratio. While utilities (gas, electricity, telecommunications) represent 2.6% of the operating costs of a restaurant according to the annual report of the Association des restaurateurs du Québec (Exhibit I-1, Tab 5, industry ratio), in the present case, the ratio was 5.6%, more than double the 2.6% figure. According to the auditor, such a ratio could result from either the overstatement of expenses or the understatement of sales and, in the appellant's case, in her opinion, it is the second hypothesis that applies. If income is reassessed on the basis that half the sales were not reported, the revised ratio is 3.1%, which is closer to the industry average.

[19] With regard to hours worked (Exhibit I-1, Tab 13, salaries), according to Ms. Massey's calculations there would only have been one employee present during 62% of the restaurant's hours of operation. However, since the restaurant offered delivery, there always had to be at least two employees present; therefore, some salaries must not have been reported. This result is consistent with a situation in which there were unreported purchases or sales.

[20] On November 7, 2011, the auditor and a colleague went to eat at the restaurant incognito (Exhibit I-1, Tab 6, report on meal). During this visit, they ordered a meal and observed the activities, the employees, the bill they were given with the bar code from the SRM, the deliveries, etc. According to Ms. Massey's testimony, the cash register drawer often remained open, particularly when slices of pizza were sold to students. These slices of pizza, the sales of which were not recorded in the SRM, were sold at the same price as those that were recorded in the SRM. By Ms. Massey's count, there were 18 clients at the restaurant, but the sales to only 9 were recorded by the SRM (Exhibit I-1, Tab 1, audit report, page 1.8). Mr. Hamade was working the cash register that day.

[21] The auditor's first announced visit was on February 23, 2012 (Exhibit I-1, Tab 7, first visit – restaurant). The auditor walked around the restaurant, looked at the inventory of the pizza boxes, obtained a copy of the SRM report and asked to balance the cash register in Mr. Hamade's presence. The X-tape from the cash register showed $67.74. However, there was $353.30 cash in the till. Mr. Hamade first said that he leaves around $68 in the till, but to justify the excess amount of around $300, Mr. Hamade then said that he left money in the till to pay suppliers (between $400 and $500).

[22] A copy of the cash register Z-tape for November 2010 was produced at the hearing (Exhibit I-1, Tab 12); according to this copy, sales for the day totalled $531.23 and there is a handwritten entry indicating "$495". Mr. Hamade tried to explain this handwritten notation but he had no exact recollection of that particular case: a large order for a party or a school. According to Mr. Hamade, the restaurant's cash register was not often out of order and if he had wanted to hide the amount, he would not have written it down; it was the only time such an entry was made. It must be noted that in his testimony Mr. Jabbour mentioned that this amount was added to the appellant's income and that the consumption taxes were paid. Mr. Jabbour confirmed in his testimony that he had only seen such a handwritten entry once. The auditor was unable to confirm that this amount was added to the appellant's income. With regard to the $495 added by hand, it shows a substantial difference from the daily average, namely 52%.

[23] Ms. Massey also explained that the sales the appellant reported corresponded to the sales recorded by the SRM; thus, if a sale did not appear in the SRM data, it was not reported by the appellant.

(2) The boxes

[24] In his testimony, Mr. Hamade said that leftover pizza (for example, the 14-inch pizza, which was discounted) was put into an 8-inch box ("Bambino boxes"); moreover, schools that ordered pizza asked that the slices be put in Bambino boxes. He added that slices of pizza from 18-inch pizzas were served on paper plates and put into paper bags. He also stated that when a client ate on the premises, the pizza was served on a paper plate; if there were leftovers, they were put into Bambino boxes, which could hold three or four slices. Additionally, when parents came to purchase lunches for their children, he put the slices in Bambino boxes. Lastly, Mr. Hamade said that he also put French fries and chicken wings in the Bambino boxes. Pizza slices were sold with a free soft drink or French fries.

[25] Mr. Hamade did not recall the exact number of pizza boxes of various sizes that were purchased. He stated that the 14-inch pizza was the biggest seller, but there were other items on the menu, including French fries, poutine, chicken wings and submarines. The 10-inch, 12-inch, 14-inch and 18-inch pizza boxes were sold in packs of 50. According to Mr. Hamade, he purchased around three packs of each size every two weeks. Considering the popularity of the 14-inch pizza, he purchased more 14-inch boxes. The Bambino boxes were sold in packs of 250. However, he stated that all the invoices from Mayrand were given to the auditor.

[26] In addition, Mr. Hamade confirmed that he did not take any inventory of the pizza boxes.

(3) Alternative method used

[27] Ms. Massey explained to the Court the method used in the present case, namely, the reconstruction of sales method, or the purchases method. In general, this method involves comparing actual purchases and actual sales; if all sales are reported, they will balance.

[28] For the purpose of determining the purchases made by a restaurant, copies of the purchase invoices from the restaurant's various suppliers are obtained from the restaurant owner and confirmation is obtained from those various suppliers. To determine the units available for sale, the inventory at the beginning of the period must be established, purchases added and then losses, complimentary items, personal consumption and the inventory at the end of the period subtracted.

[29] In the present case, the elements used for this exercise were the pizza boxes. These are easy to identify both at purchase and at sale, and there are few losses. Ms. Massey would have liked to use soft drinks for the purpose, but this element is

not easy to identify, and many were offered free of charge. She could not use the submarine buns or the pita bread because no invoices were issued when these items were purchased. As for the chicken wings, there were more purchases than sales; this element is therefore not reliable. Moreover, it was not possible to confirm the purchases of vegetables because no invoices were issued by the mobile vendors. Mr. Hamade confirmed in his testimony that he had no invoices for the vegetable purchases or for the submarine bun and pita bread purchases. However, the appellant's financial statements indicate expense amounts for these purchases (around $2,000 or $3,000 per year).

[30] Mr. Hamade confirmed that he purchased the pizza boxes from Giu-Setti, except for the Bambino boxes, which he purchased from Mayrand. Ms. Massey asked for confirmations of purchase from two suppliers, Giu-Setti and Lesters (Exhibit I-1, Tab 8, requirement to provide documents; documents from suppliers). It was not possible to obtain a confirmation from Mayrand since the appellant had no account with that supplier.

[31] The invoices issued by Giu-Setti for all sizes of boxes (except Bambino boxes) and by Mayrand (for Bambino boxes only) were used. As Mr. Hamade confirmed, no inventory was taken of the boxes, and so, the auditor could not consider that element in her calculations. However, according to Ms. Massey, since the inventory was essentially the same at the beginning and the end, this would not have had a great impact on her calculations. I will revisit this matter below.

[32] Since the SRM was operational during all of 2012, the auditor used 2012 as a reference. The 14-inch pizza boxes were eliminated from the calculation because there were more sales than boxes available for sale. Only the Bambino, 10-inch, 12-inch and 18-inch boxes were used; the respondent filed as Exhibit I-1, Tab 10 the worksheets accompanying the proposed assessment.

[33] The auditor would have liked to conduct the same exercise for the previous years, but the Z-tapes from the cash register did not provide sufficiently detailed information to identify the type of pizza sold. She did, however, conduct that exercise for the last quarter of 2011 and, according to her testimony, she obtained essentially the same results.

[34] She then extrapolated the results so obtained to the previous years, after verifying that there had not been any major changes at the restaurant and that 2012 resembled the previous years (same menu, similar number of boxes purchased, etc.).

[35] Ms. Massey analyzed the number of pizzas sold according to the SRM (Exhibit I-1,Tab 10, p. 7.6); she then calculated the number of pizza boxes purchased by size, applied a 5% loss (Exhibit I-1, Tab 10, p. 7.8) and calculated the following discrepancies:

Comparison					
	Bambino 8 inches	**Small 10 inches**	**Medium 12 inches**	**Large 14 inches**	**Jumbo 18 inches**
Units sold	1096	936	1499	3920	1310
Units available for sale	4513	1045	1805	2850	1330
Discrepancy	3417	109	306	-1070	20
Percentage	76 %	10 %	17 %	-38 %	2 %

[36] The auditor said that taking into account the other sizes of pizza boxes and not just the Bambino boxes was to the appellant's advantage: if she had only considered the Bambino boxes, she would have increased sales by 76%.

[37] She then applied to the result from the calculation of the number of pizza boxes of various sizes a weighted average to arrive at a discrepancy of around 45% between the reported sales and the unreported sales. Ms. Massey therefore applied this 45% to the entire menu in order to establish the assessment at issue.

[38] At my request, Ms. Massey provided in an affidavit sworn on May 27, 2016 (the "affidavit") additional explanations regarding the method used. As I understand it, if an arithmetical average had been used, the results would have been skewed (table in Appendix 1 to the affidavit), and I agree with the auditor. I also asked Ms. Massey to provide me with the weighting coefficients used in the calculation of the weighted average. She did not reply directly to my question, but I was able to conclude that the coefficients used were the number of units available for sale of a specific sized box over the total number of units available, and the appropriate coefficient was applied to the discrepancy percentage for the boxes of that size, as indicated in the preceding table. By adding up the various percentages calculated in this way, one arrives at a figure of 44% for unreported sales, excluding the 14-inch boxes.

[39] More particularly, according to the detailed calculations (Exhibit I-1, Tab 10, p. 7.4), 55.69% of sales were reported, and therefore approximately 45%

were not. According to Ms. Massey, this is consistent with what she observed at the restaurant and what is indicated in the document at Tab 12 of Exhibit I-1. The same percentage was used for each of the years in question, which, in Ms. Massey's view, has the benefit of taking into consideration fluctuations in clientele.

(4) Auditor's subsequent visit in March 2013

[40] After completing her review, Ms. Massey returned to the restaurant on March 15, 2013 to make sure her calculations were not too high. According to Ms. Massey, if she has observed that pizza slices were sold in Bambino boxes, she would have had to redo her calculations. In Exhibit I-1, Tab 11, observations from March 15, 2013, there is a summary of Ms. Massey's visit. It was a very quiet Friday; there were no students. After her visit, she compared the sales from that Friday with those from the five Fridays in March 2012 on the assumption that during her March 15, 2013 visit everything had been recorded by the SRM. On that basis, it can be seen that 43.84% of sales had not been reported.

[41] Ms. Massey was able to observe what Mr. Hamade had told her at the initial meeting: that pizza slices were served on paper plates and in paper bags, that it was very rare for slices to be put in boxes and that, when it did happen, they were put in a 10-inch box and only for fussy clients. If several slices were sold, they were served on plates and put in paper bags, and each bag would be stapled. Ms. Massey did not observe any leftovers being put into boxes. She therefore concluded that the pizza boxes were used for the sale of pizzas only and not for any other purpose.

C. ISSUES

(1) Was the Minister justified in using an alternative audit method?

(2) Did the Minister correctly assess the appellant by adding $23,768.85 to the calculation of the net tax for the period?

(3) Was the Minister justified in imposing penalties of $5,942.23 for the period pursuant to section 285 of the ETA?

D. PARTIES' POSITIONS AND ANALYSIS

[42] Before embarking upon the analysis of the issues, I must determine whether the financial statements of the new owner of the restaurant, filed by the appellant

as Exhibits A-5 and A-6 in order to establish the total sales from the new owner's operation of the restaurant in 2014 and 2015, constitute hearsay and therefore whether they are admissible as evidence.

[43] The rule regarding the presentation of evidence in cases before the Court that are governed by the informal procedure is set out in subsection 18.15(3) of the *Tax Court of Canada Act*, R.S.C. 1985, c. T-2:

> **18.15(3) Hearing** — 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.
>
> **18.15(3) Audition** — Par dérogation à la loi habilitante, la Cour n'est pas liée par les règles de preuve lors de l'audition de tels appels; ceux-ci sont entendus d'une manière informelle et le plus rapidement possible, dans la mesure où les circonstances et l'équité le permettent.

[44] In *Selmeci v. The Queen*, 2002 FCA 293, the Federal Court of Appeal held that this provision does not mean that no rule of evidence applies to cases governed by the informal procedure, but means rather 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). The Court further stated:

> [6] . . . 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*, [1990] 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] . . . 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 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), 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).

I was not provided with any evidence regarding the criterion of necessity stated in *Khan*. Although the financial statements produced might be reliable, I would disallow these documents because they are not relevant to the examination of the issues; indeed, these financial statements are for a taxpayer other than the appellant and, moreover, they are for a period subsequent to the period in question in the appeal.

(1) Was the Minister justified in using an alternative audit method?

[45] The ETA allows the Minister to use an alternative audit method. Subsection 299(1) of the ETA states the following:

> **299(1) Minister not bound** — The Minister is not bound by any return, application or information provided by or on behalf of any person and may make an assessment, notwithstanding any return, application or information so provided or that no return,
>
> **299(1) Ministre non lié** — Le ministre n'est pas lié par quelque déclaration, demande ou renseignement livré par une personne ou en son nom; il peut établir une cotisation indépendam-ment du fait que quelque déclaration, demande ou

> application or information has been provided.
>
> renseignement ait été livré ou non.

[46] Furthermore, under subsection 286(1) of the ETA, every person who carries on a business in Canada "shall keep record . . . in such form and containing such information as will enable the determination of the person's liabilities and obligations under this Part. . . ."

[47] Justice Favreau, in *9100–8649 Québec Inc. v. The Queen*, 2013 TCC 160, (aff'd. by 2014 FCA 20), stated the following:

> [39] Courts allow tax authorities to use alternative audit methods not only in cases where the taxpayer does not have adequate accounting records, but also when the books, registers and financial statements are not reliable.
>
> [40] In this case, the appellant had no documents in support of the inventory counts. In the circumstances, it is not open to the appellant to argue that its books, registers and financial statements are complete, adequate and reliable.

[48] Justice D'Auray of this Court, in *9103–4348 Québec Inc. v. The Queen*, 2015 TCC 220, [2015] GSTC 103, cited with approval Justice Favreau's comments and she concluded as follows:

> [50] In *9100–8649 Québec Inc*, the appellant, as in this case, had no documents in support of the inventory counts. Justice Favreau indicated that, in the circumstances, it was not open to the appellant to argue that its books, registers and financial statements were complete, adequate and reliable. Justice Favreau determined that the alternative audit method was justified.

[49] In the present case, for the reasons stated below, I am of the opinion that the Minister was justified in using an alternative audit method to assess the appellant.

[50] In his testimony before the Court, Mr. Hamade acknowledged that he did not have any invoices for the purchases of vegetables or for the purchases of submarine buns and pita bread. In the former case, the mobile vendors who would come to the restaurant did not issue invoices or, if they did, the invoices contained insufficient detail to be useful. In the latter case, the small bakery that provided the bread did not issue invoices. Mr. Hamade estimated those expenses each year and the appellant claimed a deduction in the calculation of the income from the restaurant.

[51] Mr. Hamade also acknowledged that he did not take inventory of the pizza boxes used. Nor did he take inventory of the other items used in the operation of

the restaurant. However, there were entries for such items in the financial statements.

[52] During her visits to the restaurant, Ms. Massey noticed that the cash register drawer often remained open between sales; after reviewing the reports from the SRM, she was able to confirm this practice. The appellant did not present any evidence in this regard at the hearing. According to counsel for the appellant, the fact that not all sales were recorded by the SRM was the result of an error committed in good faith by Mr. Hamade. I cannot accept that claim by counsel for the appellant. Considering the appellant's failure to adduce evidence in this regard, I conclude that the appellant's sales were not all recorded by the SRM.

[53] It must also be noted that the appellant acquired the SRM in August 2011. As a result, it was required to provide the Agence du revenu du Québec with copies of the SRM reports as of that date. However, the appellant only began providing these reports in November 2011.

[54] The appellant's books and records therefore cannot be considered reliable in view of the foregoing, and as a result the Minister was justified in using an alternative audit method.

(2) Did the Minister correctly assess the appellant by adding $23,768.85 to the calculation of the net tax for the period?

[55] The assessment is deemed to be valid. Subsection 299(3) of the ETA states the following:

299(3) Assessment valid and binding — An assessment, subject to being vacated on an objection or appeal under this Part and subject to a reassessment, shall be deemed to be valid and binding.	**299(3) Cotisation valide et exécutoire** — Sous réserve d'une nouvelle cotisation et d'une annulation prononcée par suite d'une opposition ou d'un appel fait selon la présente partie, une cotisation est réputée valide et exécutoire.

[56] In *Amiante Spec Inc. v. The Queen*, 2009 FCA 139, [2010] GSTC 26, the Federal Court of Appeal noted that the taxpayer has the initial burden of demolishing the Minister's assumptions and explained what constitutes a *prima facie* case:

> [15] *Hickman* reminded us that the Minister proceeds on assumptions in order to make assessments and that the taxpayer has the initial burden of demolishing the exact assumptions stated by the Minister. This initial onus is met where the taxpayer makes out at least a *prima facie* case that demolishes the accuracy of the assumptions made in the assessment. Lastly, when the taxpayer has met his or her onus, the onus shifts to the Minister to rebut the *prima facie* case made out by the taxpayer and prove the assumptions (*Hickman*, supra, at paragraphs 92, 93 and 94).
>
> . . .
>
> [23] A *prima facie* case is one "supported by evidence which raises such a degree of probability in its favour that it must be accepted if believed by the Court unless it is rebutted or the contrary is proved. It may be contrasted with conclusive evidence which excludes the possibility of the truth of any other conclusion than the one established by that evidence" (*Stewart v. Canada*, [2000] T.C.J. No. 53, paragraph 23).
>
> [24] Although it is not conclusive evidence, "the burden of proof put on the taxpayer is not to be lightly, capriciously or casually shifted", considering that "[i]t is the taxpayer's business" (*Orly Automobiles Inc. v. Canada*, 2005 FCA 425, paragraph 20). This Court stated that the taxpayer "knows how and why it is run in a particular fashion rather than in some other ways. He [or she] knows and possesses information that the Minister does not. He [or she] has information within his [or her] reach and under his [or her] control" (*ibid*.).

[57] These principles also apply when the Minister uses an alternative audit method. In *Landry v. The Queen*, 2009 TCC 399, 2009 DTC 1359, Justice Hogan, who was dealing with another alternative method, namely, the net worth method, noted the following with regard to the burden of proof:

> [46] . . . Essentially, the onus of proving the inaccuracy of the assessments in this case is on the appellant, who must provide *prima facie* evidence to show that the amounts thus arrived at do not represent, from a tax standpoint, the true state of her income. It is up to the appellant to identify the source and establish the non-taxable nature of her income. The Federal Court of Appeal stated that onus in *Lacroix*:
>
> > 19 The Supreme Court has endorsed this approach on a number of occasions, including in *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336, to name just one example. In that case, the Court stated the following at paragraphs 92–93:
> >
> > . . .

> 20 Applying the net worth method changes nothing in this method of proof. Where the Minister presumes that the income detected using the net worth method is taxable income, the onus is on the taxpayer to demolish this presumption. If the taxpayer presents credible evidence that the amount in question is not income, the Minister must then go beyond these assumptions of fact and file evidence proving the existence of this income.

[47] The credibility of the appellant and the sufficiency of the evidence against the net worth calculations play a crucial role. The fate of the appeal will depend entirely on those two factors.

[48] Judge Bowman (as he then was) stated the best method of challenging such assessments in *Bigayan*:

> 3 The best method of challenging a net worth assessment is to put forth evidence of what the taxpayer's income actually is. A less satisfactory, but nonetheless acceptable method is described by Cameron J. in *Chernenkoff v. Minister of National Revenue*, 49 DTC 680, at page 683:
>
> > In the absence of records, the alternative course open to the appellant was to prove that even on a proper and complete "net worth" basis the assessments were wrong.
>
> 4 This method of challenging a net worth assessment is accepted, but even after the adjustments have been completed one is left with the uneasy feeling that the truth has not been fully uncovered. Tinkering with an inherently flawed and imperfect vehicle is not likely to perfect it. The appellant chose to use the second method.

[Emphasis added.]

[58] In *Garage Pierre Allard Inc. v. Québec (Sous-ministre du Revenu)*, [1995] RDFQ 36, 1995 CanLII 5523, the Quebec Court of Appeal ruled on the required quality of the Minister's and the taxpayer's evidence where an alternative audit method has been used:

> [TRANSLATION]
>
> As regards evidence, the issue is not whether one method is preferable to another. It is essentially a matter of **reliability** and **sufficiency**. . . In either case, regardless

> of the method used, as long as it is legal and **reliable**, the evidence must be sufficient to make it of the quality required.
>
> In this case, because of the legal presumption of validity attaching to the respondent's assessment, the appellant must show that the method used for the assessment was not reliable or, if it was in itself reliable, that the conditions required for it to be reliable were not met.
>
> [Emphasis added.]

[59] The appellant claims that the method the auditor used was not reliable for the following reasons:

- The appellant's cooperation with Ms. Massey was exemplary. All the documents Ms. Massey required were given to her and she was able to verify that all the invoices provided corresponded completely with the invoices confirmed by the suppliers. Moreover, although the supplier Mayrand was unable to confirm the appellant's purchases, all the invoices Mayrand issued were provided to the auditor. The appellant noted that it would have been easy to destroy those invoices.

- Since the exact number of Bambino boxes purchased was known to the auditor, she should have used the selling price of a Bambino pizza, $4.99, as the basis for calculating the difference; the result of that calculation would show that in 2012 the unreported income for this item was only $17,000 (difference of 3,417 boxes at $4.99 per Bambino pizza). But even so, this method would not give an exact amount because the Bambino pizza boxes were used for other purposes.

- The different ratios, such as the cost of goods sold ratio, the rent ratio and the advertising ratio, would not correspond to the industry averages if the appellant's income was increased in the manner set out in the assessment at issue.

- The excess cash in the till, according to Mr. Hamade, was used to pay suppliers (Exhibit I-1, Tab 7); this is a plausible explanation. It does not prove that the appellant was hiding 50% of its receipts.

- With regard to the 14-inch pizza boxes, the negative difference is due to the fact that a number of clients ate on the premises and this item was the best deal on the days the discount was offered, namely on

> Mondays and Tuesdays. Moreover, since no inventory of the boxes was taken at the beginning of the fiscal year, the calculation cannot but be deficient.

[60] I am of the view that, on a balance of probabilities, the Bambino pizza boxes were used only for the sale of pizzas and for no other purpose. Mr. Hamade's testimony did not convince me that the Bambino boxes were used for leftovers or for chicken wings and French fries. Rather, I accept Ms. Massey's version, which was that the Bambino boxes could not be stacked because they were made of ~~a~~ very thin cardboard; moreover, she testified that during her three visits to the restaurant she never saw Bambino boxes being used for leftovers or anything other than pizzas.

[61] Additionally, in this case, we do not have an assessment that was based on ratios. The ratios were only used as indicators and the calculation of the hours worked was used in like fashion. I come to the same conclusion regarding the handwritten notation on the Z-tape from the cash register (Exhibit I-1, Tab 12).

[62] On the evidence, it is clear that the appellant did not report all of its income. Indeed, according to the auditor's uncontradicted testimony, the cash register drawer often remained open between sales, which was also confirmed by the analysis of the SRM reports. Moreover, a comparison of the sales made during the auditor's last visit in March 2013 and the average Friday sales in March 2012 leads me to conclude that not all of the sales were reported.

[63] I must therefore rule on the reliability of the method used by the auditor in the present case. In my opinion, the method the auditor chose has a significant weakness in that the 14-inch boxes are not taken into consideration in the calculations. Let me explain.

[64] The auditor determined the average total sale to be $32.94, using the following calculation: reported sales divided by the number of pizzas sold according to the SRM (excluding 14-inch pizzas). The $32.94 amount was then multiplied by the number of boxes purchased (or available for sale, excluding the 14-inch boxes), which was 8,693, to arrive at the reconstituted sales, namely, $286,334. There is therefore a discrepancy of $126,869 (when the reconstituted sales are compared with the reported sales of $159,464 for 2012). Thus, according to the auditor's method, 55.69% of sales were reported and 45% were not (Exhibit I-1, Tab 10, p. 7.4).

[65] If the same calculation is done again adding the 14-inch boxes, the result indicates that in fact 69.46% of sales were reported, and therefore approximately 30% were not.

[66] Why were the 14-inch boxes not taken into account in the calculations? The auditor stated that because, according to the SRM, there were more sales than purchases, she dismissed this element. In my opinion, the 14-inch boxes should have been included in the calculations. Otherwise, the calculations cannot provide a true reflection of reality. Indeed, according to Exhibit I-1, Tab 15 (p. 7.75), in 2011, 3,650 14-inch boxes were purchased, whereas in 2010 the appellant purchased 2,550, and in 2012, 2,850. There is clearly a large difference in 2011: 1,100 more boxes than in 2010 and 800 more than in 2012. In 2011, the appellant must have purchased more 14-inch boxes than needed; therefore the negative variance the auditor noted (Exhibit I-1, Tab 10, p. 7.5) is probably erroneous.

[67] As for the other-sized boxes, the number of boxes purchased each year remained stable. It must also be noted that, according to the SRM, the best-selling pizza size was the 14-inch size; therefore, if the boxes of that size are excluded, the results will be erroneous (Exhibit I-1 Tab 10, p. 7.6).

[68] For these reasons, it is my view that 30% of the appellant's sales were unreported, that is, sales totalling $256,047 for the period, distributed as follows:

- For 2009: $58,074
- For 2010: $62,069
- For 2011: $67,562
- For 2012: $68,342

Therefore, $12,802.35 should be added to the appellant's net tax calculation for the period, and not $23,768.85 as determined in the assessment.

(3) Was the Minister justified in imposing penalties of $5,942.23 for the period pursuant to section 285 of the ETA?

[69] Section 285 of the ETA imposes a penalty on every person who knowingly, or under circumstances amounting to gross negligence, makes or participates in, assents to or acquiesces in the making of a false statement or omission in a return,

application, form, certificate, statement, invoice or answer. The relevant part of section 285 reads as follows:

> **285 False statements or omissions** — Every person who knowingly, or under circumstances amounting to gross negligence, makes or participates in, assents to or acquiesces in the making of a false statement or omission in a return, application, form, certificate, statement, invoice or answer (each of which is in this section referred to as a "return") made in respect of a reporting period or transaction is liable to a penalty of the greater of $250 and 25% of the total of
>
> . . .
>
> **285 Faux énoncés ou omissions** — Toute personne qui, sciemment ou dans des circonstances équivalant à faute lourde, fait un faux énoncé ou une omission dans une déclaration, une demande, un formulaire, un certificat, un état, une facture ou une réponse — appelés « déclaration » au présent article — établi pour une période de déclaration ou une opération, ou y participe, y consent ou y acquiesce, est passible d'une pénalité de 250 $ ou, s'il est plus élevé, d'un montant égal à 25 % de la somme des montants suivants :
>
> […]

[70] The burden of establishing the facts justifying the assessment of the penalty is on the Minister and not the taxpayer. Subsection 285.1(16) of the ETA states the following:

> **285.1(16) Burden of proof in respect of penalties** — If, in an appeal under this Part, a penalty assessed by the Minister under this section or section 285 is in issue, the burden of establishing the facts justifying the assessment of the penalty is on the Minister.
>
> **285.1(16) Charge de la preuve relativement aux pénalités** — Dans tout appel interjeté en vertu de la présente partie au sujet d'une pénalité imposée par le ministre en vertu du présent article ou de l'article 285, le ministre a la charge d'établir les faits qui justifient l'imposition de la pénalité.

[71] According to the wording of section 285 of the ETA, two elements must exist in order for it to be found that a penalty for gross negligence applies: (1) a mental element: "knowingly, or under circumstances amounting to gross negligence"; (2) a material element: "makes . . . a false statement or omission".

[72] It was established that the appellant filed its tax returns for the period; therefore, the material element exists in this case. But what about the mental element?

[73] In *Prud'homme v. The Queen,* 2005 TCC 423, 2008 DTC 3472, Justice Dussault commented as follows in discussing a similar provision found in the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.):

> [47] . . . the facts on which the imposition of a penalty for gross negligence under subsection 163(2) of the Act is based must be analysed having regard to their particular context, which means that drawing a comparison with the facts of another situation would be a purely random exercise, if not patently dangerous.

[74] The concept of "gross negligence" was defined by Justice Strayer in *Venne v. The Queen*, [1984] FCJ No. 314 (F.C.T.D.):

> . . . "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. . . .

[75] In *DeCosta v. The Queen*, 2005 TCC 545, [2005] TCJ No. 396 (informal procedure), Chief Justice Bowman stated the following:

> [11] In drawing the line between "ordinary" negligence or neglect and "gross" negligence a number of factors have to be considered. One of course is the magnitude of the omission in relation to the income declared. Another is the opportunity the taxpayer had to detect the error. Another is the taxpayer's education and apparent intelligence. No single factor predominates. Each must be assigned its proper weight in the context of the overall picture that emerges from the evidence.

[76] Counsel for the appellant noted that Mr. Hamade demonstrated his good faith: he met his obligations, he paid the taxes owing every three months and he sent the SRM reports as required by law. During the audit, he provided all the invoices to the auditor and cooperated with her. Furthermore, counsel for the appellant added that Mr. Hamade was a citizen who had contributed to the growth of our country. I cannot accept these arguments for the purpose of vacating the penalty assessed pursuant to section 285 of the ETA.

[77] In this case, the respondent showed, on a balance of probabilities, that the appellant knowingly, or under circumstances amounting to "gross negligence" as defined in *Venne*, made a false statement or omission in its tax returns for the period. The evidence shows that the cash register drawer often remained open between sales and that the reported sales corresponded to the sales recorded by the SRM (thus, if the cash register drawer was not closed, nothing appeared in the

SRM). Moreover, the unreported sales represent 30% of total sales. These factors, in my opinion, do not merely show ordinary negligence; rather, they show gross negligence.

[78] According to the evidence, the appellant made significant and repeated omissions in the tax returns for the period by not reporting all of its sales; hence the only possible conclusion is that the appellant intentionally concealed a significant portion of its sales for the period. As Justice Hogan concluded in *4340876 Canada Inc. v. The Queen*, 2014 TCC 351, [2014] TCJ No. 299: "This amounts to gross negligence, which warrants the imposition of a penalty under section 285 of the ETA by the Minister" (para. 24).

E. CONCLUSION

[79] The appeal from the assessment made pursuant to Part IX of the *Excise Tax Act*, the notice of which is dated July 15, 2013 and covers the 16 quarterly reporting periods between January 1, 2009 and December 31, 2012, is allowed, without costs, and the assessment is referred back to the Minister for reconsideration and reassessment to reduce from $23,768.85 to $12,802.35 the amount added in the calculation of the appellant's net tax for the period and the interest and penalties shall be adjusted accordingly.

Signed at Ottawa, Canada, this 14th day of September 2016.

"Dominique Lafleur"

Lafleur J.

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COURT FILE NO.:	2015-710(GST)I
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