Docket: 2006-1747(IT)G

BETWEEN:

MAN KIT TERRENCE CHAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 19, 2009 at Edmonton, Alberta

By: The Honourable Justice Judith Woods

Appearances:

Counsel for the Appellant:	Nathan J. Whitling
Counsel for the Respondent:	Marta E. Burns Hadley Friedland (student-at-law)

JUDGMENT

The appeal with respect to an assessment made under the *Income Tax Act* for the 1999 taxation year is dismissed, with costs to the respondent.

Signed at Toronto, Ontario this 7th day of January 2010.

"J. M. Woods"

Woods J.

Citation: 2010 TCC 3
Date: 20100107
Docket: 2006-1747(IT)G

BETWEEN:

MAN KIT TERRENCE CHAN,

Appellant,

and

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Respondent.

REASONS FOR JUDGMENT

Woods J.

[1] Man Kit Terrence Chan appeals in respect of an assessment made under the *Income Tax Act*.

[2] For the 1999 taxation year, the Minister of National Revenue added an amount of $200,000 to the appellant's income on the assumption that it constituted profit from the appellant's involvement in a cocaine trafficking organization. A 50 percent penalty was also imposed under subsection 163(2) of the *Act*.

[3] The appellant submits that the assessment is in error for the reasons below.

(a) The assessment was not issued in a timely manner, and therefore is invalid pursuant to subsection 152(4) of the *Act*.

(b) Alternatively, subsection 152(4) bars the assessment because there was no misrepresentation due to neglect, carelessness, willful default or fraud in filing the tax return or supplying information under the *Act*.

(c) The appellant is entitled to a deduction for the loss of the profit in a seizure.

(d) The appellant is entitled to a deduction for legal fees incurred in connection with a related criminal prosecution.

(e) The penalty imposed under subsection 163(2) should be vacated because the failure to report the income was not done knowingly and does not amount to gross negligence.

Factual background

[4] There is limited evidence before me. The only witness was an officer from the Canada Revenue Agency (CRA) who testified on behalf of the respondent.

[5] By way of factual background, then, I will reproduce certain statements of fact from the notice of appeal. They are not in dispute.

> 2. On approximately September 24, 1999, some 35 persons, including the Appellant, were arrested pursuant to a massive joint operation of the Edmonton Police Service and Royal Canadian Mounted Police named "Project Kachou". On this date, the police also seized a number of documents from the Appellant's apartment, one of which evidenced the existence of a safety deposit box in the Appellant's name at a branch of the Royal Bank of Canada.
>
> 3. On September 28, 1999, the police seized and searched the safety deposit box pursuant to a search warrant and found that the box contained two hundred $1,000 bills, or $200,000 in cash (the "moneys").
>
> 5. The Appellant filed his Income Tax Return for the 1999 taxation year on June 27, 2000. […]
>
> 8. The date of mailing of the Appellant's Notice of Assessment for the 1999 taxation year was July 24, 2000. […]
>
> 9. On July 24, 2003, the three year limitation period prescribed by s. 152(3.1) of the *Income Tax Act* for the issuance of a Notice of Reassessment expired. […]
>
> 10. Nearly two years after the expiration of the applicable limitation period, the Appellant was served with a Notice of Reassessment dated July 14, 2005. […]
>
> 12. The Appellant and most of the other persons arrested on September 28, 1999, were subsequently charged with various criminal offences including conspiracy to traffic in cocaine and participating in the affairs of a criminal organization.

> 13. Certain other members of the alleged criminal organization were also charged with offences pertaining to the possession of proceeds of crime. The Appellant was not charged with this offence.
>
> 17. By operation of previous Orders and Consent Orders granted by the Hon. Justice M. Binder and the Hon. Justice D. Sulyma, the Crown was had been [sic] obligated to pay the Appellant's legal fees in any event.
>
> 18. By operation of a judicial stay entered by Madame Justice D. Sulyma on April 30, 2002, the Appellant was acquitted on all the charges he faced.
>
> 19. The criminal prosecutions against all the other persons arrested pursuant to Project Kachou also collapsed as a result of withdrawn charges, Crown stays and judicial stays.

[6] The statements in paragraphs 17 and 18 above are not entirely consistent with the evidence. To the extent that this is relevant to my conclusion, it will be discussed below.

Is assessment invalid by reason of delay?

[7] The notice of assessment that is at issue is dated July 14, 2005. This is almost two years after the normal reassessment period had expired.

[8] The appellant submits that the Minister should have issued the notice of assessment much earlier when the Minister first became aware of the matter. This would have either been in 1999 when the funds were seized, or in 2001 when by a court order the appellant was permitted to use part or all of the seized funds to pay his legal expenses.

[9] There is no doubt that the CRA knew of these events because the CRA officer who had issued the assessment, Terry Willisko, had been seconded to the RCMP in 1998 and was involved in Project Kachou.

[10] According to the testimony of Mr. Willisko, when these events transpired he held off considering assessment action until the criminal proceedings against all of the accused in Project Kachou had been completed. He testified that this was in accordance with CRA policy in light of the differences in investigative powers in civil and criminal proceedings.

[11] The appellant submits that an assessment is invalid if it is not issued in a timely manner pursuant to subsection 152(4). I do not agree with this submission.

[12] The relevant legislative provisions, subsections 152(1) and (4), provide in part:

> **(1) Assessment.** The Minister shall, with all due dispatch, examine a taxpayer's return of income for a taxation year, assess the tax for the year, the interest and penalties, if any, payable and determine
>
> (*a*) the amount of refund, if any, to which the taxpayer may be entitled by virtue of section 129, 131, 132 or 133 for the year; […]
>
> **(4) Assessment and reassessment.** The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if
>
> (*a*) the taxpayer or person filing the return
>
> (i) has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under this Act, […]

[13] Subsection 152(4) provides that an assessment cannot be made after the expiry of the normal reassessment period unless the taxpayer has made a misrepresentation attributable to neglect, carelessness or willful default.

[14] The position of the appellant is that a time requirement should be read in or implied under s. 152(4). The appellant refers by analogy to the due dispatch requirement in s. 152(1). As I understand it, the appellant does not suggest that s. 152(1) applies in these circumstances. Rather, it is suggested that a similar due dispatch requirement should be read into s. 152(4).

[15] In my view, it would not be appropriate to read an assessing time limit into s. 152(4). If Parliament had intended a time limit, one would have been specifically provided for. To the contrary, s. 152(4) provides that an assessment can be made "at any time."

[16] The intention of subsection 152(4) is clear, in my view, to permit the Minister to assess at any time if there has been a misrepresentation due to neglect, carelessness or willful default. This may appear to be a harsh result but it seems to be clearly what Parliament had intended.

[17] I would mention that s. 152(4) is not the only instance in which the Minister has been provided an unlimited time to assess. Another example is section 160, in which the harshness of an open-ended assessment period was considered by the Supreme Court of Canada in *The Queen et al v. Addison & Leyen Ltd.*, 2007 SCC 33, 2007 DTC 5365, p. 9-10.

Was misrepresentation due to neglect, carelessness or willful default?

[18] The appellant submits that the assessment is nevertheless out of time under s. 152(4) because the omission of the $200,000 profit from his income tax return was not attributable to neglect, carelessness or willful default.

[19] The basis for the submission is that the funds "had been seized by the Crown with the knowledge and participation of the CRA" (Appellant's Written Submissions, para. 30).

[20] There seems to be two parts to the submission. First, the appellant seems to suggest that it is not careless to omit profit from income where the profit has been seized. Second, the appellant suggests that there has been no misrepresentation if the CRA is aware of the profit.

[21] I will deal the second part first. I fail to see how the knowledge of the CRA would be relevant to the application of s. 152(4). A misrepresentation occurred when the appellant failed to report this amount as income in his income tax return.

[22] In the Canadian Oxford Dictionary (2001 edition), the term "misrepresentation" is defined as follows:

> Represent wrongly; give a false or misleading account or idea of.

[23] The failure to include this amount in the income tax return clearly gave a false account of the appellant's income. The misrepresentation is not excused if the CRA is aware of the income.

[24] The appellant also submits that there is no carelessness or negligence in circumstances where the funds had been seized before the income tax return was filed.

[25] The seizure, which took place on September 28, 1999, occurred several months before the relevant income tax return was filed on June 27, 2000.

[26] This is not a sufficient justification for failing to report the income. The circumstances of this case suggest that the appellant was willfully blind as to the tax-reporting obligation with respect to this profit.

[27] Until fairly recently, the appellant maintained that the funds did not belong to him. This is reflected in the CRA's audit report (Ex. R-1) prepared in June 2005. Under "Client Representations," the report provides:

> MR. WHITLING [lawyer for the appellant] faxed a letter to the auditors' attention on January 11, 2005, wherein he requested disclosure of all documents in possession of the Crown relating to Mr. Chan's involvement in the RCMP Project Kachou. He further claimed that Mr. CHAN did not have control or beneficial ownership of the $200,000 Cash and that Mr. CHAN could have faced reprisal from other members of the alleged criminal organization if had [sic] used the money towards payment of his income taxes.

[28] A similar position is implied by the notice of appeal, where the following statement of fact is made by the appellant:

> On the Crown's own theory of its prosecution, the moneys were in fact "owned" and controlled by the leaders of the organization. The Appellant had no practical right or ability to spend the moneys for his own benefit, nor to pay a portion of these moneys as income tax.

[29] The above statement in the notice of appeal, which was filed by the appellant's lawyer, appears to have been carefully worded. It merely implies that the $200,000 is not beneficially owned by the appellant, and stops short of stating this as a fact. This is not surprising because the appellant had previously testified in another court proceeding that the money did belong to him.

[30] The prior testimony had been given in a proceeding before the Alberta Court of Queen's Bench in 2001 as part of an application by the appellant to access the seized funds in order to pay his legal bills. The following is a portion of the transcript of this testimony:

> Q And Mr. Chan, you claim an interest in the monies that were seized from the safety deposit box; is that correct?
>
> A Yes
>
> Q Are you the owner of these monies?

A Yes

[…]

Q Mr. Chan, to your knowledge, does any other party, be it an individual person or a corporation, have any interest in the $200,000 that was seized from your safety deposit box?

THE INTERPRETER: No other party. I am the only owner.

[31] It is useful to note that the respondent did not have access to this testimony until a sealing order was lifted by the Alberta Court of Queen's Bench pursuant to an application by the respondent. The order was granted by Justice Binder on September 11, 2007 (*Canada v. Chan*, 2007 ABQB 554), and an appeal from that decision was denied on jurisdictional grounds on October 3, 2008 (*R. v. Chan*, 2008 ABCA 330).

[32] After the disclosure of the transcript, the appellant no longer denied that the funds belonged to him.

[33] Further, at an examination for discovery of the appellant held on January 29, 2009, the following exchange took place (Transcript, page 2):

Q And for the record, you're not contesting that the $200,000 was taxable income for the year 1999?

A Yes

Q And that this income was profit?

A I'm sorry?

Q This income constituted a profit?

MR. WHITLING: That's correct.

[34] In this context, it is fairly clear that the appellant had no intention of admitting that the funds were his until the respondent was able to access the testimony from the prior proceeding.

[35] I conclude that the failure to report this amount on an income tax return amounts to willful blindness.

Does seizure give rise to a deduction?

[36] The appellant further suggests that the seizure of the funds entitles him to a deduction in computing income.

[37] The appellant referred to a number of judicial decisions. Although these decisions do not rule out that a forfeiture of proceeds of crime could give rise to a deduction, they also do not support the appellant's position that a deduction is available.

[38] The respondent referred to three decisions of this Court which denied a deduction for a forfeiture of proceeds of crime: *Neeb v. The Queen*, 97 DTC 895 (TCC); *Brizzi v. The Queen*, 2007 TCC 226, 2007 DTC 896 (upheld on appeal on other grounds); *Anjaria v. The Queen*, 2007 TCC 746, 2008 DTC 2306. The last two cases were heard under the informal procedure.

[39] In *Neeb*, by Bowman J. (as he then was) stated the applicable principle, *in obiter* at page 902:

> The seizure of cash. Apart from considerations of public policy there is, however a further reason for denying the deduction. This is simply a disposition of income, albeit involuntary, after it had been earned. The principle is well settled: *Mersey Docks and Harbour Board v. Lucas* (1883), 8 App. Cas. 891, followed in *Fourth Conservancy Board v. IRC*, [1931] A.C. 540 and in *Woodward's Pension Society v. M.N.R.*, 59 DTC 1253 at 1261, aff'd 62 DTC 1002 at 1004.

[40] It is not necessary on the facts of this case to consider the decisions cited by counsel for the respondent.

[41] The main problem with the appellant's position is that the seized funds never ceased to be beneficially owned by the appellant. Unlike in the above decisions, the seized funds in this case were never forfeited and did not give rise to an expense that may be deducted.

[42] The difference between a seizure and a forfeiture was noted in *Toth v. The Queen*, 2004 DTC 2192. In that case, a deduction was sought in respect of a seizure of funds earned in an illegal business. At para. 15, Lamarre Proulx J. commented as follows:

> My third comment is that the amount was forfeited in the year 2003. It is in that year that the deduction should receive its appropriate fiscal treatment and in that

> year that it should be determined whether the taxpayer is entitled to deduct the forfeited amount.

[43] The funds seized from the appellant were never forfeited to the Crown. In 2001 the appellant made a successful application to the Alberta Court of Queen's Bench for a release of funds to pay his legal fees. Further, in 2002 the criminal proceedings were withdrawn, ending any right that the Crown had to apply for forfeiture.

[44] In the circumstances, the appellant never lost ownership of the funds. A seizure by itself does not give rise to a deduction because it is not an expense.

[45] Finally, I would comment briefly concerning the statement in the notice of appeal that the Crown was obligated to pay the appellant's legal fees. As I understand it, no order was issued that required the Crown to pay the appellant's legal fees. The appellant was able to access the seized funds so that he could pay his own legal fees.

Are legal fees deductible?

[46] The appellant submits that he is entitled to a deduction for the legal fees paid to his lawyer in 1999.

[47] There is no reliable evidence as to how much the legal expenses were and when they were incurred.[1] The implication from the appellant's argument seems to be that legal expenses of least $200,000 were incurred in 1999. As the respondent did not dispute this, at least in the pleadings, I will not base my conclusion on a failure to establish how much the legal expenses were and when they were incurred.

[48] As for whether such expenses are deductible, a similar issue was considered in *Neeb*. In a similar fact scenario, former Chief Justice Bowman concluded that legal fees were not deductible. At para. 35:

> Although one might, on one view of the matter, say that legal defence costs are a necessary incident of carrying on an illegal business, I prefer to put my decision on a different basis. Mr. Neeb defended the narcotics charge not because he intended to carry on the illegal narcotics business, but because he wanted to stay out of jail, or at least avoid going to jail for any longer than he had to. He was not defending his business or his business practices.

[49] I agree with this approach, and conclude that it is appropriate to apply the same reasoning here. I would also comment that the appellant provided the following testimony in his examination on discovery (Ex. R-11, page 14):

> Q Why did you want a lawyer, do you remember?
>
> A I want a lawyer to protect my interests.
>
> Q To protect your interests?
>
> A Yes.
>
> Q You're worried about going to jail for longer than you needed to or going to jail at all?
>
> A Yes.

[50] During argument, counsel for the appellant submitted that an expense incurred to avoid going to jail was a business-related expense because it enabled the appellant to earn additional income. There is not a sufficient factual foundation to support this argument, but even if there were I would view the personal element of the expense to be the dominant aspect.

Are gross negligence penalties appropriate?

[51] The appellant did not challenge the penalties in the notice of appeal but the respondent did not object to submissions being made at the hearing.

[52] Counsel submitted that gross negligence penalties are not appropriate because the appellant was not hiding anything since the monies had already been seized by the police by the time that the 1999 tax return was filed.

[53] For the reasons discussed above concerning the application of s. 152(4), I disagree that the appellant was not hiding anything at the time that the tax return was filed. It appears that the appellant denied that the $200,000 was his own money until 2008 when the respondent was able to obtain a transcript of the appellant's testimony in his application for a return of the seized funds to pay his legal fees.

Disposition

[54] In the result, the appeal will be dismissed, with costs to the respondent.

Signed at Toronto, Ontario this 7th day of January 2010.

"J. M. Woods"

Woods J.

[1] The appellant stated in the examination for discovery that he believed the entire amount seized was used for legal fees (Ex. R-11, page 14). I do not view this statement to be reliable.

CITATION:	2010 TCC 3
COURT FILE NO.:	2006-1747(IT)G
STYLE OF CAUSE:	MAN KIT TERRENCE CHAN and HER MAJESTY THE QUEEN
PLACE OF HEARING:	Edmonton, Alberta
DATE OF HEARING:	October 19, 2009
REASONS FOR JUDGMENT BY:	The Honourable Justice J. M. Woods
DATE OF JUDGMENT:	January 7, 2010

APPEARANCES:

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