Citation: 2009 TCC 28
Date: 20090113
Docket: 2006-3505(GST)I
2007-836(IT)G

BETWEEN:

DOUGLAS L. BROWN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

For the Appellant: The Appellant himself
Counsel for the Respondent: Justin Kutyan

REASONS FOR JUDGMENT

(Delivered orally from the Bench at Toronto, Ontario, on August 20, 2008)

Bowie J.

[1] The Appellant brings these appeals from assessments by the Minister of National Revenue under the *Income Tax Act* for the taxation years 1998, 1999, 2000 and 2001, and under the *Excise Tax Act* in respect of unremitted goods and services tax for that four-year period. All of these assessments carry with them interest, of course, and gross negligence penalties have been assessed as well.

[2] The Appellant's business consisted of arranging for accommodation in various resorts, and later, for accommodation on cruise ships as well, for people employed in the travel industry. It was described in the evidence as a niche market which he began to fill around the 1990s, and apparently filled very successfully, judging by his revenues over the years. He made arrangements for travel for people first by himself,

and later assisted by as many as three people operating out of their homes and communicating by telephone, and by a franchisee operating in Montreal. I do not propose to go into a great deal of detail about the business. It is not necessary to do so.

[3] The amounts involved in the assessments are very substantial. In the four years in question the Appellant, in filing his income tax returns, declared income from the business in 1998 of $3,086, in 1999, $4,673, and in 2000 and 2001 he declared net losses of $6,630 and $5,953. The assessments that are now contested increased the revenues of the business in the four years in question, and disallowed substantial expenses that had been claimed. The understated revenues that were assessed for the four years were approximately $45,316, $34,122, $72,300 and $101,300. The disallowed expenses for those four years were $12,822, $17,100, $20,600 and $10,700. The net understatement of income for the four years respectively comes to $58,000, $51,000, $93,000 and $112,000 for a grand total of $314,000. These numbers are somewhat rounded, but that is the magnitude of the errors and omissions.

[4] The Appellant was prosecuted and pleaded guilty to one count each of evasion of income tax and of goods and services tax and paid total fines in the amount of $100,000 on those counts. In the appeals before me today he did not dispute at all the understatement of the revenues of the business. The reassessments for the 1998 and 1999 taxation years were made beyond the normal reassessment periods, but there is no question that the Appellant made material misstatements that were either willful or negligent in those returns, thereby justifying the Minister's reopening of those years. That was demonstrated from the evidence of the Appellant himself, who, as I have said, did not contest the underreporting of his income.

[5] The onus of proof in respect of those two years shifted to the Appellant and he had the onus from the beginning in respect of the 2000 and 2001 taxation years to show the assessments to be incorrect. I think it is fair to say that he presented no meaningful evidence whatsoever to discharge the onus in respect of any of the assessments. Indeed he, in effect, confined himself to a few criticisms of the assessments. For example, at tabs 5, 6 and 7 of Exhibit R-1A is an invoice which is for $11,371.18, and an invoice from Interline Discount Travel for the period March 28 to April 9, 1999 for $1,200 and for September 16 to 17, 1999 for $1,200. The Appellant in his evidence, and in cross-examining the appeals officer who reviewed the initial reassessments and issued subsequent reassessments, took the position that these were amounts for which he had not had credit in the computation of the amount of unreported income. In each of these, he was quite wrong.

[6] The first invoice of $11,371 was for the lease of computers which were used in the Appellant's business or more accurately I should say for the sale of computers which were leased for use in the Appellant's business. The invoice in question is from the vendor of the computers to New Corp. Leasing from whom the Appellant leased the computers. It would appear that a copy of this invoice found its way into his records as the computers as is shown on the invoice, were delivered directly to him as the lessee from the purchaser, but it is clear that he did not pay the purchase price that was paid by New Corp. Leasing, but did pay the price of leasing the equipment for the four years in question, and did get credit in the reassessments for those lease payments.

[7] The two invoices from Interline Discount Travel, it appears from the evidence, were, in fact, invoices from one of the people who was hired by Mr. Brown to assist him in his business by taking orders for reservations and making reservations to fill those orders. This individual, as with the other individuals who worked for him, was paid what he described as a salary, but it was paid in the form of what might be described as fees to an independent contractor. Without getting into the legal description of employees and contractors, it is quite clear that he paid those individuals gross amounts from which he made no deductions for income tax, for Employment Insurance premiums nor for Canada Pension Plan contributions, nor did he collect and remit GST. In the computation of his income as it was assessed and reassessed again by the Minister, he clearly got credit for the payment of those, and the other invoices as well, from his employees, helpers or however they may be described. I am quite satisfied that his complaints in respect of those three documents are quite unfounded.

[8] Mr. Brown also took issue with the Minister's treatment of expenses that he claimed in respect of what he referred to as familiarization cruises that he took part in accompanied by his wife. Familiarization cruises, as I understand it, are cruises taken by people such as Mr. Brown who are in effect selling cruise bookings, so that they will know what it is that they are selling and will be able to describe it in suitably glowing terms to the people who are being booked on future cruises. Mr. Brown, I think, got some preferred rate when he took the familiarization cruises, but he certainly had to pay something for them. He deducted those amounts in the computation of his income, and the Minister has never disputed his right to deduct the amounts that he paid in respect of his own attendance on those cruises. The issue that arose was as to his right to deduct amounts paid in respect of his wife's attendance on the cruises, given the fact that his wife was in no way involved in the business, but simply went along, as it were, for the ride.

[9] The Appellant's explanation of why he should deduct the whole amount came down to this: if you book a cruise for two people traveling together, you get a rate for double occupancy that is less than twice the rate charged to somebody who travels on a single occupancy basis on the same cruise. I can probably take judicial notice that single occupancy costs more than half of double occupancy on these cruises. What I cannot take judicial notice of is the ratio of one to the other. There is no evidence before me, and I have no knowledge as to how much the Appellant would have had to pay on a single occupancy basis for the cruises that he and his wife enjoyed on a double occupancy basis.

[10] While the evidence seemed to indicate that perhaps he had been allowed only 60% of the amount paid for those cruises, if I understood Ms. Shah's evidence correctly, the cruises were booked and paid for on an American Express card. The amounts were allowed without the production of any receipts and may well have included all of the cruise amounts, it is impossible to say from the evidence. However, I am not satisfied that the Appellant was entitled to any greater deduction that he in fact got in respect of the payments for those cruises. There is ample case law that makes it clear that where spouses enjoy a cruise together which for one of them is a business item and for the other is not, the marginal cost for the cruise for two over the cost for one is a taxable benefit. By analogy, the right to deduct, when it is paid by the taxpayer who is operating a business as a sole proprietor must surely be limited in the same way.

[11] The Appellant took issue as well with the treatment of his claim for automobile expenses, but quite unjustifiably in my view. It seems to me that the Appellant totally failed in his evidence to explain why he claimed 90% of the use of his automobile for business, although he maintained no log of automobile use. On his returns for each year there are lines on the automobile expense portion of the income tax return for taxpayers to fill in the total automobile mileage for the year and the amount of business mileage for the year, from which is computed the percentage of business use. On the returns filed by the Appellant, what is shown is 100 kilometers of use each year and the claim in one year for 100 kilometers of business use and for the other three years 90 kilometers of business use. I think it is patently obvious that the business use was not properly described, nor was the total use properly described in the returns, and I would expect that this arose from the person who prepared the forms for the Appellant mistakenly putting 100 and 90 as the claimed percentages of business use, but it leaves me in the position that I have no idea how much the automobile was used in each year. I am asked to believe on faith that it was used 90% for business, which strikes me as highly unlikely, even though the Appellant did

testify that his wife had a separate automobile. Absent any cogent evidence from the Appellant, I am not persuaded that he was allowed less than the amount he was entitled to for automobile use.

[12] Ms. Shah testified at some length as to the manner in which she reviewed the initial reassessments of the Appellant as part of the objection process. It is quite clear that she received inputs from a Mr. Posner, an accountant who was representing the Appellant in the objection process, and it is apparent from her evidence that she took much of what Mr. Posner submitted to her in respect of expenses at face value.

[13] The Appellant produced four schedules of his expenses for the years in question which he said he had prepared from the original receipts that were in his possession at the time; receipts which he said were later lost in a move. Given the Appellant's quite evident understatement of his income and quite evident overstatement of his expenses, given his guilty plea to charges of evasion of substantial amounts, and given the absence of material to back up those summaries that are Exhibits A-1, A-2, A-3 and A-4, I much prefer the evidence of Ms. Shah to the evidence of Mr. Brown in respect of the established expenses of the business. Indeed, my impression is that Ms. Shah gave the Appellant the benefit of the doubt in quite a number of areas relating to the computation of his business expenses.

[14] Turning to the goods and services tax assessments, the Appellant's approach to GST in the early years, after it was brought into the Canadian world of taxation in the beginning of the 1990s, was to ignore it. On November 11, 2002, after some discussion with somebody in Calgary whom I think the Appellant was describing as an employee of the government of Canada, the Appellant decided to file GST returns for the period from January 1, 1998 to December 31, 2001. He filed those on the basis of the gross sales of the business which he had earlier understated, thereby understating the base for tax. He was unaware, I think, of the different treatment for GST of domestic and foreign sales, and thereby overstated the base by including all of the understated sales. He clearly overstated his entitlement to input tax credits. I think it is fair to say that in some respects he understated the input tax credits, and in many respects, he overstated them. The largest errors in respect of input tax credits being a claim for input tax credits in respect of the amounts paid by way of salary, as Mr. Brown expressed it, or fees, to the people working for him, which were not the subject of GST collected and remitted, and therefore could not properly be the subject of input tax credits.

[15] Ms. Madsen who was the appeals officer reviewing the GST assessments, testified at some length and in detail as to the manner in which those assessments

were raised and reviewed by her. It is clear from her evidence that the Appellant was, in a number of respects, given the benefit of the doubt. For example, in the assessments, sales made by way of bookings for non-residents of Canada were, of course, not subject to GST, and the assessor made a division between domestic and foreign sales. Mr. Posner, the accountant acting for the Appellant, apparently produced the schedule of domestic versus foreign clients, which Ms. Madsen took at face value, and from which she determined that the domestic sales appeared to be something in the order of 66% of total sales. The assessor used a lower percentage and in the assessments under appeal 53.4% was used to represent domestic sales. I would think from the evidence that that percentage is on the low side and thereby gives the benefit of doubt to Mr. Brown.

[16] With respect to the input tax credits, it is apparent that in the assessments care was taken by the assessor and Ms. Madsen to make sure that payments for insurance and other supplies not subject to GST were not the subject of input tax credits, but to ensure that those supplies on which GST should have been paid were taken into account in determining the input tax credits applied in the assessments. This was done notwithstanding that no evidence was presented to the Minister at any stage, as I understand it, that those input tax credits were, in fact, paid. So that again, Mr. Brown was given the benefit of the doubt in respect of the computation of the input tax credits to which he was entitled.

[17] The other item that Mr. Brown has contested is the penalties imposed on him under the *Excise Tax Act*. He has been subjected to late filing penalties under section 280 and also to the gross negligence penalties. The income tax assessments include gross negligence penalties as well. There has been a considerable amount written over the years in respect of gross negligence penalties dealing with such matters as what is gross negligence. According to the Court of Appeal, it means negligence of a substantial character or words to that effect. Considerations that ought to be taken into account in imposing gross negligence penalties include such things as the background, intelligence and general business acumen of the taxpayer involved, whether the amounts of income understated, or other tax understated, would be oversight or something greater than oversight, the magnitude of the amounts involved, the amount of attention paid by the taxpayer to disclosure and so on. This is not what I would call a close case in respect of the application of gross negligence penalties. The Appellant has a high school education. He did not have an accounting background nor post-secondary education, but he is certainly a person of some intelligence and business acumen who was able to begin and to operate, apparently quite successfully, a business which produced very substantial revenues for him.

[18] The magnitude of his underdeclaring of revenues and of his overstatement of expenses is, to say the least, substantial. It would be difficult, I think, to characterize as mere oversight, the filing of an income tax return that declares a business loss of something close to $6,000, when the true profit of the business was $112,000. Those are the kinds of magnitude certainly that applied in 2000 and 2001. In the first two years, 1998 and 1999, the actual income as assessed is in the order of $50,000 to $60,000 and that declared in the order of $4,000 to $5,000, so we are talking of a ratio even in those years of something like $1 declared for every $10 profit. This is, as I say, not mere oversight, nor can it be attributed simply to sloppy bookkeeping.

[19] I am satisfied from the totality of the evidence that what we have, at least in the four years under appeal (and, of course, I have no evidence before me as to other years) is a pattern of understating the profit of the business quite deliberately, and on an escalating basis. Both the income tax and the goods and services tax rely on self-reporting to a very large extent. The reason that those statutes provide for fairly severe penalties for people who deliberately, or even through negligence of a serious nature, understate their income is because a self-reporting system must have some discipline to it. So it is no unimportant matter when an audit turns up deliberate evasion of the magnitude that we have here.

[20] Quite apart from all of that, in respect of the gross negligence penalties under the *Income Tax Act*, the Appellant in his own evidence early on made it clear that he signed his returns for each of the four years under appeal without having paid the least attention to what income was included in them and what expenses were claimed in them. He said that he kept the records that he kept, prepared spreadsheets from them and gave them to a tax preparer who, in each year, prepared the returns for him based on the material that he gave her. We did not hear from her on that, but taking that statement at its face value, it still leaves the Appellant with an onus to look at the completed return before signing it and filing it with the Minister. The declaration that the taxpayer makes when he signs that form is,

> I certify that the information given on this return and in any documents attached is correct, complete and fully discloses all my income.

To sign an income tax return and make that certification without having even glanced at the contents of the return, because that is what I understood his evidence to be is of itself, in my view, gross negligence that justifies the penalties.

[21] In respect of the GST returns, the Appellant, in my view, quite deliberately misstated the sales in those returns. I am satisfied that he knew that the gross income that he had declared was less than the true gross income of the business. It may be that his claiming of input tax credits in respect of the very substantial amounts paid to his employees for these very services was the result of ignorance rather than deliberate evasion, although, I am inclined to think on a balance of probabilities that it was the latter because he must surely have known that he did not, in fact, collect and remit GST from those people when he paid their accounts, so it is difficult to see how he could have thought that there was an input tax credit to which he was entitled in respect of any of those amounts. Even accepting at face value his statement, which is probably correct, that he did not understand the way in which the *Act* worked, clearly he should have obtained some advice from somebody who did understand how the *Act* worked and he should have filed returns on a regular basis, properly stating his sales and properly stating the GST that he had paid.

[22] For all of those reasons, the appeals for 1998, 1999, 2000 and 2001 are dismissed. And the appeals under the *Excise Tax Act* for GST are dismissed.

Signed at Ottawa, Canada, 13th this day of January, 2009.

"E.A. Bowie"

Bowie J.

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APPEARANCES:

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