Docket: 2007-3331(IT)I

BETWEEN:

PATRICIA O'LEARY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on February 25, 2008, at Montréal, Quebec

Before: The Honourable Justice Réal Favreau

Appearances:

For the Appellant:	The Appellant herself
Counsel for the Respondent:	Vlad Zolia

JUDGMENT

The Appellant's appeal from the notices of reassessment dated July 20, 2006 and February 3, 2006, concerning the 2003 and 2004 taxation years, is dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 14th day of May 2008.

"Réal Favreau"

Favreau J.

Translation certified true
on this 2nd day of July 2008.

Brian McCordick, Translator

Citation: 2008TCC302
Date: 20080514
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BETWEEN:

PATRICIA O'LEARY,

Appellant,

and

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[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Favreau J.

[1] This is an appeal from notices of reassessment dated July 20, 2006 and February 3, 2006, in respect of the 2003 and 2004 taxation years, in which the Minister of National Revenue ("the Minister") assessed penalties of $1,565.08 and $1,120.55, respectively, for gross negligence pursuant to subsection 163(2) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) as amended ("the Act").

[2] The issue in this appeal is whether the Minister was entitled to impose penalties on the Appellant under subsection 163(2) of the Act because, in her returns for the years in question, she claimed rental expenses roughly 75% of which were disallowed. Specifically, the overstated rental expenses on which the penalties for gross negligence were assessed amounted to $14,418 for the 2003 taxation year and $12,197 for the 2004 taxation year, and were based on $9,900 in rental income for 2003, and $8,750 in rental income for 2004.

[3] The overstated rental expenses consisted, for the most part, of personal expenses, such as expenses associated with the Appellant's principal residence, the purchase of clothing, decorating materials and garden accessories, as well as motor vehicle expenses.

[4] The Minister determined that the Appellant had knowingly, or under circumstances amounting to gross negligence, made a false statement or omission in the returns filed in respect of the 2003 and 2004 taxation years, or had participated in, assented to or acquiesced in the making of this false statement or omission based on the following items set out in paragraph 6 of the Reply to the Notice of Appeal:

> [TRANSLATION]
>
> (i) the Appellant herself looked after the budget and the administration of the buildings (rent, taxes, maintenance, insurance, etc.);
> (ii) the Appellant was therefore aware of the size of the expenses;
> (iii) the overstated rental expenses were of a personal nature and the Appellant herself provided the accountant with the invoices or documents;
> (iv) the Minister is of the opinion that the Appellant was unquestionably negligent in this case: the Appellant should have noticed that the rental expenses established by the accountant were far too high;
> (v) the Appellant signed the returns for the taxation years in issue.

[5] At the objection stage, the Appellant disputed her liability in connection with the imposition of penalties for gross negligence for having overstated her rental expenses, citing her mental state during this period, and the fact that she considered herself a victim of her accountant's breach of trust.

Background

[6] Ms. O'Leary testified and explained that, from 1996 to 2002, her tax returns had been prepared by chartered accountants. She usually reported a small net rental income but no rental loss for the two single-family residences that she owned, one in Notre-Dame-du-Lac (Témiscouata County) and the other in Baie-Comeau. In 2003, she moved from Sept-Iles to Delson, and on April 11, 2003, she started her new position as a secretary at the head office of Hydro-Québec in Montréal.

[7] In April 2004, on the advice of her brother Carol O'Leary, the Appellant asked Serge Cloutier to prepare her tax return for the year 2003. Mr. Cloutier agreed to do so, and asked the Appellant to provide him with all her invoices, saying that he would tally them up. Accordingly, the Appellant provided him with all her invoices for the 2003 tax year for electricity, telephone, municipal and school taxes, mortgages, insurance, cable and internet for all of her residences (Baie-Comeau, Notre-Dame-Du-Lac and Delson). As requested, the Appellant also provided the residual value of her vehicle, a 1995 Jeep Cherokee Sport, which she had obtained from Club Automobile. The same scenario was repeated for the 2004 tax year: the Appellant gave Mr. Cloutier all her invoices and supplied the information described above.

[8] The Appellant signed the returns for each taxation year in issue and she acknowledges having been informed by Mr. Cloutier of the refunds that she would be receiving. Despite the substantial difference from previous years, the Appellant did not check her tax returns after they were filed and did not ask Mr. Cloutier for the reason there was such a large difference from previous years. The Appellant felt secure because she was dealing with a chartered accountant. The fee of $1,092.74 charged by this professional seemed reasonable to her, and the rental losses claimed did not overly surprise her given the sums that she had spent on renovations to her income properties.

[9] The accountant Serge Cloutier also testified, and described the procedure that was followed in all his files. He said that he had met with the Appellant when he first accepted the work, and explained to her the requirements of paragraph 18(1)(*a*) of the Act, which states that rental expenses are not deductible except to the extent that they are made for the purpose of gaining or producing income from a business or property, as well as the requirements of paragraph 18(1)(*h*) of the Act, which states that personal and living expenses are not deductible, and section 67 of the Act, which provides that an expense is only deductible if it is reasonable. Upon receipt of the Appellant's invoices, Mr. Cloutier had passed them on to Johanne Roy, a subcontractor, so that she could do the accounting and prepare a spreadsheet. Ms. Roy contacted clients if invoices were missing or if additional information was required. Mr. Cloutier confirmed that he always checked Ms. Roy's work and he often had to redo or modify the spreadsheet that she had prepared.

[10] The Appellant's spreadsheet could not be produced at the hearing because it was lost after the Canada Customs and Revenue Agency conducted a search of Mr. Cloutier's offices in August 2004. Mr. Cloutier was prosecuted criminally for tax evasion on the basis that he unduly inflated his clients' expenses. However, he was acquitted of those charges on June 11, 2007. On the other hand, 25 of Mr. Cloutier's 250 clients are currently involved in litigation with the tax authorities.

The Appellant's position

[11] The Appellant claims that Mr. Cloutier committed professional misconduct by not sorting out the bills that were deductible for income tax purposes and by unduly inflating the expenses claimed. At the hearing, the Appellant supplied examples of expenses that were clearly unjustified, such as expenses incurred in travelling to Notre-Dame-du-Lac and to Baie-Comeau.

[12] Furthermore, the Appellant claims that she is not comfortable with numbers and is not capable of completing her tax returns by herself.

[13] Finally, the Appellant claims that she never had any intention of defrauding the tax authorities because the figures provided were completely transparent and genuine.

The Respondent's position

[14] The Respondent submits that the penalties assessed under subsection 163(2) of the Act should stand because the Appellant knew that the bills and personal expenses were not deductible but nevertheless submitted them to the accountant without checking them.

[15] In her submission, there is no doubt that when the Appellant signed the returns, she realized the major difference from the returns of previous years and she abstained from asking the accountant any questions. In addition, she did not check her tax returns after they had been filed to ensure that everything was correct and in keeping with applicable standards.

Analysis

[16] Subsection 163(2) of the Act imposes a penalty on every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return filed in respect of a taxation year. More specifically, the part of subsection 163(2) of the Act which precedes the methods by which penalties are computed reads as follows:

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

Under subsection 163(3) of the Act, the burden of establishing the facts that justify the assessment of a penalty is on the Minister, not the taxpayer. Subsection 163(3) of the Act reads as follows:

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

[17] As Dussault J. put it in *Prud'homme v. The Queen,* 2005 TCC 423, at paragraph 47:

> Obviously, the facts on which the imposition of a penalty for gross negligence under subsection 163(2) of the Act is based must be analysed having regard to their particular context, which means that drawing a comparison with the facts of another situation would be a purely random exercise, if not patently dangerous.

[18] The concept of "gross negligence" established by case law is the concept that was defined by Strayer J. in *Lucien Venne v. The Queen*, 84 DTC 6247 at page 6256:

> . . . 'Gross negligence' must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not. . . .

[19] Furthermore, in *Canada (Attorney General) v. Villeneuve*, 2004 FCA 20, the Federal Court of Appeal clarified that the term "gross negligence" may include willful blindness in addition to intentional acting and wrongful intent. In this regard, Létourneau J.A. stated at paragraph 6:

> With respect, I think the judge failed to consider the concept of gross negligence that may result from the wrongdoer's willful blindness. Even a wrongful intent, which often takes the form of knowledge of one or more of the ingredients of the alleged act, may be established through proof of willful blindness. In such cases the wrongdoer, while he may not have actual knowledge of the alleged ingredient, will be deemed to have that knowledge.

[20] The application of the concept of "willful blindness" to tax cases was, in fact, confirmed by the Federal Court of Appeal in *Panini v. Canada*, 2006 FCA 224.

[21] Even though the taxpayer gets the benefit of the doubt with respect to the application of penalties under subsection 163(2) of the Act, this is a case in which there is no doubt in my mind that the Appellant committed gross negligence within the meaning of subsection 163(2) of the Act.

[22] Given the facts, it is clear to me that that Appellant knew, when she signed her tax returns, that the rental expenses claimed had been overstated by the accountant. She also confirmed that Mr. Cloutier had told her the amounts of the refunds that she should be receiving.

[23] Moreover, the Appellant was not inexperienced. She had a very good idea of which expenses were deductible for tax purposes and which were not, because her returns for the years 1996 to 2002 had been prepared by two different chartered accountancy firms. She was by no means a novice in these matters, even though she might not have been capable of preparing her own returns.

[24] This finding is confirmed by Exhibit I-2, a document produced at the hearing, entitled [TRANSLATION] "Small note to accountant", which was included with a bundle of invoices that the Appellant sent to Mr. Cloutier in connection with the preparation of her 2003 return, and with which she sent an excerpt from the *Income Tax Act* dealing with moving expenses. The document clearly shows that the Appellant knew the provisions of the Act that applied to her situation

[25] When she signed her 2003 and 2004 returns, the Appellant knew full well that the situation was very different from previous years in which she had not reported rental losses. Despite this, the Appellant did not even question the public accountant to find out the reason for such a large difference from her previous tax returns. This constitutes, in my opinion, an indication of willful blindness, if not deliberate conduct amounting to gross negligence.

[26] The Appellant also knew with whom she was doing business when she entrusted Mr. Cloutier with the preparation of her tax returns. Mr. Cloutier already looked after the preparation of the returns of the Appellant's brother Carol. The Appellant's brother certainly told her about the accountant's reputation for being aggressive in claiming expenses, since he wished her a good refund in an e-mail that he sent her on March 9, 2004 (Exhibit I-1) to let her know that the accountant in question had agreed to prepare her tax returns.

[27] The amount of the disallowed rental expenses in relation to the reported rental income, and the repetition of this conduct two years in a row, clearly demonstrate that the Appellant's involvement in the establishment of the scheme went well beyond mere negligence.

[28] Consequently, the appeal is dismissed.

Signed at Ottawa, Canada, this 14th day of May 2008.

"Réal Favreau"

Favreau J.

Translation certified true
on this 2nd day of July 2008.

Brian McCordick, Translator

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COURT FILE NO.:	2007-3331(IT)I
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APPERANCES:

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Counsel for the Respondent::	Vlad Zolia

COUNSEL OF RECORD:

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