

Docket: 2005-1776(IT)I

BETWEEN:

VIATEUR MERCIER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on January 30, 2006, at Québec, Quebec.

Before: The Honourable Justice P.R. Dussault

Appearances:

Agent for the Appellant: Diane Laverdière

Counsel for the Respondent: Anne Poirier

JUDGMENT

The appeals from the assessments under the *Income Tax Act* for the 2000, 2001 and 2002 taxation years are dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 8th day of June 2006.

"P.R. Dussault"

Dussault J.

Translation certified true
on this 24th day of May 2007
Monica F. Chamberlain, Reviser

Citation: 2006TCC310
Date: 20060608
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REASONS FOR JUDGMENT

Dussault J.

[1] These appeals are from assessments made under the *Income Tax Act* ("the Act") with respect to the 2000, 2001 and 2002 taxation years. They were heard under the informal procedure.

[2] Using the net worth method, the Minister of National Revenue ("the Minister") added \$32,867, \$14,452 and \$13,633 to the Appellant's reported income for the 2000, 2001 and 2002 taxation years, respectively. Appendix A of the Reply to the Notice of Appeal ("the Reply") sets out the relevant calculations. That appendix was tendered in evidence as Exhibit I-6.

[3] Following the Appellant's objection, the amounts added to his income were reduced to \$25,024 for 2000, \$11,482 for 2001 and \$9,366 for 2002. Appendix B of the Reply to the Notice of Appeal provides the details of these reductions, which result from reductions in personal expenses for each year, notably under the headings "transportation", "recreation and entertainment — games" and "lodging costs — vacations/trips". For the year 2000, the personal expenses, including a computer purchase and a compact disc player purchase, were reduced as well.

[4] The Appellant, Ms. Laverdière and Ms. Hodgson testified. Ms. Gagné, the auditor, testified for the Respondent.

[5] During the years in question, the Appellant operated Bar L'attraction Plus, which he purchased in 1997.

[6] The auditor used the net worth method because the business lacked internal controls and adequate bookkeeping. The Appellant signed a waiver of the normal reassessment period with respect to the 2000 taxation year.

[7] During the years in question, the Appellant lived with Diane Laverdière at her residence. Ms. Laverdière was also the manager of the bar operated by the Appellant, and she kept the books of the business from 2002 onward.

[8] The bar operated by the Appellant seated roughly 30 people. It was open seven days a week, from 8 a.m. to 3 a.m. It was equipped with a pool table, five video lottery terminals and a few other entertainment amusement devices. The Appellant also had a type of private automated teller machine (ATM) as well as a safe and a change machine. My understanding is that the ATM and change machines supplied the money needed to operate the video lottery terminals and other amusement devices. According to the Appellant, customers spent roughly \$1,000,000 per year on these machines, while the bar itself had revenues of \$250,000 per year.

[9] Louise Gagné began auditing the Appellant's operations on December 9, 2003, during a telephone conversation with the Appellant and Ms. Laverdière in the course of which she requested the documents necessary for her audit. On January 7, 2004, Ms. Gagné met with the Appellant and Ms. Laverdière at the bar and then at the home. They provided some information and gave her a limited number of documents. Following this meeting, Ms. Gagné followed up on the file, primarily with Ms. Laverdière, but also with Mr. Dawson and Mr. Lavoie, the Appellant's outside accountants. Ms. Gagné met the Appellant and Ms. Laverdière again to obtain additional information on April 26, 2004, just after the Appellant sold the bar. Ms. Gagné contacted Ms. Laverdière and the Appellant's accountants again in May 2004.

[10] After sending out her draft assessment in May 2004, Ms. Gagné met the Appellant and Ms. Laverdière at the office of the accountant Mr. Lavoie on June 8, 2004. Mr. Lavoie was apparently the person who asked for the meeting, at which several points of disagreement were noted.

[11] The efforts that Ms. Gagné made in the course of her audit, as well as her meetings and correspondence during that audit, are recorded in her notes regarding the file (Form T2020, Exhibit I-4), while her audit report (Exhibit I-5) discusses the aspects of the draft assessment that the Appellant, Ms. Laverdière and the accountant Lavoie objected to during the meeting of June 8, 2004. Since the information contained in the testimonies of the Appellant, Ms. Laverdière and Ms. Hodgson differs to some extent from the information submitted to Ms. Gagné at or before that meeting, it is important to refer directly to Ms. Gagné's audit report in order to clarify the issues and the way in which they were dealt with by reason of the information obtained. Hence, I will reproduce item F of Ms. Gagné's audit report (Exhibit I-5, at pages 2-4):

[TRANSLATION]

F. CLIENT'S EFFORTS

Meeting requested by accountant after draft assessment provided

Discussion points (see T2020 dated June 8, 2004):

Cash on hand: The accountant says that the business needs **\$30,000** in working capital (this is what he was told by the previous owner, whose accounting he also did). I told him that client told me \$15,000–18,000 is placed in the private automated teller machine (acquired in 2000) but did not justify the source of those funds or of any amount for the years prior to the acquisition of the machine. And why did he not include such an amount in the statements produced (cash on hand: only the reconciled business bank account is considered) because he claims this \$ was available since operations began; advanced by the client?

On the other hand, Viateur did tell him that he sold his principal residence and took \$35,000 of the proceeds when he got divorced in the late eighties or thereabout. In addition, he apparently got a \$40,000 lump sum from the CSST at roughly the same period (briefly saw documents, was not supplied with them). However, upon examining his bank account, we did note that the client has an investment (worth over \$50,000 in 2004). Client was questioned about this; he did not specify the exact source of these funds, but he did say that this was long ago. It could be the CSST settlement. A significant expenditure (car purchase) was also made in 1992. Thus, we have some doubts about the amount of \$ on hand in 1999.

Loans to individuals: I was given a copy of four papers (written in the handwriting of the client's spouse) dated June 2004 (see attachment #1)

confirming various loans totalling \$12,000 which the client made to individuals in 1999. No contract, no witnesses, no terms of repayment stated, and no evidence of money outflows or inflows — everything was apparently done in cash. Questioning established that three of these four loans were apparently completely repaid the following year (2000) and that one was finalized in 2001.

For all these reasons, we established cash on hand (as posted to the personal balance sheet) as follows in order achieve a total opening balance of \$30,000 cash on hand, as given to us by the accountant):

	1999	2000	2001	2002
Cash on hand	\$18,000	\$27,000	\$30,000	\$30,000
Loans to individuals	<u>\$12,000</u>	<u>\$2,500</u>	<u>0</u>	<u>0</u>
TOTAL	\$30,000	\$30,000	\$30,000	\$30,000

Non-taxable income for 2000 cash received from two adult children who lived at home and one friend who also lived at home: this fact was never brought up prior to the meeting with the accountant and was not even mentioned on the spouse's completed personal expense questionnaire. **No documentary evidence was supplied in connection with this.**

The accountant says that his clients received \$100 per person per week, i.e. \$300 per week or \$1,200 per month for a total of **\$15,000 per year**, strictly in cash. There is no evidence to substantiate this. Based on this, he asks that this amount be reduced for 2000. When questioned, Ms. Laverdière says that the friend is Johanne Hodgson, who is, in fact, one of the people that borrowed money from the client in 1999 (\$5,000). Part of the money paid in 2000 could actually be a repayment of her debt.

Based on a mere assertion, we granted 50% of this amount, i.e. \$7,500, to the client (for the purposes of settlement) as an amount received from the children who live at home (adjustment of net worth).

Personal expenses (groceries): The response on the questionnaire indicates \$6,000 per year. I asked that this be reconsidered, as it is now being stated that there were five adults in the house in 2000. The representative says that this expense was overestimated, and that the amounts for 2001 and 2002 should be reduced to \$3,000, and the amount for 2000 kept at \$6,000.

According to Statistics Canada, the expense for five adults is over \$8,000 and the expense for two adults is over \$2,000. I am therefore leaving the

amount for 2000 unchanged (\$6,000) and allowing a total reduction of \$2,000 per year in personal expenses for 2001 and 2002 for the purposes of settlement (the accountant made a brief comment on the high amount of the expenses, and I retorted that these were the client's own estimates.)

Restaurants: Client had stated \$1,500 under personal. However, the **entertainment expenses** posted to cash expenditures are restaurant expenses. After examining the vouchers, these appear to be **personal expenses** (meals for two people close to the business and home). We therefore disallowed this expense and increased (for each year) the amount indicated by the client as personal in order to foot the expenses posted under this heading (before the 50% adjustment to take account of the total actual expense incurred, as opposed to the tax deduction). The accountant disagrees. He wants the total amount to correspond to the amount deducted. We maintain our position on this point based on our objective of showing the total expense actually incurred.

Capital assets: During the discussion, it was claimed that the client purchased the **television and computer** for a business purpose, but since the television was often broken at the bar, he brought it home for personal use 2-3 months later. Same intention for the computer, except that Ms. Laverdière was unable to master the tool, so she sold it to her son shortly after the purchase. In addition, the television was delivered to the home, and the client was unable to provide justification for this. We are therefore keeping the draft as is (assets posted to the personal balance sheet with taxes and UCC revised). The representative asked us to grant 50% so there is a disagreement on this point.

With respect to the cars, we placed the Cadillac (see FT-2550) on the personal balance sheet because the TransAm is the car that is being depreciated for business purposes. It was agreed that the sale and repurchase of the vehicle would have little impact on the UCC and CCA allotted, and that we would ignore these transactions.

We allowed the following purchases (which had been disallowed in the draft because they were unsubstantiated) for the purposes of settlement: Réfrigération N.P. Inc. \$1,500; Ameublement Tanguay (player) \$222, and a \$229 water fountain.

[12] The first issue is the amount of cash kept at the bar at the end of 1999, 2000, 2001 and 2002 for the purposes of Ms. Gagné's net worth calculations. The Appellant claims that he kept \$30,000 in cash at the bar to operate the video lottery terminals and other amusement devices. In addition, he says that he lent a total of \$12,000 from his personal funds. As we know, based on the initial information

obtained from the Appellant, Ms. Gagné took the position that there was \$15,000 and then \$18,000 worth of such cash on hand at the end of each year. However, if one adds the \$12,000 that the Appellant lent to customers or friends in 1999, of which \$9,500 was allegedly repaid in 2000 and \$2,500 was allegedly repaid in 2001, she actually considered that the Appellant had a total of \$30,000 in cash on hand at the end of each year from 1999 to 2002. Thus, she agreed that the cash on hand for the operation of the bar was \$18,000 in 1999, \$27,000 in 2000, \$30,000 in 2001 and \$30,000 in 2002. Ms. Gagné made this concession after hearing the comments made by the accountant Mr. Lavoie at the meeting of June 8, 2004. However, as Ms. Gagné noted in her report, the evidence of the cash kept at the bar and the loans granted by the Appellant was meagre at best. In fact, one wonders how Mr. Lavoie could personally have known how much cash the Appellant kept on the premises of the business, since, as Ms. Gagné noted, there was no audit in this regard and this asset was never posted to the balance sheets prepared by the accountants (in addition, see Exhibit I-4, the notes dated May 11, 2004, regarding the file).

[13] The Appellant testified that he always kept \$30,000 in cash at the bar in order to operate the different machines, and that he deposited any surpluses at the bank. As for Ms. Laverdière, she claimed that she had a fixed amount of \$30,000 in the ATM safe for the use of video lottery terminal customers. She also tendered a statement dated April 2005, albeit an unsigned one, in which she affirmed that the safe alone — I understand that this is still a reference to the automated teller machine — contained \$24,000 in cash, in addition to the \$3,500 in the change machine as well as other amounts in \$2, \$50 and \$100 denominations for the years 1999, 2000, 2001 and 2002 (Exhibit A-2).

[14] In the same statement, Ms. Laverdière adds:

[TRANSLATION]

Only Viateur, Johanne and I had access to the ATM safe in the morning before the bar opened.

[15] Johanne Hodgson, who stated that she lived at Ms. Laverdière's home for five years and that she worked at the bar at few hours a day for six months, without specifying when, said that she did not have the combination of the safe. However, she claimed that in addition to cleaning up in the morning, she counted the cash with the Appellant and Ms. Laverdière. She claimed that she always counted \$30,000. It is difficult to believe that she counted exactly \$30,000 each

morning given that money must have been taken out of the safe the previous day in order to operate the video lottery terminals and other amusement devices. In fact, both the Appellant and Ms. Laverdière stated that the cash amounts kept at the bar varied. In this context, Ms. Hodgson's testimony, which was confusing and rather incoherent in other respects, lacks credibility in my view.

[16] Ms. Laverdière also tendered a banking document pertaining to a \$30,000 investment in 1997. This investment was allegedly used to repay a bank loan in the same amount, the proceeds of which purportedly constituted the cash needed to operate the video lottery terminals (Exhibit A-6). The document in question proves nothing about the way in which the loan proceeds were used, and we do not even know when this loan was granted. A relationship between the amount of the loan and the cash on hand at the end of each of the taxation years 1999 through 2002 was simply not shown.

[17] All in all, faced with the differing versions of the facts presented to Ms. Gagné and at the hearing, as well as the unreliable statements, I find that Ms. Gagné's determinations regarding the cash that the Appellant had on hand at the end of the years 1999 through 2002 in order to operate his business, and her determinations regarding the amount of the loans that he granted and the repayment of such loans, are quite generous and should not be altered.

[18] The second issue involves the money allegedly paid to Ms. Laverdière by two of her children and Ms. Hodgson when they lived in the house. Ms. Laverdière claimed that she received \$100 a week from each of these three people in 1999, in 2000, and until July 1, 2001, and she produced signed declarations to this effect from each of them (Exhibit A-1). However, only Ms. Hodgson testified.

[19] Thus, Ms. Laverdière claims that she received \$15,000 from her two children and Ms. Hodgson for room and board in 2000, and \$7,500 in 2001, and that the amount of personal expenses determined by Ms. Gagné should be reduced by an equal amount.

[20] In her report, Ms. Gagné noted that these facts were first brought to her attention at the meeting of June 8, 2004, which was rather surprising in view of the considerable contact with Ms. Laverdière over the preceding months and the fact that Ms. Laverdière filled out the personal and family expense questionnaire (Exhibit I-3) at their first meeting on January 7, 2004.

[21] But there is more. When the facts concerning the amounts that Ms. Laverdière was paid by her children and Ms. Hodgson were revealed to Ms. Gagné at the meeting of June 8, 2004, only the \$15,000 received in the course of the year 2000 was mentioned, and nothing was said about the additional \$7,500 received in 2001, as stated in her notes regarding the file (Exhibit I-4) and her audit report (Exhibit I-5). Ms. Gagné's reaction to these facts, which were presented to her for the first time, was to wish to increase the personal expenses, notably for groceries, because she learned that there were five people, not just two people, living in Ms. Laverdière's home during the year 2000. However, Mr. Lavoie, the accountant who represented the Appellant, responded by seeking a reduction of the personal expenses for 2001 and 2002, as stated in Ms. Gagné's audit report (Exhibit I-5). Ultimately, for the purposes of settlement, she agreed to reduce the personal expenses by \$7,500 for the year 2000, which represents one-half the amount that Ms. Laverdière claims to have received from her children and Ms. Hodgson during that year, and which keeps the amount of grocery expenses unchanged at \$6,000. According to the audit report, Ms. Gagné did, however, reduce the personal expenses as a whole by \$2,000 for each of the years 2001 and 2002 for the purposes of settlement (Exhibit I-5). Actually, in computing the difference in net worth, the expenses were reduced by \$2,000 for each of the years 2000, 2001 and 2002 (Exhibit I-6, pages 13, 16 and 19). I would also note that for the year 2000, Ms. Gagné forgot to post \$8,340 in personal expenses paid by cheque to the "subtotal — other" heading, resulting in a failure to include them in the "grand total" (Exhibit I-6, page 19). Thus, the personal expense total for the year 2000 is underestimated by that amount.

[22] One can see that the version of the facts that was stated at the meeting of June 8, 2004, is, once again, different from the version stated at the hearing, because initially, only the money that Ms. Laverdière received from her two children and Ms. Hodgson in 2000 was mentioned. Although Ms. Hodgson confirmed Ms. Laverdière's testimony at the hearing, the fact that two different versions of the facts of 2001 were presented on two different occasions raises serious doubt about the credibility that I must accord the testimony, especially since, as explained above, the personal expense amounts were already reduced as a result of the version presented to the auditor at the meeting of June 8, 2004.

[23] Thus, since Ms. Gagné already reduced the personal expenses for the year 2000 by \$7,500 of the requested \$15,000 in order to account for the money received from the children and Ms. Hodgson; since the personal expense total was reduced by a further \$2,000; and since a simple calculation error resulted in a

\$8,349.67 underestimate of personal expenses, I am not inclined to make any additional adjustments for that year.

[24] As for the year 2001, it has been established that a \$2,000 general reduction was already applied to the total expenses based on the comments made to the auditor at the meeting of June 8, 2004. Given the different, and contradictory, versions of the facts presented at that time and at the hearing, the doubt that has been raised as to which version is "true" leads me to the conclusion that no additional adjustments should be made.

[25] The third issue involves a television monitor and stand purchased on December 13, 2000, at a cost of \$4,702.17, and delivered to the Appellant and Ms. Laverdière's residence on December 19, 2000. Ms. Gagné, the auditor, saw the television at the home when she visited on January 7, 2004, and posted the asset to the Appellant's personal balance sheet, not the business balance sheet. In her report, Ms. Gagné noted that the Appellant was unable to explain why the television was delivered to the residence instead of the business. At the hearing, both Ms. Laverdière and the Appellant said that the television was delivered to the residence because they were waiting for a metal support or tripod to be installed in the bar before putting the television there. Once this occurred, the Appellant and a friend allegedly transported the television and the stand. Both Ms. Laverdière and Ms. Hodgson said that the television was in the bar during the holiday season. However, based on information provided to Ms. Gagné during the audit (Exhibit I-5), it was damaged by customers twice and was brought back to the residence for personal use two or three months later. At the hearing, Ms. Laverdière claimed that the television was in the bar for five or six months before being brought back to the residence definitively. Once again, the Appellant and Ms. Laverdière's differing versions cause me to doubt the veracity of their testimony. In addition, it was never shown that the television was posted to the business balance sheet and that the Appellant claimed a capital cost allowance deduction. Lastly, since the initial statements made to Ms. Gagné were to the effect that the television was converted to personal-use property after a very short period, I find that there was a justifiable basis, under the circumstances, to include the property in the Appellant's personal assets.

[26] The fourth issue involves the restaurant expenses of \$4,247, \$2,987 and \$5,667 added to the Appellant's personal expenses for the years 2000, 2001 and 2002, respectively. The Appellant had claimed 50% of these amounts as entertainment expenses (Exhibit I-6, pages 2, 11, 14 and 17). The reason that Ms. Gagné stated in her report for considering these expenses personal is that the

analysis of the vouchers showed that they were for meals for two people in restaurants located close to the business or the residence.

[27] At the hearing, Ms. Laverdière said that the restaurant expenses were for employee parties or birthdays, or for meals with customers whom they wanted to pamper because the bar had no promotions in the nature of a "happy hour." For her part, Ms. Hodgson stated that the Appellant had restaurants deliver meals for these parties. No additional details were provided, and no supporting documents were produced along with suitable explanations. In my opinion, the evidence adduced is insufficient to enable me to change the assessments in connection with these restaurant expenses. I also stress that Ms. Gagné reduced the total personal expenses by \$2,000 per year for the purposes of settlement.

[28] The fifth issue involves amounts of \$500 that Ms. Gagné considered personal gifts of money and contributions for each of the years 2000, 2001 and 2002 (Exhibit I-6, pages 12, 15 and 18). The addition of this amount for each year is consistent with Ms. Laverdière's response on her personal expense questionnaire, which she completed on January 7, 2004 (Exhibit I-3, page 5).

[29] At the hearing, Ms. Laverdière stated that this amount was part of the amounts billed by credit card, but she provided no evidence in this regard. Thus, the assessments in this regard should not be altered.

[30] The sixth and last issue involves the sale of a 1989 Cavalier model automobile. Ms. Laverdière claimed that she sold this automobile for \$1,500 in 2002. She claims that the purchaser was a patron of the bar. She produced a document attesting to this fact and signed by the purchaser's brother-in-law (Exhibit A-3). The sale was allegedly done by a "garage" which agreed to take the vehicle on consignment and made its profit at the time of sale. Ms. Gagné did not take this fact into consideration because she was not told about it at the time of her audit. In the absence of additional information concerning the cost and the year of purchase, the amount of the garage's commission on the sale and the amount of profit or loss, as the case may be, there is no basis on which to find that this sale should reduce the assessment for 2002.

[31] In light of the foregoing, the appeals from the assessments made for the 2000, 2001 and 2002 taxation years are dismissed.

Signed at Ottawa, Canada, this 8th day of June 2006.

"P.R. Dussault"

Dussault J.

Translation certified true
on this 24th day of May 2007
Monica F. Chamberlain, Reviser

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REASONS FOR JUDGMENT BY: The Honourable Justice P.R. Dussault

DATE OF JUDGMENT: June 8, 2006

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