

Docket: 2008-783(IT)I

BETWEEN:

LAVAL CÔTÉ,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on October 23, 2008, at Chicoutimi, Quebec.

Before: The Honourable Justice Robert J. Hogan

Appearances:

For the Appellant: The Appellant himself

Counsel for the Respondent: Marie-Claude Landry

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 2001, 2002 and 2003 taxation years is allowed, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant's net unreported income as stated in the reassessments in issue must be reduced by \$14,700 for each of the 2001 and 2002 taxation years, and by \$7,400 for the 2003 taxation year. The penalties imposed under subsection 163(2) of the Act are cancelled.

Signed at Ottawa, Canada, this 15th day of January 2009.

"Robert J. Hogan"

Hogan J.

Translation certified true
on this 5th day of February 2009.

Brian McCordick, Translator

Citation: 2009 TCC 34
Date: 20090115
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REASONS FOR JUDGMENT

Hogan J.

[1] The Appellant appealed from notices of reassessment issued by the Minister of National Revenue ("the Minister") in relation to the 2001, 2002 and 2003 taxation years. The notices of reassessment were made using the net worth method.

[2] The assumptions of fact upon which the Minister relied in reassessing the Appellant are set out in paragraphs 9, 10 and 11 of the Reply to the Notice of Appeal and read as follows (and the answers given by the Appellant to each of the Minister's assumptions of fact at the beginning of the hearing are set out following each assumption):

[TRANSLATION]

9. In making and affirming the reassessments dated April 5, 2006, in respect of the 2001, 2002 and 2003 taxation years, the Minister relied on the following assumptions of fact:
 - (a) Following a tax audit of Chenil Chicoutimi Inc., of which the Appellant was the sole shareholder during the taxation years in issue, it was learned that the Appellant's personal expenses were defrayed by the corporation and that the Appellant's injections of funds into the corporation might be from unreported income. (*denied*)
 - (b) The analysis of the personal bank accounts of the Appellant and his spouse Michèle Morissette revealed unidentified deposits. (*denied*)

- (c) Given this situation, the Minister audited the Appellant's income using the net worth method; a copy of the Appellant's statement of net worth is attached as an appendix hereto (pages numbered 1 through 8). (*denied*)
- (d) The Appellant's cost of living was established primarily through the withdrawals from the couple's bank accounts and from the personal expenses defrayed by the corporation. (*denied*)
- (e) For the period from December 31, 2000, to December 31, 2003, the net worth audit identified the following unreported income amounts:

<u>Taxation year</u>	<u>Additional income</u>
(i) 2001	\$35,395
(ii) 2002	\$20,247
(iii) 2003	<u>\$18,010</u>
	<u>\$73,652</u>
	(<i>denied</i>)

- (f) The details of the unreported income are as follows:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
(i) Rental income – trailer	\$2,500		
	(<i>denied</i>)		
(ii) Dividend income		\$2,664	
		(<i>denied</i>)	
(iii) Taxable capital gain		\$1,000	
		(<i>denied</i>)	
(iv) Taxable benefits received from Chenil Chicoutimi Inc.			
(a) personal expenses paid by the corporation	\$8,706	\$6,549	\$10,926
(b) taxable capital gain - tractor		\$4,793	
(c) other income	<u>\$24,189</u>	<u>\$5,241</u>	<u>\$7,084</u>
	\$35,395	\$20,247	\$18,010
			(<i>denied</i>)

- (v) During the period in issue, Michèle Morissette filed only one income tax return: her return for the 2003 taxation year. (*admitted*)

10. Based on the following elements, the Minister determined that the Appellant, upon filing his 2001 income tax return, made a misrepresentation attributable to neglect, carelessness or wilful default:
 - (a) The unreported income, computed using the net worth method, is considerable (122%) in relation to the reported income. (*denied*)
 - (b) The Appellant failed to report rental income (trailer). (*denied*)
 - (c) Personal expenses were paid by the corporation. (*denied*)
 - (d) Since the Appellant looks after the corporation's revenues and expenditures, he should have known that the income reported in his 2001 income tax return was underestimated. (*denied*)

11. Based on the following elements, the Minister determined that the Appellant knowingly, or in circumstances amounting to gross negligence, made a false statement or omission in the income tax returns filed for the 2001, 2002 and 2003 taxation years, or that he participated in, assented to or acquiesced in the making of the false statement or omission, and that, as a result, the tax that he was required to pay based on the information contained in the income tax returns filed for those years was lower than the amount of tax actually payable for those years:
 - (a) The Appellant failed to report rental income (trailer) and dividends. (*denied*)
 - (b) The corporation paid for personal expenses for each of the taxation years in issue. (*denied*)
 - (c) The corrected unreported income represents a significant percentage of the reported net income for each year in issue:
 - (i) 2001- 122%,
 - (ii) 2002- 62%,
 - (iii) 2003- 60%.

(*denied*)

[3] The Minister also imposed the following penalties for gross negligence:

	<u>Taxation year</u>	<u>Penalty imposed</u>	<u>Amounts subject to penalty</u>
(i)	2001	\$4,697.78	\$35,595
(ii)	2002	\$2,210.75	\$20,247
(iii)	2003	\$1,712.18	\$18,010

[4] In addition to testifying personally, the Appellant called three witnesses: his sister-in-law Marie-Reine Ménard, his sister-in-law Lise Champagne, and his wife Michelle Morissette.

[5] Ms. Ménard testified that she was very close to the late Imelda Boivin, who was her mother-in-law and the Appellant's wife's mother and who died in May 1999. Ms. Ménard explained to the Court that her mother-in-law was worried about whether she would have enough money to meet her needs in the event that she lived to a very old age. Hence, she testified, Ms. Boivin saved a great deal of her income.

[6] Ms. Ménard testified that she knew that her mother-in-law had a safe deposit box at Caisse populaire de Chicoutimi, where she cashed her Old Age Security (OAS) cheques. Ms. Boivin kept a bit of money for her day-to-day needs and deposited the rest into her safe deposit box. However, Ms. Ménard admitted that she never went with Ms. Boivin when she used the box.

[7] Ms. Champagne's account of the facts was the same as Ms. Ménard's. She explained to the Court that the Appellant's wife was the late Ms. Boivin's only daughter. She prepared Ms. Boivin's income tax returns for many years. She explained that Ms. Boivin saved a lot of money for her old age and that she placed her money in her safe deposit box at the Caisse populaire de Chicoutimi. Ms. Boivin had a strongbox in the closet of her unit at the seniors' residence in which she lived, and she used it to set aside some cash.

[8] Michelle Morissette testified that her mother lived with her father until he died, that is to say, for 45 years. Following his death, she sold the principal residence and moved to a small apartment. She remarried and was married to Paul Tremblay of Chicoutimi-Nord for 10 years, until he died. Ms. Morissette testified that her mother did not pay for anything during this second marriage. Mr. Tremblay covered all the expenses that were incurred. Mr. Tremblay bequeathed a bit of money and some movable property to her mother. Ms. Morissette explained to the Court that her mother was constantly worried about falling ill and being hospitalized. She did not want to be a burden to her children.

[9] Ms. Morissette testified that her mother had a safe deposit box at the Caisse populaire de Chicoutimi-Nord on Roussel Street for more than 20 years. She cashed her OAS cheques and placed most of the proceeds in her safe deposit box. She kept a bit of cash to cover the bare minimum, that is to say, her petty expenses. Ms. Morissette also testified that her mother kept a metal strongbox in her closet at the seniors' residence.

[10] Ms. Morissette explained that she chose to live near her mother in Chicoutimi in order to take care of her. She was surprised to learn that she was her mother's universal legatee. She testified that she went to the Caisse populaire Desjardins and that, upon opening her mother's safe deposit box, she found \$35,000 in cash. With the proceeds of the insurance and from the sale of the movable property, the total amount that Ms. Morissette obtained from her mother's succession was \$66,900.

[11] Ms. Morissette told the Court that, following her mother's death, she obtained a safe deposit box under her name at the Caisse populaire de Chicoutimi, on Ste-Geneviève Boulevard, near her house. She stated that, over the course of several months, she deposited all the amounts that she had received from her mother.

[12] The Appellant adduced an undated letter addressed to appeals officer Sophie Rousseau of the Canada Revenue Agency (CRA) and prepared by his accountant Serge Brassard. It was filed as Exhibit A-1. In the letter, Mr. Brassard explains to the appeals officer that the total amount received by Michelle Morissette from the succession was \$66,900. Mr. Brassard explained that his client, the Appellant, used approximately \$19,000, which left approximately \$47,900, which he accounted for in the Appellant's personal balance sheet as at December 31, 2000. The letter explains that the Appellant's net worth as at December 31, 2000, should be increased from \$136,736, the amount calculated by the CRA auditor, to \$203,636, in order to take this significant cash amount into account.

[13] The Appellant explained that in 2001, 2002 and 2003, he and his wife lodged people suffering from psychiatric or mental problems in their home. One such person was referred to them by the Institut Roland-Saucier of Chicoutimi, and the other was recommended by an official from the municipality of Chicoutimi-Nord. These individuals had no family and lived on social assistance. In 2002, the Appellant had two adults, Bruno Simard and Fernande Girard, in his home. They paid monthly rents of approximately \$650 and \$625, respectively. The Appellant and his wife received a total of \$14,700 in 2001, \$14,700 in 2002 and \$7,400 in 2003. In 2003, only Bruno Simard lived with the couple; he paid an annual allowance of \$7,500. The Appellant explained that, in 2001, he met Ms. Simard's tutor, who asked him to take care of Mr. Simard in his home. The Institut Roland-Saucier, Chicoutimi's psychiatric hospital, communicated with the Appellant's spouse and placed Ms. Girard in the Appellant's home. The Appellant alleged that he thought that the allowances that he received for the care of the two individuals were not taxable. He acknowledged that he did not include those amounts in his income tax returns. In addition, he corroborated his wife's account regarding the inheritance and regarding the placement of the amounts inherited into the safe deposit box. The Appellant says that he and his wife used these amounts to cover living expenses and to defray the costs of building their new residence, which they have since sold so that they could move to Gatineau.

[14] Guy Dion, the CRA auditor responsible for the Appellant's file, testified that the Appellant had been the subject of a net worth assessment at his Chicoutimi business, which was located close to his principal residence. At the beginning of his audit, he noticed that the Appellant had few internal controls that would have enabled him to conduct an audit using traditional methods. Mr. Dion told the Court that he audited the Appellant's and Ms. Morissette's bank accounts. Ms. Morissette had two bank accounts, and the Appellant had only one. He explained that, during the audit of the bank accounts, he noticed that many cheques had been cashed directly by the teller and were not deposited into the couple's bank accounts. Mr. Dion described these transactions as "zero deposits". He succeeded in determining that the cheques were cashed without any deposits into the Appellant's and his wife's bank account. Consequently, he decided to proceed using the net worth method.

[15] Mr. Dion prepared a list of the Appellant's assets as at December 31, 2000. At that time, the net balance was \$136,736. For the years 2001, 2002 and 2003, he did a complete audit of the banking transactions. Calculations of the net worth differential are attached to Appendix 6 of the Reply to the Notice of Appeal. Mr. Dion prepared a list of the Appellant's and his wife's personal expenses for the years 2001, 2002 and 2003. He treated all the withdrawals or cheque-cashing as personal expenses, unless he could establish that the amounts were used to pay expenses incurred by the kennel business wholly owned by the Appellant. He also added to the Appellant's income all personal expenses that the corporation paid on the Appellant's behalf. According to his calculations, the Appellant's personal expenses amounted to \$50,652 in 2001, \$48,584 in 2002 and \$40,309 in 2003. He added these amounts to the calculation of the Appellant's net worth. He subtracted some non-taxable amounts and some net income reported by the Appellant and his wife. Following his complete calculations, he determined that the Appellant's unreported income was \$35,395 for the 2001 taxation year, \$20,247 for the 2002 taxation year, and \$18,010 for the 2003 taxation year.

[16] He testified that he did not take account of the cash amounts that Ms. Morissette might have received upon her mother's death. He told the Court that he found no signs that these amounts were deposited into the Appellant's and his wife's bank accounts in 2001, 2002 or 2003. In addition, he explained to the Court that since his correction for personal expenses took into account only amounts directly withdrawn from the accounts, and cheques cashed by the Appellant, his calculations would be distorted if he took into account amounts that were not deposited into the bank account. The auditor said that if he had taken into account the \$47,900 that the Appellant says should be added to his assets at the beginning of the period, the only effect would have been to require him to increase the Appellant's personal expenses. Since he found that the construction expenses for the Appellant's and his wife's new residence were paid from the cheques drawn on the bank accounts, he explained that he should not take into account the cash amounts that Ms. Morissette might have held. Lastly, he explained to the Court that he had no evidence of the amount that Ms. Morissette received, and that she could have used these amounts for living expenses in prior years, or to make major investments that she held as at December 31, 2000, the date of the opening balance sheet.

[17] Mr. Dion admitted that he did not take into account the fact that the amounts paid for Mr. Simard's and Ms. Girard's lodging might not be taxable under the *Income Tax Act* ("the Act"). He did not exclude these amounts when computing the withdrawals that he treated as personal expenditures by the Appellant.

Analysis

[18] The Appellant asserts that the amounts that he and his wife received to lodge Ms. Girard and Mr. Simard in their principal residence (which was partly transformed into a foster home for disabled persons) are not taxable. The basis for that claim is paragraph 81(1)(h) of the Act, which reads:

81. (1) Amounts not included in income — There shall not be included in computing the income of a taxpayer for a taxation year,

...

(h) **Social assistance** -- where the taxpayer is an individual (other than a trust), a social assistance payment (other than a prescribed payment) ordinarily made on the basis of a means, needs or income test under a program provided for by an Act of Parliament or a law of a province, to the extent that it is received directly or indirectly by the taxpayer for the benefit of another individual (other than the taxpayer's spouse or common-law partner or a person who is related to the taxpayer or to the taxpayer's spouse or common-law partner), if

...

[Emphasis added.]

[19] According to this provision, a person who provides lodging to a social assistance recipient, and who receives payments directly or indirectly, does not pay tax on those amounts. In the case at bar, the Appellant and his wife testified that they lodged social assistance recipients in their home, and that the tutors of those recipients used their benefits to pay for the lodging. Furthermore, the Appellant and his wife testified that these amounts were deposited into their bank account. In my opinion, their uncontradicted testimony is *prima facie* evidence that the Appellant and his wife received non-taxable amounts that should have been excluded from the bank withdrawals that were treated as unreported income. This *prima facie* evidence shifted the burden of proof to the Minister. Since the Minister adduced no evidence with respect to this point, I must conclude that the amount of \$14,700 must be subtracted from the Appellant's unreported income for each of the years 2000 and 2001, and that the amount of \$7,400 must be subtracted from the unreported income for the year 2003.

[20] As to the second point in issue, I must conclude that the Appellant has not succeeded in showing that the amounts from Ms. Boivin's succession were deposited into his personal bank account in 2001, 2002 and 2003. Since only the funds deposited into and withdrawn from the couple's bank account in 2001, 2002 and 2003 were treated as personal expenses for the purpose of computing the adjusted net

worth, there is no risk that the capital of Ms. Boivin's succession was treated as unreported income.

[21] I must point out that the Respondent has the burden of proving, on a balance of probabilities, the circumstances that warrant the imposition of a penalty under subsection 163(2) of the Act. In my opinion, the Respondent has failed to meet this burden of proof. First of all, the method used by the auditor to complete the calculation of the adjusted net worth is very imprecise. The auditor assumed that all the withdrawals from the couple's bank account were personal expenses. In my opinion, a calculation based on an examination of actual expenditures, or based on public statistics, would have led to a better calculation of the couple's personal expenses. The evidence adduced is sufficient to establish unreported income where the burden is on the Appellant. But where a penalty is involved, it is insufficient, because the burden is on the Minister. I should note that, after adjusting for the non-taxable amounts referred to above, the Appellant's unreported income is \$20,895 for the 2001 taxation year, \$5,547 for the 2002 taxation year, and \$10,610 for the 2003 taxation year. Once these adjustments are made, the unreported income as a percentage of reported income is lower than that noted by the Respondent. For all these reasons, I order that the assessments be referred back to the Minister for reassessments that reduce the Appellant's net unreported income under the assessments in issue by \$14,700 for each of the years 2001 and 2002 and by \$7,400 for the year 2003. I also order that the penalties imposed under subsection 163(2) of the Act be cancelled.

Signed at Ottawa, Canada, this 15th day of January 2009.

"Robert J. Hogan"

Hogan J.

Translation certified true
on this 5th day of February 2009.

Brian McCordick, Translator

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STYLE OF CAUSE: LAVAL CÔTÉ v. HER MAJESTY
THE QUEEN

PLACE OF HEARING: Chicoutimi, Quebec

DATE OF HEARING: October 23, 2008

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

DATE OF JUDGMENT: January 15, 2009

APPEARANCES:

For the Appellant: The Appellant himself

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COUNSEL OF RECORD:

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Name:

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