Docket: 2008-623(IT)G

BETWEEN:

KENNETH EDGAR PEARCE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on November 12 and 13, 2009 and April 12, 2010,
at Vancouver, British Columbia

Before: The Honourable Justice Diane Campbell

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Elizabeth (Lisa) MacDonald Pavanjit Mahil Pandher

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JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 2001, 2002, 2003 and 2004 taxation years are allowed in respect to two concessions by the Respondent for the 2002 taxation years in respect to automobile and office expenses. The amounts were detailed in an Amended Schedule "A" to the Reply to the Notice of Appeal submitted by the Respondent and they result in the reduction of the total shareholder benefit amount of $39,383 by an amount of $3,890 for a revised total shareholder benefit of $35,493 in 2002. The assessments are referred back to the Minister for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

In all other respects, the appeals are dismissed with costs to the Respondent.

Signed at Charlottetown, P.E.I., this 11th day of August 2010.

"Diane Campbell"

Campbell J.

Citation: 2010 TCC 419
Date: August 11, 2010
Docket: 2008-623(IT)G

BETWEEN:

KENNETH EDGAR PEARCE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Campbell J.

A. FACTS

[1] These appeals are from reassessments by the Minister of National Revenue (the "Minister") pertaining to the Appellant's 2001, 2002, 2003 and 2004 taxation years. In respect to the taxation years 2001 and 2002, the Minister relied on subsection 152(4) of the *Income Tax Act* (the "*Act*") to reassess the Appellant beyond the normal reassessment period.

[2] The Appellant, a shareholder and employee of Pearce Forest Products Ltd. ("Pearce") during these taxation years, reported the following T4 amounts as income:

Taxation Year	Reported Income
2001	$82,876
2002	$78,000
2003	$62,900
2004	$ 6,936

The Appellant also reported a T4A amount of $44,426 as income respecting the 2004 taxation year.

[3] In reassessing the Appellant on February 2, 2007, the Minister added the following shareholder benefit amounts to his income:

Taxation Year	Shareholder Benefit
2001	$20,297
2002	$39,383
2003	$23,337
2004	$ 1,800

In addition, the Minister disallowed employment expenses of $14,144 in 2003 and $24,176 in 2004. Gross negligence penalties were levied in each of the taxation years in respect to the shareholder benefit amounts.

[4] The corporation, Pearce, was a wholesale lumber distributor which conducted its business activities from the Appellant's residence between February 1999 and April 2004. Prior to commencing this business in 1999, the Appellant was involved in other lumber trading operations. Because he was experiencing financial difficulties, three of his friends invested funds in Pearce in 2000 or 2001 and became shareholders and directors. It was clear, however, from the evidence, that the Appellant remained the operating mind of Pearce's day-to-day activities and retained signing authority and use of the company's debit card throughout these taxation years.

[5] William Wheeler, one of the investors, testified that it was their intention to loan the money, get a return on the investment and then have the Appellant buy out their interests. At the outset, the investors simply reviewed financial statements but, when the company encountered difficulties, they implemented cost control measures. Commencing in 2003, in addition to the Appellant's signature, one of the investors was required as a signatory on the corporate bank account. Mr. Wheeler testified that the only controllable costs were those that he referred to as "Ken-related costs" (Transcript, page 275, line 19) such as utilities, entertainment, automobile and so forth. Also, by 2003, Mr. Wheeler, together with another investor, Peter Bonner, assumed the task of signing the cheques so that a further check on costs could be implemented. He made reference to correspondence and e-mails between the investors and the Appellant which outlined shareholder concerns and the Appellant's agreement that not all of the expenses that he was claiming could be justified. The investors also put a limit of $9,000 monthly on expenses reimbursable to the

Appellant. Despite these controls, the expenses remained higher than they should have been, according to Mr. Wheeler. In April of 2004, the investors discovered that the Appellant had possession of a corporate debit card which he was freely using to exceed the spending limits that had been placed on him. They also discovered that the financial statements did not reflect the financial reality of the company. For example, some of the receivables, that were clearly not collectible, had been retained on the books. Also, incorrect balance sheet entries were made when cash was removed and an offsetting entry would be made and referenced as inventory. Following this, the investors made the decision to withdraw their support and close the company.

[6] Carol Logan, the bookkeeper and office manager for the company during these taxation years, testified that she was hired by the Appellant and reported directly and only to the Appellant. She was responsible for keeping track of the Appellant's expenses and stated that when he presented her with receipts, he was either reimbursed by cheque or by debit card. Early on, either the Appellant or Ms. Logan prepared the cheque for expense reimbursement to the Appellant and the Appellant would sign it. When the investors began to oversee the expense cheques for which they had established a maximum limit of $9,000 monthly, Ms. Logan was aware that such a budget had been established because the Appellant instructed her to place the monthly debit card expenses in different categories. According to Ms. Logan's evidence, the Appellant was very involved in deciding where expenses would be located in the statements and how they would be described. She simply followed his directions but testified that she had concerns that some of the expenses were personal to the Appellant. As a result, she began to make notations in the journal entries.

[7] The auditor, Judith Robitaille, concluded that many of the expenses were personal and they were treated as shareholder benefits to the Appellant. As a result, those expenses were disallowed to the corporation.

[8] The issues to be determined are:

(a) whether the Minister is entitled to reassess the statute-barred years, 2001 and 2002, pursuant to subsection 152(4) of the *Act*?;

(b) whether the company conferred benefits on the Appellant in the 2001, 2002, 2003 and 2004 taxation years in his capacity as a shareholder pursuant to section 15, or, alternatively, in his capacity as an employee pursuant to subsection 6(1) of the *Act*?;

(c) whether penalties were properly levied on the amounts of those unreported benefits pursuant to subsection 163(2) of the *Act*?; and

(d) whether the Appellant is entitled to any additional expenses in 2003 and 2004, the only years in which he claimed employment expenses in excess of the amounts allowed by the Minister?

[9] The Appellant's position is that the audit is incorrect because the benefits which have been assessed have already been accounted for. According to his Notice of Appeal, "Items originally entered as business expenses and later deemed to be "personal use" by Pearce Forest Products (PFP) were brought back into my income via my T4 for the years 2001 to 2004. This amount was $37,776. An additional amount of $44,426 covering these same years was brought back into my income via a T4A in 2004 when the company ceased business. Taxes were fully paid on these amounts, in their respective years". In effect, the Appellant is claiming that the Minister has "double taxed" his income. Consequently, since there are no misrepresentations, the Minister should not be permitted to reopen the statute-barred taxation years of 2001 and 2002. With respect to the employment expenses which the Minister disallowed, the Appellant relied on the case of *Coffen v. The Queen*, 97 D.T.C. 5552 to argue that the Minister must prove beyond a reasonable doubt that each expense in each taxation year has been properly disallowed and that each item is properly subject to be taxed.

[10] The Respondent's position is that the audit was completed properly, that the Appellant has made misrepresentations which permit the statute-barred years to be reopened and that the shareholder benefits assessed were personal and are separate from the amounts included in the T4 and T4A slips issued by the company. The T4A slip was in respect to employee advances and inventory adjustments for prepaid expenses and therefore was not in respect to benefits. The Respondent also submitted that the Appellant was either reimbursed by the company for most of his employment expenses claimed in 2003 and 2004 or that the expenses were not incurred for business purposes. The auditor was very aware of the Appellant's position and therefore paid particular attention to the amounts included in the T4 and T4A slips.

B. ANALYSIS

[11] In these appeals, the Respondent has the onus, pursuant to subparagraph 152(4)(*a*)(i) of the *Act*, of proving that the Appellant "has made any representation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under the

Act…". In addition, the Respondent has the onus in respect to gross negligence penalties. On numerous occasions throughout the hearing, I explained that the onus respecting all other issues rested with the Appellant. The Appellant argued throughout that "…it is common law that the auditor must audit each and every expense item submitted for each and every year." (Transcript, page 19, lines 15-17). This reliance stemmed from the decision of Sheppard J., in *Coffen*, where he states, at page 5554:

> … In a proceeding under the *Criminal Code*, the onus is upon the own [*sic*] to prove the guilt of the accused of the offence(s) charged beyond a reasonable doubt. In an income tax case that means the Crown must prove beyond a reasonable doubt that *each* item of income sought to be taxed is properly subject to tax in accordance with tax law and *each* expense disallowed is properly disallowed in accordance with tax law. In cases such as this where the volume of paper is enough to fill a small room, it is a daunting task. But it must be done, and it must be done for *each* taxation year. …
>
> (Emphasis added)

This principle was subsequently overturned on appeal and the Ontario Court of Appeal held that a count of tax evasion does not have to relate to a single taxation year. However, the comments of Justice Sheppard are clearly preceded by the important phrase "in a proceeding under the *Criminal Code*" and, as a result, they have no bearing in respect to the issues and onus in the present appeals.

[12] Despite the Appellant's repeated assurances that he understood that the onus was upon him (with the exception of the two statute-barred years and the penalty issues), as a result of his incorrect reliance on the *Coffen* decision, he spent most of his time attempting to show that the audit was flawed and that the Minister could not prove that the expenses were personal, instead of focussing on providing evidence to demolish the Minister's assumptions on a balance of probabilities. To simply allege that the audit is incorrect and that the amounts that were recorded as expenses should be deductible falls short in meeting the evidentiary burden which is upon him. He provided no specifics or details and, instead, spent the majority of the time making vague and general assertions. At times it appeared that he intended his submissions to be imprecise, ambiguous and misleading. In a self-assessing system, it is the Appellant that is in the best position to provide the necessary details to show why the assessments are not correct. He has simply failed to do so.

[13] With respect to the reopening of the two statute-barred years, I conclude that the Respondent has adduced sufficient evidence for me to conclude that there have

been misrepresentations by the Appellant in his tax returns for the 2001 and 2002 taxation years to allow the reopening of these years pursuant to subparagraph 152(4)(*a*)(i) of the *Act*. At the very least, there has been neglect and carelessness on his part and there is also evidence for me to conclude that he had the wilful intent to mislead.

[14] The Appellant has a Bachelor of Commerce degree from the University of British Columbia. He has been involved with other companies for many years in the lumber trading industry. He is an experienced businessperson who had complete control of the daily activities of this company throughout the taxation years and this was supported by the evidence of both the bookkeeper, Carol Logan, and one of the investors, William Wheeler. Although there were investors onboard by 2002, this was effectively his company. He directed payments to be made to cover his personal expenses and provided instructions to Ms. Logan in respect to the recording of these expenses. He had sole signing authority in the beginning and, when eventually the signature of one of the three investors was required on the cheques, he circumvented their directives and used the corporate debit card without the knowledge of the investors. He was very familiar with the difference between business and personal expenses. Based on his knowledge, education and experience, he should have been alerted to these errors. In many instances, the errors are blatantly obvious.

[15] In *Venne v. The Queen*, 84 D.T.C. 6247, Strayer J. made the following comments at page 6251:

> I am satisfied that it is sufficient for the Minister, in order to invoke the power under sub-paragraph 152(4)(*a*)(i) of the Act to show that, with respect to any one or more aspects of his income tax return for a given year, a taxpayer has been negligent. Such negligence is established if it is shown that the taxpayer has not exercised reasonable care. This is surely what the word "misrepresentation that is attributable to neglect" must mean, particularly when combined with other grounds such as "carelessness" or "wilful default" which refer to a higher degree of negligence or to intentional misconduct. Unless these words are superfluous in the section, which I am not able to assume, the term "neglect" involves a lesser standard of deficiency akin to that used in other fields of law such as the law of tort. …
>
> (Emphasis added)

[16] Strayer J. again addressed this same provision in *Nesbitt v. The Queen*, 96 D.T.C. 6588, where, at page 6589, he stated:

> … It appears to me that one purpose of subsection 152(4) is to promote careful and accurate completion of income tax returns. Whether or not there is

> misrepresentation through neglect or carelessness in the completion of a return is determinable at the time the return is filed. A misrepresentation has occurred if there is an incorrect statement on the return form, at least one that is material to the purposes of the return and to any future reassessment. It remains a misrepresentation even if the Minister could or does, by a careful analysis of the supporting material, perceive the error on the return form. It would undermine the self-reporting nature of the tax system if taxpayers could be careless in the completion of returns while providing accurate basic data in working papers, on the chance that the Minister would not find the error but, if he did within four years, the worst consequence would be a correct reassessment at that time.
>
> Thus it is irrelevant that the Minister might, despite the misrepresentation on the return form, have ascertained the true facts prior to the expiry of the limitation period. The faulty return was when submitted, and remained, a misrepresentation within the meaning of subparagraph 152(4)(*a*)(i) of the Act.
>
> (Emphasis added)

[17] The Appellant submitted that he has been transparent in his actions and that he did not attempt to hide pertinent information from the Minister. However, the standard for determining that a misrepresentation has been made is low and requires only that there be a material incorrect statement. He was involved in the maintenance of the corporate books and records and directed the bookkeeper respecting the treatment of journal entries. He prepared his own return manually for the 2002 taxation year. The evidence supports that he knew that in directing the company to pay these personal expenses, such as rent and utilities, he was conferring taxable benefits upon himself. In any event, with his background, if he did not know the results of his actions, he should have known them. The unreported gross benefits in 2001 and 2002 were $22,172 and $42,571 respectively. These amounts were not insignificant. His only explanation was that these expenses were all business-related or that they had been included in the T4A amounts. However, he produced no evidence to support this alleged duplication of amounts, nor did he adduce any evidence to show that, although these amounts were expensed by the company, they were incurred to earn income from the business or from employment. In fact, he admitted on cross-examination that most of the benefits had not been duplicated on the T4A slip. In these circumstances, the Minister was justified in reopening the statute-barred years.

[18] With respect to the benefits that the corporation paid, which amounts included rent, utilities, automobile expenses, entertainment, office expenses, travel and legal payments, I conclude that these were personal expenses and, as such, should have been included in the Appellant’s income as shareholder benefits pursuant to

subsection 15(1) of the *Act*. Essentially, the Appellant's argument is that these benefits have already been included in the T4A slip issued in 2004 by the company and to include these amounts again in his income amounts to double taxation. During his testimony, Mr. Wheeler stated that the T4A consisted of an advance to the Appellant and an inventory adjustment, which was actually another advance taken by the Appellant. The T4A was issued when these advances came to the knowledge of the investors subsequent to the controls they attempted to implement to curb the Appellant's expenditures. Mr. Wheeler concluded that many of the expenses were not related to the corporate activities. According to Mr. Wheeler, the company was either paying expenses directly or reimbursing the Appellant for the reasonable business-related expenses he incurred. This is supported by the terms of the employment contract (Exhibit R-2). Many of the types of expenses claimed by the Appellant are the same as those that the company was also paying. He did not offer any explanation for this, reasonable or otherwise. The auditor testified that she recognized the Appellant's concerns of duplication and in completing the audit, she tried to track the source of the advances to ensure that they did not include any other benefits that had been assessed. For example, the auditor traced approximately $20,000 paid to the Appellant through a series of cheques for which the Appellant conceded that they were, in fact, personal expenses which had been characterized as "prepaid expenses" in the corporate records.

[19] Although the Appellant alleged duplication, he never supported this allegation with evidence that would suggest duplication between the amounts assessed by the Minister and the amounts included in the T4A slip. The Appellant was in the best position to provide such evidence as he was clearly directing the corporate activities, involved in the corporate record-keeping and freely expensing amounts, even after the investors attempted to implement controls. The Appellant has failed to demonstrate that the auditor erred in reassessing and has also failed to show that any duplication existed.

[20] With respect to the employment expenses, the Minister disallowed expenses because they were either not incurred for the purpose of earning income or they had been reimbursed by the company. The Appellant argued that he chose to incur many of these expenses personally due to the tenuous relationship between himself and the investors. He claimed other expenses because he felt the company had not reimbursed him.

[21] The employment contract (Exhibit R-2) clearly establishes that the company would be paying for any expenses which were incurred for business purposes. The onus is on the Appellant to convince this Court that any expenses beyond those

contemplated in this contract were required for business purposes and that he had not been reimbursed for any of those expenses. However, the Appellant's evidence in this regard was again vague and ambiguous. Many of the expenses, on their face, have an apparent personal element. The Appellant failed to establish any business purpose related to expenses such as birthday parties, hunting and fishing trips, dog food, kitchen items and a trip to Blackcombe Mountain on New Year's Day. It is also telling that the shareholders/investors did not dispute the corporate reassessments which disallowed these expenses to the corporation. In fact, the investors had suspicions respecting the expensing activities by the Appellant and attempted to place controls on him, which for a period he successfully and covertly circumvented.

[22] Finally, I conclude that gross negligence penalties pursuant to subsection 163(2) of the *Act* are justified in these circumstances. Much of the Respondent's evidence with respect to the penalty issue was the same evidence adduced to support reopening the statute-barred years. However, as I noted in *Dao v. The Queen*, 2010 D.T.C. 1086, the type of conduct of a taxpayer that would support reopening statute-barred years under subparagraph 152(4) may not necessarily or automatically support the imposition of penalties under subparagraph 163(2). While subparagraph 163(2) is a penal provision, 152(4) is not. As noted by Strayer J. in *Venne*, at page 6256:

> … "Gross negligence" must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not. …

Again at page 6249, Strayer J. noted the following:

> … By virtue of sub-section 163(3) "the burden of establishing the facts justifying the assessment of the penalty is on the Minister". It will be noted that for the penalty to be applicable there appears to be a higher degree of culpability required, involving either actual knowledge or gross negligence, than is the case under sub-section 152(4) for reopening assessments more than four years old where mere negligence seems to be sufficient. …

[23] The evidence established that the Appellant was the directing mind of the company. He prepared and signed his own tax returns for the 2002, 2003 and 2004 taxation years. He directed the bookkeeper respecting the entry of items in the financial statements. He instructed the bookkeeper on the reimbursement of his expenses and her testimony was that she simply followed his directives and recorded the amounts as the Appellant instructed. E-mails between the Appellant and

shareholders/investors support their growing concerns over the Appellant's expense spending. In an attempt to avoid the controls imposed on the Appellant's spending, he used the corporate debit card. His explanation concerning the debit card use was that it was humiliating for him to have a cheque signed by Mr. Wheeler for every expense. However, I agree with the Respondent's submissions, that these events are more reasonably explained by the fact that the Appellant's ability to freely expense personal items, as he had done in the past, was now being hampered by the investors. In addition, the Appellant instructed the bookkeeper to post items in pre-paid and inventory accounts for the purpose of minimizing both creditor issues and the existing problems which the investors had with his spending. The evidence supports that he intentionally engaged in these accounting irregularities, together with the use of the company debit card, to enable his expense spending. This resulted in corporate records that were not fully transparent. Finally, the amounts, upon which penalties have been imposed, are significant. As the auditor noted in her penalty recommendation report, the unreported income, in each of the taxation years, was greater than 25 per cent of the reported income.

[24] Despite the Appellant's business background and experience, he failed to report benefits which were clearly personal and also claimed expenses which were personal or improper. He was unable to explain why he had deducted many of these expenses. He engaged in intentional accounting irregularities to wilfully misrepresent the true state of the corporate activities. All of these facts warrant the imposition of penalties pursuant to subsection 163(2).

[25] In summary, throughout the hearing, the Appellant consistently submitted that the audit was flawed and that the Minister was unable to show that the expenses were personal. Despite my warnings, he failed to recognize that it was his responsibility to submit evidence to show that he did not receive the shareholder benefits or that some benefits had already been included in the T4 and T4A slips. He also failed to show why any of the employment expenses should be allowed. His position was basically that if he could submit a receipt, he could automatically claim it as an expense without making any attempt to show how the expense was related to his employment duties. This was all the more important for the Appellant to address where an employment contract existed which directed the company to pay directly or to reimburse the Appellant for the business-related expenses. Since the Appellant failed to submit any evidence on these issues, I must infer that such evidence, if adduced, would have been unfavourable to his position. The evidence supports Mr. Wheeler's testimony that the Appellant was simply helping himself to the company's cash in spite of the efforts implemented by the shareholders/investors to control his free-spending activities.

[26] The appeals will be allowed in respect to two concessions for the 2002 taxation years which the Respondent made at the commencement of the hearing in respect to automobile and office expenses. The amounts were detailed in an Amended Schedule "A" to the Reply to the Notice of Appeal submitted by the Respondent and they result in the reduction of the total shareholder benefit amount of $39,383 by an amount of $3,890 for a revised total shareholder benefit of $35,493 in 2002. In all other respects, the appeals are dismissed with costs to the Respondent.

Signed at Charlottetown, P.E.I., this 11th day of August 2010.

"Diane Campbell"

Campbell J.

CITATION:	2010 TCC 419
COURT FILE NO.:	2008-623(IT)G
STYLE OF CAUSE:	Kenneth Edgar Pearce and Her Majesty The Queen
PLACE OF HEARING:	Vancouver, British Columbia
DATES OF HEARING:	November 12 and 14, 2009 and April 12, 2010
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DATE OF JUDGMENT:	August 11, 2010

APPEARANCES:

For the Appellant:	The Appellant himself
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