Dockets: 2012-578(GST)I
2014-85(IT)I

BETWEEN:

ADVAN BASIC,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence on December 12, 2014 and April 20, 2015, at Toronto, Ontario

Before: The Honourable Justice Diane Campbell

Appearances:

Agent for the Appellant:	Costa A. Abinajem
Counsel for the Respondent:	Tony Cheung

JUDGMENT

In accordance with the attached Reasons for Judgment:

The appeal from the reassessment made under the *Income Tax Act* for the 2006 taxation year is vacated.

The appeal from the reassessment for the 2007 taxation year is allowed, in part, as follows:

1. The Appellant can claim $423, being half of the disallowed amount in respect to the office expense category;

2. The percentage will be increased for the business use of the home from 8 percent to 15 percent; and

3. In all other respects, the Minister's reassessment is confirmed.

The appeal from the reassessment made under Part IX of the *Excise Tax Act* with respect to the reporting periods between January 1, 2006 to December 31, 2007, is dismissed, without costs.

Signed at Summerside, Prince Edward Island, this 11th day of August 2015.

"Diane Campbell"

Campbell J.

Citation: 2015 TCC 202
Date: 20150811
Dockets: 2012-578(GST)I
2014-85(IT)I

BETWEEN:

ADVAN BASIC,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Campbell J.

[1] These appeals were heard together on common evidence. The income tax appeals involved both the 2006 and 2007 taxation years, with the 2006 reassessment occurring outside the normal reassessment period. Before hearing the evidence, the Respondent advised the Court that the reassessment in respect to the 2006 taxation year should be vacated as counsel was conceding the issues in respect to that taxation year (Transcript, December 12, 2014, page 16; Transcript, April 20, 2015, page 145). That leaves the 2007 taxation year before me. The issue in that year is whether the Appellant incurred business expenses in excess of the amounts allowed by the Minister of National Revenue (the "Minister"). In respect to the *Excise Tax Act* (the "*ETA*"), the period under appeal is January 1, 2006 to December 31, 2007. The issues in respect to those periods are whether the Appellant's net tax has been properly assessed and whether the Appellant is entitled to any input tax credits ("ITCs") in excess of those allowed by the Minister.

[2] I will deal first with the income tax issue in respect to the 2007 taxation year. The Appellant operated a construction subcontracting business that specialized in aluminum siding. From January 1, 2006 to May 31, 2006, he was a 50 percent partner in this business which operated under the name BF Aluminum Contracting. From June 1, 2006 to December 31, 2007, he operated as a sole proprietor under the name A.B. Aluminum. For the 2007 taxation year, the Appellant reported gross business income of $342,294 and net business income of

$26,056. The Minister reassessed the Appellant and disallowed business expenses of $55,534.

[3] During the hearing, the Appellant conceded the insurance expenses in respect to the motor vehicle category. In respect to all other expense categories, Laurel Brown, Canada Revenue Agency Auditor, reviewed the amounts that the Minister allowed and those expenses that were disallowed due to a lack of documentation or those expenses that were considered to be incurred for personal and not business purposes.

[4] Under the "other costs" category, the primary item disallowed was an amount of $10,500, which the Appellant claimed that he paid to his son as wages. Although proof of payment existed in respect to wages paid to other employees (Exhibit A-3, handwritten receipt of payment of $6,300), the Appellant did not provide documentary evidence, such as timesheets or receipts, regarding the son's wages. The Appellant's agent, in his submissions, contended that some of the son's wages had been paid by cheque to his mother because he was only 17 years old at the time and a full-time student. However, the Appellant called neither the son nor his spouse to give testimony that would support this contention. I have no reason to interfere with the Minister's conclusion in respect to this category.

[5] Office expenses of $846 were disallowed primarily because they were personal in nature. The Appellant claimed that this amount was related to gifts that he purchased for his customers as a means of maintaining goodwill. Those gifts were for such items as chocolate and books. Many of the receipts were not legible. One of the books purchased was a philosophy text by Plato. English is not the Appellant's first language and he had a great deal of difficulty in providing his testimony. I doubt he purchased a philosophy book for personal reading and I believe some of those items may have been gifts for customers. In these circumstances, I am permitting the Appellant to claim one-half of the disallowed amount of $846 or $423.

[6] The Minister disallowed $423 of the $694 amount that the Appellant claimed for legal and accounting expenses. Some of this amount related to the total yearly security charges for the personal residence. At the appeals level, a portion of the amount was allowed under the business use of home category at 8 percent. Remaining amounts were determined to be personal and there was no evidence that would support my interference with the Minister's assumptions.

[7] Of the $8,102 expense amounts claimed by the Appellant under "advertising", $2,231 was disallowed because they were personal expenses, although claimed as advertising costs. The receipts that were submitted were for items such as children's clothing, bed linens, cutlery, cooking utensils, luggage and handbags. The Appellant's testimony was vague and general in nature and, as a result, the Minister was correct in concluding that the items were personal and in no way related to the Appellant's business.

[8] Under the category of "other expenses", the Minister disallowed $483 of the $1,309 amount that was claimed because it related to such personal expenses as cable and internet charges. The Appellant's only evidence in this regard was that he needed to check the weather as it related to his business operations. This is insufficient to allow those expenses as it does not demolish the Minister's assumptions.

[9] The Appellant's evidence regarding the "maintenance and repair" expense category was that he occasionally made other minor repairs, particularly in respect to water leaks, when he was completing siding on his customers' homes. He stated that he required additional materials and tools to do such work. While that could be correct, the receipts do not support his testimony. The documentation for purchased items relates to blinds, gardening supplies, laundry materials, arts and crafts supplies and barbeque products. The Minister's assumptions have not been demolished.

[10] Under the last category, "business use of home", the Minister disallowed $10,341 of the total amount claimed of $12,063. The Appellant claimed 25 percent of home-related costs. He was permitted 100 percent of the heating, electrical, water, property taxes and insurance costs. The two items that are in dispute are the mortgage interest amount and closing costs. The Appeals Division permitted 8 percent respecting the Appellant's business use of his home, which according to the Canada Revenue Agency ("CRA") consisted of one office and half of the garage. Although the Appellant would not allow the CRA to enter and view his premises, I am satisfied that the portion of his new residence that is being used for business purposes is higher than 8 percent. However, when he testified regarding the size of various areas used for his business, much of it was based on approximations. According to the property listing agreements and his testimony concerning his use of the entire garage, basement and other office space in the home, I conclude that he was using approximately 15 percent of his residence for business purposes.

[11] The "closing costs" related to the cost of selling one home and purchasing a second larger one. The Appellant claimed that his business had expanded and that he required a larger work space in his home. The Minister was correct in not allowing any portion of the closing costs amount of $17,268.96 as the Appellant would be incurring that cost whether the residence was sold for business or personal reasons. In addition, the Appellant's evidence was again lacking in clarity and specifics to support his allegations. In respect to the mortgage interest amount claimed of $23,103, the Minister allowed only $13,373.41 because of insufficient documentation. Exhibit A-18, an HSBC mortgage statement, supports the amount that was allowed in respect to the second property that was purchased. Exhibit A-17, a Scotia mortgage statement, relates to the mortgage that was being paid in respect to the first property. The Appellant testified that he sold the first property about the first of May, 2007. This mortgage statement is for the period January 1, 2007 to April 27, 2007 and it does identify a per diem interest rate of $42.80, which would allow me to calculate the interest paid for this period. However, the HSBC mortgage statement on the second property is for the period January 1, 2007 to December 31, 2007 and the Appellant had no explanation, on cross-examination, for why the statements overlapped for the first part of the entire period. The HSBC mortgage statement covered the entire 2007 year but he stated that he only purchased and moved into the property in May of that year. Consequently, I am not interfering with the Minister's conclusions, as it appears that the Appellant was allowed an amount for interest for the entire year pursuant to the HSBC mortgage statement. Because the Appellant's testimony was generally vague and many of his responses lacked specificity, the Minister's determination in respect to the closing costs and the mortgage interest amounts have not been demolished.

[12] In summary, the Respondent conceded that the reassessment concerning the 2006 taxation year should be vacated. In respect to the 2007 taxation year, the Appellant conceded the motor vehicle insurance expense amount. I have permitted the Appellant to claim $423, being half of the disallowed amount in respect to the "office`e expense" category. I have also increased the percentage of the "business use of home" from 8 percent to 15 percent. In all other respects, the Minister's reassessment is confirmed in respect to the income tax appeals.

[13] The remaining issues are in respect to the Goods and Services Tax ("GST") appeals and for the reasons that follow I am dismissing these appeals in respect to the reporting periods January 1, 2006 to December 31, 2007.

[14] The Appellant reported gross business income of $199,091 and $366,084 in his GST returns for the reporting periods ending December 31, 2006 and December 31, 2007, respectively. The Appellant was subsequently reassessed for the amount of $11,869.38 net tax together with interest and penalty. When the Appellant objected to the audit findings, he made additional claims for ITCs in the amounts of $289.52 and $130.04 in respect to the periods ending December 31, 2006 and December 31, 2007, respectively. The initial revenue reported for each period included GST because the Appellant had elected to use the "Quick Method" of accounting to calculate the tax. The Respondent contended that the Appellant failed to apply the correct GST rate and that he was ineligible to use the rates of 2.5 percent and 2.3 percent for the periods ending December 31, 2006 and December 31, 2007, respectively, because his cost of goods purchased for resale was less than 40 percent of the total annual taxable sales for each reporting period. Since the tax was calculated incorrectly for both periods, the Respondent maintained that unreported amounts remain outstanding.

[15] The Appellant's agent admitted in his submissions that he elected, on the Appellant's behalf, to use the Quick Method but that he was wrong in doing so and that it was "…100% my mistake…" in electing the method (Transcript, April 20, 2015, page 171). The Appellant argued that he was never entitled to use this method to compute GST and instead should have been using the ordinary or conventional method of calculating the tax. The Respondent's position was set out in a letter to the Court dated November 29, 2013, filed pursuant to an Order of Graham J. At the last paragraph of that correspondence, the Respondent stated:

> …the Respondent's position is the Appellant is entitled to use the quick method of accounting for the 2006 and 2007 reporting periods. The Appellant elected to use the quick method for the reporting periods and did not file a revocation of election at any time.

[16] A determination of the first issue, that is, whether the Minister correctly assessed the GST collectable is essentially a calculation issue, which involves the application of the correct rate in respect to the correct amount of sales.

[17] The Appellant has been a GST registrant since 2000. For the 2005 reporting period, the Appellant did not file a GST return. For the 2006 reporting period, he reported total sales, inclusive of GST, of $199,091 and for the 2007 reporting period, $366,084, inclusive of GST. He elected to use the Quick Method of accounting for calculating net tax. Pursuant to section 227 of the *ETA*, a registrant who is a prescribed registrant may elect to determine the registrant's net tax for a

reporting period by a prescribed method. Subsection 227(2) provides information respecting the prescribed form of an election and its content. The circumstances in which an election ceases to have effect is described in subsection 227(3):

> **227.** (3) An election made under this section by a registrant ceases to have effect on the earlier of
>
> (a) the first day of the reporting period of the registrant in which the registrant ceases to be a prescribed registrant or a member of a prescribed class of registrants, and
>
> (b) the day on which a revocation of the election becomes effective.

[18] Whether the Appellant is entitled to use the Quick Method is conditional upon the Appellant meeting the requirements of a "specified registrant", pursuant to section 16 of the *Streamlined Accounting (GST/HST) Regulations* (the "*Regulations*"):

> **16.** (1) Where
>
> (*a*) a person is, at any time in a reporting period of the person, a specified registrant,
>
> (*b*) the total threshold amount for the reporting period does not exceed $200,000, and
>
> (*c*) the registrant was engaged in commercial activities throughout the 365-day period ending immediately before the beginning of the reporting period and an election of the registrant did not cease to have effect in that 365-day period because of a revocation of the election,
>
> the registrant is a registrant who may file an election, to take effect on the first day of the reporting period, to determine the net tax of the registrant in accordance with this Part.
>
> (2) A registrant who has filed an election to determine the net tax of the registrant in accordance with this Part ceases to be a registrant who may so determine that net tax at the end of the earliest of
>
> (*a*) the first fiscal year of the registrant that is a reporting period of the registrant in which the registrant ceases to be a specified registrant,
>
> (*b*) the fiscal year of the registrant immediately before the first fiscal year of the registrant that is a reporting period of the registrant for which the total threshold amount exceeds $200,000,

> (*c*) the first fiscal quarter of the registrant that includes a reporting period of the registrant for which the total threshold amount exceeds $200,000, and
>
> (*d*) the fiscal quarter of the registrant immediately before the first fiscal quarter of the registrant that includes a reporting period of the registrant in which the registrant ceases to be a specified registrant.

[19] "Specified registrant" is defined in subsection 15(1) of the *Regulations* as follows:

> "specified registrant", at any time, means a registrant who
>
> (*a*) throughout the four fiscal quarters of the registrant immediately preceding the fiscal quarter of the registrant that includes that time,
>
> (i) was not a listed financial institution,
>
> (ii) did not render a legal, accounting or actuarial service in the course of a professional practice of the registrant, and
>
> (iii) did not render a book-keeping, financial consulting, tax consulting or tax return preparation service in the course of a commercial activity of the registrant,
>
> (*b*) at that time, is not a charity or a selected public service body within the meaning of section 259 of the Act, or a public institution, and
>
> (*c*) is not a qualifying non-profit organization, within the meaning of section 259 of the Act,
>
> (i) at the beginning of the reporting period of the registrant that includes that time, where that reporting period is the fiscal month or fiscal quarter of the registrant, and
>
> (ii) at the end of the reporting period of the registrant that includes that time, in any other case; (inscrit déterminé)

The Appellant has been a registrant since 2000 and qualified as a specified registrant throughout his registration. He therefore meets the requirements contained in paragraph 16(1)(*a*) for both reporting periods.

[20] Subsection 15(5) of the *Regulations* prescribes the different remittance rates that are to be applied in respect of a supply made by a registrant where the Quick Method is being used. A registrant's type of business operation, the location of its

permanent establishment and where the taxable supplies are being made determine the rate to be applied. It is not in dispute that the Appellant operates his siding business in Ontario and it is the Province of Ontario where his taxable supplies occurred in those two reporting periods.

[21] The Respondent submitted that the two rates that are available to the Appellant's business are either a rate for businesses purchasing goods for resale or businesses that provide services. Paragraph 16(1)(*b*) of the *Regulations* references "total threshold amount" which is defined in subsection 2(3) of the *Regulations*. The definition of "total threshold amount" makes reference to the term "threshold period" which is defined at subsection 15(3) of the *Regulations*:

> **15.** (3) Subject to subsection (4), for the purposes of this Part, the threshold period for a particular reporting period of a registrant is
>
> (a) where an election by the registrant to determine the net tax of the registrant in accordance with this Part becomes effective in the fiscal year of the registrant that includes the particular reporting period, any period that consists of four fiscal quarters of the registrant and ends in one of the last two fiscal quarters of the registrant immediately preceding the fiscal quarter of the registrant in which the election becomes effective; or
>
> (b) where an election by the registrant to determine the net tax of the registrant in accordance with this Part became effective before, and is in effect at, the beginning of the particular fiscal year of the registrant that includes the particular reporting period, the fiscal year of the registrant immediately preceding the particular fiscal year.

[22] In very basic terms, for the 2006 reporting period, the threshold period is the immediately preceding reporting period or 2005 and for 2007 it would be 2006. The Appellant never filed a GST return for 2005 and, therefore, the Minister had no knowledge of his taxable supplies in 2005. The Appellant made the election to use the Quick Method in 2006 and, without knowledge of the Appellant's taxable supplies in the preceding year, the Minister had no reason to question the Appellant's election, particularly when no revocation of the election had been filed. If no commercial activities were being conducted in 2005, the Appellant should have filed a nil return. Consequently, the Appellant's total threshold amounts, for the 2006 and 2007 reporting periods, are his total sales, inclusive of GST, in respect to 2005 and 2006, respectively, and those amounts did not exceed $200,000. The Appellant meets the requirement contained in paragraph 16(1)(*b*) of the *Regulations* for both reporting periods.

[23] For businesses where the cost of goods purchased for resale is less than 40 percent of the total annual taxable supplies for each reporting period, that business is one that purchases goods for resale, while those businesses that fall below the threshold of 40 percent, are those that provide services. At "assumptions of fact" 8(k) of the Reply to the Notice of Appeal, the Minister assumed that the Appellant used the incorrect rates of 2.5 percent and 2.3 percent in respect to the 2006 and 2007 reporting periods respectively:

> k) the Appellant was ineligible to use the Quick Method rates of 2.5% for the reporting period ending December 31, 2006 and 2.3% for the reporting period ending December 31, 2007 because his cost of goods purchased for resale was less than 40% of the total annual taxable sales for each reporting period;

	2006	**2007**
Sales	$199,091	$366,084
Purchases	$69,954	$123,806
Percentage	35%	34%

This places the Appellant's business as one that provides services because the cost of goods purchased for resale was less than 40 percent of the annual taxable sales and, therefore, the correct Quick Method rate to be applied is 4.3 percent. The Minister came to this conclusion using the sales and purchase figures that were contained in the Appellant's tax filings. According to the evidence of Ms. Brown, no adjustments were made to those amounts that the Appellant used in his filings. The Appellant's agent used rates for a business that purchases goods for resale. Ms. Brown applied the correct rate of 4.3 percent and then reassessed in respect to the difference between the amount that the Appellant actually reported and the amount that he should have reported. The Appellant has failed to establish that he was not eligible to use the Quick Method and the election has not been revoked. In fact, in submissions, the Respondent contended that, if the Court accepted the Appellant's agent's argument to allow reporting GST by the conventional method, the result would actually increase the Appellant's reassessment in the range of $13,000 to $20,000 for GST collectible. The Appellant would then be entitled to ITCs under this method but there is little evidence before me that would support such an entitlement. There is no documentation in respect to the ITC entitlement for the 2006 reporting period and the little that is available for the 2007 reporting period would be insufficient to lower the net tax compared to the amount that has

been currently assessed under the Quick Method. Lack of documentation in respect to ITCs will generally not be a problem under the Quick Method because the registrant foregoes a claim for ITCs except with respect to capital assets.

[24] In summary, the Appellant was entitled to use the Quick Method of accounting to calculate GST for the 2006 and 2007 reporting periods pursuant to his election to do so. He failed to apply the correct GST rates under this method and, consequently, failed to properly report net tax. His sales were taxable at the rate of 4.3 percent for those reporting periods resulting in additional net tax of $11,869.38 that the Appellant failed to report. The Appellant is not entitled to ITCs exceeding the amounts of $252.43 and $201.77 in respect to the 2006 and 2007 reporting periods.

[25] For these reasons, the appeals in respect to the GST reassessments are dismissed, without costs.

Signed at Summerside, Prince Edward Island, this 11th day of August 2015.

"Diane Campbell"

Campbell J.

CITATION:	2015 TCC 202
COURT FILE NOs.:	2012-578(GST)I 2014-85(IT)I
STYLE OF CAUSE:	ADVAN BASIC AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATES OF HEARING:	December 12, 2014 and April 20, 2015
REASONS FOR JUDGMENT BY:	The Honourable Justice Diane Campbell
DATE OF JUDGMENT:	August 11, 2015

APPEARANCES:

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Counsel for the Respondent:	Tony Cheung

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