Docket: 2010-271(IT)I

BETWEEN:

KENNETH S. GRIFFIN,

appellant,

and

HER MAJESTY THE QUEEN,

respondent.

Appeal heard on common evidence with the appeal of *Patricia Baeucker* (2010-270(IT)I) on July 12, 2010, at Toronto, Ontario.

Before: The Honourable Justice Gaston Jorré

Appearances:

Agent for the appellant:	Dan F. White
Counsel for the respondent:	Paolo Torchetti Jasmeen Mann (student-at-law)

JUDGMENT

In accordance with the attached reasons for judgment, the appeal from the assessment made under the *Income Tax Act* for the 2002 taxation year is dismissed without costs.

Signed at Ottawa, Ontario, this 21st day of November 2011.

"Gaston Jorré"

Jorré J.

Docket: 2010-270(IT)I

BETWEEN:

PATRICIA BAEUCKER,

appellant,

and

HER MAJESTY THE QUEEN,

respondent.

Appeal heard on common evidence with the appeal of *Kenneth S. Griffin* (2010-271(IT)I) on July 12, 2010, at Toronto, Ontario.

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JUDGMENT

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Signed at Ottawa, Ontario, this 21st day of November 2011.

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Jorré J.

Citation: 2011 TCC 531
Date: 20111222
Dockets: 2010-271(IT)I
2010-270(IT)I

BETWEEN:

KENNETH S. GRIFFIN,
PATRICIA BAEUCKER,

appellants,

and

HER MAJESTY THE QUEEN,

respondent.

AMENDED REASONS FOR JUDGMENT

Jorré J.

[1] The only issue in these appeals is whether the Minister of National Revenue was justified in applying gross negligence penalties pursuant to subsection 163(2) of the *Income Tax Act* for the appellants' 2002 taxation year.[1]

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[1] Between the time of the original assessments and the final reassessments which are the subject of the appeals, the issues were narrowed between the parties. When compared with the appellants' T1 tax returns filed, the final reassessments increased the appellants' gross revenues significantly and disallowed certain business expenses claimed as being personal; however, the only issue remaining relates to gross negligence penalties.

The original notices of appeal were very brief and simply said: "The Minister has erred in his reassessment of the taxpayer. Gross negligence penalties have been applied incorrectly."

The appellants brought motions to amend their notices of appeal. The motions were filed about half a month before the date set for trial. The motions were heard at the opening of the hearing scheduled for the trial of the matter. At the opening of the hearing, the appellants also advised the Court that they no longer intended to pursue the cell phone expense issues raised in the amended notices of appeal.

I allowed the amendment but also ruled that certain conditions apply.

First, in order to allow the matter to proceed as scheduled rather than adjourning the matter to allow the respondent to file amended replies, so as to eliminate any doubt, I ruled that the respondent would not be considered to have admitted any allegations in the amended notices of appeal.

Secondly, the amended notices of appeal raised issues in relation to interest. On the face of the amended notices of appeal, the issue raised is a request for relief from interest pursuant to the taxpayer relief provisions — see paragraphs 28 to 31 of the amended notices of appeal. Such a request for relief from interest pursuant to subsection 220(3.1) of the *Act* must first be made to the Minister; once the Minister has made a decision, that decision is subject to judicial review in the Federal Court, not this Court. I would add that, in any event, the amended notices of appeal do not allege that an application was made under the taxpayer relief provisions; it is alleged in paragraph 30 that the Minister "redirected that application be made under the taxpayer relief provisions".

Accordingly, given that this Court cannot deal with a request for a taxpayer relief, I will not do so.

In addition, with respect to interest, while the motions were being heard, the appellants appeared to raise other interest-related issues. While it is not entirely clear to me, the appellants appear to be alleging that the interest was improperly calculated or, alternatively, that it should be deleted because the Minister had taken so long in dealing with the matter. The amended notices of appeal do not raise any such issues and I further ruled that I would not allow a further amendment to raise any such issues.

[2] These appeals were heard together on common evidence.[2]

[3] Both appellants testified as well as Pauline Burdett, an employee of the Canada Revenue Agency who at the relevant time was in the office examination section, and Julie Gil, an employee of the appellants' agent.[3]

[4] The appellants are common-law spouses.

[5] Both appellants are self-employed and are senior information technology consultants. At the core of Mr. Griffin's business he assists clients with software testing; Ms. Baeucker provided training and consulting services related to testing automated software.

[6] Mr. Griffin obtained a Computer Science diploma in 1983. He also has a Master of Business Administration from the Richard Ivey School of Business at the University of Western Ontario. Ms. Baeucker has a college diploma in Information Technology and a great deal of experience in the quality assurance field.

[7] In the 2002 taxation year virtually all of the appellants' income was generated from work done for one company in the United States, XL Vianet.

[8] XL Vianet wanted to deal with a single person in terms of billing and paying for the services of the appellants. Mr. Griffin took care of these functions for the appellants.

[9] XL Vianet paid the appellants in US dollars.

[10] In his return Mr. Griffin reported gross business income of about $166,000 and net income of about $47,000 from his business. Apart from his income from the

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I would comment that in view of paragraph 169(1)(*b*) of the *Act* which enables a taxpayer to push a dispute forward, it is hard to see how a claim that the Minister took too long could justify eliminating the interest. Further, while this Court could deal with an issue of interest computation in an assessment or reassessment if it were properly brought before the Court, to the extent that a dispute is about the computation of interest running on a taxpayer's ongoing balance owing after being assessed, such dispute properly belongs before the Federal Court, not this Court.

Of course, to the extent that there is a change with respect to the one issue before the Court, the penalties, consequential adjustments to the interest, will naturally follow.

As a result the only issue before this Court relates to gross negligence penalties pursuant to subsection 163(2).

[2] The original version of these reasons is in English.

[3] The evidence of Julie Gil was not of assistance. She is a case manager in the appellants' agent's office and attempted to understand what had happened. She had not been involved in the preparation of the appellants' tax returns nor did she have any direct knowledge of the facts. Before I ruled that she could not continue, Ms. Gil had also started to testify as to what was in effect an experiment using Excel software conducted by someone else in the appellants' agent's office.

business the only other income he reported was about $2,000 in interest and dividend income.[4]

[11] Although the Minister initially disallowed a much greater quantum of expenses, after Mr. Griffin objected, the Minister further reassessed and as a result the amount of disallowed expenses became approximately $30,000. The Minister disallowed the expenses on the basis they were personal.

[12] The Minister also added to Mr. Griffin's gross revenues an amount of unreported income of $76,900.

[13] The net result of all of this was to increase Mr. Griffin's business income from about $47,000 to about $154,000.

[14] In the case of Mr. Griffin, at one point during the audit Mr. Griffin explained that certain amounts paid by XL Vianet did not belong in his income because he had incorporated a company in the course of calendar 2002 and certain amounts paid by XL Vianet belonged in the corporation's income.[5]

[15] On February 11, 2005 the Agency left Mr. Griffin a telephone message asking for copies of the corporate returns indicating the business number so that they could verify that the income had been accounted for by the corporation.

[16] Mr. Griffin provided a fax of the corporate T2 return which was for the taxation year ending on October 30, 2003. The corporate tax return was dated February 15, 2005, after the telephone request was made, and was filed with the Agency on February 25, 2005, long after due date for the corporate tax return.[6]

[17] In 2002, Mr. Griffin made an RRSP contribution of about $10,000.

[18] Gross negligence penalties were imposed by the Minister in relation to the $76,900 in unreported income. They were not imposed with respect to the expenses disallowed.

[19] In the case of Ms. Baeucker, she reported gross business income of about $127,000 and net business income of about $35,000. Apart from her business income the only other income she reported was about $1,000 in interest income.[7]

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[4] See Exhibits R-1 and R-8, page 2.
[5] The company belonged to both appellants: see page 211, lines 18 to 23 of the transcript.
[6] See Exhibit R-8, page 5. In Exhibit R-6, which lists items paid by XL Vianet, there are five lines where the annotation on the extreme right says "reported by corporation".
[7] See Exhibit R-9, page 2.

[20] Although the Minister initially disallowed a greater quantum of expenses claimed, after Ms. Baeucker objected, the Minister further reassessed and as a result the amount of disallowed expenses became approximately $8,000. The Minister disallowed the expenses on the basis they were personal.

[21] The Minister also added to Ms. Baeucker's income gross unreported income of $79,352.

[22] The net result of these changes was to increase Ms. Baeucker's net business income from about $35,000 to about $122,000.

[23] For 2002, Ms. Baeucker made an RRSP deduction of about $6,000.

[24] Gross negligence penalties were imposed by the Minister in relation to the $79,352 in unreported income. They were not imposed in relation to the disallowed expenses.

[25] Among other things, Ms. Burdett explained her reasoning for raising the gross negligence penalties. The penalty reports for the appellants were put into evidence.

[26] At the core of the penalty decisions was the very large discrepancy between the actual income and the reported income as well as the Agency's belief that the income was relatively low and inconsistent with certain expenditures.

[27] The appellants' position was that they carefully recorded their incomes and when **they** filed their returns they believed that they were reporting all their income; the error was caused by what happened when a formatting change was made in a spreadsheet.

[28] Mr. Griffin did his own bookkeeping and prepared his own tax return using one of the tax preparation software packages.

[29] Mr. Griffin testified that he kept an Excel spreadsheet for both appellants containing all the invoicing and that this spreadsheet was the source of the gross revenues used in reporting both appellants' business income.

[30] An enormous amount of Mr. Griffin's testimony was devoted to the consequences of his having made a formatting change to that Excel spreadsheet. According to Mr. Griffin, that formatting change resulted in both appellants reporting the wrong amount of gross income.

[31] His testimony was that after he learned in the course of the audit that the wrong amount of gross income was reported he tried to figure out the cause since he carefully kept his spreadsheet in which he duly recorded all the amounts invoiced both in the original US dollar amounts as well as in Canadian dollars.

[32] Eventually, Mr. Griffin concluded after some experimentation that the cause of the error was a formatting change that he made removing a column in the spreadsheet.

[33] The arrangement that the appellants had with their client was that the client would pay them a fixed allowance for travel based on certain rules. The client did not reimburse them for their actual travel expenses.

[34] The travel allowances were part of gross business receipts and the actual travel expenses were part of the expenses to be deducted.

[35] On the spreadsheet there was a row for each invoice and a number of columns including separate columns for the travel allowance invoiced to XL Vianet, for the fee invoiced to XL Vianet and for the total of the two amounts invoiced to XL Vianet.

[36] There were also separate columns breaking down the invoiced amounts between the two appellants. Thus, for Mr. Griffin there were columns showing the travel allowance invoiced, the fee invoiced and the total of the two amounts. There were three similar columns for Ms. Baeucker.

[37] The three columns showing fees invoiced[8] were immediately to the left of the three columns for the total amounts invoiced.[9]

[38] Mr. Griffin's testimony was that before the formatting change there was a cell at the bottom of each of the three fee columns in which the Excel software was instructed to put in the sum of the fees in the column. I will refer to these as the "Three Cells".

[39] In his view, because of the way he made the format change removing one column and shifting all the columns to the right of the deleted column one column to

[8] i.e. for each invoice, (i) one column showing the total of the fees invoiced to XL Vianet, (ii) another showing the portion of those fees relating to Mr. Griffin and (iii) a third showing the portion of those fees relating to Ms. Baeucker.

[9] Again, one column with total amounts (fees plus travel advance) invoiced to XL Vianet, one showing the portion relating to Mr. Griffin and a third showing the portion relating to Ms. Baeucker.

the left, the Three Cells were left underneath what had become the total amount invoiced columns rather than the fees column.

[40] Further, notwithstanding the fact that they were now below a column containing different numbers than previously, the Three Cells continued to show the sum of the rows containing the fees invoiced rather than the sum of the total amounts invoiced, the column they were now under.

[41] As a result, when the appellants took the total at the bottom of the total amounts invoiced to put in as their gross revenues for the profit and loss statement of their tax returns, they unknowingly took the wrong gross revenue.

[42] Mr. Griffin also discovered that the precise way in which the format change was carried out made a difference. In some cases, the result was that the Three Cells would contain the sum of the column to the immediate left whereas when the change was carried out in a different way the Three Cells would contain the sum of the columns immediately above the cells.[10]

[43] He also testified that he did not review on a regular basis how the business was doing and in 2002 no financial statements for the business were drawn up.

[44] Ms. Baeucker testified that she prepared her tax return with Mr. Griffin's help and that she honestly believed that the tax return was correct.

[45] For her gross revenue she relied on the Excel spreadsheet kept by Mr. Griffin but she reviewed every line of the spreadsheet to make sure that the details were accurate.

[46] Ms. Baeucker testified that she was not at home that much during the relevant period. She was in the Greater Toronto Area, in Montréal, in Wisconsin, in Connecticut and in Michigan.

[47] Ms. Baeucker also testified that her income varied a great deal from year to year and that she could survive on $27,000 a year.[11]

Analysis

[10] The lengthy evidence about the format change takes up several pages of the transcript and was at times quite confusing. However, this paragraph and the immediately preceding paragraphs set out the gist of this evidence. Exhibit R-12 sets out visually Mr. Griffin's ex-post reconstruction of what happened.

[11] See transcript, page 218.

[48] The classic statement as to what constitutes gross negligence for the purposes of subsection 163(2) is that of Strayer J. in ***Venne v. The Queen***[12] where he states:

> . . . "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. . . .

[49] In examining this issue I must also consider whether the conduct of the appellants amounted to wilful blindness. As stated by Nadon J.A. speaking for the Court in *Panini v. Canada*:[13]

> . . . Consequently, the law will impute knowledge to a taxpayer who, in circumstances that dictate or strongly suggest that an inquiry should be made with respect to his or her tax situation, refuses or fails to commence such an inquiry without proper justification.

[50] First, I will analyze the Minister's evidence.

[51] In round numbers Mr. Griffin reported $166,000 in gross revenues and failed to report $77,000. The unreported amount exceeds 30 percent of the total gross revenues and is about 45 percent of the gross revenues reported.

[52] One consequence of this is that instead of the reported net income of around $47,000 from business, the appellant had, in fact, approximately $124,000 in income from the business. If one adds in approximately $2,000 of other income reported by the appellant, one sees that instead of, in round numbers, a $50,000 reported income the appellant had a $125,000 income, a $75,000 difference.

[53] Put another way, the income available to the appellant, before tax, was **two-and-a-half** times what he reported.[14]

[54] In round numbers Ms. Baeucker reported $127,000 in gross revenues and failed to report $79,000. The unreported amount exceeds 38 percent of the total gross revenues and is about 62 percent of the gross revenues reported.

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[12] 84 DTC 6247 (FCTD), at page 6256, [1984] F.C.J. No. 314 (QL).

[13] 2006 FCA 224, at paragraph 43; see also paragraphs 41 and 42.

[14] In computing these ratios, for both appellants I have compared their net income reported with their net income as if the correct amount of net income were their net income reported plus the unreported gross revenue. I have not included the effect of the disallowed expenses. This approach has the effect of *reducing* the difference between the reported net business income and the actual business income by about $30,000 and $8,000 in the case of Mr. Griffin and Ms. Baeucker respectively.

I do this solely for the purpose of considering the existence or not of gross negligence. I have done this because, given that no penalties were applied to the disallowed expenses and no gross negligence was alleged in respect of the disallowed expenses, I am satisfied that it would not be appropriate to compare the reported net income with the actual net income after the final reassessment including the effect of the disallowed expenses.

[55] One consequence of this is that instead of the reported net income of around $35,000 from business, Ms. Baeucker had, in fact, approximately $114,000 in income from the business. If one adds in the approximately $1,000 of other income reported by the appellant, one sees that instead of, in round numbers, a $36,000 reported income, Ms. Baeucker had a $115,000 income, a $79,000 difference.

[56] Put another way, the income available to Ms. Baeucker, before tax, was more than three times what she reported.

[57] Viewed as a family, the appellants reported about $86,000 in income when in fact their income was $240,000, more than **two-and-three-quarters** times the amount reported.

[58] Whether one examines each appellant separately or whether one examines the two of them together, the Minister's evidence shows such a great discrepancy between what was reported in the actual income as to make a conclusion of knowledge or willful blindness as described in *Panini* inevitable in the absence of a compelling explanation.

[59] Briefly, the evidence of the appellants' is that they believed they were fully reporting their income and the error resulted from the wrong total being at the bottom of the column showing the total amount invoiced for each appellant as a result of an unforeseen consequence of changing the formatting of the Excel spreadsheet in a particular way.

[60] There was also some evidence that they were very busy in the year, traveling a lot and that they could live on the relatively modest amount shown as their reported income.

[61] I have no difficulty in accepting that the Excel software may have behaved as the appellants described in certain circumstances. Indeed, I note that the unreported amounts appear to correspond to the travel allowance totals.

[62] However, I do not **accept** the appellants' evidence as to the cause of the underreporting and I do not accept their explanation, irrespective of what the Excel software may have done.[15]

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[15] I note with respect to the spreadsheet, that, initially, there was no total for the columns with the total amounts invoiced prior to the formatting change: see Exhibit R-14 and pages 176 and 177 of the transcript. Similarly in Mr. Griffin's demonstration in Exhibit R-12, at page 2 of 7, initially there is only a total at the bottom of the fees columns. Had there been a total below the columns with the total amounts invoiced initially, after the formatting change there would have been a total beneath the next column to the right that appeared out of place; that would likely have raised concerns.

[63] There is a world of difference between living on $50,000 a year and living on $125,000 a year (Mr. Griffin), between living on $36,000 a year and living on $115,000 a year (Ms. Baeucker) and between living on $86,000 a year and living on $240,000 a year (the two as a family).

[64] If the appellants spent a good deal more than their reported income, one would expect that to trigger serious questions when they computed their net business income.

[65] Alternatively, if, as suggested, they lived on their reported income, then their assets would have been growing rapidly or their debts shrinking rapidly — or some combination thereof. Again, one would expect questions to arise in their minds.

[66] Whatever the appellants' level of spending, when they reached the point of reviewing their profit and loss statement in their return and their net business income figure one would expect that to trigger serious questions in their mind as to the divergence between their financial situation and their net income.

[67] Both appellants struck me as quite intelligent; they are Information Technology professionals and have been in business for some time. Mr. Griffin has an MBA from Western.

[68] The income discrepancy here does not involve some complicated aspect of tax law; it simply involves recognition that the **business's** net income is dramatically higher, two-and-a-half to three times higher than reported.

[69] There is nothing in the evidence that would explain the failure to notice such a big discrepancy.[16]

[70] The appellants were ". . . in circumstances that dictate or strongly suggest that an inquiry should be made with respect to [the appellants'] tax situation, . . . " Indeed, they were in circumstances where, upon reviewing their profit and loss computation in their tax returns, alarm bells should have been going off, causing them to re-examine their profit and loss statements.

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[16] There are no other special circumstances in evidence that could reasonably explain this. The discrepancy **is** not small in relation to the appellants' other income.

Finally, I note that nothing in the evidence suggested that the difference in timing between cash flow and tax rules would have made it very easy not to notice the discrepancy. I looked at the capital cost allowance in Exhibit R-11 at page 3 of 5 of the T2032 to see if there could be a very large asset addition that was not depreciated during the year; no additions are shown.

[71] In these circumstances, I do not see how I can avoid concluding that there was gross negligence.

[72] Accordingly, the appeals will be dismissed.

These amended reasons for judgment are issued in substitution for the reasons for judgment signed on November 21, 2011.

Signed at Ottawa, Ontario, this 22nd day of December 2011.

"Gaston Jorré"

Jorré J.

CITATION:	2011 TCC 531
COURT FILE NOS.:	2010-271(IT)I 2010-270(IT)I
STYLE OF CAUSE:	KENNETH S. GRIFFIN, PATRICIA BAEUCKER v. HER MAJESTY THE QUEEN
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APPEARANCES:

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