

Citation: 2010 TCC 310
Date: 20100623
Docket: 2007-3161(IT)G

BETWEEN:

JDI 2000 TRANSPORT LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

AMENDED REASONS FOR JUDGMENT

Woods J.

[1] JDI 2000 Transport Ltd. operates a trucking business specializing in the transport of mail. It is wholly-owned by Mr. Inderjit Dhillon. At issue in this appeal is the deductibility of certain expenditures made by this corporation and whether gross negligence penalties were properly assessed.

[2] Assessments were issued under the *Income Tax Act* which disallowed deductions totaling \$306,693 for the 2003 taxation year and \$423,039 for the 2004 taxation year.

[3] The appellant has raised four issues:

- (1) whether a deduction may be taken for personal items purchased for the Dhillon family,
- (2) whether a deduction may be claimed for expenditures made in relation to the business of related companies,
- (3) whether the auditor wrongly concluded that amounts were deducted twice, and

- (4) whether penalties under subsection 163(2) of the *Act* are appropriate.

[4] Testimony on behalf of the appellant was provided by Mr. Dhillon and Mr. Lawrence Sammy, who was employed as the bookkeeper of the appellant and other companies owned by Mr. Dhillon. Testimony on behalf of the respondent was provided by Mr. Dal Jawandha, an auditor with the Canada Revenue Agency.

Personal items

[5] Mr. Dhillon, his wife and daughter made extensive purchases with a number of credit cards. Some of the items were business-related but a large number were personal expenditures of the family. It does not appear that the spouse or daughter worked in the business.

[6] During the years at issue, Mr. Dhillon gave the credit card statements to the bookkeeper, Mr. Sammy, for the purpose of arranging payment by the appellant.

[7] Mr. Sammy recorded the payments on the credit cards in journal entries under either “repairs and maintenance” or “travel.” Only the total from each credit card statement was recorded and not each individual purchase. There were approximately nine credit cards in total.

[8] Mr. Sammy did not suggest that this bookkeeping was proper, but he testified that he simply recorded the amount paid on each statement in the corporate account to which the majority of the expenses related.

[9] The auditor, Mr. Jawandha, asked for back up of the journal entries during the audit. Upon being provided with the credit card statements, the auditor disallowed a portion of the deductions on the basis that they represented personal items for the family and were not business related. Mr. Jawandha testified that he gave the appellant the benefit of the doubt with respect to many items. For example, all meals over \$50 were treated as business expenses.

[10] The total amounts on account of personal expenditures that were disallowed were \$155,271 for the 2003 taxation year and \$143,241 for the 2004 taxation year. Most of the items related to the credit card purchases but the disallowance also included expenses relating to an automobile used by Mr. Dhillon for personal purposes and life insurance premiums.

[11] In addition to assessing the appellant, the Minister also assessed Mr. Dhillon to include these amounts in his income as shareholder benefits pursuant to subsection 15(1) of the *Act*.

[12] The appellant does not dispute that these amounts were properly included in Mr. Dhillon's income, but it is suggested that the appellant should be entitled to a deduction to avoid double taxation.

[13] The avoidance of harsh tax consequences is not a sufficient justification for a deduction. If the expenditures are appropriations by Mr. Dhillon in his capacity as a shareholder, the legislation does not permit their deduction as they are not laid out for the purpose of earning income.

[14] The deduction is prohibited by paragraph 18(1)(a) which provides:

18(1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of

[...]

(a) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property;

[15] A payment made, not in the course of the business, but as an appropriation by a shareholder is subject to the above prohibition. The fact that the result is harsh is something that is clearly contemplated by the legislation, presumably to discourage abuse.

[16] If the personal expenses had been paid, not as shareholder appropriations, but as compensation for services rendered, the expenditures could be deducted as business expenses subject to considerations of reasonableness.

[17] I did not understand this to be the appellant's position, however. The only argument seemed to be the avoidance of double tax.

[18] In any event, the evidence does not support a conclusion that these amounts were intended to be paid as compensation for services rendered. The evidence as a whole suggests that there was no intention on the part of the appellant or Mr. Dhillon to treat these amounts as compensation.

[19] The amounts were very large in relation to Mr. Dhillon's other income. If Mr.

Dhillon had intended that these amounts be paid as compensation, he would have taken steps to provide for this and include the amounts in his income.

[20] Instead, Mr. Dhillon did not report the amounts as income and Mr. Sammy falsely recorded the amounts in the appellant's books and records. I find it extremely unlikely that Mr. Sammy acted on his own in this regard, notwithstanding the evidence of both Mr. Sammy and Mr. Dhillon to the contrary.

[21] The reasonable inference that should be drawn from the evidence is that Mr. Dhillon had no intention of treating these amounts as compensation on which he would have to pay tax. His intention was to extract these funds for the benefit of himself and his family without having to pay tax on them. Quite simply, he got caught.

[22] Mr. Sammy and Mr. Dhillon testified that they had not discussed how these amounts should be recorded in the financial statements. I did not find their vague testimony to be convincing.

[23] It defies common sense that a bookkeeper would falsely record expenses of this nature without the involvement of the business owner. Mr. Sammy testified that he recorded the credit card payments on corporate accounts to which the majority of the purchases related. This makes no sense in the context of credit cards used by Mr. Dhillon's family. It also appears contrary to the credit card statements that were entered into evidence (R-1).

[24] Counsel for the appellant submitted that Mr. Sammy's evidence should be accepted because it was not self-interested. I disagree. Mr. Sammy is employed as a bookkeeper for corporations wholly-owned by Mr. Dhillon. He was involved in making false journal entries, for no apparent reason other than to assist Mr. Dhillon to avoid paying tax on these amounts. There is good reason to view Mr. Sammy's testimony with suspicion.

Related company expenses

[25] As mentioned above, some of the credit card purchases were business-related. On the credit card statements, Mr. Dhillon had recorded the names of other wholly-owned companies beside some of the entries. It was acknowledged that these items were purchased for the other companies and that the appellant paid for them.

[26] The assessments disallowed these items on the basis that they were not laid out

for the purpose of earning income by the appellant.

[27] The amount that was disallowed is not clear to me but it appears to be in excess of \$150,000 for the two years at issue. This is based on the total amount of credit card expenses that were disallowed in excess of personal expenditures included in Mr. Dhillon's income (Ex. R-1, Tab 2, 3).

[28] The appellant submits that the expenditures are deductible because the related companies provided offsetting services to the appellant, such as truck maintenance by a business called Apple Autobody. No other payment was made for these services, it was suggested.

[29] Mr. Sammy testified that he kept an informal tally to keep track of this barter arrangement. These records were not retained.

[30] I was not satisfied with Mr. Sammy's vague testimony that he tracked goods and services provided by each of these corporations. If Mr. Sammy was diligent enough to keep such records, he likely would have been diligent enough to retain them.

[31] There may well have been services provided by the related companies to the appellant, but the value of these services cannot be determined without some type of records being retained. There is no reliable evidence on which I could make a determination as to the reasonableness of the expenses claimed by the appellant. As often stated by judges of this Court, if this result is harsh, the appellant has only itself to blame for not keeping adequate records.

Duplicate expenditures

[32] Mr. Sammy testified that he did not record expenses on a contemporaneous basis and that the books and records were only updated on a periodic basis.

[33] The auditor discovered a number of expenditures that were recorded twice resulting in duplicate deductions. The auditor disallowed the double entries.

[34] The total amounts disallowed as a result of duplications were \$19,556 for the 2003 taxation year and \$186,892 for the 2004 taxation year.

[35] The appellant does not dispute that there were duplications but it is submitted that adjusting entries for both years were made on December 31, 2004 when Mr.

Sammy realized that the duplicate entries had been made.

[36] I was not satisfied with this explanation. First, the purported adjusting entries do not appear on their face to relate to this problem (Ex. A-1, Tab 3, loose pages). Further, according to the auditor's notes, no explanation was provided to him during the audit concerning the duplicate entries. I reject Mr. Sammy's testimony that he made appropriate adjusting entries for these duplicate items. These amounts were properly disallowed.

Penalties

[37] The appellant was assessed penalties in relation to the credit card payments that had been disallowed. The amounts total \$273,784 for the 2003 taxation year and \$208,368 for the 2004 taxation year. These amounts include the personal expenditures of the Dhillon family and purchases for the related companies.

[38] The relevant part of subsection 163(2) is set out below:

163(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of \$100 and 50% of the total of

(a) the amount, if any, by which

(i) the amount, if any, by which

(A) the tax for the year that would be payable by the person under this Act

exceeds

(B) the amounts that would be deemed by subsections 120(2) and (2.2) to have been paid on account of the person's tax for the year

if the person's taxable income for the year were computed by adding to the taxable income reported by the person in the person's return for the year that portion of the person's understatement of income for the year that is reasonably attributable to the false statement or omission and if the person's tax payable for the year were computed by subtracting from the deductions from the tax otherwise payable by the person for the year such portion of any such deduction as may reasonably be attributable to the false statement or

omission

exceeds

(ii) the amount, if any, by which

(A) the tax for the year that would have been payable by the person under this Act

exceeds

(B) the amounts that would be deemed by subsections 120(2) and (2.2) to have been paid on account of the person's tax for the year

had the person's tax payable for the year been assessed on the basis of the information provided in the person's return for the year,

[39] Subsection 163(3) places the burden of proof on the respondent. This provision reads:

163(3) Where, in an appeal under this Act, a penalty assessed by the Minister under this section or section 163.2 is in issue, the burden of establishing the facts justifying the assessment of the penalty is on the Minister.

[40] There are several elements to the penalty provision that are potentially relevant here. First, there must be a false statement or omission in a return, form, certificate, statement or answer. Second, the appellant must have made or participated in the false statement or omission either knowingly or in circumstances amounting to gross negligence. Third, the amount of the penalty is based on the understatement of income reasonably attributable to the false statement or omission. The minimum amount is \$100.

[41] In my view, a reduction in the amount of the penalties is justified in this case.

[42] A portion of the penalties were based on the related company expenses. Based on the evidence presented, it is quite possible that these errors were a matter of sloppy bookkeeping. If so, it would constitute negligence but it would not elevate to the level of knowledge or gross negligence as required by s. 163(2).

[43] I would note, for example, that Mr. Dhillon went to the effort to note on the credit card statements which company the purchases related to. On its face, it appears that he intended the expenditures to be recorded to the proper company. The fact that the bookkeeper did not do this does not amount to knowledge or gross negligence on

the part of the appellant.

[44] The respondent suggested that Mr. Dhillon's companies may have achieved a tax reduction by having the expenses claimed by the appellant. The implication was that this may have been motivated by tax avoidance rather than simply sloppy bookkeeping. The auditor mentioned in his testimony that the other companies may have also claimed the same deductions, or that the companies may have claimed excessive small business deductions.

[45] The concerns that were expressed by the auditor may well be justified in the circumstances of this case. However, no evidence was brought in support of these concerns and the respondent has not satisfied the burden of proof in my view.

[46] Turning to the personal expenditures of the Dhillon family, I have concluded that penalties are appropriate. The deduction of these items as "repairs and maintenance" and "travel" was admittedly falsely made. Given the large amounts involved, the false claims were made either knowingly or under circumstances amounting to gross negligence in the sense of willful blindness.

[47] Further, claiming deductions for expenditures as repairs and travel when they clearly were not resulted in an understatement of the appellant's income which is reasonably attributable to the false statements.

[48] All the elements for the imposition of the penalty relating to the personal expenditures of the Dhillon family have been established.

[49] This conclusion is supported by a number of judicial decisions that were brought to my attention by counsel for the respondent: *2622-4121 Quebec Inc. v. The Queen*, 2005 TCC 238, 2008 DTC 3296; *2960-0731 Quebec Inc. v. The Queen*, 2006 TCC 270, 2008 DTC 3854; *Vialink Inc. v. The Queen*, 2009 TCC 117, 2009 DTC 1093; *Harland Associates 02 Inc. v. The Queen*, 2010 TCC 105.

Disposition

[50] In the result, the appeal is allowed only with respect to the gross negligence penalties on expenditures for related companies. In other respects the appeal is dismissed. Since the respondent has largely been successful in the appeal, it will be entitled to its costs.

These Amended Reasons for Judgment are issued in substitution for the

Reasons for Judgment dated June 4, 2010.

Signed at **Edmonton, Alberta** this **23rd** day of June 2010.

“J. M. Woods”

Woods J.

CITATION: 2010 TCC 310

COURT FILE NO.: 2007-3161(IT)G

STYLE OF CAUSE: JDI 2000 TRANSPORT LTD. and
HER MAJESTY THE QUEEN

PLACE OF HEARING: Vancouver, British Columbia

DATES OF HEARING: May 20 and 21, 2010

REASONS FOR JUDGMENT BY: The Honourable Justice J. M. Woods

DATE OF JUDGMENT: June 4, 2010

**DATE OF AMENDED
REASONS FOR JUDGMENT: June 23, 2010**

APPEARANCES:

Counsel for the Appellant: R. Keith Oliver

Counsel for the Respondent: Victor Caux

COUNSEL OF RECORD:

For the Appellant:

Name: R. Keith Oliver

Firm: Oliver & Co.
Coquitlam, British Columbia

For the Respondent: Myles J. Kirvan
Deputy Attorney General of Canada
Ottawa, Canada