Docket: 2011-2546(IT)I

BETWEEN:

MARTINO KNIGHT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on March 27, 2012, at Vancouver, British Columbia.

Before: The Honourable Justice Gaston Jorré

Appearances:

For the appellant:	The appellant himself
Counsel for the respondent:	Andrew Duncan

JUDGMENT

In accordance with the attached reasons for judgment, the appeal from the reassessment made under the *Income Tax Act* for the 2009 taxation year is dismissed, without costs.

The Court draws to the appellant's attention that, with respect to the taxpayer relief provisions in subsection 220(3.1) of the *Income Tax Act*, the Canada Revenue Agency publishes an information circular, IC07-1 "Taxpayer Relief Provisions", as well as a form, RC4288 "Request for Taxpayer Relief", for making taxpayer relief applications.

Signed at Ottawa, Ontario, this 16th day of April 2012.

"Gaston Jorré"

Jorré J.

Citation: 2012 TCC 118
Date: 20120416
Docket: 2011-2546(IT)I

BETWEEN:

MARTINO KNIGHT,

Appellant,

and

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REASONS FOR JUDGMENT

Jorré J.

Introduction

[1] When are 10% civil penalties for omitting income greater than 50% civil penalties for omitting the same amount either wilfully or in circumstances amounting to gross negligence?[1]

[2] When there are matching omission and gross negligence penalties under both the federal and the provincial income tax acts the omission penalty will very frequently exceed the gross negligence penalty. In British Columbia, where this appeal arises, if one considers both the federal and provincial penalties, when the individual's "total income" is under $100,000[2] the omission penalties will exceed the gross negligence penalties; if the total income is above $100,000 the omission penalty will be 91.5% or more of the gross negligence penalty.

[3] ***In Alberta, the omission penalties will always exceed the gross negligence penalties.***

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[1] I am referring to the repeated omission penalty of 10% in subsection 163(1) of the *Income Tax Act* (*Act*) and the "gross negligence" penalty in subsection 163(2) of the *Act*.

[2] The $100,000 is an approximate number; in 2012, the precise number is below $103,205. In addition, if the income reported before adding the omission was below the $103,205 threshold and the income after adding the omitted amount is above the threshold, then the omission penalty might still be greater than the gross negligence penalty for an individual with a total income above the $103,205 threshold depending on how much of the omitted amount was below the $103,205 threshold and how much above.

[4] I will review how this comes about shortly.

[5] The appellant, who resides in British Columbia, appeals from the assessment of a 10% civil penalty for omitting income in his 2009 taxation year.

[6] For the reasons set out below, I am satisfied that, on the facts before me and given the law, the penalty has been validly assessed.

[7] The existence of a penalty for repeated omissions is understandable. That a taxpayer would be subject to some penalty in the circumstances of this case is also understandable.

[8] But the severity of the penalty in this case is inappropriate and appears to be unforeseen. When one looks at the operation of the omission penalty and the scheme of the federal and provincial acts, it becomes clear that there are likely to be a great many cases where the severity of the penalty would appear to be both inappropriate and unforeseen.

The operation of subsection 163(1) of the federal Income Tax Act and section 38 of the Income Tax Act of British Columbia

[9] Subsection 163(1)[3] of the federal *Act* creates a civil penalty where:

i) a person fails to include an amount of income in a return for a tax year and;

ii) where a person previously failed to report an amount of income in one of the three preceding tax years.

[10] The burden of proving these facts is on the Minister of National Revenue. A due diligence defence is available to the taxpayer.

[11] If the relevant facts are proven and the taxpayer is unable to show due diligence then the individual is liable to a penalty of 10% ***of the omitted amount of income***.

[3] Subsection 163(1) reads as follows:

> Every person who
>
> (*a*) fails to report an amount required to be included in computing the person's income in a return filed under section 150 for a taxation year, and
>
> (*b*) had failed to report an amount required to be so included in any return filed under section 150 for any of the three preceding taxation years
>
> is liable to a penalty equal to 10% of the amount described in paragraph (*a*), except where the person is liable to a penalty under subsection (2) in respect of that amount.

[12] Subsection 163(1) also provides that the penalty cannot be applied where the penalty under subsection 163(2), the "gross negligence penalty", applies.

[13] Section 38 of the *Income Tax Act* of British Columbia (BC *Act*) imposes an identical 10% penalty. It also gives the federal Minister the power i) to refrain from levying the provincial penalty or ii) to reduce the provincial penalty where the taxpayer is liable to the federal penalty.[4]

[14] Thus, in British Columbia, when there is an omission under subsection 163(1) there will potentially be a combined 20% penalty under the federal *Act* and the BC *Act*.

[15] Subsection (2) of section 163 of the federal *Act* creates what is known as the "gross negligence" penalty. This penalty applies when someone "knowingly, or under circumstances amounting to gross negligence" makes "a false statement or omission in a return". The penalty under subsection (2) is 50% ***of the amount of tax on the omitted amount of income***.[5]

[16] Section 38 of the BC *Act* also incorporates subsection 163(2) by reference.

[17] Under the criminal tax evasion offence in section 239 of the federal *Act* on prosecution by summary conviction there is a minimum 50%, and a maximum 200%, penalty of the amount of tax that was sought to be evaded together with the possibility of imprisonment for a period not exceeding two years; on prosecution by indictment the penalty is a minimum of 100% and a maximum of 200% together with the possibility of imprisonment for a period not exceeding five years.

[18] In general, one sees in the scheme of the federal *Act* a continuum of civil penalties and criminal penalties depending on the circumstances and the seriousness of the matter. The civil gross negligence penalty of 50% is the same as the minimum level of criminal penalty for tax evasion.

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[4] *Income Tax Act*, RSBC 1996, c 215, as amended. The relevant portions of section 38 read as follows:

> (1) Section 163(1) and (2) of the federal Act applies for the purposes of this Act except that, in addition to any other necessary modifications, section 163(2) of the federal Act is to be read without the references to section 120(2) and as though
>
> …
>
> (2) If a collection agreement is in effect, the federal minister may refrain from levying or may reduce a penalty provided for in this section if the person who is liable to the penalty is required to pay a penalty under section 163 of the federal Act in respect of the same failure or the same false statement or omission, as the case may be.

[5] I have simplified the description of what the 50% penalty is levied upon; for the purposes of this discussion this is an accurate enough statement.

[19] The civil penalty in subsection 163(2), where an omission or false statement must be done knowingly or in circumstances amounting to gross negligence, is clearly intended to deal with a greater degree of culpability than the civil penalty in subsection 163(1) which is simply based on the existence of two omissions within a four year period and an absence of due diligence.[6]

[20] It is instructive to compare the penalty payable on a given omitted amount depending on whether it is subject to the omission penalty or the gross negligence penalty.

[21] In 2009, the year in issue, the marginal rates and starting thresholds for tax were:

Federal

15.00%:	$0
22.00%:	$40,726
26.00%:	$81,452
29.00%:	$126,264

BC

5.06%:	$0
7.70%:	$35,716
10.50%:	$71,433
12.29%:	$82,014
14.70%:	$99,588

[22] If an individual has omitted an amount knowingly or in circumstances amounting to gross negligence and the 50% subsection 163(2) penalty is assessed

[6] This hierarchy is recognized in the CRA Audit Manual where at Chapter 28.3.1 it states:" When the unreported income amount is $5,000.00 or more, a penalty under 163(2) of the ITA must be considered first. Consequently, a penalty for repeated failure under subsection 163(1) would only be applied if gross negligence cannot be proven."(Source: Text as reproduced in TaxPartner 2012 – Release 3.)

together with the provincial equivalent, then the gross negligence penalty will always be half of the federal and provincial marginal rate(s) *of tax* on the omitted amount.[7]

[23] The federal subsection 163(1) omission penalty of 10% *and* the provincial equivalent of 10% total 20% and are applied *on the omitted amount of income*.

[24] As a result, the following tables show the rate of penalty ***as a percentage of the omitted amount of income added***, depending upon the marginal rate applicable in 2009, the year under appeal:

Threshold	**Federal Marginal Rate**	**Omission Penalty**	**Gross Negligence Penalty**
$0	15.00%	10%	7.5%
$40,726	22.00%	10%	11.0%
$81,452	26.00%	10%	13.0%
$126,264	29.00%	10%	14.5%
Threshold	**BC Marginal Rate**	**Omission Penalty**	**Gross Negligence Penalty**
$0	5.06%	10%	2.530%
$35,716	7.70%	10%	3.350%
$71,433	10.50%	10%	5.250%
$82,014	12.29%	10%	6.145%
$99,588	14.70%	10%	7.350%

[25] As can be seen from these tables the federal omission penalty is greater than a federal gross negligence penalty would be when the omitted amount together with the reported amount results in a total income of less than $40,726.[8]

[26] In British Columbia, the BC omission penalty is always greater than a BC gross negligence penalty on the same amount.

[27] When both the federal and the BC omission penalties are levied, they are greater than would be a gross negligence penalty on the same amount whenever the taxpayer's total income is less than $99,588 after the reassessment.

[28] Indeed, when taxable income is below $35,716 the combined federal and BC omission penalty would be close to 100% of the federal and BC ***tax*** on the omitted

[7] Marginal rate(s) given that when the added omitted amount straddles a threshold, part of it will be penalized at half of the lower marginal rate and part of it at half of the higher marginal rate.

[8] Where the reported total income is less than $40,726 and the omitted amount brings the total income above $40,726 the omission penalty will be greater than the gross negligence penalty for that portion of the omitted income that brings the total income just up to the $40,726 threshold.

amount;[9] a federal and BC gross negligence penalty in respect of the same amount would be half as much.

[29] For income at the top marginal rate the combined federal and BC omission penalties together are about 91.5% of the combined federal and BC gross negligence penalties.

[30] The consequence of all this is that a penalty involving less blameworthy conduct frequently results in a higher amount of penalty than a penalty requiring more blameworthy conduct.[10] Even when that is not the case the less blameworthy conduct still attracts a penalty almost as high as the more blameworthy conduct.[11]

[31] In Alberta, if both the federal and provincial omission penalties are levied, they **will always be greater** than would be a federal and provincial gross negligence penalty on the same omitted amount.[12]

[32] Subsection 163(1) makes no distinction between circumstances where the omitted amount was subject to withholdings and circumstances where it was not. The existence of withholdings, or not, has a significant practical effect in terms of the harm to the treasury and in terms of the benefit to the taxpayer resulting from the omission.

The particular consequences in the appellant's case

[33] In filing his 2009 return the appellant's reported approximately $44,000 in employment income. He failed to include $40,878 in employment income.

[34] The omitted amount of about $40,000 was reported by the payer in a T4 slip and a T4A slip. With respect to the omitted amounts, there were withholdings of $7,556.63 in federal and provincial income tax, $1,244.26 in Canada Pension Plan contributions and $461.25 in employment insurance contributions.

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[9] 99.7% to be more precise.

[10] Arguably, the final words of subsection 163(1) stating that an individual is liable for the 10% penalty ". . . except where the person is liable to a penalty under subsection (2) in respect of that amount" seem to suggest that no one expected that subsection (1) could produce a higher penalty than subsection (2).

[11] One could describe the omission penalty as regressive in the sense that the penalty as a proportion of the unreported tax liability increases as the individual's total income decreases; in contrast the gross negligence penalty is proportionate since it is at a constant rate of the tax liability not reported.

[12] This is because of Alberta's 10% flat tax rate. Given a maximum combined federal and provincial marginal rate in Alberta of 39 %, the gross negligence penalty of 50% of the tax can never exceed 19.5% of the omitted amount with the result that the combined federal and Alberta omission penalty of 20% will always be higher. Section 53 of the *Alberta Personal Income Tax Act*, RSA 2000, c A-30, incorporates section 163 of the federal *Income Tax Act*. Ontario is more like BC although the threshold at which the gross negligence penalty is higher than the omission penalty is different.

[35] The following table shows the amounts of the federal, British Columbia and total income tax assessed in the initial assessment based on the returns as filed and in the reassessment made to include the omitted amounts shown in the T4 and T4A slips for the omitted amounts. The table also shows the increase in the amounts assessed and 50% of those amounts. The federal and provincial omission penalty assessed was $8,175.60.[13]

	Tax on initial assessment	Tax on reassessment	Increase	50% of increase	10% federal and 10% BC penalty
Federal	$4,626.18	$13,752.50	$9,126.32	$4,563.16	$4,087.80
BC	$1,852.48	$5,438.47	$3,585.99	$1,792.99	$4,087.80
Total	$6,478.66	$19,190.97	$12,712.31	$6,356.15	$8,175.60

[36] In the appellant's case we see that the federal omission penalty is about $475 less than the amount of a federal gross negligence penalty on the same amount. However, the provincial omission penalty is about $2,295 greater than a provincial gross negligence penalty on the same amount. Overall, for both levels of government the omission penalty is about $1,820 more than a gross negligence penalty on the same amount.

[37] What was the harm done to the treasury and the benefit to the appellant? If this were a case of unreported income which had not been subject to withholdings the harm to the federal and provincial treasury would have been $12,712.31 plus interest. Here, because there were withholdings the federal and provincial treasury were, at the time of the reassessment, out-of-pocket $3,874.72 including interest; most of the money that the treasury was out-of-pocket was the result of a $3,361.15 refund on the initial assessment of June 1, 2010; the balance consisted of the shortfall in withholdings, an amount of $215.95, interest of $286.82 and a late filing penalty of less than $11.[14]

[38] As a result in this case the federal and provincial treasury were short $3,874.72 from the 1st of June until the 1st of November; ***the penalty for this is $8,175.60 or about 211%***[15] ***of the shortfall for a few months***.[16]

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[13] The amounts of federal tax assessed, BC tax assessed in total tax assessed both initially and on reassessment are on page 3 of Exhibit H to the affidavit filed by the respondent. The total penalty shown on page 3 includes a late filing of less than $11. Page 1 of the same Exhibit sets out the $4,087.80 federal omission penalty and the $4,087.80 provincial omission penalty.

[14] $3,874.72 is the $12,050.32 balance due on the reassessment minus the $8,175.60 federal and provincial omission penalties; again, this can be seen on page 3 of Exhibit H to the affidavit filed by the respondent. The interest was modest because there was a very short time between the initial assessment of June 1 and the reassessment of November 1.

[15] 211% -- in contrast to a maximum 200% penalty of the amount that was sought to be evaded where criminal tax evasion is prosecuted by indictment.

The Facts

[39] The appellant had been in the labour force about eight years in 2009, the year in issue. He had completed a two-year college program in marketing and sales.

[40] The appellant included in his tax return employment earnings of $44,362; this amount was the total shown on a T4 from Business Objects Company/SAP Canada and a T4 from FINCAD Corporation.

[41] The appellant failed to include about $40,878 of salary and severance pay in his return, close to half his income. These amounts were the subject of two T slips, a T4 and a T4A, prepared by the Business Objects Company and SAP, respectively.

[42] When reassessing the appellant to include the omitted amounts, the Minister assessed an "omission" penalty pursuant to subsection 163(1) of the *Income Tax Act* as well as pursuant to section 38(1) of the *Income Tax Act* of British Columbia.[17]

[43] This appeal was heard under the informal procedure.

[44] The appellant testified and the respondent filed certain evidence by affidavit; the appellant did not seek to cross-examine the affiant.

[45] In 2009 he worked for two different companies: the Business Objects Company, which was bought out by SAP, and, later in the year, FINCAD.

[46] He received a severance package from Business Objects Company/SAP Canada and assumed that all the taxes were deducted. Substantial withholdings were made on the severance payments.[18]

One might also contrast the situation here, where there were source deductions and T4s, with paragraph 11 of Information Circular IC00-1R2, "*Voluntary Disclosures Program*". Paragraph 11 states: "If the CRA accepts a [voluntary] disclosure as having met the conditions set out in this policy, it will be considered a valid disclosure and the taxpayer will not be charged penalties or prosecuted with respect to the disclosure."

[16] It was somewhat fortuitous that I was able to see the complete picture and not just the situation vis-à-vis the federal penalty. Currently, many appeals proceed before this Court without the tax returns, reassessments or objections in issue entering into evidence; had that been the case I would probably have only seen the federal penalty in isolation.
In this case I had the benefit of a reconstructed notice of reassessment showing a complete picture of the reassessment: federal tax, provincial tax, employment insurance premiums and Canada Pension Plan premiums.

[17] This Court does not have jurisdiction with respect to appeals of assessments under the *Income Tax Act* of British Columbia. However, in practice, where there is a successful appeal of a federal assessment and the logical consequence of the change to the federal assessment is a similar change to the provincial assessment, the Minister of National Revenue will reassess the provincial tax accordingly; as a result the vast majority of BC disputes are resolved by the decision on the federal appeal.

[18] See paragraph 34 above.

[47] There seem to have been some delays by the company in sending him payment of the severance package.

[48] He did not receive the two T slips totalling $40,878 prior to filing of his 2009 income tax return.

[49] There was some evidence by the appellant that he tried to obtain the missing T slips. This evidence was confusing.

[50] The appellant filed Exhibit A-1 which is a chain of three e-mails; the respondent filed Exhibit R-1 which is a different chain of e-mails.

[51] Both, however, contain an almost identical e-mail to the appellant from SAP in Pennsylvania entitled "T4 Request Form" with the following text:

> "Please note that the original T4's were returned back to the payroll department so I will forward you the original.
>
> Please provide me with your current address and I will mail these out to you today."

[52] There is one very significant difference between the "T4 Request Form" in A-1 and the same e-mail in R-1. The first shows a sending date of 8 April 2010, before the appellant's filing due date, and the second shows a sending date of 8 August 2010.

[53] The appellant also testified that he had made numerous efforts to call SAP and follow up. However, in cross-examination it became apparent that his prime focus was on getting timely payment of his severance; this is also apparent in the e-mails on pages 2 and 3 of Exhibit R-1.

[54] In filing, he did not indicate in any way on his tax return that there were substantial amounts of the earnings that were not reported on his return.

[55] The appellant did not remember when he received the missing T slips although it was prior to the reassessment. He did not send the missing slips to revenue prior to the reassessment.

[56] The appellant was surprised that the T4s had been mailed to the wrong address given that his address had not changed for five years. He suspects that this may have in some way been related to the transition resulting from the takeover of Business Objects Company by SAP.

[57] The appellant testified that there had been certain income slips missing in the past and he had become used to the Canada Revenue Agency simply sending him a

reassessment adding the amounts and either asking him to pay any balance or sending him a refund.

[58] He expected the same to happen again. He also testified that he did not expect there to be any additional tax payable because there had been withholdings on the amounts for which he did not have T slips.

[59] The appellant did not dispute the respondent's affidavit evidence that: i) he had been reassessed with respect to the 2005 taxation year to include an unreported amount of $1,054; ii) he had been reassessed with respect to the 2006 taxation year to add a lump-sum payment of $2,896 that had not been reported; and iii) he had been assessed an omission penalty in respect of the unreported amount in the 2006 tax year.

Analysis

[60] There was an omission in the year under appeal as well as in the 2006 taxation year, within three years of the year under appeal.

[61] In *Paquette v. The Queen*[19] Chief Justice Rip reviewed the requirements for a due diligence defence at paragraph 9:

> In *Résidences Majeau Inc. v. Canada* and *Corporation de l'école polytechnique v. Canada* the Federal Court of Appeal stated that a defendant may rely on a defence of due diligence if either of the following can be established: that the defendant made a reasonable mistake of fact, or that the defendant took reasonable precautions to avoid the event leading to imposition of the penalty. In *Résidences Majeau*, Justice Létourneau explained:
>
> > 8 According to *Corporation de l'école polytechnique v. Canada*, 2004 FCA 127, a defendant may rely on a defence of due diligence if either of the following can be established: that the defendant made a reasonable mistake of fact, or that the defendant took reasonable precautions to avoid the event leading to imposition of the penalty.
> >
> > 9 A reasonable mistake of fact requires a twofold test: subjective and objective. The subjective test is met if the defendant establishes that he or she was mistaken as to a factual situation which, if it had existed, would have made his or her act or omission innocent. In addition, for this aspect of the defence to be effective, the mistake must be reasonable, i.e. a mistake a

[19] 2011 TCC 208, paragraph 9.

> reasonable person in the same circumstances would have made. This is the objective test.
>
> [Footnotes omitted].

[62] There is nothing in the appellant's evidence which suggests due diligence by the appellant in respect of either the 2006 and 2009 omission.[20]

[63] The appellant's belief that the Canada Revenue Agency would automatically reassess him and either send him a refund, given the withholdings, or ask for the balance due with no further consequence is not a mistake ". . . as to a factual situation which, if it had existed, would have made his or her act or omission innocent." The mistake is a mistake as to the consequences of the omission.

[64] Nor did the appellant take reasonable precautions. While the appellant may have made some kind of inquiries in April 2010 regarding the missing T slips, he made no effort to indicate on his return that close to half his income was missing. As well, in the period after the initial assessment and prior to the reassessment in issue,[21] the appellant made no effort to draw the missing T slips to the attention of the CRA once he received them.

[65] The jurisprudence cited by the appellant involve quite different situations from that here and is not applicable:

a. In *Paquette v. The Queen*[22] the appellant had difficulties with both language and mathematics and had completed grade 12 in a program for persons with learning disabilities; Mr. Paquette made what were reasonable efforts in his circumstances.

b. In *Dunlop v. The Queen*[23] the appellant estimated the amount of his income in respect of the missing T4 slip, an estimate that was fairly close to the actual amount.

c. Both *Franck v. The Queen*[24] and *Alcala v. The Queen*[25] are cases based on the appellants' relative lack of knowledge of the system.[26] *Franck* was a young man who had just left high school and started working in the

[20] And it is unnecessary for me to decide whether the penalty can be applied if due diligence can be shown in respect of the prior omission.
[21] See paragraph 23 of the decision of Justice Boyle in *Dunlop v. The Queen*, 2009 TCC 177, 2009 DTC 1124, and the text of the **General Income Tax and Benefit Guide – 2009** at page 8 under the heading "**What if you are missing information?"** and at page 55 under the hearing "**How do you change a return?".**
[22] 2011 TCC 208.
[23] 2009 TCC 177, 2009 DTC 1124.
[24] 2011 TCC 179, 2011 DTC 1142.
[25] 2010 TCC 198, 2010 DTC 1147.
[26] See paragraph 9 of *Franck.*

> labour force; he had worked in the year as short-order cook in four different establishments and had not received his T4 slip from one of them. *Alcala* was a recent immigrant to Canada who arrived from the Philippines in 2005 and omitted amounts in 2006 and 2007. These are both different situations from that of the appellant who had been in the labour force for a number of years.[27]

Conclusion[28]

[66] Accordingly, given that the necessary requirements of the penalty are made out and no due diligence defence has been shown, I must uphold the assessed penalties and dismiss the appeal.

[67] I hope the appellant makes an application under the taxpayer relief provisions (also often referred to as the fairness provisions).[29]

[68] If such an application is made I hope that the Minister will seriously consider substantially reducing the federal and provincial penalties to an amount very significantly less than the $3,863.92 balance owing, apart from the penalties, at the time of the reassessment adding the omitted amounts.

Signed at Ottawa, Ontario, this 16th day of April 2012.

"Gaston Jorré"

Jorré J.

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[27] While I did not hear the appellant make this argument, I note that *Perusco v. The Queen*, 2011 TCC 409, [2012] 1 C.T.C. 2161, rejected an argument that the subsection 163(1) penalty could not be applied where the employer had reported the income.

[28] No *Charter* argument was made but I note that in *Perusco v. The Queen*, 2011 TCC 409, [2012] 1 C.T.C. 2161, a *Charter* argument based on sections 7 and 12 of the *Charter of Rights and Freedoms* was rejected.

[29] Subsection 220(3.1) of the federal *Income Tax Act* as well as under section 38 of the *Income Tax Act* of British Columbia. I note that nothing in subsection 220(3.1) precludes the Minister from acting on his own initiative even without an application.

CITATION:	2012 TCC 118
COURT FILE NO.:	2011-2546(IT)I
STYLE OF CAUSE:	MARTINO KNIGHT AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Vancouver, British Columbia
DATE OF HEARING:	March 27, 2012
REASONS FOR JUDGMENT BY:	The Honourable Justice Gaston Jorré
DATE OF JUDGMENT:	April 16, 2012

APPEARANCES:

For the appellant:	The appellant himself
Counsel for the respondent:	Andrew Duncan

COUNSEL OF RECORD:

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