Docket: 2005-1590(IT)I

BETWEEN:

FRED HICKERTY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 10, 2008, at Edmonton, Alberta

Before: The Honourable Justice Valerie Miller

Appearances:

Agent for the Appellant:	Betty Hickerty
Counsel for the Respondent:	Gregory Perlinski

JUDGMENT

The appeals from the reassessments made under the *Income Tax Act* for the 1998 and 1999 taxation years are allowed to increase the business use of home from 30% to 45% and to allow the Appellant a deduction for CCA for the Quonset.

The reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the foregoing basis.

Signed at Ottawa, Canada, this 22nd day of October 2008.

"V.A. Miller"

V.A. Miller, J.

Citation: 2008TCC578
Date: 20081022
Docket: 2005-1590(IT)I

BETWEEN:

FRED HICKERTY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 20051588(IT)I

AND BETWEEN:

BETTY HICKERTY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

V.A. Miller, J.

[1] These are appeals from reassessments of the Appellant's 1998 and 1999 taxation years wherein the Minister of National Revenue (the "Minister") disallowed farming expenses; assessed net business income; and, assessed penalties pursuant to subsection 163(2) of the *Income Tax Act* (the *Act).*

[2] The appeals were heard on common evidence and only Betty Hickerty testified on behalf of the Appellants.

[3] The issues were as follows:

a) whether the Appellants underreported their income;
b) whether the Appellants are entitled to deductions in excess of the amounts allowed by the Minister for work space in the home, the use of the telephone, insurance, maintenance and repairs and the Quonset; and,
c) whether the Minister properly assessed gross negligence penalties under subsection 163(2) of the *Act*.

[4] The Appellants are married and during the years under appeal they resided in a home near Sundre, Alberta. They operated an accounting and tax preparation business, a construction business and an advertising sales business (the "Businesses") from their home. They also had a farm operation near Youngstown, Alberta. All Businesses and the farm operation were run as an equal partnership between the Appellants.

[5] The Appellants did not keep proper books and records. They kept documents loosely in a binder and file folder. The expense invoices they submitted to the Canada Revenue Agency (the "CRA") could not be reconciled with the amounts claimed on their returns. The Appellants prepared a synoptic or a ledger as requested by the CRA and this as well could not be reconciled with the amounts claimed on the returns.

FARM OPERATION

[6] The Appellants' farming operation was near Youngstown, Alberta. They operated a cattle farm by leasing property from Tim and Jeff Laughlin (the Laughlins) and sharing expenses with them.

[7] The only issue raised by the Appellants with respect to the Farming Operation was the Quonset. Mrs. Hickerty stated that they had bought the Quonset in 1999 with the intention of selling it. It cost $12,000. Instead of selling the Quonset they used it as a mechanical shop and storage shed. They still own the Quonset and it is being used by the Laughlins in Youngstown.

[8] Patricia McCulloch, an appeals officer with the CRA, testified that she did not allow any deduction for the Quonset as she was told that it was purchased with the intention of selling it. However, after hearing the evidence, Ms. McCulloch stated that capital cost allowance ("CCA") should have been allowed on the Quonset.

BUSINESS OPERATIONS

[9] With their income tax returns ("returns") the Appellants filed a Statement of Farming Activities (the Statement). They included the income from their Businesses on this Statement under the heading "Custom or contract work and machine rentals". As well, the Appellants each indicated on their returns that they were 100% partners.

[10] The Appellants operated an accounting/tax preparation business as well as construction and advertising businesses. Most of the Appellants' income was earned from the accounting/tax preparation business. Mrs. Hickerty stated that in the years under appeal she and her spouse prepared returns for approximately 300 to 400 clients. However, on cross-examination she agreed that they prepared returns for approximately 700 clients.

[11] Mr. Hickerty has completed grade 12 and is a journeyman carpenter. He has taken some accounting/bookkeeping courses. He has operated an accounting/tax preparation business for 26 years.

[12] Mrs. Hickerty also has grade 12 and has taken accounting courses. She has operated an accounting/tax preparation business with her spouse for 18 years.

[13] The Appellants calculated their income from this source by reviewing the bank statements as they said that all monies received were deposited into their bank accounts. Mrs. Hickerty said that they used the cash method because some of their clients did not pay for a year. In total they reported gross income of $46,420 and $32,510 from the Businesses in 1998 and 1999 respectively.

[14] Ms. McCulloch used the Appellants' invoice books to determine that the Appellants had earned gross income in the amount of $63,051 and $76,550 in 1998 and 1999 respectively. The Appellants were given a deduction for accounts that could not be collected (bad debts) for those years. The bad debts were only the amounts of $1,880 and $1,953 in 1998 and 1999 respectively.

[15] Mrs. Hickerty stated that she and her spouse did not underreport their income yet they produced no documents at the hearing of the appeal. She stated that she was not sure what her income was but that she disagrees with the Minister's calculations.

[16] The Appellants have not shown that the Minister's computation of income was incorrect. It really does not matter whether the cash method or accrual method of calculating income was used; in either scenario, it is evident that the Appellants failed

to report all the income they earned each year. The amount of bad debts for each of the years was minimal.

[17] The Appellants ought to have computed their income for tax purposes by matching their revenues and their expenses.[i] This would have given a more accurate computation of their income for each year.

WORK SPACE IN THE HOME

[18] The Appellants used their home as their principal place of business. The Appellants claimed that they used 75% of their home for business purposes as every room contained items that related to their Businesses. Mrs. Hickerty explained that they always had their clients' papers stored in filing cabinets. The filing cabinets were stored in their bedroom and in sheds. They had a photocopier in their bedroom and one bedroom in the house was used exclusively for business. Their busy season started in November and by November they usually had hired people to work with them.

[19] The appeals officer allowed a deduction of 30% for business use of the home. She stated that the Appellants had told her that they used almost 100% of their home for business purposes during tax filing season (March to May). The appeals officer estimated that the business use of the home was 25% for January, 50% for February through May and 15% for June through December. As a result she allowed a 30% deduction of the telephone, utilities, property taxes and interest expenses.

[20] In the absence of any documentary evidence, 75% business use appears to me to be too high. However, based on Mrs. Hickerty's description of her business and her home it is my opinion that a more reasonable estimate of the business use of her home for the period under appeal was 45%.

TELEPHONE EXPENSES

[21] Ms. McCulloch stated that she had intended to allow the Appellants to deduct 30% of their telephone and utilities expenses. At the hearing she noticed that she had only allowed 25% of the telephone expense. The Appellants have requested that they be allowed to deduct 80% of their telephone expense.

[22] The Appellants agree that their telephone and utilities expense did not exceed $7,347 in 1998 and $6,927 in 1999.

[23] I have allowed a deduction of 45% for the telephone expense for each of the years under appeal.

INSURANCE EXPENSES

[24] The Appellants have been allowed deductions for home and vehicle insurance. However, they have asked for a deduction for “Combined Insurance”, the proceeds of which they say would be taxable in the event of accident or disability. The Appellant have not submitted anything to show that they paid premiums or that they have an insurance policy the proceeds of which would be taxable.

MAINTENANCE AND REPAIRS

[25] The Appellants claimed maintenance and repair expenses in the amounts of $5,269.16 and $6,991.26 in 1998 and 1999. Mrs. Hickerty thought that these amounts related to fence and building materials. On cross examination she admitted that she did not really know what they had bought with these amounts.

PENALTIES

[26] On filing their income tax returns the Appellants each reported net income of $6500 and $7000 in 1998 and 1999 respectively. As a result of the reassessment, each Appellant’s net farm income was calculated to be $11,306 and $9,308 in 1998 and 1999 respectively. Each Appellant’s net business income was reassessed to be $17,880 and $24,161 in 1998 and 1999 respectively.

[27] The Appellants failed to report income of $16,631 and $44,040 from their Businesses in 1998 and 1999 respectively.
[28] The Appellants operate an accounting/tax preparation business. They provide consultation in tax matters to other taxpayers. They very often represent other taxpayers at the audit and appeal stage with the CRA.

[29] The Appellants kept no books and very poor records for themselves.

[30] The Appellants felt that they should have been given a warning and that gross negligence penalties should not have been assessed. I disagree. I believe that the penalty was properly imposed.

[31] In *DeCosta v. R.*[ii], Chief Justice Bowman wrote 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.

[32] In the present appeal all factors indicate that the Appellants knowingly or under circumstances amounting to gross negligence made a false statement or omission in their returns. Their omissions were not mere inadvertence. They claimed expenses which they could not substantiate and they failed to report a substantial amount of their income.

[33] The appeals are allowed to increase the business use of home from 30% to 45% and to allow the Appellants a deduction for CCA for the Quonset.

Signed at Ottawa, Canada, this 22nd day of October 2008.

"V.A. Miller"

V.A. Miller, J.

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[i] Neonex International Ltd. v. Her Majesty the Queen (1978), 78 D.T.C. 6339 (F.C.A.)
[ii] 2005 TCC 545

CITATION:	2008TCC578
COURT FILE NO.:	2005-1590(IT)I
STYLE OF CAUSE:	FRED HICKERTY AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Edmonton, Alberta
DATE OF HEARING:	October 6, 2008
REASONS FOR JUDGMENT BY:	The Honourable Justice Valerie Miller
DATE OF JUDGMENT:	October 22, 2008

APPEARANCES:

Agent for the Appellant:	Betty Hickerty
Counsel for the Respondent:	Gregory Perlinski

COUNSEL OF RECORD:

For the Appellant:

Name:
Firm:

For the Respondent: John H. Sims, Q.C.
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