

Docket: 2006-705(IT)G

BETWEEN:

VIALINK INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeal of *Hubert Watt*
(2006-841(IT)G) on November 26 and 27, 2007 and April 22 and 23, 2008
at Toronto, Ontario

Before: The Honourable Justice Diane Campbell

Appearances:

Counsel for the Appellant: Osborne G. Barnwell

Counsel for the Respondent: Nimanthika Kaneira and
Laurent Bartleman

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* with respect to the taxation years ended December 31, 2001 and December 31, 2002 are allowed and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 20th day of February 2009.

"Diane Campbell"

Campbell J.

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Date: 20090220
Dockets: 2006-705(IT)G
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REASONS FOR JUDGMENT

Campbell J.

[1] These appeals were heard together on common evidence and relate to the 2000, 2001 and 2002 taxation years for Hubert Watt and the taxation years ending December 31, 2001 and December 31, 2002 in respect to Vialink Inc. (“Vialink”). Mr. Watt is the sole shareholder and director of Vialink, which operated an internet cyber café under the name, Telnet Entertainment. Vialink was incorporated in 1998 to carry on the business of 1-900 telemarketing chat lines. It ceased operations in 2002.

[2] In March 2003, an audit was commenced in respect to Hubert Watt. This audit was triggered by an incident occurring in February 2002, in which Mr. Watt was detained by RCMP upon his arrival from England at the airport in Toronto, for possession of cash in the amount of £39,000. This cash was eventually returned to the Appellant after an investigation exonerated Mr. Watt of any wrongdoing. The Minister of National Revenue (the “Minister”) used the net worth method to

determine the taxable income of Hubert Watt and imposed penalties under subsection 163(2) of the *Income Tax Act* (the “Act”). As a result, the Minister determined that the Appellant, Hubert Watt, had failed to report total income in the amounts of \$56,040.27, \$82,373.56, and \$239,309.97 for the 2000, 2001 and 2002 taxation years respectively. Mr. Watt had late-filed his income tax return for the 2000 taxation year on June 5, 2001 and, following up on several requests from the Canada Revenue Agency (“CRA”), late-filed his returns for the 2001 and 2002 taxation years on May 12, 2003. The income he reported from all sources for the 2000, 2001 and 2002 taxation years was rental income of \$10,273.00, \$5,495.00 and \$4,729.00 respectively.

[3] The tax returns for Vialink for the taxation years ended December 31, 2001 and December 31, 2002 were also late-filed on May 12, 2003 and reported nil income in each of these taxation years. Vialink filed amended T2 returns after the audit commenced for both of these taxation years (as well as for the taxation year ending December 31, 2000) on March 1, 2004, reporting gross business income of \$64,995.00 and \$1,890.00 and a net loss of \$3,795.00 and \$5,564.00 respectively for each of these years. Although a net worth assessment was completed in respect of Hubert Watt, the auditor used a bank deposit analysis in respect to Vialink in determining that there was unreported business income of \$187,192.00 and \$7,768.00 in regard to these two taxation years. Vialink was reassessed on June 15, 2004 to include these amounts in income and penalties were imposed.

[4] Although the auditor found no documentation to verify actual business expenses, she did allow the amount of \$33,309.00 in the 2001 taxation year, being the amount which was showing on the books as a shareholder loan. During the course of the hearing, counsel for the Appellants submitted further documentation and after review by Respondent counsel, an additional sum of \$25,302.17 was conceded as business expenses in that same taxation year. It should be noted that, although Respondent counsel conceded the additional amount, there were concerns expressed that there was some duplication of expense amounts.

[5] The issues in these appeals are:

- (1) Whether the Minister properly included amounts as unreported income in the 2000, 2001 and 2002 taxation years of Hubert Watt.
- (2) Whether the Minister properly included amounts as unreported business income in computing Vialink’s income in the taxation years ended December 31, 2001 and December 31, 2002.

- (3) Whether Vialink is entitled to claim additional business expenses beyond the amounts of \$33,309.00 and \$25,302.17 allowed/conceded in respect to the taxation year ended December 31, 2001.
- (4) Whether gross negligence penalties have been properly imposed pursuant to subsection 163(2) of the *Act* in respect to each Appellant.

[6] The focus in both appeals centered around the larger sums of money flowing through the Vialink account in the relevant taxation years. The Appellant's short answer was that, although large amounts of money flowed through the business account, they represented gifts/loans to Mr. Watt personally from family and friends, as well as amounts forwarded to Mr. Watt from Gary Williams in England for potential investment in a restaurant/bar business in Canada. The Minister concluded that there was either no documentation to support the Appellant's contentions or that it was inadequate.

[7] The Appellants relied on the evidence of Mr. Watt; his wife, Sita Loretta Gardner; the operators of a currency exchange centre, Sujatha Sivanathan and Sinnathurai Sivanathan; senior manager with the Town of Whitby, Peter LeBel; and, Jacqueline Gilling, who gave her evidence by videoconference from England. The Respondent relied on the evidence of the auditor, Theresa Abernathy, and the appeals officer, Colette Ouimet.

The Evidence:

Hubert Watt

[8] Mr. Watt's educational background is in hotel management. He has a certificate from a college in Jamaica as well as a diploma from George Brown College and a degree from Ryerson. He has worked in the airline industry and in various food establishments and hotels as a food and beverage cost controller and as a night auditor. Since 2004, he has been a licensed real estate agent.

[9] Although he incorporated Vialink in 1998 to operate 1-900 fantasy chat lines, he did not officially commence operations until January 2000. Each caller to the chat line was charged on a per call basis with the amount being billed to their telephone account. After Bell Canada deducted its fees, a monthly statement was issued to Vialink together with a cheque for the balance. Although Vialink maintained a corporate account at the Royal Bank, Mr. Watt testified that

occasionally the Bell Canada cheques may have been cashed elsewhere. Since it was a twenty-four hour operation, Vialink employed a number of women on a contract basis to deal with these calls. They were paid twice monthly in cash. One of the largest expenses, the cost of advertising, was paid through his personal credit cards.

[10] Mr. Watt testified that during this period he continued to investigate potential business opportunities in the hospitality field, particularly restaurant franchises. His friend, Gary Williams, expressed an interest in being involved with Mr. Watt in a restaurant venture in Canada. Mr. Watt had been introduced to Mr. Williams through an acquaintance, Jackie Gilling, in 1998.

[11] Mr. Watt's evidence was that he made a number of trips to England to meet with Mr. Williams and that, beginning in the fall of 2001, Mr. Williams wired him significant sums of money through Sindi Financial, a currency exchange centre. These transfers occurred on different occasions to satisfy franchise commitments and application fees. Mr. Watt testified that Vialink was used as a "facilitator" in having these monies flow through the Vialink corporate account. However, on one occasion the sum of £39,000 was given to Mr. Watt personally while he was in England to carry back with him to Canada, instead of being wired.

[12] Mr. Watt was detained by Customs and the RCMP upon his arrival to Canada at the airport in Toronto in February, 2002. The money was retained for a number of months before eventually being returned to him. When this occurred, Mr. Williams got "cold feet" and requested the return of all of his money. Mr. Watt testified that he returned a total of \$120,000.00 to Mr. Williams over a period of time. This was all of the money, which Mr. Williams provided to him, except for the £39,000 held by the RCMP. On cross-examination, he clarified that it was actually \$161,389.00 that had been returned to Mr. Williams (November 26, 2007 Transcript, page 152). Mr. Williams died in July 2002. It appears that Mr. Watt never returned the £39,000 to Mr. Williams.

[13] According to Mr. Watt's evidence, there was a trust relationship between them because Mr. Watt had given advice to Mr. Williams in the past with respect to his restaurant in England. There were no official records kept by Mr. Watt respecting these loans and no written agreements respecting this money or Mr. Williams's role in a potential business venture in Canada. However, Exhibit A-2 contained copies of cheques from Sindi Financial payable to Telnet Communications, received in the period October 2001 to early 2002. Exhibit A-1, Tab 1 contained bank account statements for Vialink, showing

deposits to the corporate account of \$15,000.00 on October 23, 2001, \$18,280.00 on October 23, 2001, \$15,000.00 on October 29, 2001, \$17,569.00 on November 5, 2001, \$15,000.00 on November 6, 2001, \$30,000.00 on November 13, 2001, \$35,000.00 on December 13, 2001, and \$15,540.00 on December 17, 2001.

[14] Mr. Watt testified that he pursued three possible business ventures during this time period: Tim Hortons, Licks Restaurant and the Pump House in Whitby, Ontario. Exhibit A-1, Tab 2, contained a license application to Tim Hortons which was completed but not signed. Exhibit A-1, Tab 4, contains a letter from the Tim Hortons group dated June 29, 2001 acknowledging receipt of a completed franchise questionnaire (Exhibit A-1, Tab 5). Since locations that he proposed for a Tim Hortons' site were already saturated, he then looked into a Licks franchise. The only documentation supplied in this respect was a one page letter (Exhibit A-1, Tab 9), dated November 5, 2001, from Licks referencing introductory franchise information. While pursuing a Licks franchise, Mr. Watt also investigated a potential site for a restaurant and bar known as the Pump House in Whitby. Mr. Watt testified that he obtained information from the Planning Department of Whitby and, subsequently, he and his wife met with Peter LeBel concerning development of this site.

[15] In addition to the significant amounts received from Mr. Williams, Mr. Watt testified that he received gifts and loans from family and friends in Jamaica. According to Mr. Watt's evidence, he and his wife were to hold 51% share of any business venture entered into with Mr. Williams. To raise the 51% share required by the franchisors, he intended to use their family assets, as well as a bar in Jamaica, gifted to him by his father. Through an agreement with his stepmother, he sold this bar to her and received the sum of \$75,000.00 (instead of the initial agreed upon amount of \$150,000.00), which was paid to him over a period of time. Since he did not receive the original price of \$150,000.00, he listed the value of the bar at \$90,000.00 in the Tim Horton's licensing application which, by his own admission, was \$15,000.00 more than he testified that he had received. He stated that he used these funds to pay down his mortgage. A Bank of Montreal statement (Exhibit R-3, Tab 1) showed mortgage payments of \$20,000.00 in 2001 and \$20,000.00 in 2002. In addition, correspondence from an attorney in Jamaica was introduced to confirm that Mr. Watt's stepmother purchased the bar from him to keep it in the family and that lump sum payments were made to Mr. Watt in the period 2000 to 2002 (Exhibit A-3). When Mr. Watt agreed to accept less money for the sale of the bar to his stepmother, he asked Mr. Williams for a further advance of money. He travelled to England to obtain money from Mr. Williams and, on February 24, 2002, he was detained with the £39,000. When this occurred,

he told authorities that £19,000 belonged to him personally and that only £20,000 belonged to Mr. Williams. However, in the pleadings, he admitted that he was responsible to repay the entire amount of £39,000 to Mr. Williams.

[16] In cross-examination, Mr. Watt confirmed that, in the 2000, 2001 and 2002 taxation years, he reported only rental income and reported no income from Vialink. After he claimed deductions for rental expenses and support payments, he reported net income of \$6,373.80 in 2000, \$1,595.79 in 2001 and \$827.09 in 2002. In 2001 and 2002 Vialink reported income of nil. All of these returns were late-filed. Mr. Watt testified that he filed those returns quickly, without giving them much thought, subsequent to a request by CRA after the airport incident. The personal and corporate returns for 2001 and 2002 were filed on May 12, 2003. After the audit commenced, he filed amended T2 returns for Vialink showing a loss of \$20,291.00 in 2000, a loss of \$3,795.00 in 2001 and a loss of \$5,564.00 in 2002. The balance sheets in the amended returns for the taxation years ended December 31, 2000 and December 31, 2001 list a liability of over \$38,000.00 due to shareholder. The amount due to shareholder in the amended return for the taxation year ended December 31, 2002 was in excess of \$40,000.00.

[17] In addressing the source of payments made on several credit cards, Mr. Watt stated that he was able to make those credit card payments because he either transferred advances from one credit card to another, used funds he obtained from family or used funds from the repayment of loans he had made to friends. He acknowledged transferring amounts totalling \$44,572.75 in 2001 and \$18,059.00 in 2002 to his MBNA card; \$11,527.50 in 2000, \$7,273.58 in 2001 and \$7,000.00 in 2002 to his Canada Trust card; and \$9,258.22 in 2000, \$29,735.65 in 2001 and \$10,079.19 in 2002 to his Royal Visa card. All payments substantially exceeded his net reported income in each year.

[18] By consent of both parties, an MBNA application form received by the Bank in January 2001 was entered as an exhibit, which, although unsigned, contained Mr. Watt's name, address and referenced his annual income at \$100,000.00. In addition, two forms completed for the Tim Horton's franchise listed his salary as \$45,000.00 annually, which he admitted as being inaccurate.

[19] In correspondence to Theresa Abernathy (Exhibit R-1, Tab 22) dated March 17, 2004, to clarify matters Mr. Watt supplied information regarding the funds which were purportedly from investors and loan providers as well as gifts from his family. Mr. Watt admitted that the content of the letter was, in his words, "an embellishment" but that the history of his family and the inheritance in Jamaica

were so complicated that it was simply easier to explain the origin of funds in the manner he did. He also admitted that the amount of \$20,000.00 which he claimed to have received from his mother, Vera Jones, was another “embellishment” and that the amount of the funds was \$5,000.00 or \$10,000.00. The letter (Exhibit A-1, Tab 15) from Vera Jones was also an “embellishment” of the stated amount.

[20] In respect to the money which he testified he returned to Mr. Williams, he stated that he used an exchange agency recommended by Mr. Williams and that individuals not known to Mr. Watt came to his house and picked those funds up in cash. He produced handwritten receipts (Exhibit R-6) to support this claim. All of the receipts were signed by an R. Thompson or an R. Smith but did not contain an agency name. They were never provided to the auditor or appeals’ officer and were introduced only at the examination for discovery. In reviewing the Vialink bank statements, he identified withdrawals for the amounts returned to Mr. Williams by picking out amounts he thought might relate to those withdrawals. However, he admitted that there was no apparent correlation between the receipts and the withdrawals.

Sita Gardner

[21] Sita Gardner, the Appellant’s wife, testified that she was never involved in Vialink’s business operations but that she did intend to act in a management position if they were successful in obtaining a restaurant franchise.

[22] Ms. Gardner testified that because franchises required application fees to be paid upfront, her husband went to relatives and friends, including Mr. Williams, to obtain funds. However, she never actually saw money transferred from Mr. Williams; she never saw bank accounts or statements connected to her husband’s business; and she was never privy to any information or documentation concerning his rental property, other than what her husband told her. She completed franchise applications for Tim Hortons and Licks, based on financial information supplied by her husband. She testified that she attended a meeting with Peter LeBel concerning a potential restaurant in the Town of Whitby.

Sujatha Sivanathan and Sinnathurai Sivanathan

[23] These individuals are co-owners of Sindi Financial, a currency exchange centre located in Scarborough. Because their records are kept for a period of five years only, they were unable to provide any documentation respecting these money transfers from England for the period under appeal.

[24] Sujatha Sivanathan identified the cheques payable to Telnet Communications, at Exhibit A-2, as those cheques representing the funds that came from England with instructions from a dealer there to contact Mr. Watt to obtain identification and to then issue cheques. She stated that the instructions were to issue the cheques to the company.

[25] Sinnathurai Sivanathan confirmed that it was Mr. Watt who attended at their office to pick-up the cheques. He confirmed that he recalled receipt of instructions from his dealer in the United Kingdom respecting those orders.

Peter LeBel

[26] Mr. LeBel is a senior management employee with the Town of Whitby. He testified that the Town had authorized him to assist in having a heritage building, known as the Pump House, converted to a restaurant and that proposals could be entertained from potential investors. Over the last eight or nine years, there have been about fifteen inquiries. He had documentation in his possession confirming applications and other information concerning the Pump House property between 1995 and 2005. He explained that an individual interested in completing such an application would follow a procedure, beginning with consultations with Mr. LeBel. He confirmed that the documentation submitted by the Appellant to the Court, concerning the Pump House application, at Exhibit A-1, Tab 10, would be accessible by the general public without beginning the process of an application. He had no recollection that Mr. Watt or his wife had ever made an application to locate a restaurant at the Pump House site and he had no documentation in his records between the years 1995 to 2005 that evidenced any dealings of any kind with Mr. Watt, including a possible meeting.

Jackie Gilling

[27] Ms. Gilling stated that Mr. Watt had been an acquaintance since 1998 when they both resided in Jamaica. She testified that Mr. Williams and Mr. Watt were business associates and that Mr. Williams had expressed an interest in investing in a restaurant in Canada. She testified that he told her that he sent funds to Mr. Watt in Canada. She had no knowledge of the amounts. She also stated that Mr. Watt had visited them in England on a couple of occasions. She had no knowledge of whether Mr. Watt had returned any of those funds to Mr. Williams but stated that Mr. Williams had requested that they be returned.

[28] On cross-examination, Respondent counsel referred Ms. Gilling to an affidavit (Exhibit R-5) that she had signed and sworn on July 21, 2006. In that affidavit she stated that when Mr. Watt visited England, Mr. Williams would give him cash to carry back to Canada. Contrary to her oral testimony, Ms. Gilling in the affidavit stated that she had no specific knowledge of the type of business venture for which Mr. Williams was advancing funds to Mr. Watt. The affidavit also contradicted her oral evidence respecting the return of the funds to Mr. Williams. At paragraph 10 of that affidavit, she stated that some of the money had been returned.

Theresa Abernathy

[29] Ms. Abernathy, an auditor during this period with the special investigation department of CRA, received the file in 2002 to complete a jeopardy assessment after Mr. Watt had been detained at the Toronto airport. Upon completion of the jeopardy assessment, the £39,000 was returned to Mr. Watt through the RCMP. She then commenced an audit, in March 2003, using a net worth analysis with 1999 as the base year. She used a net worth approach because insufficient information was supplied to enable her to correctly determine what amounts should have been reported on the returns.

[30] Ms. Abernathy completed her analysis of the family unit using year-end bank statements, tax returns, a review of properties owned and property tax statements. As she was unsuccessful in getting responses for information from Mr. Watt or his then solicitor, Bruce Olmsted, a “requirement for information” was issued to his bank. The information, obtained from this, was used to complete the net worth analysis. Statistics Canada data was used throughout the analysis with the auditor making any adjustments based on the tax returns because Mr. Watt did not respond to correspondence concerning adjustments to these proposed figures. The result was that substantial discrepancies existed between the reported income (\$10,273.00 in 2000, \$5,495.00 in 2001 and \$4,729.00 in 2002) and the additional amounts to be included in his income \$56,040.27 in 2000, \$82,373.56 in 2001 and \$239,309.97 in 2002). Vialink’s bank account was reviewed to ascertain if some of these discrepancies could be accounted for. She was able to readily identify the Bell Canada revenue. The unidentified deposits were attributed to income of Vialink. In 2001, she allowed \$33,309.00, the value of the shareholder loan, as a deduction for business expenses, although there was actually no documentation to support this amount. She stated that she simply used the expenses from the prior year to offset the shareholder loan. No deductions were permitted for business expenses in 2002 as she had no information respecting these.

[31] The auditor also completed an analysis of the credit card statements and reviewed the information and documentation that was submitted concerning the investments and franchises during the last meeting with Mr. Watt. She concluded that the documentation, respecting Tim Hortons, Licks and Pump House property in Whitby, simply consisted of general information available to the public and were not the actual applications. Therefore, she rejected Mr. Watt's explanation that the unidentified amounts, flowing through the Vialink account, related to the franchise fees. She could not verify the loans from family/friends nor could she verify amounts. Mr. Watt claimed some funds came from gambling because he had gambled in Europe and the Caribbean but this could not be substantiated either. She did not reassess Vialink using the amended T2 returns of Vialink because "Mr. Watt had actually filed T2 returns that were signed by Mr. Watt showing zero income in all years" (April 22, 2008 Transcript, pages 86-87) and Vialink was not under audit. The withdrawals from the Vialink account could not be supported by documentation.

[32] The auditor also completed an analysis of reported income and expenses from Mr. Watt's T1 returns beginning in 1992 when he came to Canada to see whether some of the unreported amounts could have accrued from prior years as investments. Although this analysis (Exhibit R-1, Tab 25) assisted in providing an overall financial picture, it did not provide any additional information respecting the origin of the amounts. She also completed an analysis (Exhibit R-1, Tab 26) of Mr. Watt's expenditures and income, summarized and itemized monthly, between 1999 and 2002. Discrepancies in each year were not supported by any reported income.

[33] Her conclusion in respect to the volume of withdrawals in each of the taxation years 2000, 2001 and 2002 was that they were for personal use and that they were actually appropriations because Mr. Watt was using the corporate bank account for his personal use.

[34] On cross-examination, the auditor stated that Vialink's books were reviewed to determine the amounts Mr. Watt should have reported. Where there were supporting documents, amounts were identified as Bell Canada amounts in her report, otherwise amounts were identified as "other" and included in income for Vialink. She confirmed that since the audit was being completed for Mr. Watt, the figures for Vialink were prepared subsequent to the audit in conjunction with the determination of unreported income by Mr. Watt.

[35] The auditor confirmed that she did not use Vialink's amended T2 returns because she considered Vialink's reassessment to be secondary to Mr. Watt's audit. She testified that she did not pursue a detailed investigation into the origin of Vialink's income because Vialink was only reassessed and that the net worth analysis was in respect to Mr. Watt.

[36] The auditor confirmed that in her analysis of the personal credit cards, she recognized that Mr. Watt personally paid some of the expenses belonging to Vialink. Since Mr. Watt did not provide sufficient documentation, she allowed expenses for Vialink in 2001 up to the amount of the shareholder advance of \$33,309.00 or up to the extent of the benefit conferred on Mr. Watt. She did not know why she used subsection 15(1) instead of subsection 15(2) in categorizing the unknown amounts in Vialink's account nor did she recall why in 2002 she attributed \$7,768.00 as an appropriation from Vialink to Mr. Watt.

[37] On redirect, she clarified that the amount of \$7,768.00 consisted of the deposits to the Vialink account that could not be identified and that were therefore attributed as income to Mr. Watt.

Collette Ouimet

[38] Ms. Ouimet, the appeals officer, reviewed the objections filed by both Appellants. All of the numbers, with the exception of the appropriation figures for Vialink, came from the auditor's working papers. She revised those appropriation figures for the 2001 and 2002 amounts because the auditor had used the deposit amounts to the Vialink account rather than the withdrawal amounts in determining the appropriations. However, she conceded that she had omitted to adjust the penalties on the adjusted appropriation figures, and that the penalties should be adjusted to reflect the proper revised amounts in 2001.

[39] Ms. Ouimet stated that the basis for assessing unreported income in respect to Vialink was that there was no actual supporting documentation to verify the flow of funds in and out of the Vialink account. Although explanations were provided, there was no evidence to substantiate the explanations respecting the origin of the funds. On cross-examination, she testified that not all of the documentation respecting the Licks, Tim Hortons and the Pump House pre-dated the Vialink deposits, during the period of October to December 2001. She also stated that the documentation she received from Mr. Watt was not sufficient to verify the amounts and the explanations he was providing. For example, she rejected a letter from Jacqueline Gilling, respecting dealings between Mr. Watt and

the deceased Mr. Williams, as being too vague and general in regard to specific dates and amounts. As she received no verification of expenses, she determined that the unidentified withdrawals from the Vialink account were not in respect to the business operations and therefore were appropriately identified as shareholder appropriations pursuant to subsection 15(1).

Analysis

[40] The net worth method was described in *Ramey v. The Queen*, 93 DTC 791 (T.C.C.), at page 793, as follows:

...A net worth assessment involves a comparison of a taxpayer's net worth, i.e. the cost of his assets less his liabilities, at the beginning of a year, with his net worth at the end of the year. To the difference so determined there are added his expenditures in the year. The resulting figure is assumed to be his income unless the taxpayer establishes the contrary.

The Ramey decision identified this method as a last resort to be used when all else fails. The Minister must show only that the taxpayer's net worth has increased between two points in time. In *Bigayan v. Canada*, [1999] T.C.J. No. 778, Justice Bowman, as he then was, at paragraph 2 stated:

...Frequently it is used when a taxpayer has failed to file income tax returns or has kept no records. It is a blunt instrument, accurate within a range of indeterminate magnitude. It is based on an assumption that if one subtracts a taxpayer's net worth at the beginning of a year from that at the end, adds the taxpayer's expenditures in the year, deletes non-taxable receipts and accretions to value of existing assets, the net result, less any amount declared by the taxpayer, must be attributable to unreported income earned in the year, unless the taxpayer can demonstrate otherwise. It is at best an unsatisfactory method, arbitrary and inaccurate but sometimes it is the only means of approximating the income of a taxpayer.

[41] In *Hsu v. Canada*, [2001] F.C.J. No. 1174, Justice Desjardins at paragraphs 29 and 30 described net worth assessments as follows:

29 ... Its purpose is to relieve the Minister of his ordinary burden of proving a taxable source of income. The Minister is only required to show that the taxpayer's net worth has increased between two points in time. In other words, a net worth assessment is not concerned with identifying the source or nature of the taxpayer's appreciation in wealth. Once an increase is demonstrated, the onus lay entirely with the taxpayer to separate his or her taxable income from gains resulting from non-taxable sources (*Gentile v. The Queen*, [1988] 1 C.T.C. 253 at 256 (F.C.T.D.)).

30 By its very nature, a net worth assessment is an arbitrary and imprecise approximation of a taxpayer's income. Any perceived unfairness relating to this type of assessment is resolved by recognizing that the taxpayer is in the best position to know his or her own taxable income. Where the factual basis of the Minister's estimation is inaccurate, it should be a simple matter for the taxpayer to correct the Minister's error to the satisfaction of the Court.

[42] The burden is on the taxpayer to show, to the satisfaction of the Court, that the net worth assessment is wrong, provided the Minister has properly conducted the audit work. Justice Hamlyn in *Saikely v. M.N.R.*, 93 DTC 397, stated the following, at page 401, as to how a taxpayer may attack such an assessment:

A taxpayer may prove that some of his increase arose from non-taxable receipts, such as inheritances or gambling; that his net worth at the beginning of the period was undervalued or that his assets at the end were overvalued; that liabilities existing at the end were omitted or undervalued; that the money had been borrowed or that income losses were greater than assessed. Whatever is alleged by the taxpayer must be proved by him; a mere statement is not enough. Moreover, cogent evidence is required to disprove a net worth assessment.

[43] Almost all of the evidence focused on the alleged advances totalling \$160,000.00 from Gary Williams. In fact it was the incident at the airport in Toronto, in February 2002, that led to the examination of Mr. Watt's affairs. The Appellant argued that these monies were forwarded to him personally to pursue franchise investments and that the funds simply flowed through the Vialink account for convenience until he was able to incorporate another company with a separate account. As such, these monies would generally not be taxable. However, the problem is that there was little, if any, direct documentation to support the flow of funds from Mr. Williams. I must be satisfied that the Appellant has produced enough evidence to substantiate the source of these funds.

[44] In respect to the documentary and oral evidence produced, I have cheques totalling \$143,109.00 (Exhibit A-2) issued to the corporation by Sindi Financial between October and December 2001. These funds originated in England and were forwarded to Sindi Financial by their dealer in the United Kingdom. On the flip side, I was provided with copies of the receipts (Exhibit R-6) which, according to the Appellant, support his position that he returned these monies to Mr. Williams. These receipts total \$143,080.00, a slight discrepancy from the documents at Exhibit A-2. The owners of Sindi Financial did not retain the records and with the passage of time could provide little evidence except that they recalled that the money came from their currency dealer in the United Kingdom. They were uninterested third parties but they could do little else except confirm the origin of

these cheques at Exhibit A-2 as coming from England. Their agency was not involved with the alleged return of the funds to Mr. Williams.

[45] The evidence of Sita Gardner in respect to the transfer of these funds added very little because she never saw money going from Gary Williams to Mr. Watt and never saw Vialink's bank statements or accounts.

[46] Ms. Gilling had no first-hand knowledge as to whether Mr. Williams actually wired money to Mr. Watt. She stated that money had been given to Mr. Watt when he was in England but she had no knowledge of the amount. She stated that Mr. Williams told her that some of the money had been returned but she did not know the amount. The problem with much of the evidence is that it was hearsay and based on information that Mr. Williams supposedly told her. In addition, there were discrepancies between her oral testimony and her affidavit.

[47] The receipts dated between March and June 2002, Exhibit R-6, were handwritten and of a generic type, with no identifying earmarks, as to the name of the financial institution that wired the funds or the address. They were signed by an R. Williams and R. Smith, who picked up the cash from Mr. Watt, according to his evidence. These individuals were not called as witnesses and because of the Appellant's admissions, that he had falsified other documentation, I can give no weight to these receipts. In addition, I am unable to locate or to match up Vialink withdrawals or other documentation to the amounts indicated in these receipts. Mr. Watt in reviewing the bank statements did pick out amounts that he thought would be related to the amounts in the receipts. However, there was never one amount that specifically corresponded to the amount in a receipt because it was his evidence that he would keep withdrawing smaller amounts at various times until he had a larger amount to return to Mr. Williams. Another problem, which I have with these receipts, is that they were never provided to the appeals officer or the auditor either voluntarily or in response to numerous requests to provide supporting documentation. They were finally submitted during the examination for discovery.

[48] However, the main problem with respect to these wire transfers is the lack of existence of a link or connection between the transfers through Sindi Financial or family/friends and the Vialink bank deposits. The precise correlation is missing and because of the credibility issues, that are problematic in these appeals, I consider it essential that such a satisfactory correlation exist or be provided. After all, the onus is upon the Appellant to rebut the assumptions contained in the Reply to the Notice of Appeal and I do not believe it is unreasonable in these

circumstances to expect that the Appellant could provide sufficient evidence linking the deposit to the source.

[49] With respect to the franchise documentation, all of the exhibits relating to the Pump House investment were clearly documents that were available to the general public. In addition, Peter LeBel had no record of any meeting with Mr. Watt and no record of any application by Mr. Watt concerning this property. There was one exhibit concerning Licks restaurant and it confirmed only that information on a Licks franchise had been forwarded to Mr. Watt. There was no evidence of further follow-up. There was more information submitted respecting the Tim Hortons' franchise, with the most important document being the license application dated November 19, 2001. Although it supports the Appellant's contention that he was actively pursuing franchise investments in late 2001, it listed a salary of \$45,000.00 which was shown to be inaccurate when the figure was compared to income stated in his returns. I am left with a great deal of doubt in terms of giving too much weight to such documents. I do not believe the salary information was mere inadvertence on the part of Mr. Watt because he also completed MBNA application forms which inaccurately listed his yearly salary as \$100,000.00. Yet none of his returns reflected these figures. When asked about this information he advised CRA officials that it was none of their business to make such an inquiry. It seems that Mr. Watt is engaged in a pattern of supplying false information to achieve his own ends and in a larger context this casts a shadow not only on his documentary evidence but on his oral evidence as well.

[50] Some of Mr. Watt's evidence related to gifts and loans received from family and friends, including money received from his stepmother in respect to a bar in Jamaica that had been gifted to him by his father. However, Mr. Watt admitted that the correspondence (Exhibit R-1, Tab 22) in which Mr. Watt provided names of franchise investors and the amounts loaned to him, together with the amounts of gifts he had received from family, was falsified in its entirety.

[51] The bar in Jamaica was to be used as one of the assets to show that he had the ability to finance his share of the potential franchise investments. However, he listed the value of the bar at \$90,000.00, although he actually received only \$75,000.00. He admitted that he previously submitted false information on this. In addition he admitted in the following exchange, during cross-examination, that the letter, at Exhibit A-1, Tab 15, from his stepmother, verifying the sale of the bar and some of the payments she forwarded to him, had been falsified:

Respondent counsel: ... Are you saying that she was not being completely truthful in writing this letter, as well?

Mr. Watt: As I said, it was an embellishment on the amount.

(Transcript November 26, 2007, page 149)

He admitted that none of these amounts in this exhibit were correct and that they were “embellishments”, to use his terminology, but that his stepmother did give him some money and “It could be \$5,000, or \$7,000, or it could be \$10,000” (Transcript November 26, 2007, page 147). It is not clear from the evidence whether Vera Jones, the stepmother, drafted this document and signed it at the request of Mr. Watt or whether Mr. Watt drafted it and signed her name to it.

[52] Whichever scenario applies, it creates another problem in my acceptance of another piece of correspondence (Exhibit A-3) from a lawyer in Jamaica which supposedly confirmed payments to Mr. Watt between 2000 and 2002 respecting this bar. There were no particulars supplied in respect to amounts paid or dates of payment in that correspondence but, more importantly, there was no independent evidence produced to authenticate this document nor was Respondent counsel able to cross-examine on its authenticity. In different circumstances where I had no evidence before me of falsification of other documentation, I would be inclined to give it some weight but the problems associated with some of the related documentation casts a pall of suspicion on all of it.

[53] During the hearing, Mr. Watt produced a summary schedule (Exhibit A-5) of the expenses in 2000, 2001 and 2002 that he was able to locate for Vialink. Bell Canada receipts were produced, as well as those respecting advertising, but there was no documentation respecting other expense categories such as salaries or rental payments. Beyond the sufficiency of supporting documentation, there appear to be errors in the numbers that were provided. For example, Mr. Watt claimed that the advertising expenses, as per the actual receipts, totalled \$24,667.15 when in fact the total should have been \$21,013.00. In addition, it appears that this figure relates to Bell Canada expenses and not the advertising expenses.

[54] In another set of facts, I might have overlooked such a variance but taken in conjunction with the other problematic documentation, it is at best yet another example of careless record keeping. It supports my lack of confidence in any of the documents produced by the Appellant. Net worth assessments turn largely on their facts and credibility issues. The Appellant has admitted to submitting inaccurate,

false and misleading information not only to CRA officials but on other documentation, including MBNA credit card application forms and on Tim Hortons' franchise applications. Mr. Watt's willingness to misinform and, as he put it, "embellish", taints the entirety of his evidence. Whatever language one wishes to use, it boils down to multiple fabrications, pure and simple.

[55] Mr. Watt's educational background includes degrees in marketing and hospitality management from several colleges. He is an experienced businessman who has held management level positions in various businesses. This is unlike the case of an inexperienced and uneducated taxpayer. Based on Mr. Watt's background, it is not unreasonable to expect that at minimum a general ledger would be kept tracking revenues and expenses. The closest thing to a ledger produced at the hearing was the summary schedule of expenses (Exhibit A-5) and the uncorroborated financial statements appended to the amended T2 returns. It is clear from the evidence that CRA officials made numerous requests to Mr. Watt to supply supporting documentation. Although some documentation was provided, it was inadequate and as discovered, after the documents were submitted, some of them had been falsified. In completing the net worth, the entire family unit was considered. Although Sita Gardner gave evidence, she was not questioned in direct examination in respect to her assets and liabilities and how those figures might materially impact upon the net worth. The Statistics Canada figures used in the assessment were not questioned either. I believe the reasonable conclusion to draw from this is that the net worth analysis was correct in this respect because a further review in either of these areas would either have adversely affected the Appellant by raising the net worth assessment or simply may not have altered it at all.

[56] In conducting a net worth assessment, the Minister is relieved of the usual obligation of identifying a source of income (*Hsu v. Canada*, previously quoted). The Minister is responsible to demonstrate only that an increase in the taxpayer's net worth has increased between two points in time and this is premised on the fact that the taxpayer has provided insufficient or inaccurate information or no information at all. Taxpayers are always in the best position to know their own affairs. It is logical that they should be able to furnish adequate information to counter a net worth assessment and to satisfy a Court, on a balance of probabilities, as to the source of unreported income.

[57] The Minister relied on subsection 15(1) to identify some of the larger amounts coming out of the Vialink account as shareholder appropriations. Mr. Watt is the sole shareholder and director of Vialink so the control resides with him. He admitted to co-mingling the personal and business accounts. The appeals

officer altered the net worth assessment to focus solely on the withdrawals from Vialink, as opposed to the deposits as the auditor had done. Due to a lack of documentation suggesting anything to the contrary, the Minister assumed that these amounts were appropriated from Vialink for Mr. Watt's personal use. I believe the wording in subsection 15(1) is broad enough in its scope to encompass withdrawals such as these and that, if the evidence suggests that a shareholder has appropriated "in any manner", then, it is reasonable that the Minister in a net worth assessment should make such an assumption, particularly where the taxpayer supplies no evidence to the contrary. In the case of *Penny v. Canada*, [1994] F.C.J. No. 1847, Justice Simpson made the following comment concerning subsection 15(1) at paragraphs 18 and 19:

18 ...However, it seems to me that, in the case of an appropriation of corporate property by a shareholder, the tax consequences to the shareholder are unambiguous. They are clearly set forth in section 15 of the Act. In these circumstances, I am satisfied that Parliament must have intended the tax consequences which flow from the operation of the section.

19 ...The section applies if the shareholder appropriates "in any manner". To me, this language encompasses a de facto taking. As long as the shareholder derives a benefit, the legality of the appropriation matters not.

If such an assumption is made, it seems to me that it should be a simple matter for a taxpayer to produce documentation, such as a general ledger or actual receipts, that could easily refute the Minister's assumptions.

[58] I have been given a lot of documentation, some of which has been falsified and contains incorrect or inaccurate information. Where an Appellant demonstrates a history of misrepresenting information, it is only clear, concise, specific and uncontroverted evidence that will demolish the Minister's assumptions. Despite the otherwise misleading information, I have been given no such evidence here. I have evidence of wire transfers but only conjecture respecting their link to the Vialink withdrawals; handwritten generic receipts; documents purporting to relate to Licks and Pump House applications which were simply requests to obtain information or information available to the general public; allegations of a meeting with Mr. LeBel in support of the Pump House application, which Mr. LeBel cannot recall and had no supporting records to substantiate either the meeting or the application; credit card and Tim Horton's franchise applications where Mr. Watt supplied incorrect information; and letters written by Mr. Watt and/or his stepmother, respecting investors and monies loaned or gifted, that Mr. Watt admits contained

false and misleading information. All of this was general and vague and nowhere nearly sufficient in satisfying the onus which is upon the Appellant.

[59] Mr. Watt's explanation for filing late returns with zero income for Vialink was that since he had been caught with £39,000 at the airport he quickly completed the returns and filed them. However, this is yet another inconsistency in his evidence because the Vialink returns were filed more than one year after the airport incident. The fact that the Appellant subsequently filed amended T2 returns has no direct bearing other than as an attempt to rectify the situation he found himself in. It appears from the evidence that the auditor ignored these amended T2 returns but I do not think that this had much bearing because the audit was underway. In relying on the initial returns as filed, the requests for adequate documentation, if complied with, might have otherwise settled the net worth analysis that was being conducted. Instead, he submitted false documents and incorrect information. As a result, the method of last resort employed by the Minister was the net worth assessment, with a bank deposit analysis used in respect to Vialink to determine its revenue. In giving her evidence, the auditor stated that she did not perform an audit of Vialink. On re-direct, she clarified that her evidence meant that she had not done an extensive review of all of the documentation of Vialink. Although a bank deposit analysis may not have been as thorough a vehicle to determine Vialink's unreported income as that of an audit, a reassessment was completed with assumptions pled in support of that reassessment. That does not change the rules that follow concerning burden of proof.

[60] In respect to 2001, the auditor allowed the amount of \$33,309.00 as business expenses because she discovered a shareholder loan account in the same amount in the year 2000. She allowed this amount because there was no question that Vialink was conducting a business that would incur some expenses, even though no documentation had been provided. Her explanation was that the 2000 shareholder loan advance was not there in 2001 so she assumed that it was expenses and "docked it out". This was an arbitrary figure that she chose, although I am not convinced of its accounting efficacy. In addition, to this amount, a further sum of \$25,302.17, based on limited documents produced during the hearing in respect to expenses in 2001, was conceded for total allowable expenses in 2001 of \$58,611.17. No amount was allowed for expenses in 2002 because Vialink ceased operating early in the year; it had minimal revenues compared to prior years; and, unlike 2001 there was no shareholder loan account and no receipts. I do not believe any additional amounts should be allowed in respect to business expenses. The \$33,309.00 was permitted as an expense deduction without supporting documentation. The documentation supporting the second amount of \$25,302.17

was limited and there were legitimate concerns raised that there could be some duplication in these amounts. The Appellant's contention that the auditor had not done enough to ascertain the expenses, when it is his responsibility to provide properly itemized documents and the fact that he initially filed returns showing zero income for Vialink and personal returns showing insignificant amounts of revenue in comparison to his lifestyle, must also be factored in.

[61] Finally there is the matter of penalties imposed by the Minister pursuant to subsection 163(2) of the *Act*. The Minister bears the onus with respect to penalties and must show on a balance of probabilities that there is gross negligence. It is necessary under this provision that the taxpayer has "knowingly, or under circumstances amounting to gross negligence ... participated in or assented to or acquiesced in the making of" a false statement or omission in a return. This wording also implies knowledge or the requisite mental state on the part of the taxpayer of such mis-statements in those returns.

[62] Based on all of the facts before me, I conclude that the Respondent has met the onus and has sufficiently proved that the Appellant knowingly made misleading and false statements that justify the imposition of gross negligence penalties. There were both intentional and indifferent actions taken by the Appellant which involve a greater neglect than simply a failure to use reasonable care.

[63] Mr. Watt is an educated individual with several college degrees and work experience with a number of different companies. He came across as a bright and competent individual. He was the sole shareholder and director of Vialink and had total control of the corporate activities. He co-mingled his corporate account with his personal business. He stated that he made deposits to the Vialink account, which were from family and friends, that had nothing to do with Vialink's business. However, some of his supporting documentation for this included, by his own admission, falsified, inaccurate and incorrect information. I am asked to overlook these documents and accept the Appellant's explanations which are supported only by general, vague and non-specific documents and information. These deposits are significant and remain largely unsubstantiated by the evidence. Although he had a tax preparer complete his returns, he was responsible for supplying the figures and he signed the returns. Other than receipts contained in a box supplied to the auditor, he maintained no records, including ledgers or payroll accounts.

[64] As the sole individual in charge of the corporate activities, I believe Mr. Watt should have known that the withdrawals, in excess of his outstanding shareholder loan, could become part of his corporate income, and that if it originated otherwise from a non-taxable source, that proper records should be kept to support this claim. In addition, any information that has been supplied appears to have been provided sporadically, in dribs and drabs, and haphazardly in respect to sequence and order. The evidence also suggests that he was uncooperative in supplying information during the audit. Initially he refused to supply the requested information concerning these alleged loans. When he finally did provide the names of those individuals, with their telephone numbers, that had gifted/loaned him money, he did not go the step further and supply exact dates of receipts of these funds or the connection to the deposits to the Vialink account. This had the potential of supporting some of his contentions concerning the Vialink account and how he maintained his lifestyle based on the insignificant amounts of reported income. CRA officials were unable to substantiate the telephone numbers of the individuals that loaned him money or other information he provided. Eventually Mr. Watt admitted to having falsified this document in its entirety.

[65] In respect to Mr. Watt's personal reported income and lifestyle, he reported total income of \$10,273.00, \$5,495.00 and \$4,729.00 from rental income in 2000, 2001 and 2002 respectively. During this period and based on reported rental income, he incorporated Vialink, loaned it \$33,309.00 in 2000 and paid significant amounts against the mortgage on the rental property in each year. According to his evidence, he made numerous trips to England and Jamaica. Even if one considered his spouse's income, the lifestyle is not supported by the figures provided. The amount of the shareholder benefit, being in excess of \$377,000.00, is significant over the three year period. The auditor's reasons for imposing penalties in respect to both Appellants are clearly supported by the evidence.

[66] On a final note, I want to commend Appellant counsel who did a superb job of cross-examination of the auditor and the appeals officer. While I believe there were some problematic areas in their approach, overall, on a balance of probabilities, given the facts before me, it was not sufficient, in the end, to discredit the audit procedure employed or the net worth assessment as being straightforward and credible. After all, by its very nature, a net worth analysis is an inherently unreliable attempt at reconstructing a taxpayer's business and personal activities but sometimes, as in these appeals, it remains the only means of approximating a taxpayer's income. The auditor acted on the best evidence she could find.

[67] In summary, it is my conclusion that the documentation and explanations submitted are insufficient to meet the onus which is upon a taxpayer in a net worth assessment. In addition to the problem of verifying the accuracy of these, the Appellant's credibility issues cast a long dark shadow over much of the evidence.

[68] Since the additional amount of \$25,302.17 for expenses was allowed during the hearing and because adjustments respecting penalties were also conceded, I am allowing the appeals to permit the additional amount of \$25,302.17 for total deductible business expenses of \$58,611.17 in 2001. Ms. Ouimet admitted that when she adjusted the figures for the shareholder appropriations under subsection 15(1) and reassessed the total tax payable in 2001, she omitted to readjust penalties. Therefore the penalties in 2001 should be adjusted to reflect the proper amount of tax payable. The penalty amount for 2002 shall remain unchanged because if an adjustment were to be made to this amount it would increase the assessment for that year. In addition, there will be an interest adjustment for the period of time in which the processing of these matters was delayed by the CRA (April 23, 2008 Transcript, page 87).

[69] The appeals are allowed and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment to incorporate the preceding concessions and adjustments.

[70] If the parties are unable to agree as to the issue of costs, they may provide written submissions within 60 days from the date of the within Reasons.

Signed at Ottawa, Canada, this 20th day of February 2009.

"Diane Campbell"
Campbell J.

CITATION: 2009 TCC 117

COURT FILES NO.: 2006-705(IT)G AND
2006-841(IT)G

STYLE OF CAUSE: Vialink Inc. and
Hubert Watt and
Her Majesty the Queen

PLACE OF HEARING: Toronto, Ontario

DATES OF HEARING: November 26 and 27, 2007 and
April 22 and 23, 2008

REASONS FOR JUDGMENT BY: The Honourable Justice Diane Campbell

DATE OF JUDGMENT: February 20, 2009

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