Docket: 2007-4741(IT)G

BETWEEN:

JOSEPH HAJEK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on February 16, 2010, at Sudbury, Ontario.

Before: The Honourable Justice François Angers

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Ryan Hall

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* is allowed and the reassessment is vacated in accordance with the attached Reasons for Judgment.

Each party will bear its own costs.

Signed at Ottawa, Canada, this 18th day of March 2010.

"François Angers"

Angers J.

Docket: 2007-4742(GST)G

BETWEEN:

JOSEPH HAJEK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on February 16, 2010, at Sudbury, Ontario.

Before: The Honourable Justice François Angers

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Ryan Hall

JUDGMENT

The appeal with respect to an assessment under Part IX of the *Excise Tax Act* dated April 6, 2006 for the reporting periods from January 1, 2001 to December 31, 2003 is allowed in part and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Each party will bear its own costs.

Signed at Ottawa, Canada, this 18th day of March 2010.

"François Angers"

Angers J.

Citation: 2010 TCC 154
Date: 20100318
Dockets: 2007-4741(IT)G,
2007-4742(GST)G

BETWEEN:

JOSEPH HAJEK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Angers J.

[1] It was ordered by this Court on April 23, 2008, that the provisions of sections 17.1, 17.2 and 17.4 to 17.8 of the *Tax Court of Canada Act* were to apply to the Goods and Services Tax ("GST") appeal and both appeals were consolidated.

[2] By a Notice of Reassessment dated April 13, 2006 and confirmed on August 28, 2007, the Minister of National Revenue (the "Minister") reassessed the appellant's tax liability for the 2003 taxation year under the *Income Tax Act* (the "*Act*") by increasing the appellant's business income in the amount of $132,556 for that year. By a Notice of Assessment dated April 6, 2006 and a Notice of Decision dated August 30, 2007 confirming the assessment, the Minister assessed the appellant under the *Excise Tax Act* (the "*ETA*") for net GST in the amount of $9,278.91, penalties in the amount of $1,292.30 and interest in the amount of $517.49 for the reporting periods from January 1, 2001 to December 31, 2003. The appellant is appealing from both.

[3] Going back in time, at the end of 2002 and the beginning of 2003, the appellant, although still an employee of D.C.S. Teleservices Inc. ("D.C.S.") decided to do business under the business name of Phoenix Computers ("Phoenix"). His objective was to secure purchasing power for computer parts. The appellant testified

that the business was never actually in operation as it had no customers nor did it conclude any sales other than a few transactions with D.C.S., his employer. D.C.S. is a corporation active in the telemarketing field. The appellant's father, Lothan Hajek, is a director and shareholder with another partner.

[4] Lothan Hajek testified that, in early 2003, D.C.S. purchased a computer with the appropriate software that automatically dials up to 24 potential clients at the same time to solicit business or to conduct surveys. The purchase was made from Phoenix on February 25, 2003 for $101,598.40 plus PST for $8,127.87 and GST for $7,111.89 for an all inclusive total of $116,836.16. In the same year, D.C.S. is said to have made other purchases from Phoenix, such as memory sticks, but he could not remember exactly when and whether D.C.S. claimed input tax credits on these purchases.

[5] The appellant testified that the equipment he sold to D.C.S. was purchased from Clairvoyance International ("Clairvoyance") Inc., a company from Mississauga, Ontario, represented by one Matthew Iniski. He purchased the equipment for the same price as he sold it to D.C.S. He explained that he intervened as a middleman simply to accommodate the bank ("CIBC") that was financing the purchase for D.C.S. The Bank preferred to deal directly with the appellant rather than Clairvoyance. The appellant did tender a photocopy (Exhibit A-5) of bank drafts payable to Phoenix on behalf of D.C.S. for an amount of $58,419 on February 25, 2003, $35,051 on March 25, 2003 and $23,367 on April 14, 2003. These three payments are consistent with the invoice from Phoenix to D.C.S. (Exhibit A-1) as to price and terms of payment, namely 50% on February 24, 2003, 30% on March 3, 2003 and 20% upon completion.

[6] The original invoice showing the purchase of the computer hardware and software by Phoenix from Clairvoyance was not offered in evidence. The appellant testified that he had submitted the original invoice to the auditor from Revenue Canada but that it was refused since it did not bear a GST registrant number from Clairvoyance. Neither he nor the Respondent have a copy of any move. He did offer an invoice dated April 18, 2006 (Exhibit A-2) from Clairvoyance for essentially the same equipment; this is all he could receive from Clairvoyance after the transaction. That invoice does not show Clairvoyance's registration number for GST purposes either.

[7] A record of the auditor's conversation with Matthew Ilniski on May 29, 2006 refers to original purchases invoices and proof of payment. At first, Ilniski says that the invoice is not accurate as he remembered a sale of about $22,000 to Phoenix and

none of $116,000. After being asked for copies of the proper invoice, Ilniski replies that his records are being withheld by a former director. He is also asked why the sale of $32,000 was not reported to which he replies that the system sold may have been a personal item. The auditor asks for a proof of payment from Phoenix and, if the expense could be supported, Clairvoyance would require an adjustment to make an inclusion into the income, at which time Ilniski replies that he may be able to obtain the "true" invoice after all.

[8] The appellant testified that the transaction was made through his bank account at Scotiabank. The only document he could offer is Exhibit A-4. The document is illegible; there are pencil markings on the document that the appellant could not identify. He did make efforts to obtain the bank documents through Scotiabank's archives but he was unsuccessful.

[9] The appellant acknowledges that he did not report that sale in his tax return for the 2003 taxation year as he described the transaction as a simple handover at the same price he paid. He did not claim any expenses either. Similarly, he acknowledged that he did not file GST returns for the periods in issue as he did not do any business other than this transaction and the sale of small items to D.C.S. on two other occasions which would have resulted, with the input tax credits ("ITCs"), to a nil net tax.

[10] The appellant was found guilty by the Ontario Court of Justice of violations of subsection 326(1) of the *ETA* for failing to file his GST returns for the relevant periods and was fined $3,000. Subsequent to the conviction, he did file his GST returns for the relevant periods and it showed net GST owing of nil for each period.

[11] The appellant acknowledges that he had no books or records but says he had some form of filing system although he readily admits it is not a good system. He does say he had the invoices at one time but blames his situation on his young age.

[12] The respondent in her reply to the notice of appeal refers to <u>a</u> sale that was concluded on or about February 25, 2003 between Phoenix and D.C.S. and that the proceeds from the sale amount to $132,556 with a GST of $9,278.91 in respect of the sale. It turns out though that, during the period from January 1 to December 31, 2003, there was more than one sale by Phoenix to D.C.S. as the evidence revealed and which explains the discrepancy in the numbers between the invoice and the assessments. The pleadings though were not amended accordingly.

[13] Daniel Robillard, appeals officer for the Canada Revenue Agency, testified that the appellant's audit was conducted as a result of an audit conducted at D.C.S. which had claimed input tax credits of $9,279 in relation to four transactions it had concluded with Phoenix in 2003. The first ITC was for $7,111 in round numbers for February 2003 which corresponds to the GST charged on its invoice with Phoenix (Exhibit A-1) and Clairvoyance (Exhibit A-2), the second is for March 2003 with an ITC of $1,818, a third for June 2003 with an ITC of $7 and a last one in July 2003 with an ITC of $241. Sales of $132,556 would therefore generate that amount of GST which explains the numbers in the assessments. In doing so, the auditor verified if Phoenix had reported the GST it had collected on its GST returns and it turned out Phoenix had not done so. Mr. Robillard did not do the actual audit and did not have the invoices supporting the D.C.S. ITCs that they claimed.

[14] The appellant was requested to provide documents such as bank records, receipts of deposits and withdrawals; no such document was provided, which explains the confirmation of both the assessment and the reassessment.

[15] The issues are whether the Minister was correct in including business income in the amount of $132,556 in the appellant's income for the 2003 taxation year and assessing the appellant net GST owing in the amount of $9,278.91, penalties in the amount of $1,292.30 and interest in the amount of $517.49 for the relevant periods.

[16] As it turns out, there was more than one sale during 2003 but the pleadings refer to one sale only. Paragraph 4 of both notices of appeal refer to an acquisition from Clairvoyance by Phoenix of computer equipment during 2003 and that Phoenix disposed of it by way of a sale the said equipment to D.C.S. The notice of appeal for the GST file refers at paragraph 5 to the transaction in question. In her reply to both notices of appeal, the Respondent at paragraph 3 admits that in 2003, the appellant disposed of computer equipment by way of a sale (the "Sale") to D.C.S. and that the appellant received in 2003 proceeds from the sale. At paragraph 5 of the same reply to the notice of appeal, the respondent admits only that the Sale was a taxable supply and that the appellant and D.C.S. were registrants for the purposes of the GST. The reference to the Sale is repeated throughout the pleadings.

[17] Reference to additional transactions came out on the cross-examination of Lothar Hajek who was unable to recall the GST component of these additional purchases of memory cards. It seems to me that other transactions may have taken place between Phoenix and D.C.S. during the relevant period but the pleadings refer only to one single transaction (the February Sale of the computer software to D.C.S.), which constitutes the basis of these assessments.

[18] The appellant did clearly deny that he received proceeds from the Sale in the amount of $132,556 and that he collected GST in the amount of $9,278.91 in respect of the Sale and rightfully so. According to the evidence, the Sale was for $101,598.40 with a GST of $7,111.89 and that was also confirmed by Mr. Robillard in his evidence of the ITC claimed by D.C.S. for February 2003.

[19] The respondent acknowledges that the Sale was made in the course of carrying on business (see paragraph 10(c) of the Reply to the Notices of appeal) but says that the property was acquired at a cost of nil (see paragraph 9(b) of the Reply to the Notices of appeal). As a person carrying on a business, the appellant is allowed, in computing his income from a business, to deduct an outlay or expense it made for the purpose of gaining or producing income from the business (s. 18(1)(*a*) of the *Act*). In order to make a sale of computer equipment to D.C.S., Phoenix must have had to acquire that computer equipment from someone.

[20] I will concede that the documentary evidence to some extent may not be as reliable as one would expect and that an original invoice showing the purchase of the equipment by Phoenix Computers from Clairvoyance would have been more reliable; nevertheless, the evidence given by the appellant as to what actually transpired in February 2003 appears to me to be most credible. In fact, his credibility at trial was not severely shaken such that although the appellant may not have been able to confirm the veracity of his doings through an original invoice, I have no reasons to disbelieve the events he described surrounding his purchase of the computer equipment from Clairvoyance and the sale thereof for the same price to D.C.S. As such, the appellant is allowed to deduct the cost of the computer equipment he purchased for resale to D.C.S. Mr. Matthew Ilniski was not called as a witness by the appellant but given the gist of his conversation with the auditor, I do not believe and am not prepared to draw an inference that his evidence would have been unfavourable to the appellant.

[21] Although the appellant had a duty to report his business income and claim his business expenses for his 2003 taxation year, I find that the Minister's increase of the appellant's business income by the amount of $132,556 is incorrect as there is no taxable business income (profit) resulting from the Sale from Phoenix to D.C.S. The appeal is allowed and the reassessment under the *Act* is vacated.

The GST Assessment

[22] The appellant collected the amount of $7,111.89 in respect of the Sale and has failed to remit that amount. He did not file GST returns for the three periods and when he did after his conviction, the returns showed net GST owing of nil for each period. The appellant argues that, since this was a simple handover from Clairvoyance to Phoenix and then to D.C.S. for the same price with the same amount of GST, the input tax credit resulted in a nil net tax.

[23] In order for the appellant to claim an input tax credit, he must be able to produce the required documentation, as required by paragraph 169(4) of the *ETA* and other relevant provisions, which are:

> Section 169 of the *Excise Tax Act (ETA)* provides as follows:
>
> > **(4) Required documentation --** A registrant may not claim an input tax credit for a reporting period unless, before filing the return in which the credit is claimed,
> >
> > > (a) the registrant has obtained sufficient evidence in such form containing such information as will enable the amount of the input tax credit to be determined, including any such information as may be prescribed; and
>
> The *Input Tax Credit Information (GST/HST) Regulations* relate to Section 169 of the *ETA* and says at Section 3
>
> > (c) where the total amount paid or payable shown on the supporting documentation in respect of the supply or, if the supporting document is in respect of more that one supply, the supplies, is $150 or more,
> >
> > > (i) the information set out in paragraphs (a) and (b)
>
> Paragraph (b), subsection (i) says
>
> > the name of the supplier of the intermediary in respect of the supply, or the name under which the supplier or the intermediary does business, **and the registration number assigned** under subsection 241(1) of the *Act* to the supplier of the intermediary, as the case may be,

Not only did the appellant not properly claim the ITC but the document provided by the appellant does not disclose the registration number implied to Clairvoyance which would have no doubt prevented him from claiming the ITC in any event.

[24] The Federal Court of Appeal in *Systematix Technology Consultants Inc. v. Q.*, [2007] G.S.T.C. 74 held that the legislation is mandatory in that it requires persons who have paid GST to suppliers to have valid GST registration numbers for those suppliers when claiming input tax credits. This court has also denied ITC because of a failure to provide GST registration numbers on invoices. See *San Clara Holdings Ltd. v. Canada*, [1994] G.S.T.C. 84 and *Metro Exteriors Ltd. v. Canada*, [1995] G.S.T.C. 62.

[25] The amount of GST owed by the appellant with respect to the Sale is $7,111.89 together with interest.

[26] As for the penalties assessed by the respondent, the appellant blames his young age and inexperience for his mistakes and errors in thinking that there was no reason to report or conclude the Sale in his returns when he did as everything came to a net tax of nil remittance. In my opinion, his defence of due diligence has not been made out. Former Chief Justice Bowman made it clear in *Pillar Oilfield Projects Ltd. v. Canada*, [1993] G.S.T.C. 49 that the defence requires affirmative proof that all reasonable care was exercised to ensure that errors not be made. Not only did the appellant not file any returns but he also failed to properly disclose the GST collected on the Sale when he filed his return after his conviction. The appellant did not act with due diligence.

[27] Given the fact that the appellant has already been fined as well as the particular circumstances and findings I have made of this case, the appellant might consider submitting this matter to the Minister under subsection 169(5) of the *ETA*.

[28] The GST assessment is sent back to the Minister for reassessment in accordance with these reasons namely that the amount of GST owed is $7,111.89 together with interests and penalties.

[29] Each party will bear its own costs.

Signed at Ottawa, Canada, this 18th day of March 2010.

"François Angers"

Angers J.

CITATION:	2010 TCC 154
COURT FILE NOS.:	2007-4741(IT)G and 2007-4742(GST)G
STYLE OF CAUSE:	Joseph Hajek and Her Majesty the Queen
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APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Ryan Hall

COUNSEL OF RECORD:

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Name:

Firm:

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