Docket: 2009-2561(GST)G

BETWEEN:

GASTON DIONNE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on February 27 and 28, 2012, at Rimouski, Quebec.

Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant:	Pierre Lévesque
Counsel for the Respondent:	Caroline Roy

JUDGMENT

The appeal is allowed in part and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment. There is no award of costs.

Signed this 17th day of May 2012.

"François Angers"
Angers J.

Translation certified true
on this 28th day of February 2013.

Erich Klein, Revisor

Citation: 2012 TCC 136
Date: 20120517
Docket: 2009-2561(GST)G

BETWEEN:

GASTON DIONNE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Angers J.

[1] On May 10, 2007, the appellant was assessed by the Minister of National Revenue (the Minister), under the *Excise Tax Act* (ETA), an amount of $47,288.43 representing unremitted goods and services tax (GST) for the period from January 1, 2001, to September 30, 2005. The appellant duly objected to the assessment and, on July 10, 2009, the Minister confirmed the assessment but adjusted the amount thereof for part of the period in issue, namely, the period from January 1, 2003, to December 31, 2004. The adjusted amount was $47,867.07 on July 10, 2009.

[2] At the objection stage, many transactions were examined and placed under various headings, but the transactions contested by the appellant were the ones under the headings [TRANSLATION] "business income" and [TRANSLATION] "other income" by the auditor. Ultimately, it is only the latter heading that is at issue in this case.

[3] The [TRANSLATION] "other income" totals $192,242 and it represents a series of bank deposits the appellant was unable to explain to the auditor's satisfaction and that she considered as being in respect of taxable supplies. The amount of GST on the [TRANSLATION] "other income" is, therefore, $13,456.96.

[4] During the period in issue, the appellant ran a real estate business, which operated under the name Immobilier de l'Estuaire Inc. (hereinafter the company). He was the shareholder and acted as a real estate agent. He also conducted real estate transactions, namely, the purchase and sale of properties, on his own behalf. Over the course of the years from 1999 to 2004, the appellant personally acquired 13 properties and sold 11. For some of those purchases, the appellant carried out renovations and all the invoices pertaining to each of the properties were kept in a folder.

[5] In 1999, the appellant was seriously injured in a car accident. He suffers, as a result of that accident, from a permanent partial disability for which he receives monthly benefits from the Société d'assurance automobile du Québec (SAAQ) and for which he also received lump sums. Among the effects of the accident is craniocerebral trauma causing restrictions that have serious effects on the appellant's day-to-day life in that he has difficulty managing and organizing his affairs. He succeeded very well, however, in giving coherent testimony and answering questions clearly.

[6] Johanny Tremblay is a tax audit technician with the Ministère du Revenu du Québec. She began her audit in November 2005 and found that the appellant kept no accounting records. She therefore chose to proceed by means of an alternative audit method, namely, the deposit method. Accordingly, she made a list of all deposits for the purpose of comparing them with the income reported. The appellant's sources of income, from what she was able to tell, were rent, his SAAQ benefits, the sale of properties and, finally, deposits that remained unexplained.

[7] She looked at four bank accounts of the appellant's, focussing on a period of three years. In 2002, the appellant made in the four accounts deposits totalling $462,114.14. For 2003, the total is $248,522.22 and, for 2004, it is $581,966.95. Deducted from those amounts were non-business-related deposits such as loans, deposits from his line of credit, certain deposits from other accounts that were traceable, traceable bank transfers, and SAAQ benefits. She then subtracted the business income reported, that is, rental income and other income, to finally arrive at the figures found under the heading [TRANSLATION] "other income" and totalling $88,956.24, $62,820.05 and $40,465.83 for 2002, 2003 and 2004 respectively. The total of those three figures comes to the $192,242.62 that remained unexplained. At the objection stage, the auditor learned that the appellant also held accounts with the National Bank and the Business Development Bank of Canada. She did not, however, verify the transactions. Ms. Tremblay acknowledged that it is possible that among the unexplained deposits there are transactions that are not of a commercial nature and

which are, therefore, non-taxable. She was unable, however, to put forward any hypotheses in that regard.

[8] Ms. Tremblay also took into consideration, in her alternative method, certain loans from members of the appellant's family and, when supporting documentation was submitted to her, she granted the amount and reduced accordingly the amount of the unexplained deposits.

[9] Nicole Ruest, who is an auditor for Revenu Québec, reviewed the appellant's claim with respect to inputs and everything related to the real estate transactions. As for the issue of the unexplained deposits under the heading [TRANSLATION] "other income," she did not receive from the appellant or his accountants any explanation that would have allowed her to subtract from those deposits any amount that would not be taxable. She therefore taxed the full amount.

[10] The appellant explained the financial difficulties he has endured since his accident and particularly during the period at issue. He reviewed his real property acquisitions, the renovations carried out and the resales. Some of those transactions did not yield any profit, he said. He also explained that only one of the four bank accounts was personal. The three other accounts existed because he had taken out loans from the institutions concerned. He made deposits in those accounts to cover the payments. Moreover, the majority of the deposits were made in his personal account.

[11] The appellant testified that his financial difficulties led to his making many transfers from one account to the other so as to be able to cover the cheques in circulation. He used the Internet to make the transfers. He also turned to his two brothers and his mother, borrowing money from them in order to cover the cheques in circulation and avoid being overdrawn. However, he has no document to corroborate all those transactions and is not able to identify the deposits used for that purpose. A number of them were made at automatic teller machines and there is no deposit slip to identify the source of the amounts deposited.

[12] The appellant's two brothers testified that they regularly lent money to the appellant because he was short of money all the time. They explained the difficulties the appellant experienced with respect to the management of his affairs after his accident and particularly when renovating his properties and when he converted one of them into a seniors' residence. During the period in issue, the total of the amounts loaned by each of the two brothers was close to $20,000, it was said, but only some of them could be identified during the audit; in such instances, copies of the cheques

were put in evidence. Although the two brothers do not have supporting documentation for the other advances, they explained that there were many advances and for amounts varying between $1,000 and $3,000 each time. Finally, they explained that their brother's lifestyle is not consistent with the income Revenu Québec attributes to him considering his financial difficulties, particularly during the period in issue.

[13] The appellant called as a witness Marcel Léveillé, a chartered accountant. Mr. Léveillé was retained in December 2006 so that he could help the appellant with his challenge. He reviewed the deposits made at the four financial institutions where the appellant has an account, but many supporting documents were missing. He made a compilation of the properties purchased and sold by the appellant. The appellant's sources of income were the rent from residential and commercial rental properties, the profits, if any, made from the sale of properties, and the benefits paid by the SAAQ. He made submissions to Revenu Québec to show that it was impossible for the appellant to have had the income that was attributed to him considering his debts, the NSF cheques he issued and his other financial difficulties.

[14] In January 2011, he proceeded to determine the appellant's net worth. I would note that Mr. Léveillé did not testify as an expert on accounting matters. His report was, nevertheless, admitted into evidence. Mr. Léveillé wanted to demonstrate, through the net worth method, that Revenu Québec's assessments were ill-founded since, in order for the income that Revenu Québec attributes to the appellant to have been generated, the appellant's net worth would have had to increase by $96,000 in 2002, $164,000 in 2003 and $99,000 in 2004, which is not the case.

[15] In order to determine the appellant's net worth and prepare a balance sheet for each year, Mr. Léveillé took the amount of the cash on hand and the balance owing on the loans according to the bank statements. For the properties, he relied on the agreements of purchase, adding expenditures for renovations and expansions. The amounts payable include those owing as a result of various legal proceedings, those payable for renovations as well as property taxes outstanding at the end of the year. He added personal expenses, income reported, the non-taxable amounts received from the SAAQ as well as the additional income assessed, except for business income and other income and the amounts disallowed by Revenu Québec. Mr. Léveillé calculated a discrepancy of $28,846 for 2002, $7,790 for 2003 and $9,999 for 2004, which, in his view, is a far cry from the income established by the Minister.

[16] In his testimony, Mr. Léveillé said that he found that the appellant transferred money from one account to the other, but added that he could give no assurances in

that regard. In cross-examination, Mr. Léveillé acknowledged that the amount he determined as personal expenses on the personal balance sheet is purely arbitrary. He did not question the appellant about his cost of living, but rather based his determination on the amount the appellant received from the SAAQ. Nor did he calculate the appellant's cost of living on the basis of the withdrawals made by the appellant from his bank accounts. He was unable to explain with certainty certain expenses related to a residential move and simply speculated as to the amount.

[17] In his testimony, Mr. Léveillé acknowledged that the appellant had made many transactions at automated teller machines, including, obviously, a number of deposits, but said that he was unable to obtain from the financial institutions any supporting documentation or any document identifying the source of the funds. He reiterated the appellant's position that the appellant took advantage of the interval between the moment a cheque is drawn on a bank account and the moment it is deposited into another banking institution then transferred again to another institution; thus, the same money might appear in three or even four bank accounts, but it is always the same money. He said that this way of doing things could explain the large number of deposits. He said as well that the multiple loans the appellant obtained from his two brothers and his mother can also explain certain deposits, as those loans were not entered in the accounting records. Mr. Léveillé did not attempt to verify this. He explained that, for there to be income, it is necessary to identify the source, which the deposit method fails to do. Finally, he acknowledged being unable to establish a link between the withdrawals made by the appellant from his company and the deposits.

[18] He also acknowledged that the net worth method is itself flawed. In cross-examination, he admitted that it is possible that some of the appellant's assets might not be identified, just as it is possible that there might be unidentified debts, and that the result is a distortion of the net worth. With respect to the issue of the advances made by the company to the appellant, Mr. Léveillé stated that the information is not derived from the company's financial statements but emerges from documents that the appellant's accountant provided to him. He acknowledged that $10,000 should have been added to the appellant's assets, which amount represents the value of the Class A shares the appellant held in the company. Mr. Léveillé also acknowledged not having questioned the appellant on his personal cost of living; he stated that he proceeded on the basis of an amount based on the income the appellant received from the SAAQ. He acknowledged that the amount indicated is purely arbitrary. Certain expenses attributed by him to the appellant's properties are based on speculation also.

[19] The issue is therefore whether the Minister properly determined the amount of taxable supplies made by the appellant during the period in issue.

[20] There is no doubt that in the case at bar the invoices and other supporting documentation, just like the appellant's accounting records, were lacking or deficient. Moreover, the appellant acknowledged this shortcoming and his lack of rigour in his bookkeeping and in the transactions on his bank accounts. He even admitted that he did not keep separate his personal accounts and those of his company. That, therefore, opens the door to assessments based on an alternative method, in this case, the deposit method.

[21] For his part, the appellant, to counter the method used by the Minister, also availed himself of an alternative method, namely, the net worth method. The reason the appellant used that method is that, according to him, it is impossible that he could have earned all the income the respondent attributes to him without there being a consequential increase in his assets. What the two methods used in the case at bar do not indicate, however, is in what proportion the income is taxable having regard to the business activities described by the appellant. In both methods, unreported and potentially taxable income is attributed to the appellant, but is all of that income taxable?

[22] It is recognized as a matter of law that the alternative method is unsatisfactory and imprecise and that it is an instrument to be used as a last resort (see *Khullar Au Gourmet International Ltd. v. Canada*, [2003] T.C.J. No. 348 (QL), [2003] G.S.T.C. 100. It is also recognized that objective standards which are either official or generally recognized by the industry must be used, failing which evidence of their reliability must be adduced at trial. I reproduce in that regard the following passage from the judgment of Dussault J. of this Court in *Brasserie Futuriste de Laval Inc. v. R.*, [2008] G.S.T.C. 36, paragraph 158 (affirmed by the Federal Court of Appeal, 2007 FCA 393):

> . . . If the tax authorities believe that the only way to determine the sales of a taxpayer whose accounting is deficient and who does not have the appropriate documents is to mark up its sales by a certain percentage, they must still show, by means of evidence regarding industry standards or otherwise, and, if not by an expert, then with statistics, that the markup being applied is a recognized, reasonable and appropriate standard for the taxpayer's business. I cannot accept the submission by counsel for the Respondent that the presumption of an assessment's validity automatically carries with it a presumption that all the assumptions on which the Minister relied to make the assessment are valid and that no evidence of any kind need ever be offered. The 200% markup that Ms. Morand used may well constitute a

> recognized, reliable and reasonably applicable standard in this case, though I doubt it under the circumstances. It is also possible that the appropriate markup was 175%, 150% or even less. In short, when a taxpayer can raise a serious doubt, it must be shown that the markup used is not a purely subjective standard, but, rather, a standard that is objective, reliable and acceptable under the circumstances. One cannot hide behind the presumption of an assessment's validity in order to avoid having to offer such evidence. To claim otherwise is to open the door to arbitrariness by allowing the tax authorities to propound any theory with the assurance that it would be deemed valid. Just because a taxpayer has failed to meet its obligations, has deficient accounting, does not have the appropriate documents, or has destroyed those documents, does not mean that all assumptions are warranted and that those assumptions will be deemed valid under all circumstances. In income tax cases where a taxpayer is assessed by means of the indirect net worth method, and, for lack of anything better, his personal expenses are determined by means of assumptions, this is done by using minimum objective standards drawn from official statistics published by Statistics Canada with respect to the cost of living for individuals and households in different parts of the country, not by relying on numbers that stem from the auditor's impressions. In my opinion, this approach is also applicable to GST cases. . . .

[23] That said, the burden is still on the appellant to prove his case on a balance of probabilities, that is to say, to produce sufficient evidence to demolish the Minister's assumptions which are the basis for the assessment. It is a matter of presenting at least a *prima facie* case.

[24] In the case at bar, I think it is important to stress the fact that the appellant's taxable business activities can be summarized as consisting of the rental of commercial premises, the purchase and sale of properties, and the renovation of properties. It is not a retail business. It should also be noted that the heading [TRANSLATION] "other income" has nothing to do either with the transactions relating to the aforementioned properties or with commercial rental income. Involved here are unexplained deposits in the appellant's personal accounts, deposits whose source is unknown.

[25] In his evidence, the appellant told of his financial difficulties and the means he used to deal with those difficulties. It became apparent during the audit that the appellant used his bank accounts to take advantage of the interval between the moment a cheque is drawn on a bank account and the moment the amount of the cheque is deposited into another account, which meant that the same money could appear in three or four different accounts. It was not possible, however, to identify through the audit all the instances of this because the amounts did not match. The appellant testified that he did it over the Internet and that this was a common practice

for him. It is therefore impossible in this case to specify any amount of money that was used in that way.

[26] The appellant also testified that on several occasions he had had to borrow money from his two brothers and his mother. His two brothers testified with regard to that, and while they did not have any supporting documentation to confirm the advances they made to the appellant during the period in issue, their testimony was credible. I therefore find as a fact that they both advanced to the appellant amounts between $15,000 and $20,000 during that period, that is, amounts exceeding the amount of the advances that were traced during the audit.

[27] There is no doubt that the net worth established by Mr. Léveillé contains flaws that skew the results. I believe, however, that in spite of those flaws, it is difficult, considering all of the evidence, to conclude that the appellant was able to earn during the period in issue all the income the Minister would like to attribute to him. I must, therefore, give some weight to the balance sheet prepared by Mr. Léveillé and I conclude that it cannot all be income that is subject to income tax or to the GST.

[28] If I take into consideration the loans obtained from his brothers, the overlap of the deposits in several accounts, the net worth established and the appellant's testimony, it is possible to rather substantially reduce the amount indicated under the heading [TRANSLATION] "other income," except that the reduction would be purely arbitrary.

[29] The remaining balance under that heading constitutes income that is subject to income tax, but in the present circumstances is it subject to the GST? The tax audit technician who compiled the deposits acknowledged, in her testimony, that she did not know whether the source of all the deposits was of a commercial nature and that it was possible that some were not subject to the GST. The difficulty lies in the fact that the appellant's business activities generate rental income and income from the purchase and the sale of properties that were taxed under headings other than the heading [TRANSLATION] "other income." The Minister simply chose to tax all the unexplained deposits without excluding whatever may not have been taxable and, in that respect, he perhaps had no more choice than I have, at least with respect to the balance that remains unexplained.

[30] In light of all these facts, I conclude that it is probable that the amount to be attributed under the heading [TRANSLATION] "other income" is not $192,000. I am therefore prepared to arbitrarily reduce the amount and I set it at $100,000.

[31] Given the nature of the appellant's business activities, but taking into consideration the fact that the *Excise Tax Act* taxes more business activities than it does not tax, I find that 80% of the income I have determined is taxable under the ETA.

[32] The appeal is allowed in part and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with these Reasons for Judgment. There is no award of costs.

Signed this 17th day of May 2012.

"François Angers"

Angers J.

Translation certified true
on this 28th day of February 2013.

Erich Klein, Revisor

CITATION:	2012 TCC 136
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APPEARANCES:

Counsel for the appellant:	Pierre Lévesque
Counsel for the respondent:	Caroline Roy

COUNSEL OF RECORD:

For the appellant:

Name:	Pierre Lévesque
Firm:	Cain Lamarre Casgrain Wells Rimouski, Quebec

For the respondent: Myles J. Kirvan
Deputy Attorney General of Canada
Ottawa, Canada