

Docket: 2002-1227(GST)I

BETWEEN:

2760-3125 QUÉBEC INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 10 and November 6, 2003, at Chicoutimi, Quebec
Before: The Honourable Justice Alain Tardif

Appearances:

Counsel for the Appellant: Pierre Bernard Bergeron

Counsel for the Respondent: Frank Archambault

JUDGMENT

The appeal of the assessment under Part IX of the *Excise Tax Act* (the "Act"), the Notice for which is dated November 29, 2001, and bears the number 1245794, related to the Goods and Services Tax for the period from May 1, 1995 to April 30, 1999, is allowed and the assessment is referred to the Minister of National Revenue for review and reassessment in consideration of the fact that the amount of Goods and Services Tax, which was \$6,835.39, must be reduced to \$3,500, to which must be added \$972.56 for input tax credits paid but not due, plus the interest and penalties under the *Act*, in accordance with the attached reasons for judgment. The whole without costs.

Signed at Ottawa, Canada, this 29th day of April 2004.

"Alain Tardif"

Tardif J.

Translation certified true
on this 20th day of September 2004.

Shulamit Day, Translator

Citation: 2004TCC183
Date: 20040429
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REASONS FOR JUDGMENT

Tardif J.

[1] This is an appeal of an assessment under the *Excise Tax Act* (the "Act") related to the Goods and Services Tax ("GST") for the period from May 1, 1995 to April 30, 1999, which includes interest and penalties.

The facts

[2] Since 1992, 2760-3125 Québec Inc. (the "Appellant"), better known by the business name of Dépanneur Péribonka enr., has been operating a service station that includes a small convenience store.

[3] In his testimony, Roger Martel, the Appellant's shareholder, believed that 85% of the sales made by his business was the sale of gasoline.

[4] The company also operated a small snack bar under the business name La Soupière. The two businesses have different GST registration numbers. The businesses are located on the same site.

[5] One of the reasons for the audit was that the Appellant generally claimed more input tax credits ("ITCs") than he remitted in GST. This practice seemed somewhat unusual given the nature of the business, and the Respondent therefore implemented the audit process.

[6] After the audit, the Minister of National Revenue (Minister) issued, on September 14, 2000, a notice of reassessment with respect to the Appellant's GST for the period from May 1, 1995 to April 30, 1999 (the "period covered") in the amount of \$15,824.04 including interest and penalties.

[7] The reassessment applied only to the service station and the convenience store; the snack bar was in no way affected by the reassessment.

[8] Initially, in making the reassessment, the Minister assumed a mark-up of 25%, which he established using sampling compiled with the assistance of Mr. Martel's wife.

[9] On December 4, 2000, the Appellant submitted a notice of objection. On November 29, 2001, the Minister issued a corrected reassessment in the amount of \$9,932.23, including interest and penalties. The reassessment breaks down as follows: GST = \$6,835.59, unjustified ITCs = \$972.56, interest = \$1,095.41 and penalties = \$1,028.77. To make the reassessment, the Minister first reduced the mark-up to 20%, then, after various observations, to 10%.

[10] Although the 10% mark-up was essentially consistent with the Appellant's claims, the corrected assessment during the objections phase still did not satisfy the Appellant. In his opinion, the assessment should simply have been cancelled.

[11] To support his claims, shareholder Roger Martel asserted that the mark-up was much lower than 10%, after having advanced that this was the applicable percentage.

[12] Mr. Martel also asserted that the assessment should be cancelled, since the Minister had deemed as taxable sales all the products offered free as part of business promotions, all the products and merchandise transferred to the snack bar, and, finally, goods lost through theft and various damage.

[13] Roger Martel, the shareholder, confirmed that, on average each week, the Appellant gave away products of an approximate value of \$150 as part of

promotions and sponsorships. He believed that the Appellant's annual budget for promotions and sponsorships was \$7,800.

[14] The Appellant believes it is reasonable to believe that the value of the taxable goods offered free as promotions and sponsorships equals approximately 2% of his annual sales. This percentage applies to total sales, including gasoline sales.

[15] The Dépanneur Péribonka enr. convenience store and the La Soupière snack bar shared the same cold storage room. Mr. Roger Martel indicated that he regularly transferred taxable goods from the convenience store to the La Soupière snack bar. He assessed these transfers at a value of approximately \$10,000 per year.

[16] The Appellant was not able to clearly determine the amount of non-taxable sales made during the period covered. It had no records or documents to permit assessment or tabulation of the value of the products that were distributed without charge as part of promotions or the value of the merchandise that was subject to inventory transfer. Even with respect to the losses caused by theft or damage, the Appellant's statements were essentially guesswork, or arbitrary answers.

[17] The Appellant's main witnesses were Mr. Martel, his spouse, and Mr. Langis Landry, a tax expert. The accountant who took care of the books did not testify.

[18] The testimony of Mr. Martel's and his spouse was hardly convincing. First, I think that Mr. Martel knew a great deal more than he wanted to let us believe. The inaccuracy, confusion and the lack of answers to some questions was irreconcilable with the clarity and firmness of some other answers so that it appears that he adjusted his testimony according to what he believed was important to his case.

[19] Mr. Martel and his spouse even claimed that they did grocery shopping several times each day for their personal needs.

[20] Mr. Roger Martel demonstrated a very selective memory: often very specific for details with little relevance, his answers quickly became vague, confused and unclear for factors that were, however, very important. See the transcript of page 63 of the testimony on June 10, 2003:

[TRANSLATION]

Pierre Bernard Bergeron re-examination of Roger Martel

...

Q. Now, let us go back to a week in which there was a Pepsi promotion.

A. Pepsi promotion?

Q. Yes.

A. Yes.

Q. To one of your lawyer's questions, you replied that you could have given away up to \$400 in Pepsi in that week.

A. If it was \$13... it cost \$13 for eight, there were eight in a... we gave five each day, sometimes... crates, you know, we gave five of them. That's the promotion we were running. It actually cost us \$0.86, it cost \$0.86 per item.

Q. OK. Tell me, what I want to know is this: did your wife write down in her accounting "\$200/week promotion" or it was – \$400 or \$100? Was it written down, under publicity/promotions?

...

[21] After sustaining and confirming that promotions could represent up to \$400 per week, when he was required to recognize the actual cost, Mr. Martel indicated that there had been a promotions book at one time, but that it had been lost, as he states on pages 69 and 70 of the testimony of June 10, 2003:

[TRANSLATION]

Pierre Bernard Bergeron's re-examination of Roger Martel

...

PIERRE B. BERGERON:

Just one little question, Your Honour.

Q. The promotions record, you did not find it, you said?

- A. No. The promotions book I had, was in the boxes... when they came to get the boxes, it was there. We looked until midnight last night to try to find them, I did not find the sheet, the binder. It was supposed to be in there, but it wasn't. We looked. We did three boxes to be sure that the promotions book was there, the sheets we submitted every week were there, the sheets which we submitted every week, and we didn't find them. They were stapled sheets.

...

[22] On several occasions during his testimony, Mr. Martel answered that his spouse was in a better position to answer the questions adequately. However, Patricia Carbonneau, who was responsible for the accounting, was totally unable to provide appropriate answers. It would be more correct to say that she wrote the journal entries; her testimony revealed that she had neither the knowledge nor the skill required to understand the significance of the data she entered.

[23] The Appellant's position could be summarized as follows: [TRANSLATION] *"I collected all the taxes that had to be collected, and I sent them in. Any assessment is therefore incorrect. I have engaged the services of a tax expert to prove it."*

[24] The tax specialist whose services were retained by the Appellant took all the Appellant's claims for granted and considered that his mandate was to convince the Court that the Appellant's claims were correct.

[25] The tax specialist arbitrarily set the percentages for the transfers, promotions and merchandise lost or stolen and concluded that the Appellant's claims were well founded. At the same time, he recognized that there were unusual and significant gaps in the financial statements with respect to the years used for comparison purposes. He testified about financial statements he had not prepared, and the individual who did prepare them did not testify. The following extract, from pages 51, 52, 58 and 61 of the testimony on November 6, 2003, is quite revealing:

[TRANSLATION]

Frank Archambault's cross-examination of Langis Landry

...

- Q. Therefore you are starting with the total purchases that you took from the forms, in the manuscripts we saw earlier. OK, so, you are telling me that from twelve point five percent (12.5%) promotions,

you get \$7,206. OK. That percentage for promotions, twelve point five percent (12.5%), where do you get that? Where are you taking that percentage from?

A. Well, the percentages, we did... that percentage, I, I have here the follow-up from the first day of the hearing, that this was admitted, in any case by our side, that the transfers were more or less \$13,000 according to Mr. Martel's testimony and the promotions... in any case, there were... transfers plus the... there were \$18,500 per year, on average. So, then, \$18,500 per year, that was quite a lot, so I reduced it a bit, it would have been thirty percent (30%), but I dropped it a bit.

Q. O.K. So...

A. But really, I had room to play with up to \$18,500 if I relied on the first day of the hearing. But you know, 12.5%, I set it a bit... I put 25% for both of them together, the two factors.

Q. You had 25% based on the testimony of Mr. Martel, is that what I am to understand?

A. Well yes, it's... yes...

Q. O.K. There is no documentation, then, to support what you are saying, that's what I understand.

A. Correct.

...

Q. So with respect to the percentages set for the promotions, transfers, it's, essentially to summarize, it was established based on the testimony of Mr. Martel. With respect to the usual losses that you assessed at three percent (3%), and which you estimated at \$1,730 for 1998, that's based on what? What is the basis for the percentage of losses?

A. Ah! It's...

Q. How do you get it?

A. It's a bit... there is no standard, it's... I set it there. The...

...

- A. Yes, I was not there, I don't know which transfer... there are transfers, but which elements were transferred...

...

[26] In short, the Appellant asserted that the many taxable products that were not sold but given to clients free as part of promotions to boost gasoline sales, the business' main source of income, partially explain the gap noticed by the Respondent. With respect to the rest, it was explained that other products, also taxable, that were not sold but were simply the Appellant's inventory transferred to the inventory of the snack bar, the La Soupière, as part of the mutual cooperation that existed between the two businesses.

[27] Mr. Martel completed the explanations by confirming that certain products bought were not sold because of theft or because these were products that became unmarketable due to damage. He stated vigorously that all the sales made at the service station were in fact recorded and that the tax had been collected.

[28] To support his statements, he reported strict instructions given to his children and his staff, even adding that when he took a package of chewing gum, he entered and paid for it.

[29] The significance of the amounts at issue for the inventory transfers, the promotions and free giveaways of various products during gasoline sales were also factors that were completely improbable.

[30] The Respondent issued an assessment based on a limited analysis of the service station and the convenience store, even though the close relationship with the other business was mentioned. The basis was established using a sample of the products sold at the convenience store; the mark-up was based on information given by Mr. Martel's spouse.

[31] Ms. Renée Potvin, the auditor, stated that the Appellant kept his books very well; on the other hand, she indicated that the records and the available accounting data did not permit a precise assessment of mark-up. She also indicated that the contents of the cash register Z readings could not be validated or confirmed. According to Ms. Potvin, she could not verify whether the taxable sales had been recorded in the cash register as non-taxable or were simply not recorded.

[32] She explained that she had to use an alternative method because it was totally impossible to confirm the taxable sales with the books that were kept on-site. It seems that there was no way to confirm the taxable sales; therefore, she used an alternative method.

[33] The taxable sales were based on the taxable purchases for which the Appellant requested ITCs because these were taxable purchases that would later be sold. Ms. Potvin explained the discussions she had with Rosaire Tremblay, the Appellant's accountant; he did not testify.

[34] The work conducted by Ms. Potvin seems well summarized in the following extract from the transcripts, on pages 63, 64, 65, 67 and 68 of the testimony of November 6, 2003.

[TRANSLATION]

Frank Archambault's examination of Renée Potvin

...

Q. Can you explain to us briefly how... what method you used, with respect to your audit, and why you used this method?

A. OK. First, I used... I did... the audit took place in two phases. I did one part that is quite standard. I verified that the taxes in the books were submitted correctly, that the statements made to the Minister were correct, that there were supporting documents for the ITCs and the input tax refunds claimed and that this was in fact in the books.

Then, I proceeded with the second step, and, well, with respect to the convenience store, we know that there was a lot of... there are non-taxables; therefore there are... We did tests to see whether the taxes were claimed correctly. Then, well, when I did the first tests, I could see that the taxes claimed were very high compared to the taxes that were remitted. Because, normally, a taxable sale, we start with the principle that a taxable sale will... a taxable purchase, excuse me, will lead to a taxable sale, therefore there must be a certain percentage profit taken from it. Therefore we decided that... Since it's difficult because the non-taxables are counted from the cash register Z readings, from the books, we decided to use a method, an alternative method that is based on reconstructing the ITCs, so the ITCs for the convenience store resales.

THE HONOURABLE JUSTICE

Q. Tell me about the accounting, I mean, what was available for this work?

A. Well, what was available were the books we had there, the general ledger, the journals with each purchase entered, with the taxes claimed, each cash register Z reading, each end-of-day cash reconciliation with income, taxes payable, gasoline sales and all that, which were recorded daily. That's what was available, with all the invoices to support it and the cash register Z readings, the little... the summaries for each day on the cash register.

...

A. Those, those were amounts that were... that were assessed because, well, at the time of the purchase, the amounts were claimed, which is completely normal, except that there are suppliers who were paid with stock that was taken, either gasoline or stock taken from the convenience store then, at that time, the ITCs and input tax refunds were claimed a second time. So that was claimed twice, so I cut a part; the part that was claimed twice, I assessed it.

...

Analysis

[35] The Appellant had several means available to him to support the validity of his claims, such as the presence of competent witnesses to demonstrate the reality of the competition to which he referred several times to justify the many giveaways and to ensure the concession for gasoline sales.

[36] Was there a relationship between gasoline sales and the generous promotions? Nothing of the sort was demonstrated; Mr. Martel testified according to his recollection, which, more often than not, was vague, hazy and very unclear.

[37] When a business decides to invest in publicity and promotion, especially when it involves an unusual, if not uncommon, scenario that is not very consistent with custom and usage, it therefore becomes imperative to gather as much information and documentation as possible in order to attest to its validity, especially when the business is an agent for the collection of taxes, as a rule, on all sales.

[38] Although the Appellant's claims were that the giveaways and transfers were negligible in comparison to the amount of gasoline sales, this does not excuse or justify the total absence of records in this respect, all the more because these were products presumed to be taxable.

[39] Having the burden of proof or the responsibility therefore is very demanding. This is a very heavy, challenging and restrictive obligation, not a banal statement with no impact. It is not sufficient to criticize and attack the evidence presented by the other side or to bring out vague factors likely to make the desired conclusions possible.

[40] It is essential to demonstrate, using objective and credible factors, that the desired conclusions are reasonable and probable. There must be, among other things, probable, reasonable, coherent claims that are consistent with all the facts and accounting data available. If an agent does not fill out the necessary records to enable him to be accountable with all the relevant supporting documents, he exposes himself to having to assume the consequences of his arbitrary explanations.

[41] When an individual does not ensure he has in his possession all the relevant documents to support his claims, he must therefore use an alternative method, which is arbitrary by nature.

[42] Unfortunately, the government must often use such methods to collect what it is owed. The argument that the same logic can be used to support the merits of an appeal does not hold. The total or partial absence of relevant information or documents constitutes negligence, if not an error, which has consequences for the person who committed it. In other words, it is totally unacceptable for an agent to use evidence that is essentially verbal and unsupported by evidence that is relevant for the rendering of accounts required during an audit.

[43] Challenging the validity of an assessment is difficult and restrictive as a result of the obligation to satisfy the burden of proof. It is especially perilous to do so when one does not have possession of the evidence, documents or other items to challenge the accuracy of an assessment in a probable and reasonable manner, from which arises the real danger of having to assume the consequences of an assessment, even though it is marked by arbitrariness. An assessment is always assumed to be correct and well founded.

[44] The need to use an alternative method does not exempt the government from the obligation to proceed in keeping with generally accepted practices. An assessment must be the result of serious professional work that is conducted consistently with generally accepted practices in the circumstances.

[45] In this case, the Respondent audited the Appellant's file using an alternative method. The information and explanations available during the tour of the premises made the reality of the two businesses clear, so that it would have been appropriate, under the circumstances, to audit both businesses, all the more so because the Appellant used the snack bar to justify the taxes that were not collected on products from the convenience store.

[46] Yet the information was not validated by an audit of the snack bar; the assessment was based on a percentage that was considered normal in these matters. Then everything was rounded down, first by 5% and then by an additional amount of 10%, or a difference of 15% between the first assessment and the assessment that was corrected at the objections stage.

[47] Although sometimes there may be difficulties and obstacles primarily caused by accounting that was totally deficient, if not totally non-existent, and therefore likely to produce an arbitrary result, it is still important to show the credibility and reasonableness of the assessment, by facts or documents specific to the business and not only using standards related to the economic activity of the business that is being audited.

[48] The fact that the burden of proof is on the individual contesting the accuracy of the assessment should have no effect on the quality of the work done to establish or justify some laxness.

[49] In this file, the Respondent was responsible for establishing a convincing assessment. It appears from the evidence that the assessment was based on incomplete facts. Although it was certainly the Appellant's responsibility, the Respondent could still have validated a portion of his claims by conducting a parallel audit of the snack bar, thereby obtaining very relevant information.

[50] The Appellant required the cooperation and presence of a tax specialist to support his claims. Rather than submit a presentation based on the Appellant's accounting data, he essentially referred to a working document prepared by the Respondent, the reliability of which was questionable, since it was a document prepared as part of negotiations to which he was not a party.

[51] The data that appear therein are essentially working hypotheses developed during discussions between the auditor and Mr. Tremblay, the Appellant's accountant, who furthermore did not testify.

[52] During his testimony, the tax specialist never used any compilation of data from the Appellant who had in fact dealt with an accountant. Essentially, the specialist attempted to criticize the work conducted to establish the assessment. He should have focused his energies on developing work that was based on the Appellant's accounting data instead of trying to ridicule the work that gave rise to the assessment.

[53] To satisfy the burden of proof, it is not sufficient to contest certain points here and there and to suggest certain interpretations of certain figures presented by the opposing party. It is essential to base one's reasoning and arguments on relevant and, especially, real data from the business involved.

[54] Yet, in this respect, the evidence essentially attempted to demonstrate that, according to the Appellant, there was a specific context with the objective of selling as much gasoline as possible. In other words, the focus was on selling gas, at the risk of operating the convenience store at a loss. This approach was neither documented nor proven.

[55] Such a scenario was possible, but unlikely, especially because the only available piece of evidence with which to judge its validity was the self-serving testimony of Mr. Martel, which was of no value since it is not credible.

[56] The credibility of a testimony has nothing to do with the difficulties an individual might have in life. Credibility lies in the facts and data that could validate the verbal explanations. The confusion relating to some answers and the exemplary precision in other cases is surely an indicator that a great deal of caution is required with respect to credibility, if not the pure and simple rejection of a testimony.

[57] In any case, I simply do not believe the statements that quite significant amounts of money were invested in promoting activities related to gasoline sales.

[58] The assessment being appealed was assumed to be correct. It was the Appellant's responsibility to prove that it was not justifiable in terms of the law.

[59] To do this, the Appellant provided verbal explanations that were unsubstantiated by appropriate accounting. It essentially advanced uncorroborated hypotheses.

[60] The snack bar was not audited. On the other hand, the original assessment was corrected significantly, which creates the impression that the Respondent never was comfortable with the basis for the assessment. To top it all off, the Respondent indicated that the Appellant's bookkeeping was acceptable.

[61] Given this, I cannot disregard the fact that the burden of proof is upon the Appellant. Certainly it was useful to show the arbitrariness used when establishing the assessment, but that was insufficient for drawing a conclusion with respect to the validity of the appeal. The Appellant had to credibly and plausibly establish that his conclusions were correct and well founded.

[62] The Appellant freely chose to operate two business activities through two businesses with separate GST registrations, accounting and bank accounts. According to the testimony of Mr. Martel and his spouse, they made this distinction to the point of completely separating their personal food needs.

[63] According to their testimony, they took absolutely nothing from either of the businesses and did their shopping at a specific supplier's in order to avoid any confusion.

[64] Both businesses were operated using two separate GST registration numbers, which has a whole series of consequences, specifically, two accounting systems, two registration numbers, two inventories, two tax returns, etc.

[65] After making this demanding choice, without doubt for reasons of transparency and to ensure better follow-up, these same people then state that they might make exchanges, loans and merchandise repayments for amounts of up to \$7,000 to \$10,000, without any records.

[66] What explanation can there be for such strict discipline for one aspect of the operations and such a jumble for aspects such as transfers and promotions, which have considerable tax implications?

[67] After we were told that the accounting was adequate, which in fact was recognized in part by the Respondent's auditor, it appears that the accounting was not sufficiently detailed to permit an audit that could provide conclusive findings.

This is clear from the following extract on pages 116 and 117 of the transcripts from June 10, 2003:

[TRANSLATION]

Pierre Bernard Bergeron's examination of Langis Landry

...

- A. ... So then, the analysis... after some searching we became aware that if we *deflated* the "Purchases" account by the promotions and transfers that were made to the other restaurant, we would have arrived at a lower amount of purchases, and we could have compared it with the sales and could have managed to re-establish the gross margin.

However, the problem was the accounting book in which the "purchases" item was not *deflated* by the promotions and transfers to the restaurant. So I said to Ms. Potvin, about this: "You might want to... there were transfers to the restaurant, or so we should, if we want to have a real idea, we should audit the restaurant..."

[68] On several occasions over the two days of the hearing, I stressed the need to submit rationally based evidence to the court, so that it would be possible to deduce reliable conclusions with a reliable basis.

[69] Unfortunately, such evidence did not arrive, and I must dispose of the appeal in accordance with the evidence submitted, which does not permit a rational conclusion.

[70] Although the parties' evidence was presented by witnesses who were supposed to have the necessary expertise and skills to submit an articulate, coherent and reliable presentation, this was not the case.

[71] Although the evidence demonstrated otherwise, the Respondent indicated that the Appellant's accounting was acceptable. I admit I did not understand how the Appellant's accounting could be called acceptable, since it did not permit an adequate audit with respect to the Appellant's obligation to collect and remit GST on taxable supplies and with respect to his right to claim the ITCs due.

[72] No doubt believing that our court has the innate ability to discover what the assessment should have been, the parties were satisfied with incomplete and totally deficient evidence.

[73] For all these reasons, given the impossibility of making a conclusion based on reliable foundations, the appeal is allowed, and I am referring the file to the Respondent for review and reassessment in consideration of the fact that the GST amount, which was \$6,835.39, must be reduced to \$3,500, to which must be added \$972.56 for the ITCs that were not due, plus the interest and penalties under the *Act*. The whole without costs.

Signed at Ottawa, Canada, this 29th day of April 2004.

"Alain Tardif"

Tardif J.

Translation certified true
on this 20th day of September 2004.

Shulamit Day, Translator