Docket: 2005-2621(IT)I

BETWEEN:

126632 CANADA LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard August 30, 2007, at Sherbrooke, Quebec
Before: The Honourable Justice Alain Tardif

Appearances:

Counsel for the Appellant: Michèle Gérin

Counsel for the Respondent: Simon-Nicolas Crépin

JUDGMENT

The appeal from assessments established under the *Income Tax Act* for the 1995, 1996, and 1998 taxation years is allowed, without costs, and the assessments are vacated, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 14th day of March 2008.

"Alain Tardif"

Tardif J.

Translation certified true
on this 6th day of May 2008.

Elizabeth Tan, Translator

Citation: 2008TCC132
Date: 20080314
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BETWEEN:

126632 CANADA LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

[OFFICIAL ENGLISH TRANSLATION]

Tardif J.

[1] This is an appeal regarding the 1995-1996 and 1998 taxation years. As for the 1997 taxation year, it is not subject to the appeal because there was no assessment for that year. As a result, the Court does not have jurisdiction regarding the 1997 taxation year.

[2] The issues are:

(a) to determine whether the Appellant's Amended Notice of Appeal against a new notice, dated May 15, 2002, that no income tax was payable for the 1997 taxation year, is allowable;

(b) to determine, if relevant, whether the amount of $9,429 was correctly added to the calculation of the Appellant's income for the 1997 taxation year, as additional income;

(c) to determine whether the amounts of $5,547, $7,591 and $13,245 were correctly added to the calculation of the Appellant's income for the 1995, 1996 and 1998 taxation years, respectively, as additional income.

[3] The Respondent established the assessment under appeal based on the following presumptions:

[TRANSLATION]

(a) the company "126632 Canada Ltd.", under the trade name "Le Café Fine Gueule" operated a small restaurant and provided catering services during the period in question;

(b) the fiscal year of the company "126632 Canada Ltd." ended on February 28 of each taxation year;

(c) the ordinary shares of the company "126632 Canada Ltd.", during the period in question, were held entirely by Nicole Blanchette;

(d) at the company "126632 Canada Ltd.", Nicole Blanchette held the positions of administrator, president and employee during the period in question;

(e) following the "Memorandum on Objection" prepared by Revenue Quebec, the Minister approved the agreement signed January 7, 2003, by Nicole Blanchette, representative of the company "126632 Canada Ltd." and Rémi Boulay from Revenue Quebec, regarding the 1995, 1996, 1997 and 1998 taxation years;

(f) following the agreement signed January 7, 2003, by Nicole Blanchette, representative of the company "126632 Canada Ltd." and Rémi Boulay of Revenue Québec, the Minister adjusted the income tax return of the company "126632 Canada Ltd." as follows:

	1995	1996	1997	1998
(i) additional income	$5,547	$7,591	$9,429	$13,245

(g) the adjustments for the 1995, 1996 and 1997 taxation years were made possible because the T2029 form, "Waiver in Respect of the Normal Reassessment Period", was filed within the prescribed time for each of the years in question, all signed by Nicole Blanchette on February 18, 2000, on behalf of the company "126632 Canada Ltd.";

(h) a T2029 form, "Waiver in Respect of the Normal Reassessment Period", was also filed for the 1998 taxation year;

(i) the adjustments were calculated as follows for each of the taxation years:

		1995	1996	1997	1998
(i)	Sales according to available invoices	$7,401	$11,635	$9,478	$8,735
(ii)	Number of invoices	467	1 077	816	709
(iii)	Average sales	$15.85	$10.80	$11.62	$12.32
(iv)	Number of invoices missing according to numerical order	638	1,365	1,402	1,831
(v)	Estimated additional sales (iii) x (iv)	$10,085	$14,322	$16,866	$22,074
(vi)	Additional expenses granted	$4,538	$6,731	$7,437	$8,829
(vii)	Additional income (v)- (vi)	$5,547	$7,591	$9,429	$13,245

(j) the additional expenses come from the increased cost of merchandise sold attributable to the additional income so as to maintain the profit margins before adding the additional income in question.

[4] First, the Appellant was subject to assessments established by Revenue Quebec. Following the settlement, the information was transmitted to the Canada Revenue Agency (the "Agency"), which established the new assessments that are the subject of this appeal.

[5] Revenue Quebec first established assessments at more or less $200,000. The Appellant then served her Notice of Objection. She also made arrangements to make anticipated periodic payments.

[6] The case then followed a twisted path, and the time it took to handle the objection was very long, despite various initiatives on the Appellant's part to help the case progress.

[7] The assessment that is the subject of this appeal was essentially established based on the settlement reached with Revenue Quebec.

[8] Ms. Blanchette, the Appellant's shareholder, testified. She described the company's only economic activity, operating a restaurant.

[9] She agreed that the accounting was not exemplary. She did, however, provide all available documents.

[10] As the Appellant's shareholder, Ms. Blanchette explained that she was determined to put everything in order to keep the restaurant in operation, since she

was completely invested in it, and she admitted she did not have impeccable daily accounting.

[11] She mentioned many difficulties that she faced. To succeed in keeping the restaurant in business, Ms. Blanchette explained that she had to give up some personal belongings including her car, launch various services and even work elsewhere.

[12] She also acquired the shares of the other shareholder who was less determined and optimistic regarding the chances the company would survive; she changed the business hours of the restaurant to reduce expenses; she also launched some new services, such as preparing meals to be delivered and consumed outside the restaurant.

[13] To bring the business back up to par, she agreed to take charge of a canteen on a very busy site, more favourable and more profitable than the Appellant's restaurant, with the hope of making some money.

[14] Ms. Blanchette described the facts surrounding the establishment of the assessment under appeal. First, she indicated that the company was audited a few months earlier by the Agency, following which the Appellant was subject to an assessment for a minimal amount.

[15] She explained that this audit was carried out in an atmosphere of mutual respect and cooperation; during this audit, she provided all the documents available, and she confirmed that she did not recall any snags or particular complaints.

[16] During the audit that led to the assessment established by Revenue Quebec, the settlement of which was used as a basis for the assessment currently under appeal, things were done in a completely different manner.

[17] Ms. Blanchette stated that the audit was carried out in a tense atmosphere and that relations were very strained and difficult.

[18] Blaming Ms. Blanchette for the mediocre quality of the accounting and criticizing her for her lack of coherence in invoice management, the auditor from Revenue Quebec allegedly established an assessment according to her evaluation and opinion, in an arbitrary manner.

[19] The auditor carried through with her threats and established an assessment with no explanation, taking into consideration that allegedly missing invoices represented undeclared sales for meals that she established as having an average value of $40.

[20] This finding ignored Ms. Blanchette's explanations for the "missing" invoices. According to her, the servers used the same numbered pads for invoices to take orders. The numbers on the invoices therefore did not necessarily follow each other, which, in her opinion, would explain why certain invoices were not there and could lead the auditor to conclude that a greater number of meals had been sold than actually had been.

[21] The average value of the meals was established arbitrarily from the auditor's personal viewpoint, based on the style and mood of the restaurant. The facts available at the time of the audit, such as the actual invoices establishing the average meal price at $10, were brushed aside.

[22] The arbitrary and clearly exaggerated evaluation led to an assessment of $200,000. Stunned by the assessment, Ms. Blanchette stated she contacted the auditor from the Agency who had carried out the audit in the preceding months to explain the situation and, especially, for advice. This was unusual, to say the least, but very telling of the context of the audit carried out by Revenue Quebec.

[23] Given that the assessment established by Revenue Quebec would lead to the permanent closure of the restaurant, Ms. Blanchette wanted to avoid this at all costs.

[24] Her ultimate goal being to keep the restaurant afloat, Ms. Blanchette focused on the tax issue in order to find a solution that would allow the restaurant to survive.

[25] Ms. Blanchette explained that she wanted to reach a settlement. To achieve this, she accumulated a certain amount, the majority coming from activities carried out primarily outside her place of business, namely operating the canteen. Obviously, she challenged the validity of the assessment. The case dragged on for months.

[26] She made an arrangement based on her ability to pay and started saving in order to eventually settle the case. When the time came, she and her counsel went to the Revenue Quebec offices where they met with Rémi Boulay and his

supervisor to discuss and negotiate; they finally came to a settlement, which was signed in the early afternoon that same day.

[27] Rémi Boulay, who was present at the signing of the settlement, also testified. He admitted that the case took a very unusual route; he indicated that he did not understand or could not explain certain details, in particular regarding the delays and the substantial gap between the first assessment and amount of the settlement.

[28] Mr. Boulay admitted that the elements such as the kindness, compassion, precariousness of a taxpayer's financial situation or ability to pay, the possibility of ruining or bankrupting someone are all factors that have no effect or influence on a case review.

[29] According to the auditor, only the relevant elements deemed valid are taken into consideration during the review of a case at the objection stage or during discussions and negotiations for the purpose of coming to a settlement.

[30] In other words, the review that led to the settlement was the result of considerations of relevant elements and facts that were considered relevant; nothing more and nothing less.

[31] From this statement, which corresponds exactly to the provisions of the Act, the conclusion is that the initial assessment of $200,000 was grossly exaggerated, completely arbitrary and totally disproportionate considering the difference between the initial assessment and the one that was the subject of a settlement.

[32] The file was subject to a settlement after a long meeting with Rémi Boulay and his supervisor.

[33] I noted that Mr. Boulay was a reasonable, calm and thoughtful person, fully capable of discussing or negotiating in a professional manner.

[34] The fact that the settlement overshadowed all the arguments about the financial consequences of the assessment is a rather convincing confirmation that the analysis carried out during the audit in the field was botched up and that the findings used to establish the initial assessment were extremely exaggerated, which is totally unacceptable.

[35] The amount of the settlement corresponds to barely 10% of the amount of the first assessment. I restate again that Mr. Boulay clearly indicated that only the relevant facts were to be taken into consideration when establishing an assessment.

[36] During the settlement, the issue of interest was brought up and the Appellant stated that the time between the assessment and the meeting was not her responsibility and it was a relevant reason to justify waiving the interest calculated by Revenue Quebec. This argument was dismissed by Revenue Quebec and the Appellant had to pay the interest.

[37] Of course, on this, the burden of proof is on the taxpayer who initiates an appeal; this does not mean that those who are responsible for conducting an audit have the right to do whatever they want, any way they want, on the basis that the taxpayers will only need to prove the validity of their claims if they do not agree with a first assessment.

[38] Audits are work to be done seriously and professionally, while respecting the taxpayers' rights and the applicable standards. Exaggeration and arbitrariness have no place in this field.

[39] It is unacceptable to establish an assessment based on any frustration or petty, unjustified reactions. If an auditor is not able to carry out his or her work in an acceptable manner, it is not the taxpayers' responsibility to accept the consequences.

[40] What can we conclude from the settlement, where only the elements deemed relevant by the Minister, represented by Mr. Boulay in this case, were taken into consideration, and which led to an amount that corresponded to only 10% of the initial assessment? Does this not clearly show that the basis of the initial assessment was highly exaggerated to the point where it is reasonable to call the work a botched audit, or even irresponsible?

[41] Can such a situation be used as a reasonable excuse to get out of the fundamental responsibility regarding implementing an effective accounting system in terms of keeping supporting data and documents?

[42] Was the Appellant careful, vigilant and responsible in her obligation to keep adequate accounting that would allow for reliable results during an audit, according to the standards? The answer, clearly, is no.

[43] In this case, however, it is clear to me that the Appellant's case was the subject of a botched audit that led to findings that had no valid basis.

[44] The bases for justifying the first assessment were highly exaggerated, to the point that the finding must be that they were simply unreasonable.

[45] Moreover, this became clear on the testimony of the auditor in charge of the case at the objection stage, and the statements by counsel for the Respondent. The following in an excerpt from the arguments:

[TRANSLATION]
Simon-Nicolas Crépin's Arguments (pages 79, 80, 81):

> We have heard about saving Ms. Blanchette's business. Mr. Boulay told you that the bankruptcy aspect of a company has nothing to do with the assessment aspect.
>
> ...
>
> This is what Ms. Blais of Revenue Quebec noted, and I agree with Ms. Gérin on this, and agree with the parties that the assessments were exaggerated. I think the A-10 agreement is a better reflection of reality.
>
> ...
>
> You must definitely decide which is a more credible version. Was this an agreement between a taxpayer and a tax body? Ms. Blanchette told you: it was that or I was bankrupt. You have Mr. Boulay who testified something resembling: bankruptcy is not my field. I do not handle cases on the person's ability to pay. I handle cases based on the available data. If there is a subsequent problem with bankruptcy, it is the recovery section that takes care of it.

[Emphasis added.]

[46] Taking for granted that the settlement with Revenue Québec is a sufficient and satisfactory basis for justifying the assessment under appeal, counsel for the Respondent stated (at page 79): [TRANSLATION] It would be, Mr. Justice, exceptional to me for a taxpayer to accept a settlement with a tax body, be it Revenue Quebec or the Canada Revenue Agency, to pay more income tax than they actually owe." This statement makes complete sense and is very reasonable.

[47] However, after being the subject of an assessment, the amount of which was around $200,000, would it not be reasonable to settle for an amount representing around 10% of the amount, considering there had been some small deficiencies in terms of acceptable accounting?

[48] Moreover, the very strange circumstances and context of this case also justify that a reasonable person would want to put an end to this tax saga.

[49] Ms. Blanchette had invested everything to meet the challenge of keeping her business afloat, despite having to face a first assessment, for an astronomical amount.

[50] After this ordeal, a reasonable person would have accepted the settlement, considering the extreme power of tax auditors.

[51] First, Ms. Blanchette was fully aware that her bookkeeping had some deficiencies and that a number of documents were missing, which led her to feel a certain amount of guilt. This is another element that led her to accept the settlement Revenue Quebec proposed.

[52] She cooperated, she followed up and took initiatives to resolve the case and still, it was months before a settlement was reached, which was attributable to her.

[53] The settlement was accepted in order to be rid of the threat the assessment posed, like a sword of Damocles, to the survival of the business. Why did the Appellant present her case before the Court after settling with Revenue Québec?

[54] At one point, Ms. Blanchette had an amount she thought was sufficient to cover her obligations before the two tax bodies. Given that she still had money after the first settlement, she thought she could come to an agreement with the Canada Revenue Agency.

[55] This would likely have happened if it had not been the interest that was added to the principle of the assessment, which was mentioned during the settlement.

[56] It was mentioned that interest would not be added. On one hand, Revenue Quebec had the power to waive it, and on the other, the facts and circumstances from the evidence were such that it was highly likely there would be mention of the interest being waived, which is not what happened in reality.

[57] As indicated above, in tax matters, the burden of proof is on the person who initiates the appeal. In this case, the burden is on the Appellant.

[58] Considering the facts from the evidence, I do not believe that the settlement was acceptable evidence to justify the validity of the assessment under appeal, even more so because the settlement was clearly for the sole purpose of settling a file of great concern.

[59] Could the Agency use Revenue Quebec's calculations to establish its assessments? Counsel for the Respondent admitted (see page 6 of the transcript) that the Agency did not verify the amounts provided by Revenue Quebec but merely took the same figures.

[60] I will cite the statements by Madam Justice L'Heureux-Dubé in *Hickman Motors Ltd.. v. R.*, 1997 CarswellNat 3047, [1998] 1 C.T.C. 213, 148 D.L.R. (4th) 1, 97 D.T.C. 5363, 131 F.T.R. 317 (note), 213 N.R. 81, [1997] 2 S.C.R. 336 regarding the burden of proof:

> 92 It is trite law that in taxation the standard of proof is the civil balance of probabilities: *Dobieco Ltd.. v. Minister of National Revenue*, [1966] S.C.R. 95, and that within balance of probabilities, there can be varying degrees of proof required in order to discharge the onus, depending on the subject matter: *Continental Insurance Co. v. Dalton Cartage Co.*, [1982] 1 S.C.R. 164; *Pallan v. M.N.R.*, 90 D.T.C. 1102 (T.C.C.), at p. 1106. The Minister, in making assessments, proceeds on assumptions (*Bayridge Estates Ltd.. v. M.N.R.*, 59 D.T.C. 1098 (Ex. Ct.), at p. 1101) and the initial onus is on the taxpayer to "demolish" the Minister's assumptions in the assessment (*Johnston v. Minister of National Revenue*, [1948] S.C.R. 486; *Kennedy v. M.N.R.*, 73 D.T.C. 5359 (F.C.A.), at p. 5361). The initial burden is only to "demolish" the exact assumptions made by the Minister but no more: *First Fund Genesis Corp. v. The Queen*, 90 D.T.C. 6337 (F.C.T.D.), at p. 6340.
>
> 93 This initial onus of "demolishing" the Minister's exact assumptions is met where the appellant makes out at least a *prima facie* case: *Kamin v. M.N.R.*, 93 D.T.C. 62 (T.C.C.); *Goodwin v. M.N.R.*, 82 D.T.C. 1679

> (T.R.B.)… The law is settled that unchallenged and uncontradicted evidence "demolishes" the Minister's assumptions: see for example *MacIsaac v. M.N.R.*, 74 D.T.C. 6380 (F.C.A.), at p. 6381; *Zink v. M.N.R.*, 87 D.T.C. 652 (T.C.C.). As stated above, all of the appellant's evidence in the case at bar remained unchallenged and uncontradicted...
>
> 94 Where the Minister's assumptions have been "demolished" by the appellant, "the onus . . . shifts to the Minister to rebut the *prima facie* case" made out by the appellant and to prove the assumptions: *Magilb Development Corp. v. The Queen*, 87 D.T.C. 5012 (F.C.T.D.), at p. 5018. Hence, in the case at bar, the onus has shifted to the Minister to prove its assumptions that there are "two businesses" and "no income".
>
> 95 Where the burden has shifted to the Minister, and the Minister adduces no evidence whatsoever, the taxpayer is entitled to succeed: see for example *MacIsaac*, *supra*, where the Federal Court of Appeal set aside the judgment of the Trial Division, on the grounds that (at p. 6381) the "evidence was not challenged or contradicted and no objection of any kind was taken thereto". See also *Waxstein v. M.N.R.*, 80 D.T.C. 1348 (T.R.B.); *Roselawn Investments Ltd.. v. M.N.R.*, 80 D.T.C. 1271 (T.R.B.). Refer also to *Zink*, *supra*, at p. 653, where, even if the evidence contained "gaps in logic, chronology, and substance", the taxpayer's appeal was allowed as the Minister failed to present any evidence as to the source of income…

[61] It is the Appellant's responsibility to show that the Minister's presumptions are unfounded; once this is done, the Minister can no longer simply rely on the result of an unacceptable audit to establish assessments.

[62] The Appellant was in possession of certain elements to dismiss the claims.

[63] Given the context surrounding the settlement between the Appellant and Revenue Quebec, it has no relevance in this case. To support this finding, I refer to the statements by Lamarre Proulx J. in *Abderrahman v. R.*, 2000 CarswellNat 1976, 2000 D.T.C. 2565 (Fr.), [2002] 1 C.T.C. 2429, 2000 CarswellNat 3611, at paragraph 47:

> … the document may have been relevant if the amounts allowed had been allowed for reasons related to the facts or the *Act* that were explained in the offer or another attached document. The amounts were allowed solely to settle the dispute, and that was also why they were proposed to the individual taxpayer. That offer is therefore of no use to the debate herein and in that sense it is not relevant...

[64] Despite the above, I will use a much simpler reasoning to address this case.

[65] Counsel for the Respondent indicated the following in his observations:

Simon-Nicolas Crépin's arguments (pages 78, 79, 81, 82):

> [translation]
> We agree, Ms. Gérin, this is an issue of credibility, Mr. Justice. You have two contradictory versions from Mr. Blanchette before you.
>
> …
>
> You must definitely decide which version is more credible. Was there an agreement between a taxpayer and a tax body? Ms. Blanchette says: it was that or I was bankrupt.
>
> …
>
> Now, it is really a question of credibility, Mr. Justice. You must decide, considering the circumstances. Do the A-10 agreement and the deficient accounting by the Appellant's company carry more weight than the testimony you heard before you today, namely that it was not deficient accounting. It was a way of operating and the missing invoices were not really invoices, and the A-10 agreement was, I believe, to settle everything to avoid bankruptcy and to eventually be able to continue with the business. And I did not at all think I would owe taxes to the Agency by signing that form. For that reason…

[66] However, there is nothing in the evidence would lead me to believe that Ms. Blanchette is not trustworthy. On the contrary, I feel she testified frankly, honestly and sincerely.

[67] She answered questions addressed to her precisely and directly. As a result, I allow the appeal and vacate the assessment under appeal.

Signed at Ottawa, Canada, this 14th day of March 2008.

"Alain Tardif"

Tardif J.

Translation certified true
on this 6th day of May 2008.

Elizabeth Tan, Translator

CITATION:	2008TCC132
COURT FILE No.:	2005-2621(IT)I
STYLE OF CAUSE:	126632 CANADA LTD. and Her Majesty the Queen
PLACE OF HEARING:	Sherbrooke, Quebec
DATE OF HEARING:	August 30, 2007
REASONS FOR JUDGMENT BY:	The Honourable Justice Alain Tardif
DATE OF JUDGMENT:	March 14, 2008

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