

Docket: 2009-1608(IT)I

BETWEEN:

THOMAS E. HARLAND,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on December 08, 2009, at  
Charlottetown, Prince Edward Island

Before: The Honourable Justice Valerie Miller

Appearances:

Agent for the Appellant: Cleve Myers  
Counsel for the Respondent: Devon E. Peavoy

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**JUDGMENT**

The appeal from the reassessment made under the *Income Tax Act* for the 2005 year is allowed and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment, on the basis that in 2005, the Appellant received a taxable dividend in the amount of \$102,810. In all other respects, the appeal is dismissed.

The appeal from the reassessment made under the *Income Tax Act* for the 2006 year is dismissed.

Signed at Ottawa, Canada, this 22<sup>nd</sup> day of February 2010.

“V.A. Miller”

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V.A. Miller, J.

Docket: 2009-1609(IT)I

BETWEEN:

HARLAND ASSOCIATES 02 INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on December 08, 2009, at  
Charlottetown, Prince Edward Island

Before: The Honourable Justice Valerie Miller

Appearances:

Agent for the Appellant: Cleve Myers  
Counsel for the Respondent: Devon E. Peavoy

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**JUDGMENT**

The appeal from the reassessments made under the *Income Tax Act* for the 2005 and 2006 taxation years is dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 22<sup>nd</sup> day of February 2010.

“V.A. Miller”

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V.A. Miller, J.

Citation: 2010TCC105  
Date: 20100222  
Docket: 2009-1608(IT)I

BETWEEN:

THOMAS E. HARLAND,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2009-1609(IT)I

BETWEEN:

HARLAND ASSOCIATES 02 INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

### **REASONS FOR JUDGMENT**

V.A. Miller, J.

[1] These appeals were heard on common evidence. The Appellants have appealed the reassessment of their 2005 and 2006 taxation years. The fiscal year end for Harland Associates 02 Inc. is February 28.

[2] The issues raised in the pleadings were as follows:

THOMAS E. HARLAND (Harland)

- a) Whether benefits in the amount of \$34,579 and \$23,675 had been conferred on Harland by Harland Associates 02 Inc. in 2005 and 2006 respectively;

- b) Whether a taxable dividend in the amount of \$108,045 was properly included in Harland's income in 2005;
- c) Whether the rental losses – the expenses associated with Harland's personal residence in 2005 and 2006 – were incurred for the purpose of gaining or producing income from business or property;
- d) In the alternative, if the rental losses were incurred for the purpose of gaining or producing income from business or property, whether the expenses relating to furniture, household items and renovations were capital expenditures; and,
- e) Whether Harland is liable for gross negligence penalties in respect of the shareholder benefits.

HARLAND ASSOCIATES 02 INC. (the Corporation)

- a) Whether the Corporation's income was over-reported by \$2,000 in 2006;
- b) Whether the Corporation is liable for gross negligence penalties with respect to the shareholder benefits.

[3] The Appellants were represented by Cleve Myers, a chartered accountant. At the commencement of the hearing, Mr. Myers informed the court that the only issues which were being contested were the calculation of the taxable dividend that was included in Harland's income in 2005 and the imposition of subsection 163(2) penalties for Harland and the Corporation in 2005 and 2006. Mr. Myers stated:

...We've chosen all along not to contest the re-assessment of the specific amounts that were denied as expenses to the company and therefore added to shareholders' appropriation to Mr. Harland's account.

The reason for not pursuing that was not an admission that we agreed with the re-assessment. It was simply expediency. There wasn't, from Mr. Harland's point of view, a large gain in expending an amount for somebody like me to go through everything with what he could gain in return.

He just thought it would be better to pay the tax on that but he chose not to admit to the penalties and he wanted to pursue that.

## **Dividends**

[4] In his income tax return for the 2005 taxation year, Harland reported that he had received a taxable dividend of \$86,435.96. At the initial assessment stage, the Minister of National Revenue (the Minister) reclassified this amount as "other

income”. No explanation for this reclassification was ever given to Harland or for that matter, to the court.

[5] Harland requested the Canada Revenue Agency (“CRA”) to change the amount of \$86,435.96 from “other income” to taxable dividends and he requested a dividend tax credit.

[6] In reassessing Harland, the Minister assumed that the Corporation had paid Harland a dividend of \$86,435.96 and that he had failed to gross it up when he reported it on his 2005 income tax return. The Minister included a taxable dividend of \$108,044.95 in Harland’s income.

[7] Sherwyn MacArthur, a business tax auditor with the CRA, gave evidence on behalf of the Respondent. He explained his reason for concluding that the dividend reported by Harland was not grossed up. He stated that it is a normal procedure for most corporations to distribute dividends at the end of its fiscal year when it knows how much money it has available for distribution. In such a scenario, the corporation normally pays the dividends within six months of its fiscal year end. With this in mind and the fact that the Corporation and Harland had different year ends, Mr. MacArthur stated that he reviewed the Corporation’s income tax returns for 2004, 2005, 2006, 2007 and 2008 to ascertain the amount of dividends that it reported was paid in each of these fiscal years. He also reviewed Harland’s income tax returns for 2004, 2005, 2006 and 2007 to ascertain the amount of taxable dividends that he reported. Mr. MacArthur concluded that the dividends in the amount of \$86,435.96 were not grossed up but were cash dividends.

[8] Harland was able to show that the Minister’s assumption was incorrect. However, I do not totally agree with Harland’s calculation of the dividends that he received in 2005. In order to compute his dividends, Harland deducted various amounts from the draws (\$139,551) which he received from the Corporation in 2005. One of these amounts (\$13,100) was allegedly for an expense incurred by the Corporation for the business use of Harland’s boat. Subparagraph 18(1)(l)(i) of the *Income Tax Act* explicitly denies the Corporation a deduction for the use or maintenance of a boat. That subparagraph reads as follows:

**18. (1) General limitations** -- In computing the income of a taxpayer from a business or property no deduction shall be made in respect of

(l) **use of recreational facilities and club dues** -- an outlay or expense made or incurred by the taxpayer after 1971,

(i) for the use or maintenance of property that is a yacht, a camp, a lodge or a golf course or facility, unless the taxpayer made or incurred the outlay or expense in the ordinary course of the taxpayer's business of providing the property for hire or reward, or

[9] Using the calculations given by Harland in exhibit A-3, I conclude that in 2005, Harland received a cash dividend of \$82,248 which is a taxable dividend of \$102,810.

### **Gross Negligence Penalties**

[10] The courts have interpreted gross negligence to involve greater neglect than a failure to use reasonable care. They have held that it involves negligence which is tantamount to intentional acting or indifference as to whether or not the law is complied with<sup>1</sup>.

[11] Harland is very well educated and is an experienced businessman. He is an engineer. He had operated a former business under the name of Harland Associates from the early 1970's until 1997. He had the Corporation incorporated in 2002 and he is its President and sole shareholder.

[12] Harland disputed the gross negligence penalty on the basis that he had both a bookkeeper and an accountant who prepared the records for the Corporation. He stated that his bookkeeper made the journal entries and his accountant reviewed the entries and made several adjusting entries. It was his position that he had a system in place to keep proper records and that he did not knowingly make a false statement in either his income tax returns or those of the Corporation.

[13] I have concluded that the penalties were appropriate in this case. The evidence disclosed that, during the relevant period, Harland used his personal credit cards for both personal and business purposes. His secretary, who was also his bookkeeper, used his monthly credit card statements and the bank statements to enter amounts in the Corporation's records. There was no evidence that Harland ever reviewed the entries made by his secretary/bookkeeper. These records were forwarded to the external accountants at year end. They completed a trial balance, adjusting entries and prepared the corporate tax returns for Harland's approval. Harland prepared his own income tax returns.

[14] Harland had the Corporation pay the following personal expenses:

YEAR	PERSONAL CREDIT	MEALS	BOAT	TOTAL
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	CARDS			
2005	\$19,000	\$3,994	\$11,585	\$34,579
2006	\$7,751	\$2,824	\$13,100	\$23,675

[15] In 2005, the amount of \$19,000 represented the total payments made to Harland's credit cards. In 2006, the amount of \$7,751 was the interest charges and fees incurred on the credit cards.

[16] These personal expenses of Harland, which were paid by the Corporation, represented 17.7% and 44.6% of the Corporation's taxable income in 2005 and 2006 respectively.

[17] Harland demonstrated a level of indifference tantamount to intention. The appeal is allowed on the basis that in 2005, Harland received a taxable dividend in the amount of \$102,810. In all other respects, the appeals are dismissed.

Signed at Ottawa, Canada, this 22<sup>nd</sup> day of February 2010.

“V.A. Miller”

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V.A. Miller, J.

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<sup>1</sup> *Venne v. R.* (1984), [1984] C.T.C. 223 (F.C.T.D.) at paragraph 37.

CITATION: 2010TCC105

COURT FILE NO.: 2009-1608(IT)I  
2009-1609(IT)I

STYLE OF CAUSE: THOMAS E. HARLAND AND  
HER MAJESTY THE QUEEN  
  
HARLAND ASSOCIATES 02 INC. AND  
HER MAJESTY THE QUEEN

PLACE OF HEARING: Charlottetown, Prince Edward Island

DATE OF HEARING: December 08, 2009

REASONS FOR JUDGMENT BY: The Honourable Justice Valerie Miller

DATE OF JUDGMENT: February 22, 2010

APPEARANCES:

Agent for the Appellant: Cleve Myers  
Counsel for the Respondent: Devon E. Peavoy

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

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