

Docket: 2015-262(IT)G

BETWEEN:

JOHN THOMPSON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 17, 2017, at Edmonton, Alberta

Before: The Honourable Justice Robert J. Hogan

Appearances:

Counsel for the Appellant: James Yaskowich

Counsel for the Respondent: Mary Softley

JUDGMENT

The Appellant's appeal with respect to the notices of reassessment issued by the Minister of National Revenue for his 2006 and 2007 taxation years is dismissed in accordance with the attached reasons for judgment.

The Respondent is awarded one set of costs with respect to this appeal and the appeal of the Estate of Denise Thompson, heard on common evidence.

Signed at Ottawa, Canada, this 20th day of June 2017.

“Robert J. Hogan”

Hogan J.

BETWEEN:

ESTATE OF DENISE THOMPSON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 17, 2017, at Edmonton, Alberta

Before: The Honourable Justice Robert J. Hogan

Appearances:

Counsel for the Appellant: James Yaskowich
Counsel for the Respondent: Mary Softley

JUDGMENT

The Appellant's appeal with respect to the notices of reassessment issued by the Minister of National Revenue for the 2006, 2007 and 2008 taxation years is dismissed in accordance with the attached reasons for judgment.

The Respondent is awarded one set of costs with respect to this appeal and the appeal of John Thompson, heard on common evidence.

Signed at Ottawa, Canada, this 20th day of June 2017.

“Robert J. Hogan”

Hogan J.

Citation: 2017 TCC 115

Date: 20170620

Docket: 2015-262(IT)G

BETWEEN:

JOHN THOMPSON,

Appellant,

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Respondent,

Docket: 2015-265(IT)G

ESTATE OF DENISE THOMPSON,

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and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Hogan J.

I. Introduction

[1] John Thompson and the Estate of his late wife, Denise Thompson (together the “Appellants”) are appealing reassessments issued by the Minister of National Revenue (the “Minister”) beyond the normal three-year limitation period.

[2] The appeals were heard on common evidence.

[3] It is undisputed by the parties that John Thompson failed to report income of \$51,836 and \$91,970 received from 1140629 Alberta Ltd. (the “Corporation”) for services rendered to the Corporation in his 2006 and 2007 taxation years. It is also undisputed that Denise Thompson failed to report income of \$13,994, \$140,787

and \$11,392 received by her from the Corporation in her 2006, 2007 and 2008 taxation years.

[4] The sole issue in dispute is whether the errors on the Appellants' tax returns were attributable to the Appellants' neglect, carelessness or wilful default.

[5] The Appellants allege that they provided all relevant information pertaining to the income received from the Corporation to their accountant, Mr. Halford, a licensed chartered accountant in Alberta. They allege that they were unaware of the fact that Mr. Halford failed to report all of the income received from the Corporation on their personal tax returns. As the errors on their tax returns were not attributable to their neglect, carelessness or wilful default, they argue that the taxation years in dispute remain statute-barred.

[6] Not surprisingly, the Respondent defends the contrary view. The Respondent alleges that the Appellants showed neglect and carelessness in delegating the preparation of their tax returns to their accountant without exercising oversight over his work. The Respondent argues that the evidence shows that the Appellants knew how much money they were drawing in the form of salary from the Corporation in the taxation years under review and that, on reviewing their tax returns, they failed to properly question their accountant as to why there was a large discrepancy between the amounts reported on their tax returns and the actual amount of cash received from the Corporation.

II. Factual Background

[7] Mr. Thompson testified that he joined the Canadian Imperial Bank of Commerce (the "CIBC") in 2003 in a junior position. Over time he became a loans officer processing mortgage loan applications for the bank.

[8] In late 2003, the CIBC informed the Appellant that they wished to sever their employment ties with him. According to the witness, the CIBC desired to outsource part of their mortgage business to independent brokers who would earn commission income for new mortgages issued by the CIBC.

[9] While the evidence on this point is not entirely clear, it appears that the Appellant was encouraged by the CIBC to offer his mortgage brokerage services through a corporation. I surmise that this was done to sever Mr. Thompson's employment ties with the bank. This could have been difficult to achieve had the Appellant continued to work personally and exclusively for the bank.

[10] Mr. Thompson testified that he hired Mr. Halford to assist him and his wife to properly account for the income earned under this new arrangement. Mr. Thompson left high school after completing grade 10. His wife finished high school. Neither of the Appellants had training in financial and tax reporting matters. Mr. Thompson alleged that he and his wife were unable to perform the tasks outsourced to Mr. Halford.

[11] As their computer skills were limited, they adopted a simple manual financial reporting system. Apparently Mr. Halford encouraged them to proceed in this fashion. They would record each month, in a new coil notebook, the commission income earned and the expenses incurred by the Corporation and the amounts that they withdrew from the Corporation each month to pay their personal living expenses and to save for retirement.

[12] Mr. Thompson testified that, after reviewing his personal tax return with Mr. Halford in 2005, he questioned why the income reported on his return was less than the amount of cash received from the Corporation in the period. According to Mr. Thompson, Mr. Halford explained that, because the Corporation had an August 31 year-end, part of the Appellants' income could be deferred for at least one year (hereinafter the "Deferred Income"). This was possible because amounts received by the Appellants during the calendar year could be treated initially as a shareholders' advance. For example, amounts withdrawn by the Appellants in 2005 could be treated as advances from the Corporation until 180 days after the August 31, 2006 year-end of the Corporation. At the Corporation's year-end of a bonus could be accrued equal to the amounts received by the Appellants during the fiscal year of the Corporation. Provided the amounts accrued as bonuses were paid out by the Corporation within 180 days of its year-end, the bonuses would be deductible. The Appellants' shareholder loan payable would be reduced in payment of the bonuses. In this manner the Appellants' income tax on the income could be deferred for one year.

[13] The Appellants accepted this explanation and relied on their accountant to properly report the Deferred Income in the subsequent periods. They did not question their accountant on this matter again. Mr. Thompson testified that he saw no reason to do so because the question was asked, and it had been answered by Mr. Halford. According to Mr. Thompson, he and his wife were unqualified to keep track of the Deferred Income. Mr. Halford was hired to ensure that the Appellants' tax returns were properly prepared.

[14] The evidence shows that in late 2009 and early 2010 Mr. Thompson began to question whether Mr. Halford was paying proper attention to the Appellants' and the Corporation's affairs. According to the witness, Mr. Halford was late for meetings. When he arrived he appeared dishevelled, unorganized and seemed to have been drinking.

[15] Mr. Thompson testified that soon thereafter he discovered significant errors in the draft financial statements prepared by Mr. Halford in respect of the Corporation's 2009 financial year-end. By that time Mr. Thompson had lost confidence in Mr. Halford and decided to hire a new accountant for his wife, himself and the Corporation. He approached Ruben Jeffery, a chartered professional accountant and partner at Ernst and Young ("EY") who agreed to take on their account.

[16] Mr. Jeffery was called as a witness. He testified that he was asked to finalize the Corporation's 2009 financial statement and ensure that the Appellants' and the Corporation's income had been properly reported by the Appellants' former accountant.

[17] The transition between Mr. Halford and Mr. Jeffery was difficult. Mr. Halford was unresponsive to Mr. Jeffery regarding his prior work for the Appellants. In taking on the mandate, Mr. Jeffery feared that Mr. Halford may have failed to keep proper track of the Deferred Income. There were inconsistencies that he identified between the income reported on the Appellants' personal tax returns and the management expenses recorded by the Corporation. The management expenses reported by the Corporation exceeded the income reported by the Appellants on their tax returns.

[18] Mr. Jeffery, acting on Mr. Thompson's instructions, asked Mr. Halford to reconcile the management expenses of the Corporation with the income reported by the Appellants. Mr. Halford prepared an excel spreadsheet that showed that the Appellants had unreported income of at least \$65,360.

[19] Mr. Jeffery had little confidence in the accuracy of Mr. Halford's work. At that point, Mr. Halford stopped responding to Mr. Jeffery's inquiries. Mr. Thompson tried to recover the accounting records kept with Mr. Halford to no avail. Mr. Halford's office was closed and a sheriff's seizure notice was posted on the door.

[20] Mr. Jeffery, working with reconstructed accounting records, redid Mr. Halford's work. He discovered that the Appellants had failed to report the income amounts in question in these proceedings, with respect to which the parties are in agreement.

[21] As Mr. Jeffery was hired to finalize the Corporation's 2009 financial statements, he proposed that the unreported income be reported by the Appellants in their 2009 tax returns. He added the unreported income to the income that they received from the Corporation in 2009. He reduced the Corporation's management expenses for 2009 to account for the fact that it had expensed the unreported income in prior years.

[22] The Canada Revenue Agency ("CRA") did not accept the treatment proposed by Mr. Jeffery. Instead it added the unreported income was added to the Appellants' income for the relevant taxation years.

III. Analysis

[23] Section 152 of the *Income Tax Act*, Canada (the "ITA") authorizes the Minister to assess tax, interest and penalties as provided for in the ITA. That section sets out the time for making reassessments. Under paragraph 152(3.1)(b) of the ITA, the Minister may reassess a taxpayer within three years of the day that an original assessment has been sent to the taxpayer in respect of the taxation year at issue (the "Normal Reassessment Period"). Subparagraph 152(4)(a)(i) of the ITA provides an exception to the Normal Reassessment Period. Under that provision, an assessment may be made after the Normal Reassessment Period if the taxpayer or the person filing the return has made a misrepresentation that is attributable to neglect, carelessness or wilful default.

[24] Where the Minister wishes to reassess the taxpayer beyond the Normal Reassessment Period, the Respondent has the burden of proving, on a balance of probabilities, both that a misrepresentation has been made and that such misrepresentation was attributable to carelessness, neglect or wilful default.

[25] Both of the parties referred me to my decision in *Aridi*.¹ While they drew different conclusions from that case, they argue that it is relevant to the outcome of this matter. In *Aridi*, I held that an accountant's neglect or carelessness in preparing a tax return is not sufficient in and of itself to allow the Minister to reassess beyond

¹ *Ibrahim Aridi v. The Queen*, 2013 TCC 74 [*Aridi*].

the Normal Reassessment Period. The taxpayer must also be shown to have acted in a neglectful or careless manner.

[26] There is no evidence as to who filed the tax returns for the taxation years at issue in this matter. For the purposes hereof, I will assume that the relevant tax returns were prepared by the Appellants' accountant, but were filed by them. While the accountant's carelessness or neglect is conceded by the Appellants, that is not a sufficient reason to disregard the Normal Reassessment Period. The Respondent must prove, on a balance of probabilities, that the Appellants did not exercise reasonable care in reviewing their tax returns at issue in this matter prior to filing them.

[27] I will now examine the evidence in this context. The evidence shows that the Appellants knew that they had to account for Deferred Income in the subsequent taxation years. This had been explained to Mr. Thompson by Mr. Halford in 2005. Mr. Thompson admitted that his wife had adopted the practice of setting aside 25% of the amount of their cash draws from the Corporation in their savings account in order to have the funds available to pay the tax when due.

[28] Mr. Thompson also admitted that he did not review his tax returns for the years at issue to verify whether the Deferred Income was properly accounted for. The evidence shows that he was able to understand the impact that the Deferred Income would have on his annual tax liability. Money was set aside by the couple to fund their deferred tax liability. Mr. Thompson had identified the impact of the deferral on his 2005 income tax liability and questioned his accountant on that matter. The evidence shows that he failed to do so in the subsequent years, when the Deferred Income was required to be reported.

[29] The Appellants' counsel argues that it was perfectly reasonable for the Appellants to delegate to their accountant the responsibility to properly account for the Deferred Income because they were unable to account for or keep track of it themselves. While I appreciate that they may not have had the necessary skills to keep track of the Deferred Income, they certainly had the ability to question their accountant on whether or not it was being properly done. They could have asked for a reconciliation of the Corporation's management expenses and the income reported by them each year.

[30] I also observe that Mr. Thompson's ability to spot errors was greater than that suggested by his counsel. The evidence shows that Mr. Thompson was able to

identify errors in the Corporation's draft financial statements for 2009, when he turned his attention to the matter.

[31] When a taxpayer hires an accountant to prepare his tax return and is aware that tax planning involving a deferral strategy, such as that adopted by the Appellants, is being used to secure a tax advantage for the taxpayer's benefit, a minimum degree of attention to or oversight over the accountant's work must be exercised by the taxpayer. In the case at hand, the evidence shows that the Appellants exercised oversight in 2005 but failed to pay reasonable attention to the reporting of the Deferred Income thereafter. In my opinion, the absence of oversight constitutes carelessness on the part of the Appellants. Had they paid attention to the matter by asking questions, the errors on their returns could have been avoided.

[32] Considering the evidence as a whole, I conclude that the Appellants were also careless or neglectful with respect to the errors made on their tax returns. Consequently, the appeals are dismissed, with one set of costs awarded to the Respondent.

Signed at Ottawa, Canada, this 20th day of June 2017.

"Robert J. Hogan"

Hogan J.

CITATION: 2017 TCC 115

COURT FILE NO.: 2015-262(IT)G
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STYLE OF CAUSE: JOHN THOMPSON, Estate of DENISE THOMPSON v. HER MAJESTY THE QUEEN

PLACE OF HEARING: Edmonton, Alberta

DATE OF HEARING: May 17, 2017

REASONS FOR JUDGMENT BY: The Honourable Justice Robert J. Hogan

DATE OF JUDGMENT: June 20, 2017

APPEARANCES:

Counsel for the Appellant: James Yaskowich
Counsel for the Respondent: Mary Softley

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