

Docket: 2014-1429(IT)I

BETWEEN:

BERND STRUCK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of *468543 B.C. Ltd.*
2014-3204(IT)I on March 29 - 30, 2017, at Victoria, British Columbia

Before: The Honourable Justice Valerie Miller

Appearances:

For the Appellants: Bernd Struck
Counsel for the Respondent: Natasha Wallace

JUDGMENT

The appeal from the Notices of Reassessment dated April 20, 2012 made under the *Income Tax Act* for the Appellant's 2008, 2009 and 2010 taxation years is allowed and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the shareholder benefits are to be reduced to the amounts of \$14,525, \$14,521, and \$4,840.02 in 2008, 2009 and 2010 respectively.

The gross negligence penalties are to be reduced accordingly.

In all other respects, his appeal is dismissed.

Signed at Ottawa, Canada, this 29th day of May 2017.

“V.A. Miller”

V.A. Miller J.

Docket: 2014-3204(IT)I

BETWEEN:

468543 B.C. LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of *Bernd Struck*
2014-1429(IT)I on March 29 - 30, 2017, at Victoria, British Columbia

Before: The Honourable Justice Valerie Miller

Appearances:

For the Appellants: Bernd Struck
Counsel for the Respondent: Natasha Wallace

JUDGMENT

The appeal from the Notice of Reassessment dated May 7, 2012 made under the *Income Tax Act* in respect of the Appellant's taxation years ending November 30, 2008 and November 30, 2009 is dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 29th day of May 2017.

“V.A. Miller”

V.A. Miller J.

Citation: 2017TCC94
Date: 20170529
Docket: 2014-1429(IT)I

BETWEEN:

BERND STRUCK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2016-3204(IT)I

AND BETWEEN:

468543 B.C. LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

V.A. Miller J.

I. Overview

[1] Mr. Bernd Struck (“Mr. Struck”) appealed from income tax reassessments dated April 20, 2012 in respect of his 2008, 2009 and 2010 taxation years. 468543 B.C. Ltd. (the “Corporation”) appealed from income tax reassessments dated May 7, 2012 in respect of its taxation years ending November 30, 2008 and November 30, 2009. Mr. Struck was the only shareholder in the Corporation during the years in issue. The appeals were heard on common evidence.

[2] Prior to the hearing, the parties agreed on a number of issues that had been raised in the reassessments. The only issues that remained in dispute in respect of Mr. Struck’s appeal were as follows:

- a) Whether the Corporation conferred shareholder benefits on Mr. Struck in accordance with subsection 15(1) of the *Income Tax Act* (“Act”) in the amounts of \$32,803, \$33,493, and \$33,493 in the 2008, 2009 and 2010 taxation years respectively?
- b) Whether Mr. Struck was liable for a gross negligence penalty under subsection 163(2) of the *Act* in respect of his omission to include the subsection 15(1) shareholder benefits in his income?
- c) Whether Mr. Struck was properly assessed a shareholder loan benefit in the amount of \$81,425 in accordance with subsection 15(2) of the *Act* in his 2009 taxation year?

[3] With respect to the Corporation’s appeal, the following issues were in dispute:

- a) Whether the Corporation was allowed to claim interest expenses in the amounts of \$27,402 and \$14,039 in the 2008 and 2009 taxation years respectively?
- b) Whether the Corporation was allowed to deduct direct wage expenses in the amounts of \$8,000 and \$10,000 in the 2008 and 2009 taxation years respectively?
- c) Whether the Corporation was liable for gross negligence penalties under subsection 163(2) of the *Act*?

[4] For the reasons that follow, I have allowed Mr. Struck’s appeal in part and I have dismissed the Corporation’s appeal.

II. Bernd Struck

[5] The witnesses at the hearing were Mr. Struck, Ms. Leah Norminton, an auditor with the Canada Revenue Agency (“CRA”) and Mr. Jason Chow, a Business Valuator with the CRA. As I will describe in my decision, I found that Mr. Struck was not credible. Many of his statements were self-serving and were not supported by the documents filed at the hearing.

A. 15(1) Shareholder Benefits

(1) Facts

[6] In the 1980s, Mr. Struck started his career as a tree planter with a company in British Columbia. He later purchased this company and renamed it Cardinal Forestry Consulting Co. Limited (“Cardinal”). For months at a time, he worked in logging camps as a log harvester and quality control consultant. In the early 2000s, Mr. Struck caused Cardinal to change its business to become a certified home warranty building company. Mr. Struck continued to earn employment income from Cardinal during the years at issue.

[7] In 1994, Mr. Struck together with his father, Horst Struck (“Horst”), incorporated the Corporation under the laws of British Columbia.

[8] The Corporation was in the business of residential property rentals. At all materials times, the Corporation had no employees. Mr. Struck and his father performed the small repairs, maintenance work, and day-to-day operations that the Corporation required for its properties. The Corporation hired Cardinal to perform any larger renovations and repairs that it may have required.

[9] From 1994 until 2005, Mr. Struck and Horst were equal shareholders of the Corporation.

[10] On February 1, 2005, Horst gifted his shares in the Corporation to Mr. Struck. Horst did not report the transaction on his income tax return and, in 2008, the CRA audited Horst with respect to the gift of his shares. Jason Chow, a CRA Business Valuator, determined the fair market value of the Corporation’s shares at the time of disposition. Mr. Chow testified at the hearing of these appeals regarding his role in the 2008 audit.

[11] During the years at issue, Mr. Struck was the Corporation’s sole shareholder. He was also a director, an officer and the directing mind of the Corporation. While Horst maintained his cheque-signing authority for the Corporation, he was no longer involved in the running of the Corporation due to age.

[12] Mr. Struck testified that the Corporation started with no assets. By 2009, the Corporation owned six rental properties. He testified that the rental income alone was not sufficient to generate this level of growth. According to the unaudited Financial Statements filed at the hearing, the Corporation only had a net income in

2002, 2005 and 2006 when it sold some of its properties. In all other years since 2001, it showed net losses. I note that these Financial Statements were prepared by Mr. Struck.

[13] Mr. Struck stated that the Corporation was only able to purchase its properties because the shareholders personally invested large amounts of capital in the Corporation. The capital invested included advances of mortgage proceeds that were secured on the shareholders' personal residences. To that end, Mr. Struck further testified that there was an agreement between the shareholders and the Corporation that since the mortgage proceeds were advanced to the Corporation for its benefit, the Corporation would take on the mortgage liabilities and make the corresponding mortgage payments.

[14] As detailed below, I found that Mr. Struck's testimony was contradicted by the documentary evidence provided at the hearing. The evidence presented in respect of the mortgages that were taken out on the two properties at issue: (a) 1601 Keating Cross Road, Saanichton, BC (the "Keating Property"); and (b) 2326 Weiler Avenue, Sidney, BC (the "Weiler Property") do not support Mr. Struck's testimony that the mortgage proceeds were advanced to the Corporation for its benefit.

(a) Mortgages on the Keating Property

[15] In 2001, Mr. Struck purchased the Keating Property from Robert George Martin, Robert William Martin and Elizabeth Martin (the "Martins") for \$160,000. He used his personal savings for a down payment of \$20,000 and the Martins provided him with a mortgage of \$140,000 (the "Martin Mortgage").

[16] Mr. Struck purchased the Keating Property so that he could build his personal residence on it.

[17] In March 2003, Mr. Struck and Horst agreed to take a first mortgage on Horst's personal residence, the Weiler Property, in the total amount of \$220,000. This mortgage was registered with a BC Land Titles registration number EV024789 (the "Weiler Mortgage"). The proceeds of the Weiler Mortgage, net of legal fees, were disbursed as follows:

- a) \$140,797.68 was used to discharge the Martin Mortgage on the Keating Property for the benefit of Mr. Struck;

- b) \$19,456.21 was used to pay the tax deferral on the property taxes owed by Horst personally; and
- c) The remaining balance of \$58,028.46 was paid to Horst.

[18] In 2003, Mr. Struck and his spouse had matrimonial difficulties which led to a divorce. On the advice of his lawyer, Mr. Struck transferred ownership of the Keating Property to Horst. As a result of the transfer, Mr. Struck was assessed a taxable capital gain of \$10,000 in his 2003 taxation year.

[19] In July 2003, Horst obtained a construction mortgage with number 6216628 (“Construction Mortgage”) from CIBC in respect of the Keating Property in the amount of \$250,000. The BC Land Titles registration number was EV84590. Mr. Struck was the guarantor on the Construction Mortgage.

[20] Horst received three advances under the Construction Mortgage. On August 8, 2003, there was a first advance of \$150,000. In May 2004, the Construction Mortgage was modified to increase the available loan principal to \$350,000.00. The BC Land Titles registration number for the modified Construction Mortgage was EW73790. On or about June 15, 2004, \$110,546.00 was advanced on the Construction Mortgage. On February 4, 2005, a third mortgage advance was made in the amount of \$38,650.85. The advances on the Construction Mortgage totalled \$299,196.85.

[21] For the Corporation’s taxation year ending on November 30, 2005, the Construction Mortgage was recorded in the Corporation’s unaudited Financial Statement as a long-term debt. It is otherwise unclear based on the evidence whether the remaining loan balance (i.e. 350,000 – 299,196.85) was ever drawn and disbursed or if it was, whether the Corporation or Horst or Mr. Struck received it.

[22] Mr. Struck testified that there were draws on the Construction Mortgage that were used for the Corporation’s business. However, he could not provide any documentary evidence during the audit or at Court to support his assertion.

[23] At the hearing, Mr. Struck claimed that the amount of the Construction Mortgage was not \$299,196.85 but was only \$195,000. The evidence has shown otherwise.

[24] The notes to the Financial Statements for the Corporation for 2005 showed that the Construction Mortgage was \$299,196.85

[25] Mr. Struck completed the construction of his personal residence on the Keating Property in January 2006.

[26] Mr. Struck testified that Horst probably transferred the property back to him in 2006.

[27] Notwithstanding this testimony, I find that the Keating Property remained in Horst's name throughout the years at issue. My conclusion is based on the following evidence. On January 14, 2006, the Construction Mortgage of \$299,196.85 was converted into a conventional mortgage on the Keating Property (the "Keating Mortgage"). The Keating Mortgage was in the amount of \$199,190.85 and was a CIBC Mortgage with number 6216629. Despite the conversion from a Construction Mortgage to a conventional mortgage, Horst continued to be the mortgagor on the Keating Mortgage, as shown on the annual mortgage statements for 2008 and 2009.

[28] However, the Keating Mortgage continued to be recorded as the Corporation's long-term debt on its unaudited Financial Statements for the taxation years ending November 30, 2006, November 30, 2007, November 30, 2008 and November 30, 2009.

[29] The earliest documentary evidence which showed the Keating Property in Mr. Struck's name was a BC Land Titles registration document (CA153192). It registered a mortgage dated April 21, 2010 that Mr. Struck had given on the Keating Property to First National Financial Corporation. The mortgage was in the amount of \$585,000 and the proceeds were used as follows:

- a) To discharge the Keating Mortgage by paying the balance in the amount of \$179,985.37;
- b) To discharge Mr. Struck's personal line of credit in the amount of \$298,958.99; and,
- c) To pay himself the balance of \$104,950.29.

[30] A letter dated April 27, 2010 from First National Financial Corporation to Mr. Struck congratulated him on the purchase of his new home.

[31] Mr. Struck testified that the Corporation did not pay the mortgage payments after April 2010.

[32] The Keating Property has been Mr. Struck's personal residence from 2006 to the present.

[33] The Minister assessed Mr. Struck pursuant to subsection 15(1) of the *Act* on the basis that the Corporation conferred a benefit on him by paying the mortgage payments for the Keating Property in the amount of \$14,525, \$14,521 and \$14,521 in 2008, 2009 and 2010 respectively.

[34] However, the Minister audited the Corporation for its 2008 and 2009 taxation years only. For the 2010 taxation year, she assumed that the amount of mortgage payments for the Keating Property was the same (\$14,521) as that paid in 2009.

[35] As a result of the evidence provided at the hearing, the Respondent has conceded that the amount included in Mr. Struck's income, with respect to the Keating Property for 2010, should be reduced to \$4,840.02 to take into account that the Keating Property was registered in Mr. Struck's name in April 2010 and he stated that he paid the mortgage payment from that time.

(b) Mortgages on the Weiler Property

[36] At all material times, the Weiler Property was Horst's personal residence.

[37] As stated above, in 2003, while Horst was still a 50% shareholder of the Corporation, he agreed to mortgage the Weiler Property. The mortgage proceeds of \$220,000 were paid out as I have described in paragraph 17 above.

[38] The Weiler Mortgage, which had a BC Land Titles registration number EV024789 and a CIBC mortgage number 6130483, was recorded as a liability on the Corporation's books from 2004 to 2009.

[39] At all material times, Horst was the mortgagor on the Weiler Mortgage. However, the Corporation's unaudited financial statements showed the Weiler Mortgage as one of the Corporation's liabilities.

[40] Mr. Struck testified that he and Horst had agreed that the Corporation would assume the liability on the Weiler Mortgage because Horst had loaned the Corporation his personal savings of \$160,000.

[41] I do not believe Mr. Struck for several reasons. He did not submit any documentary evidence to corroborate this testimony. He failed to call Horst as a witness to testify to this matter and I have drawn a negative inference from this failure. The CRA auditor, Ms. Norminton, testified that Mr. Struck did not mention this alleged loan during the audit.

[42] During the 2008 and 2009 taxation years, the Corporation made mortgage payments on the Weiler Mortgage in the amount of \$18,278 and \$18,972 respectively.

[43] In March 2010, Horst remortgaged the Weiler Property by granting a mortgage to MCAP Service Corporation in the amount of \$400,000. The mortgage proceeds were disbursed as follows: (i) pay out of the Weiler Mortgage in the amount of \$157,266.39; (ii) payment of the lawyers' fees in the amount of \$811.63; and, (iii) payment of the balance of \$241,906.38 to Horst. This amount was deposited into Horst's personal bank account.

[44] On March 25, 2010, Horst withdrew \$235,000 from his bank account and deposited it into the Corporation's bank account.

[45] The Corporation issued cheques on March 30, 2010, April 5, 2010 and April 7, 2010. Each cheque was in the amount of \$50,000. The April 5, 2010 cheque was made payable to Mr. Struck. Mr. Struck did not submit copies of the cheques dated March 30 and April 7, 2010. There was no evidence whether the March 30 and April 7 cheques were used for business purposes. There was also no evidence whether the balance of \$85,000 was used for business purposes.

[46] The Minister assessed Mr. Struck pursuant to subsection 15(1) of the *Act* on the basis that the Corporation conferred a benefit on him by paying the mortgage payments for the Weiler Property in the amount of \$18,278, \$18,972 and \$18,972 in 2008, 2009 and 2010 respectively.

(2) Analysis

(a) *Shareholder Benefits*

[47] Subsection 15(1) of the *Act* provides:

15.(1) Where at any time in a taxation year a benefit is conferred on a shareholder, or on a person in contemplation of the person becoming a shareholder, by a corporation otherwise than by

...

the amount or value thereof shall, except to the extent that it is deemed by section 84 to be a dividend, be included in computing the income of the shareholder for the year. [emphasis added]

[48] While the wording of the provision is quite broad, it clearly only captures benefits conferred by a corporation on (i) a shareholder; or (ii) on a person in contemplation of his or her becoming a shareholder. A shareholder is defined in subsection 248(1) of the *Act* to include “a member or other person entitled to receive payment of a dividend.”

[49] It is my view that subsection 15(1) is not broad enough to capture the mortgage payments made by the Corporation on the Weiler Property. In this regard, the Corporation conferred a benefit on Horst who was not a shareholder at the relevant time. It is settled law that subsection 15(1) of the *Act* only applies when the benefit is conferred on a person *qua* shareholder: *MNR v Pillisbury Holdings Ltd*, 64 DTC 5184 (EX Ct).

[50] The Corporation did not confer a benefit on Mr. Struck for the mortgage payments made on the Weiler Property.

[51] However, the Corporation did confer a benefit on Mr. Struck when it made the mortgage payments on the Keating Property during the years in issue. The Corporation paid the mortgage on Mr. Struck’s personal residence. This was definitely a benefit to Mr. Struck.

[52] In her written submissions, counsel for the Respondent took the position that paragraph 15(1.4)(c) of the *Act* allows the Minister to assess a benefit on Mr. Struck for all mortgage payments. I disagree. Paragraph 15(1.4)(c) is an interpretative provision and it reads as follows:

15(1.4) For the purposes of this subsection and subsection (1),

...

(c) a benefit conferred by a corporation on an individual is a benefit conferred on a shareholder of the corporation, a member of a partnership that is a shareholder of the corporation or a contemplated shareholder of the corporation—except to the extent that the amount or value of the benefit is included in computing the income of the individual or any other person—if the individual is an individual, other than an excluded trust in respect of the corporation, who does not deal at arm's length with, or is affiliated with, the shareholder, member of the partnership or contemplated shareholder, as the case may be; [emphasis added]

[53] Paragraph 15(1.4)(c) was not in force during the years at issue. Specifically, it was added by S.C. 2013, c. 34, subsection 177(3) and is applicable in respect of benefits that are conferred on or after October 31, 2011.

[54] The shareholder benefit included in Mr. Struck's income is reduced to \$14,525, \$14,521, and \$4,840.02 in 2008, 2009 and 2010 respectively.

(b) Gross negligence penalties

[55] It is my view that the gross negligence penalties levied in respect to the mortgage payments made by the Corporation for the Keating Property must be maintained.

[56] During the relevant period, Mr. Struck was the only shareholder and the directing mind of the Corporation. He intended and directed the Corporation to make the mortgage payments on both the Weiler Mortgage and the Keating Mortgage. He commingled his personal expenses and the Corporation's expenses. He prepared the Corporation's books and records.

[57] The proceeds from the various mortgages were used toward the payment or construction of Mr. Struck's personal residence.

[58] Mr. Struck has not provided any credible evidence that the proceeds from the Weiler Mortgage or the Keating Mortgage were ever used for the Corporation's business. I find that the gross negligence penalties with respect to the Keating property only were properly imposed.

(c) Shareholder Loan Inclusion

(i) Facts

[59] Mr. Struck admitted that he has never maintained the shareholder loan account in accordance with the generally accepted accounting principles (GAAP). He did not keep a “running tally” of the amounts in and out of the account. Instead, he relied on a methodology he concocted to track the account balance.

[60] In its 2009 taxation year, the Corporation reported a balance of zero in the shareholder loan account. The Corporation’s balance sheet showed a balance of \$423,230.88 in the Due to Shareholder account in 2009. The audit of the taxpayers in 2011 was commenced as a result of this inconsistency. This led to the reassessments at issue.

[61] During the audit, Mr. Struck represented to Ms. Norminton, the auditor, that neither amount was accurate. He subsequently made numerous submissions to her providing a different number for the account balance each time. Eventually, Mr. Struck arrived at a shareholder loan account balance of negative \$81,425 at the end of the Corporation’s 2009 taxation year. He revised the Corporation’s 2009 Financial Statement on or about January 30, 2012 to reflect that amount.

[62] The auditor testified that there were no source documents or transactional records provided that would allow her to verify any of the numbers claimed by Mr. Struck. The auditor eventually accepted Mr. Struck’s own representation that he owed the Corporation \$81,425 and the Minister assessed him accordingly pursuant to subsection 15(2) of the *Act*.

[63] The Corporation’s 2010 taxation year was not audited because the 2010 tax return had not been filed by the time the audit was conducted. The auditor could not verify if the negative balance in the shareholder’s loan account had been repaid in 2010 because the Corporation did not keep a transactional record of the shareholder loan account.

[64] Mr. Struck reconstructed the shareholder loan account for the Corporation’s 2008, 2009 and 2010 taxation years for the hearing of his appeal. He stated that he reconstructed the shareholder loan account pursuant to his lawyer’s instructions.

[65] According to this reconstruction, the shareholder loan account had a credit balance of \$223,367 at the beginning of the Corporation’s 2009 taxation year. Mr. Struck alleged that, during the year, he made various shareholder contributions for a total of \$248,122 in the form of advances from his personal line of credit or cash purchases and utilities payments made on behalf of the Corporation. In this reconstruction, Mr. Struck also received benefits which were recorded as loans

from the Corporation, such as payments for Mr. Struck's personal VISA in the year for a total amount of \$552,914. This reduced the shareholder loan account from a credit balance of \$223,367 to a debit balance of \$81,425 at the end of the 2009 taxation year, i.e. the amount that was assessed.

[66] For the 2010 taxation year, Mr. Struck maintained at trial that the outstanding shareholder loan at the end of the 2009 taxation year was repaid by him in 2010. He argued that the shareholder loan account reconstruction prepared by him at Exhibit A-2, Tab 23 supported his position. The Chart showed that Mr. Struck made contributions and payments on behalf of the Corporation for a total of \$124,717 in the 2010 taxation year. He also received similar types of payments which were recorded as loans made by the Corporation for a total amount of \$84,829. However, in computing the net shareholder contribution for 2010, Mr. Struck did not include a payment of \$50,000 that he received from the Corporation on April 7, 2010. He made the following notation beside this amount: "paydown 1601 Keating Mortgage - not to be included in shareholder loans." As a result, the total amount of shareholder loan allegedly taken in 2010 was determined to be \$34,829. Therefore, the net shareholder contribution or repayment was \$89,888, thereby allegedly bringing the shareholder loan account back to a credit balance of \$8,463 by the end of the Corporation's 2010 taxation year.

[67] The Respondent took the position that Mr. Struck did not make a net repayment of \$89,888 in respect of the shareholder loan account in 2010. The Respondent argued that Mr. Struck's testimony was suspect and the shareholder loan account reconstructions at Exhibit A-2, Tabs 23 to 25 were made up for the purposes of the trial and should not be given any weight as Mr. Struck did not provide any source documents from which one could verify the entries.

[68] The Respondent argued in the alternative that, even accepting all of the other shareholder contributions and repayments as reconstructed by Mr. Struck, the \$50,000 payment by the Corporation to Mr. Struck in respect of the Keating Mortgage should be included as a shareholder loan to Mr. Struck in 2010. Therefore, the shareholder loan account should remain in the debit balance of \$41,537 (i.e. \$39,888-\$81,425), which amount ought to be included in Mr. Struck's income for his 2009 taxation year.

(ii) Analysis

[69] Subsection 15(2) of the *Act* provides as follows:

(2) Where a person ... is

(a) a shareholder of a particular corporation,

...

and the person ... has in a taxation year received a loan from or has become indebted to the particular corporation ... the amount of the loan or indebtedness is included in computing the income for the year of the person or partnership.

[70] Subsection 15(2.6) of the *Act* provides an exemption to the application of subsection (2) where the indebtedness is repaid within one year after the end of the corporation's taxation year in which the indebtedness arose. The provision read as follows during the years at issue:

15(2.6) Subsection 15(2) does not apply to a loan or an indebtedness repaid within one year after the end of the taxation year of the lender or creditor in which the loan was made or the indebtedness arose, where it is established, by subsequent events or otherwise, that the repayment was not part of a series of loans or other transactions and repayments.

[71] The Minister accepted Mr. Struck's own representation that the shareholder loan account had a negative balance of \$81,425 at the end of the 2009 taxation year and assessed him accordingly since the Corporation's tax return for the 2010 taxation year had not been filed at the time of the audit. There was no way to verify if the outstanding amount was repaid. Mr. Struck alleged that the shareholder loan in 2009 was repaid by the end of the Corporation's 2010 taxation year. Consequently, pursuant to subsection 15(2.6) of the *Act*, the negative balance should not be included in his income in 2009. Mr. Struck produced a transactional listing of entries in and out of the shareholder loan account, Exhibit A-2, Tab 23, which he prepared for the purpose of the trial. In support of his reconciliation, Mr. Struck only produced deposit slips, bank account statements, and like documents.

[72] I find that Mr. Struck has not shown that he repaid the amount of \$81,425 that he owed to the Corporation at the end of the 2009 taxation year.

[73] There were no documents submitted from which I could verify the entries on Exhibit A-2, Tab 23 and from which I could glean whether the amounts were personal or business.

[74] The reliability of Mr. Struck's evidence regarding the shareholder loan repayment in 2010 is suspect, to say the least. He testified that he did not follow

the GAAP and instead used his own methodology to compute the shareholder loan account. He admitted that he did not maintain a transactional record of the shareholder loan account contemporaneously ever since the Corporation was incorporated in 1994. He reported wildly inaccurate numbers in respect of the “Due to Shareholder” account on the Corporation’s Financial Statements that were incompatible with the Corporation’s tax returns for the relevant years. Both of these documents had been prepared by him personally. During the audit and objection stage, he made various different submissions to the auditor who eventually had no better option but to accept his own estimate for the 2009 taxation year.

[75] Second, as the Respondent correctly pointed out, Tab 23 also showed a \$50,000 payment by the Corporation to Mr. Struck dated April 7, 2010, with a note stating “paydown 1601 Keating Mortgage – not to be included in the shareholder loans”. Mr. Struck’s explanation for this entry was that the Keating Mortgage was the liability of the Corporation. The evidence has shown that his explanation was simply not correct.

[76] I have not been persuaded that Mr. Struck paid the outstanding balance in the shareholder’s account by the end of the Corporation’s 2010 taxation year. Mr. Struck’s evidence was self-serving. He has not provided any convincing evidence to support his statements.

[77] Therefore, I conclude that the shareholder loan balance of \$81,425 was correctly included in Mr. Struck’s income in 2009.

III. 468543 BC Ltd (the “Corporation”)

A. Disallowed Interest Expenses

(1) Interest payments on the Weiler Mortgage and the Keating Mortgage

[78] In addition to the shareholder benefits assessed to Mr. Struck as the shareholder of the Corporation, the Minister also assessed the Corporation for its 2008 and 2009 taxation years by disallowing the deduction of (i) \$8,713 and \$3,923 in mortgage interest payments made by the Corporation in respect of the Weiler Mortgage, and (ii) \$9,100 and \$8,823 in mortgage interest payments made in respect of the Keating Mortgage.

[79] Paragraph 20(1)(c) of the *Act* provides that interest payments made on “borrowed money used for the purpose of earning income from a business or property” may be deducted.

[80] Mr. Struck claimed that the mortgage proceeds on the Weiler Mortgage and Keating Mortgage were advanced to the Corporation for its business use including the acquisition of rental properties by the Corporation. Specifically, Mr. Struck alleged that the proceeds from the mortgages were used to acquire the property located at 9609 Fifth Street, Sidney, BC (the “9609 Property”) “free and clear” of any encumbrances.

[81] Based on the evidence, I am not convinced that the mortgage proceeds were used for a business purpose.

[82] With regard to the Weiler Mortgage, the documentary evidence showed that in March 2003 none of the Weiler Mortgage was used for the Corporation’s business. See my paragraph 17 above where I list how the proceeds of the mortgage were disbursed. After paying off the Martin Mortgage, the amount of \$58,000 was given to Horst.

[83] Mr. Struck claimed that Horst advanced the amount of \$58,000 to the Corporation so that it could purchase the 9609 Property. In support of his testimony, Mr. Struck produced a copy of the Corporation’s bank statement for the month of June 2004 which showed a deposit of \$60,000 on June 18, 2004. I place no weight on this evidence. There were no documents to link the \$60,000 to Horst. The amounts do not match and the \$60,000 deposit occurred more than a year after the Weiler Mortgage proceeds were disbursed to Horst. There was also no

evidence that any of the proceeds from the Construction Mortgage on the Keating Property were advanced to the Corporation for its business.

[84] The Appellants also rely on Mr. Chow's testimony as evidence that the Keating Property and the Weiler Property, as well as their respective mortgages, were the Corporation's assets and liabilities. I disagree. Mr. Chow clearly testified that he simply relied on Mr. Struck's representations in his valuation and he did not conduct an audit of the mortgages himself. During the 2008 valuation audit, Mr. Struck represented to Mr. Chow that the Weiler and Keating Mortgages were liabilities of the Corporation. The Minister is certainly not bound by Mr. Chow's earlier valuation opinions or any misrepresentations that Mr. Struck made to Mr. Chow. Mr. Chow's evidence is not relevant for the purposes of these appeals.

[85] In conclusion, I find that there was simply no credible evidence that would demonstrate that any part of the Weiler Mortgage or Keating Mortgage proceeds actually went to finance the Corporation's business. Rather, the documentary evidence showed that most, if not all, of the proceeds from the mortgages were used for Mr. Struck's or Horst's personal expenses. Therefore, the mortgage interest expenses that the Corporation attempted to deduct during the relevant years were properly denied by the Minister as the mortgages on the Weiler Property and the Keating Property cannot be considered as "borrowed money used for the purpose of earning income from a business or property" under paragraph 20(1)(c) of the *Act*.

(2) Interest Discrepancies

[86] For the Corporation's taxation years ending on November 30, 2008 and November 30, 2009, the Minister disallowed the deduction of \$9,589 and \$2,968 respectively, due to a lack of supporting documentation. These amounts were labelled interest discrepancies.

[87] Mr. Struck testified that most of the amount of \$9,589 claimed in the 2008 taxation year represented a missed invoice from the Corporation's lawyer. The actual invoice was for the amount of \$9,355. The expense was incurred in 2007. Rather than re-filing the Corporation's 2007 tax return, Mr. Struck claimed the amount in the Corporation's 2008 return. Mr. Struck requested the Court to allow this amount in 2008. He stated that the net effect to the Corporation would be the same because, in both 2007 and 2008, the Corporation was in a loss position.

[88] The Respondent submitted that the Corporation was entitled to claim the \$9,589 expense in the 2007 taxation year and it could submit a T2 adjustment for that year with the supporting documents. Counsel stated that if the Court allowed the Corporation to claim the amount that was incurred in the 2007 taxation year in the 2008 taxation year, there is no mechanism in the *Act* that would prevent the Corporation from amending its T2 return for 2007. In other words, the Respondent was concerned about the problem of “double-dipping”. I agree.

[89] It is a fundamental principle of Canadian tax law that a current expense should only be deducted in the year that it was incurred. This amount, which was incurred in the Corporation’s 2007 taxation year, cannot be deducted in the 2008 taxation year. The Corporation should amend its T2 return for the 2007 taxation year to claim this amount.

[90] During the audit, the Corporation made representations to the auditor that there was an additional interest expense of \$4,133 that should have been claimed and allowed in the 2009 taxation year. The Corporation’s submissions were accepted by the auditor and the adjustments were reflected in the reassessment dated May 7, 2012. Mr. Struck appeared to take the view in his written submissions that the adjustments were not made and he has asked for the deduction of an interest expense in 2009 of \$2,968.

[91] I have checked the relevant documents. The relief sought by the Corporation in respect of the 2009 discrepancy had already been adjusted in accordance with the Corporations’ request. The auditor made an adjustment for \$7,100 that included both the underreported amount and the discrepancy. No further action is necessary.

(3) Duplicative Interest Deduction by Shareholder on T1

[92] The Minister disallowed an additional \$1,924 in interest expense which was claimed by both the Corporation on its 2009 tax return as well as by Mr. Struck on his income tax return.

[93] Mr. Struck acknowledged at trial that this item was not in dispute.

(4) Interest expenses on U.S. property

[94] In September 2009, the Corporation also gave mortgages on three of its properties. A portion of the mortgage proceeds was used by a U.S. corporation named Kool Holdings Inc. (“Kool Holdings”), a real estate company incorporated

in 2009 and co-owned by Mr. Struck and his wife, to purchase properties in the U.S. The Minister pro-rated the portion of the interest payments corresponding to the proceeds that went into the Corporation's Canadian business operations and disallowed \$3,501 in interest expenses that were claimed by the Corporation in respect of Kool Holdings' U.S. operations.

[95] In a letter dated June 13, 2013, Mr. Struck on behalf of the Corporation indicated that this item remained in dispute.

[96] However, the Corporation did not raise this issue at trial. The Corporation also did not produce any evidence to contradict the assumption of fact made by the Minister in her pleadings that the interest at issue related to money borrowed for Kool Holdings' business in the U.S.

[97] As such, the Minister's assessment on this amount stands.

B. Direct Wage Expenses

[98] The Corporation filed T5 slips and summaries in its 2008 and 2009 taxation years with respect to dividends it issued in the amount of \$8,000 and \$10,000 respectively.

[99] In his 2008 personal tax return, Mr. Struck reported a total of \$11,600 in dividend income. This amount included the dividend of \$8,000 he received from the Corporation as well as dividends he received from shares held in his trading account.

[100] On his 2009 personal tax return, however, Mr. Struck did not report any dividend income but reported the amount of \$12,104.74 as a taxable capital gain. Mr. Struck testified that he made a mistake in his filings and that this amount should have been dividend income.

[101] The Respondent submitted that Mr. Struck lacked credibility on this issue. In particular, Mr. Struck admitted on cross-examination that he was an active trader during the years at issue. Documentary evidence showed that in the 2009 taxation year, Mr. Struck reported share dispositions for a total of \$411,365 and a capital gain from these share dispositions in the amount of \$24,209.

[102] Notwithstanding the above, the Corporation reported the dividends on its financial statements in the respective years as operating expenses and reported the amounts as wage expenses in the Corporation's tax returns in the relevant years.

[103] The Minister disallowed the wage expenses pursuant to paragraph 18(1)(a) of the *Act* on the basis that the amounts constituted dividends which were paid out of the Corporation's profit and hence cannot be characterized as an outlay or expense incurred for the purpose of gaining or producing income.

[104] Mr. Struck did not dispute that the amounts were dividends. In a letter dated June 13, 2013 to the auditor, Mr. Struck indicated that he agreed with the reduction in wage expenses. In his written submissions, Mr. Struck addressed this issue again and sought the following relief:

I ask that the court allow the numbered company to report the dividends it paid out to Bernd Struck on its 2008 and 2009 T5 statement, to be recorded in the numbered companies Financial Statement for the respective years.

[105] It is unclear what relief Mr. Struck is seeking on this issue based on his submission. But to the extent that he is requesting that the amounts be allowed as an expense for the Corporation's 2008 and 2009 taxation years, the relief is denied.

[106] Mr. Struck was clearly conflating the concepts of a dividend versus a wage. A dividend is paid out from the after-tax profits of a corporation whereas a wage expense is deducted in computing a corporation's profit for the purpose of determining a corporation's taxable income and tax payable.

[107] The Minister properly denied the deduction of dividend payments as wage expenses of the Corporation.

C. Gross negligence penalties

[108] Subsection 163(2) of the *Act* provides as follows:

(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty ... [emphasis added]

[109] In *Venne v Canada*, [1984] CTC 223, Justice Strayer stated the test for gross negligence as follows:

"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.

[110] The Minister has discharged the onus of proving that the Corporation is liable for gross negligence penalties under subsection 163(2) in respect of the disallowed expenses. Mr. Struck was the directing mind of the Corporation during the years at issue. Mr. Struck prepared the Corporation's books and records. Although Mr. Struck had many years of business experience, he commingled his personal expenses and the Corporation's business expenses. I find that Mr. Struck either knowingly or in circumstances amounting to gross negligence, or "tantamount to intentional acting" and "indifference", directed the Corporation to deduct expenses that clearly should not have been claimed. This includes, among others, (i) mortgage interest expenses that were clearly personal in nature; (ii) interest expenses that were incurred in respect to another corporation's business; and (iii) dividend payments.

IV. Conclusion

[111] Mr. Struck's appeal is allowed to reduce the shareholder benefit to \$14,525, \$14,521, and \$4,840.02 in 2008, 2009 and 2010 respectively. The gross negligence penalties are to be reduced accordingly. In all other respects, his appeal is dismissed.

[112] The Corporation's appeal is dismissed.

Signed at Ottawa, Canada, this 29th day of May 2017.

"V.A. Miller"

V.A. Miller J.

CITATION: 2017TCC94

COURT FILE NO.: 2014-1429(IT)I
2014-3204(IT)I

STYLE OF CAUSE: BERND STRUCK AND HER MAJESTY
THE QUEEN
468543 B.C. LTD. AND HER MAJESTY
THE QUEEN

PLACE OF HEARING: Victoria, British Columbia

DATE OF HEARING: March 29-30, 2017

REASONS FOR JUDGMENT BY: The Honourable Justice Valerie Miller

DATE OF JUDGMENT: May 29, 2017

APPEARANCES:

For the Appellants: Bernd Struck
Counsel for the Respondent: Natasha Wallace

COUNSEL OF RECORD:

For the Appellant:
Name:
Firm:

For the Respondent: William F. Pentney
Deputy Attorney General of Canada
Ottawa, Canada