Docket: 2007-3805(IT)I

BETWEEN:

PATRICK GRAU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on October 22, 2008 at St. Catharines, Ontario

Before: The Honourable Justice G. A. Sheridan

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Laurent Bartleman

JUDGMENT

The appeals from the reassessments made under the *Income Tax Act* for the 1996, 1997, 1998, 1999, 2000 and 2001 taxation years are dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 30th day of January, 2009.

"G.A. Sheridan"

Sheridan J.

Citation: 2009TCC60
Date: 20090130
Docket: 2007-3805(IT)I

BETWEEN:

PATRICK GRAU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Sheridan, J.

[1] The Appellant is appealing the reassessment of his 1996 to 2001 taxation years. There are two unrelated issues under appeal. The first is whether the Appellant is entitled to deduct certain expenses in respect of a sailing charter business he claimed to have operated from 1999 to 2001. The second issue is whether he may deduct amounts claimed as spousal support for 1996 to 2001 under paragraph 60(*b*) of the *Income Tax Act*. Under this head, in respect of the 1996 to 1998 reassessments only, there is the threshold question of whether the Minister of National Revenue was justified in reassessing beyond the normal reassessment period pursuant to subsection 152(4) and if yes, whether penalties were properly imposed under subsection 163(2) of the *Act*.

The Sailing Charter Expenses (1999, 2000, 2001)

[2] In 1999, the Appellant purchased a 38-foot sail boat for $15,836.20[1]. At that time, the boat had been out of the water for 10 to 12 years and needed a lot of work. The Appellant explained that he had purchased the boat with the intention of realizing his dream of doing sailing charters on Lake Ontario. That said, he admitted

[1] Exhibit R-1, Tab 8; Exhibit R-2.

that the boat remained on dry land throughout all of 1999, 2000 and 2001. Nonetheless, the Appellant claimed expenses of $9,156, $9,225 and $3,150, respectively, for such items as maintenance, repairs, insurance and interest. In 1999 only, he also deducted expenses for the costs of delivery and licensing as well as legal and accounting fees.

[3] The Minister disallowed the Appellant's claims on the basis that he had not, in fact, been operating a boat charter business in those years. The Respondent's position is that the Appellant's dream of running a charter operation never crystallized into an actual business; accordingly, the expenses claimed cannot be said to have been incurred in the course of earning income from a business as contemplated by the *Income Tax Act*.

[4] Counsel for the Respondent referred the Court to the two-step test established by the Supreme Court of Canada in *Stewart v. R.*[2]: once it is determined that a venture, by its nature, could be either commercial or personal, the Court must consider whether the taxpayer's "… predominant intention is to make a profit from the activity and [whether] the activity has been carried out in accordance with objective standards of businesslike behaviour"[3]. To make that determination, the Court must engage the second step of the process by considering the factors in *Moldowan v. R.*[4]:

> 1) the profit and loss experience in past years;
>
> 2) the taxpayer's training;
>
> 3) the taxpayer's intended course of action; and
>
> 4) the capability of the venture to show a profit.[5]

[5] A sail boat may be used for personal recreation as easily as in a business pursuit. Thus, the Appellant has the onus of showing that he embarked on the sailing charter venture in a "sufficiently commercial manner" to be considered a source of

---

[2] [2002] 3 C.T.C. 439, Respondent's Book of Authorities, Tab 11 at paragraphs 53 to 55.

[3] Above, at paragraph 54.

[4] [1978] 1 S.C.R. 480.

[5] *Stewart* , above at paragraph 55.

income under the *Act*. When considered in light of the factors listed above, his evidence falls far short of that mark.

[6] In all three of the taxation years under review the Appellant incurred significant losses and earned not a penny. That his charter business failed to generate any income is not surprising considering that, at all material times, the boat was firmly anchored in his driveway. While the Appellant's sincerity in respect of his dream of having such a business is entirely credible, the fact is he lacked the wherewithal to realize that dream: he had no money for start up and no training in business or management. Though as a youth he had worked on the Great Lakes and shortly after buying the boat, had taken some sort of refresher course in sailing, as far as I can see, he had no certification to take paying passengers out on the water; perhaps none is needed. As for a business plan, he had never determined how much he would have had to charge to break even on a trip but said that was hard to judge because there were no comparable businesses operating in the area. Indeed, he added, that very lack was among the factors that had prompted him to buy the boat. While that is not on its face unreasonable, without researching the matter, it is equally possible to conclude that no such businesses existed because there was no market for them. Even the documentary evidence is against him: the yacht surveyor's report[6] made at the time of the purchase shows the use of the boat as "pleasure".

[7] In enumerating these weaknesses in the Appellant's claim of having had a business, my aim is not to demean in any way the value of his dream or its importance to him personally. It is only to show that based on the tests in the case law, his evidence fails to prove that he had ever established a commercial activity in respect of which he was entitled to deduct expenses. Accordingly, none of the amounts claimed may be deducted as business expenses.

The Spousal Support Deductions (1996 to 2001)

[8] From 1996 to 2001, the Appellant began deducting amounts[7] for what he claimed were spousal support payments. The Minister disallowed the deductions on the basis that if such payments were made, they were not paid pursuant to "an order of a competent tribunal or under a written agreement" as required by paragraph

[6] Exhibit R-2.

[7] From 1996 to 2001: $12,000, $13,800, $15,600, $15,600, $15,600 and $11,200, respectively.

56.1(4)[8] of the *Act*. The auditor in charge of the Appellant's file was Bryce Corbett. He explained that as he began investigating the Appellant's claims, a further concern arose as to whether the Appellant had, in fact, been living separate and apart from his spouse. Mr. Corbett's review of certain documents, including the Appellant's separation agreement and various government and public records, ultimately led to the suspicion that the Appellant had claimed a spousal support deduction to which he knew he was not entitled. It was on this footing that the Minister justified the reassessment beyond the normal reassessment period of the 1996 to 1998 taxation years pursuant to subsection 152(4) and the imposition of penalties under subsection 163(2) of the *Act*. Because the onus in respect of these issues shifts from the Appellant to the Minister, these aspects of the 1996 to 1998 reassessments are dealt with separately below.

[9] Certain background facts are not in dispute: at all material times, the Appellant remained married to his then spouse. The address of the matrimonial home was 98 Leaside Drive. His mother owned a residence a few doors down at 84 Leaside Drive. A separation agreement was executed on June 27, 2001[9]; it contains a clause stating that he and his former spouse had lived separate and apart since January 2000.

[10] The Appellant admitted that prior to the separation agreement dated June 27, 2001, there was no court order or other written agreement under which he was required to pay spousal support; he did so based on what he felt was his proper obligation as a responsible husband and father. Each month, he paid all of the family's living expenses, mortgage payments, utility bills, municipal taxes and so on; based on that total, he then claimed a lump sum[10] in each taxation year for spousal support.

[11] The above admission is, in itself, sufficient to dispose of the Appellant's appeal of the 1996 to 2001[11] taxation years in respect of his entitlement to a spousal

---

[8] The definition in subsection 56.1(4) is made applicable to the term "support amount" in paragraph 60(*b*) by subsection 60.1(4) of the *Act*.

[9] Exhibit R-1, Tab 2.

[10] For example, a copy of a hand-written receipt for the total paid in 1996 appears at Exhibit R-1, Tab 15.

[11] For the period July to December 2001, the Minister allowed a deduction of $2,400 for amounts of $400 per month paid by the Appellant pursuant to the separation agreement dated June 27, 2001. That deduction is not in dispute.

support deduction under paragraph 60(*b*). That provision allows for the deduction of a "support amount" as defined in paragraph 56.1(4)(*a*):

> "support amount" means an amount payable or receivable as an allowance on a periodic basis for the maintenance of the recipient, children of the recipient or both the recipient and children of the recipient, if the recipient has discretion as to the use of the amount, and
>
> (a) the recipient is the spouse or common-law partner or former spouse or common-law partner of the payer, the recipient and payer are living separate and apart because of the breakdown of their marriage or common-law partnership and the amount is receivable under an order of a competent tribunal or under a written agreement;
>
> …

[12] Because the above definition is written conjunctively, even without considering whether the Appellant and his former spouse were living separate and apart, either of the fact that (1) the alleged amounts were not paid pursuant to "an order of a competent tribunal or under a written agreement"; or (2) they were not paid "on a periodic basis" is sufficient to exclude them from the meaning of "support amount". From this it follows that the Appellant is not entitled to a spousal support deduction under paragraph 60(*b*) of the *Act* for the taxation years 1996 to 2001.

Subsection 152(4) Reassessment and Subsection 163(2) Penalties (1996, 1997, 1998)

[13] In respect of the 1996 to 1998 taxation years only, it remains to determine whether the Minister was entitled to reassess beyond the normal reassessment period and to levy penalties against the Appellant. The Minister bears the onus of showing that the requirements of subsections 152(4) and 163(2) have been satisfied.

[14] According to the Respondent, during the 1996 to 1998 taxation years, the Appellant was living with his spouse at 98 Leaside Drive and claiming spousal support, all the while knowing that his eligibility for such a deduction was contingent on, among other things, his living separate and apart from his spouse.

[15] The Appellant flatly denied that he was living at 98 Leaside Drive during those years, insisting that he had lived a few doors down the street with his mother at 84 Leaside Drive. To corroborate his evidence, he called his former spouse, his mother and his then girlfriend.

[16] Starting first with his former girlfriend, her evidence was of no assistance to the Appellant in respect of the 1996 and 1997 taxation years as she did not meet him until 1998. I accept her evidence that she never visited his maternal home (84 Leaside Drive) and that she did not set foot in the matrimonial home (98 Leaside Drive) until sometime after July 2001; indeed, her presence at that address prior to that date was specifically prohibited under Clause 29 of the separation agreement. Thus, she was in no position to say whether the Appellant had been living at 84 Leaside Drive or 98 Leaside Drive in 1996, 1997 or 1998.

[17] As for the Appellant's former spouse and his mother, their relationship to the Appellant constrained the forthrightness of their testimony and accordingly, I am unable to give it much weight.

[18] That leaves only the Appellant's testimony which, to resist the force of the evidence ably marshalled by counsel for the Respondent, needed to be convincing indeed. Conceding that the Respondent had no direct evidence of the Appellant's place of residence, counsel for the Respondent relied on the auditor's testimony and documentary evidence to support the inference that the Appellant had been living at 98 Leaside Drive during the years in question. Of particular note is the separation agreement which dates the time of separation as January 2000. The Appellant downplayed the importance of that fact by explaining that even though he had really moved out in 1996, he had agreed to the January 2000 date to permit his former spouse to assign a higher valuation to the matrimonial home. Not only was this statement not confirmed by his former spouse, she looked frankly perplexed when cross-examined on this point. In any event, the Appellant's explanation makes no sense. It is clear from the separation agreement that both the Appellant and his former spouse were represented by counsel. Clause 15(1) of the separation agreement specifically acknowledges that no formal appraisal of the property was requested or made. In these circumstances, it seems to me that for the purposes of settling the terms of their separation, the parties were free to assign any value they chose to the matrimonial home.

[19] His credibility thus in tatters, the Appellant was unable to provide any reasonable explanation as to why, if he was not living there, the following documents showed his place of residence as 98 Leaside Drive: land registration documents[12], motor vehicle registration records[13], telephone book listing[14], the bill of sale for the

[12] Exhibit R-1, Tab 10.

[13] Exhibit R-1, Tab 3.

[14] Exhibit R-1, Tab 4.

sail boat[15] (which he candidly admitted was parked at 98 Leaside Drive from 1999 to 2001), his vessel licence[16], his sailing refresher course registration form[17] and a bank statement in the name of his sailing business[18]. While admittedly, only the telephone directories were created in the 1996 to 1998 taxation years, the Appellant's story was that he had left 98 Leaside Drive on March 23, 1996 and never moved back in until July 2001 when he became entitled to possession of the matrimonial home under the separation agreement. On that premise, one would think that at least some of the above documentation would show an address other than 98 Leaside Drive. As it turns out, the only documents in which the Appellant was careful not to use the 98 Leaside Drive were his income tax returns for 1996 to 2000, no doubt to give some credence to his claim for spousal support (as well as using his mother's address at 84 Leaside Drive, he also checked the "separated" box to indicate his marital status in each return) and to ensure the safe delivery of any refund cheques. All in all, the Appellant's version of events simply lacks the ring of truth.

[20] Subparagraph 152(4)(*a*)(i) of the *Act* requires the Minister to show that in claiming a deduction for spousal support in his 1996, 1997 and 1998 income tax returns, the Appellant "… made any misrepresentation that is attributable to neglect, carelessness or willful default or … committed any fraud in filing the return …". As counsel for the Respondent quite fairly pointed out, the provisions of paragraph 60(*b*) are technically complex. And I accept the Appellant's evidence that because he had to support himself at a young age, he did not have the same educational advantages that many enjoy. Accordingly, I am not prepared to say (and I did not understand the Respondent to be arguing) that the Appellant's conduct amounted to fraud.

[21] However, I am satisfied that claiming spousal support deductions in the circumstances described above was attributable to neglect, carelessness or willful default thereby justifying the Minister's reassessment beyond the normal reassessment period. The Appellant admitted that he had always done his own returns and those of various family members. Further, he solicited work for himself as a tax preparer at his place of employment and earned a few dollars each year acting in that

---

[15] Exhibit R-1, Tab 8.

[16] Exhibit R-3.

[17] Exhibit R-1, Tab 9.

[18] Exhibit R-1, Tab 7.

capacity. Finally, a spousal support deduction is not just stumbled into: because of the complexity of paragraph 60(*b*) and its related provisions, it is difficult to blame an unjustified claim on sloppy records-keeping or slipshod accounting. The evidence shows that the Appellant knew just enough about the paragraph 60(*b*) requirements to get himself into some serious trouble.

[22] Which brings me to the matter of the penalties imposed under subsection 163(2) of the *Act*. To be entitled to levy penalties under that provision, the Minister must be able to show that the Appellant "knowingly, or under circumstances amounting to gross negligence … participated in, assented to or acquiesced in the making of" a false statement in a return. The jurisprudence is clear that given the penal nature of subsection 163(2), this language imposes on the Minister a higher standard of proof than is required under subsection 152(4)[19]. The evidence considered above shows a deliberate course of conduct which, together with Mr. Corbett's testimony that the Appellant's file was one of a group using the same income splitting strategy, is consistent with the conduct described in subsection 163(2). The Appellant's only response to the Respondent's case was to cling to his denial that he was living at 98 Leaside Drive during the years in question. I regret to say I am unable to believe him. All in all, I am satisfied that the Respondent has successfully met its burden of showing that the Minister was entitled to impose penalties under subsection 163(2) in respect of the 1996, 1997 and 1998 taxation years.

[23] For the reasons set out above, the appeals are dismissed.

Signed at Ottawa, Canada, this 30th day of January, 2009.

"G. A. Sheridan"

Sheridan J.

[19] *Venne v. R.*, [1984] C.T.C 223 (F.C.T.D.) at page 233.

CITATION:	2009TCC60
COURT FILE NO.:	2007-3805(IT)I
STYLE OF CAUSE:	PATRICK GRAU AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	St. Catharines, Ontario
DATE OF HEARING:	October 22, 2008
REASONS FOR JUDGMENT BY:	The Honourable Justice G. A. Sheridan
DATE OF JUDGMENT:	January 30, 2009

APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Laurent Bartleman

COUNSEL OF RECORD:

For the Appellant:	
Name:	
Firm:	
For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada