Docket: 2014-2611(GST)G

BETWEEN:

RESTAURANT GIOVANNINA PIZZÉRIA INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 2, 3 and 22, 2016, at Montréal, Quebec

Before: The Honourable Mr. Justice Alain Tardif

Appearances:

Counsel for the Appellant:	Laurent Tessier Jean-François Poulin Marie-Camille Hudon
Counsel for the Respondent:	Chantal Paris

JUDGMENT

The appeal from the assessment issued under Part IX of the *Excise Tax Act*, R.S.C. 1985, c. E-15, is allowed in that the assessment at issue in this appeal is vacated. The associated penalties are also vacated with costs in favour of the Appellant in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 28th day of October 2016.

"Alain Tardif"

Tardif J.

Translation certified true
On this 23rd day of June 2017

François Brunet, Reviser

Citation: 2016 TCC 244
Date: 20161028
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REASONS FOR JUDGMENT

Justice Tardif

[1] This is an appeal from the assessment issued under the *Excise Tax Act*, R.S.C. 1985, c. E-15 (the "ETA").

[2] In 1960, Mr. Nicola Buffolino immigrated to Canada. In 1970, he purchased a restaurant that served mainly Italian food, evidently including pizza.

[3] The restaurant had a good reputation and a strong customer base and was a popular destination in Sainte-Marie-de-Beauce.

[4] The restaurant was located on the main floor of a building, while the family of five—Nicola, his wife and their three children—lived in an apartment above the restaurant.

[5] Business was going well, and all three of the Buffolinos' children, Enza, Maria and Nicola Jr., worked part-time at the restaurant while attending school.

[6] In 1970, the father died suddenly. Although still relatively young at the time of their father's death, Enza, Maria and Nicola Jr. decided with their mother to rise to the challenge of continuing to operate the restaurant.

[7] The transition went smoothly, and business remained strong.

[8] At one point, a grocery store went out of business, and the opportunity arose for them to purchase the vacant building and relocate the restaurant. That building was very large but also strategically located near the Chaudière River. After some hesitation and deliberation, the mother decided to buy the building in question. On August 9, 2007, Giovannina Pizzéria Inc. was registered to accommodate the new restaurant.

[9] Enza, Maria and Nicola Jr. were the sole shareholders, and a credit union approved a loan to them in the amount of $700,000. Additional funding was arranged in the form of an additional loan of $300,000 from their mother, which was converted into preferred shares. Each of the three young shareholders guaranteed the loan from the credit union up to the amount of $70,000 each.

[10] Under the plan, the future restaurant would be divided into three sections: a bar with a view of the river, a dining room and a take-out counter.

[11] In the light of the scope of the plan and the substantial cost of its implementation, each shareholder took on specific responsibilities in a context also requiring their close interaction and cooperation. Although they had a sizeable budget, they had to make choices on a regular basis to keep the plan within the originally established parameters.

[12] Nicola Buffolino explained that the purchase of an ideal cash register system was consequently put off due to the higher than anticipated cost, and in the end an adequate, but used, system was acquired at a much lower cost. This system worked well enough for the dining room and bar, while it was arranged that the Appellant would use the nearly new cash register from the former location for the take-out counter.

[13] Nicola Jr. looked after the renovations and the computer system in addition to doing the cooking, while Maria did the bookkeeping and Enza looked after the customers and managed the staff.

[14] Although the children had authority over their respective areas, they worked closely together and maintained constant communication.

[15] On October 31, 2008, after several months' work, the Appellant opened the new restaurant, which had 260 seats in addition to the bar and take-out counter.

[16] Nicola Jr. described in detail how sales were recorded in each of the restaurant's three sections.

[17] Maria, meanwhile, explained the nature of her work as to bookkeeping and accounting. She also explained the circumstances under which the Appellant hired an accountant, Ms. Laflamme, to oversee the accounting procedures. The presence and involvement of Ms. Laflamme was also an essential condition for obtaining the $700,000 loan from the credit union.

[18] Ms. Laflamme was hired to make verifications; she was responsible for drawing up and reviewing financial statements to ensure they were accurate and reliable.

[19] Ms. Laflamme explained that she conducted various tests to confirm her conclusions. She explained that she was fulfilling an obligation at the express request of the credit union, the creditor behind the $700,000 loan amortized over a 10-year period. She also testified at length concerning the colossal amount of work required for the audit process.

Genesis of audit

[20] On August 21, 2001, Louis-Philippe Dion, a manager at Revenu Québec, and his wife stopped at the Appellant's business while in Sainte-Marie-de-Beauce to purchase a pizza at the take-out counter.

[21] He ordered a pizza and paid cash for it when it was presented to him. When Mr. Dion asked for a receipt, the server wrote one out for him by hand, which raised certain suspicions for him, particularly insofar as observations of this nature generally lead to an audit process to determine whether or not the sale was recorded.

[22] To follow up on Mr. Dion's perception concerning the possibility that the business could be failing to record, and consequently report, sales, the Respondent

arranged for a Ms. Doucet to return to the site. The transaction scenario was repeated.

[23] During testimony, Ms. Doucet did not recall the date or even the year of this event; she also had not documented it whatsoever at the time and was relying essentially on her own questionable memory.

[24] When she visited the Appellant's premises, she did not ask any questions concerning its procedure for managing and recording sales at the takeout counter.

[25] She first had a meal in the dining room, the billing for which appeared to be customary and in order. However, when she proceeded to place a takeout order, the scenario reported by Mr. Dion was reproduced.

[26] Believing that the situation could involve unreported sales, Mr. Dion consequently gave instructions to initiate an audit. This, in itself, was a legitimate and entirely appropriate reflex.

[27] At this stage, I find it important to digress to explain in detail, on the basis of the testimony of Nicola Buffolino Jr., the procedure followed at the takeout counter at the time of the visits of both Mr. Dion and Ms. Doucet.

[28] In the light of the importance of the *modus operandi* at the takeout counter, I cite from the text of the Appellant's written argument, which covers the flow of events and the explanations brought to light by the evidence:

- the customer calls or goes to the restaurant and places an order;
- a waiter on duty takes down the order on an order slip;
- the same waiter gives the order slip to the kitchen so the order can be prepared;
- when the order is ready, the order slip is attached to the pizza box containing the pizza ordered by the customer;
- the box containing the pizza and bearing the order slip is then placed in the oven used to keep food warm;

- for telephone orders, when the customer opens the door to enter the takeout area, an alarm alerts the waiters in the dining room that a customer is at the counter;

- the next available waiter, who may not necessarily be the server who took down the order when the original call came in, goes to the takeout counter to give the pizza to the customer and accept payment for the order;

- at this time, the server enters the order into the cash register and the order price is displayed on a screen to the customer;

- the order, as entered into the cash register, is then printed on the tape mounted inside the cash register which is used to keep track of all sales at the takeout counter;

- the customer pays for the order and leaves with the takeout order;

- during the period in issue, Revenu Québec did not yet require the use of a sales recording module ("SRM") in restaurant establishments. Use of the SRM did not become mandatory until November 1, 2011;

- in that context, the Appellant did not provide a receipt to customers who placed orders at the takeout counter, because the cash register was not equipped to print customer receipts;

- however, if a customer requested a receipt for a transaction conducted at the takeout counter, the waiter who took the payment issued a paper receipt indicating the restaurant name, the restaurant number, the transaction date, the transaction amount and the Appellant's GST and QST numbers, and the receipt had to be signed by the issuing waiter.

[29] In accordance with Mr. Dion's directives, the audit process was initiated via a letter followed by a preliminary visit on November 7, 2011, from a Mr. Toth, the auditor assigned to the file.

[30] That visit was brief; the Appellant's representatives were asked very few questions, who then turned over all requested documents properly organized and filed in three boxes.

[31] At that time, Maria provided the auditor oral explanations concerning the number and size of the boxes used to sell pizza at the takeout counter as well as the quantity and size of the boxes used in the restaurant's dining room for customers wishing to take home with them any uneaten food.

[32] The auditor left the premises with three boxes of accounting books and records with a view to conducting a review and analysis of them at the office of the Appellant's accountant, who had taken the initiative to set aside a space for the auditor to use for this task.

[33] Five days later, on November 11, 2011, the auditor returned all of the documents to the Appellant.

[34] Upon completion of his audit, Mr. Toth identified an overpayment in relation to GST and a shortfall in relation to QST. After reconciliation, the final result was an overpayment in the amount of $156.34 in favour of the Appellant.

[35] Between this date and the date of presentation of the first proposed assessment on June 3, 2012, the auditor exchanged information with the Appellant's various suppliers, including brewers, pizza box manufacturers and so on.

[36] On June 3, the auditor returned to the restaurant accompanied by his supervisor, Jean-Pierre Pueil, to present his proposed assessment.

[37] The Buffolinos, astonished and totally flabbergasted, brought to the auditor's attention that he had neglected to take into account the transactions conducted at the takeout counter.

[38] Given the extent of this oversight, Mr. Toth became uncomfortable in the presence of his colleague, and the conversation quickly came to a close with the auditors agreeing that they would leave the site to perform additional audit work. They then left with the cash register tapes but without the boxes of documents they had returned to the Appellant on November 11, 2011.

[39] On October 14, 2012, or 14 months after the launch of the audit process, the auditor presented a second proposed assessment.

[40] Completely stunned, even traumatized by the auditor's presentation, Nicola Jr. and Maria expressed their total disapproval of Mr. Toth's findings. They made

arguments essentially similar to the information they provided at the first meeting, notably the fact that the vast majority of nine-inch pizza boxes were used not at the takeout counter but rather in the dining room for customers to use as “doggy bags” when they did not finish their meals.

[41] In the light of the nearly total absence of receptiveness on the part of the auditor, the Appellant’s representatives decided to fully and unreservedly seek to demonstrate that the assumptions followed by the auditor were completely unsupported and in no way reflected reality.

[42] To validate and confirm their claims, they brought in their accountant, who proceeded to undertake a colossal amount of work with a view to demonstrating beyond reasonable doubt that the information used by the auditor was baseless and that the information provided by the Appellant was what corresponded to reality.

[43] To validate and support its claims, the Appellant implemented a system in the dining room to track the exact number of pizza boxes used for customers to take uneaten food home from the dining room.

[44] The log it put in place tracked the exact dates, quantities and box sizes. This log was simple but reliable, particularly since a waiter had to initial every time a box was used for this purpose. In addition to having the waiters follow the new procedure to the letter, the Appellant performed recounts on a daily basis to confirm the numbers recorded.

[45] In the face of the Appellant’s strong opposition, the auditor agreed to make certain trivial and essentially arbitrary adjustments, increasing its assigned proportion of the number of boxes used in the dining room from 4% to 10%. It did not accept the arguments of the Appellant’s representatives. Insofar as the number of pizza boxes used in the dining room constitutes a fundamental issue with respect to the outcome of the appeal, it is highly interesting to note the very detailed description in paragraphs 47 *et seq*. of the Appellant’s written argument:

> 47. [TRANSLATION] **On October 4, 2012,** following presentation of the proposed assessment, Mr. Toth emailed Marie-Carmel Nazon, an auditor at Revenu Québec, to request her assistance in handling the Appellant’s file. The content of his email message, reproduced below, is highly revealing as to Mr. Toth’s areas of concern:
>
> > “Hello Ms. Nazon,

> I submitted a project today for a pizzeria (Giovannina Pizzéria) in Sainte-Marie-de-Beauce. This is my first file at RQ. The restaurant has 230 seats. He tells me that he gives out more than 150 pizza boxes a week as doggy bags!! (7,800/year, which corresponds to 40% of his annual pizza box purchases)
>
> My question is this:
>
> 1- Over the years, have you ever come across a pizzeria that gave out so many doggy bags in a year? . . ."

48. Ms. Nazon forwarded Mr. Toth's message to Michel Charrette, department head at Revenu Québec.

49. **On October 19, 2012,** Mr. Charrette replied to Ms. Nazon as follows:

> . . . It's more a matter of logic; in order to need doggy bags, the food portions have to be large. Someone who orders a small pizza is not going to ask for a doggy bag. . . . How many people were at the table (going by the number of beverages ordered) if a large was ordered? Also, there are no doggy bags for delivery orders. . . .
>
> **He could run a test like this over a period of one month**. . . . [my emphasis]

[46] The very basis of the Appellant's claims depends on the implementation of a reliable, closely managed system in this regard. In other words, the Appellant went beyond the advice offered to the auditor by colleagues of his with experience and expertise in this field of business activity.

[47] Indeed, a log for tracking the exact quantity and size of pizza boxes used in the dining room was put in place on November 8, 2012, for a period of not one month, as suggested, but instead more than two months, or until January 13, 2013.

[48] The evidence also showed that all employees were involved in maintaining this log and had followed the very strict instructions by initialling each transaction.

[49] Although the effort undertaken by the Appellant was thorough and professional, it was also monitored and supervised very closely by the accountant, Ms. Laflamme. The auditor never showed any interest in it on the pretext that the data in question were compiled after the period targeted for audit.

[50] Subsequent to this highly pertinent and revealing demonstration as to the quality and merit of the Appellant's arguments, no real progress was made on the file, as Mr. Toth maintained his position despite the thoroughness and relevance of the Appellant's submissions.

[51] Additionally, Mr. Toth, for whom this was the first case in this area, decided to disregard his colleagues' advice or suggestions and to rely on his intuition, which, according to the evidence, was not based on any reliable or even detailed information.

[52] When it came to the objection, the case was never subjected to genuine analysis, as the officer assigned to it, Ms. Latendresse, limited her effort to consulting the auditor. She mainly followed Mr. Toth's advice to uphold the assessment and followed the same arguments to the effect that the data were inadmissible since they had been compiled after the period targeted for audit.

[53] During her testimony, she explained the work she performed, which included conversations with auditor Toth.

[54] She explained further that she did not take the Appellant's submissions into account on the grounds that they were prepared subsequently to the audit. She was unable to describe the nature of the work actually carried out insofar as she had documented little to no descriptive information concerning the work in question.

[55] When asked why she had taken nearly a year to conclude, she stated that she had complied with the standards.

[56] Remaining taciturn throughout her testimony, Ms. Latendresse was on the defensive, stating that she had always acted within the parameters of her responsibility.

[57] Instead of conducting her own analysis on the basis of the relevant information submitted, she opted for the easier route of relying on the opinion of Mr. Toth, the first auditor on the file.

[58] However, despite coming to that quick conclusion, she held on to the file for nearly a year. That kind of behaviour may not necessarily reflect bad faith, but it certainly constitutes a serious breach of her obligation to conduct a proper audit by proceeding with a new analysis in accordance with the standards of her profession.

[59] When a notice of objection is filed, the file should be handed over to one or more different auditors whose responsibilities include reviewing the work that led to the notice of assessment. That exercise is to be carried out in an objective and impartial manner. The new evaluation and analysis must be independent and allow for, and encourage, the exchange of information and documents with the assessee.

[60] However, Ms. Latendresse's testimony shows convincingly that these guidelines were not followed. She merely reviewed the exchanges with auditor Toth and was unable to explain or provide details concerning the work she performed despite having control of and responsibility for the file for a period of one year.

[61] She essentially confirmed the assessment solely on the grounds provided by Mr. Toth to the effect that the basis of the Appellant's arguments was data collected subsequent to the period targeted for audit.

[62] The memo prepared by the auditor and forwarded to counsel for the Respondent prior to trial reads, in part, as follows:

> [TRANSLATION] In conclusion, I can state that there is nothing new in the boxes submitted and that I would be very disappointed if an agreement were reached since we have an ironclad case and it would be a shame for the restaurant to get out of it in any way.
>
> [My emphasis.]

These comments are clearly inappropriate and totally unacceptable. The Court has every reason to believe that the auditor had the same attitude and behaviour with Ms. Latendresse, who clearly followed Mr. Toth's directive to the letter despite the fact that this was his first experience with a case of that nature.

[63] This interpretation was also confirmed by the strategy adopted by the Respondent to place greater importance on the testimony of Mr. Toth than that of Ms. Latendresse, who, both in fact and in law, established the assessment being appealed from. However, the auditor maintained control over the Appellant's file and never allowed any discussion of the case, which, in his mind, was airtight.

[64] The Appellant emphasized that its accounting was done in accordance with professional standards and was verified by a reputable accounting firm whose representative, Ms. Laflamme, had been assigned specific responsibility in this regard and was required, among other requirements, to follow the strict criteria of

the restaurant's main backer so the latter could monitor the Appellant's financial position to ensure the security of its debt.

[65] Meanwhile, the Appellant admitted and acknowledged having made certain errors, which it called minor and that were always corrected very quickly. It emphasized further that the shareholders responsible for operation and management had fully cooperated and promptly provided all relevant documents in neatly organized format, without exception.

[66] The Appellant emphasized that the auditor had intended purposely from the start to follow a particular method for auditing the Appellant's file, this being an estimation method.

[67] The Respondent, for her part, submitted that the Appellant's accounting system entirely justified the use of this estimation method. It listed and described the problems and/or shortcomings forming the basis of its decision to make use of an alternative audit method:

- the observation made by Mr. Dion and confirmed over the following days through an anonymous visit by Ms. Doucet;
- multiple errors;
- the electronic system in place at the take-out counter was inadequate, notably due to the fact that it was not connected to the company's main system;
- cash register tape that did not provide purchase details;
- ratio of cost to profit margin;
- no mention concerning credit notes;
- duplicate entries;
- lack of consistency;
- cash drawer always open.

[68] Taken of context and without further explanation, the list of problems appears to support the auditor's submission concerning its choice of audit method.

[69] In actuality, however, and in view of the context and highly credible explanations, things appear quite differently.

[70] The auditor took into account information provided by a leading expert in the restaurant industry to guide his work and conclusions. Unfortunately, those experts did not testify. Worse, he opted to disregard the advice of industry experts in his own office who suggested the use of a log to collect reliable data.

[71] It is important to note that the dispute relates primarily to sales at the take-out counter. The two other areas, the bar and dining room, were not problematic; indeed, the audit of these two areas resulted in determination of a QST and GST overpayment by the Appellant.

[72] In essence, the Respondent's position may be summarized as follows:

- First, the situation required use of an alternative audit method. The audit was conducted in accordance with professional standards while maintaining objectivity at all times.

- Second, the Appellant's shareholders implemented a system for unjustified and unacceptable reasons to hide sales of a considerable amount.

[73] My first impression is that prior to launching a large-scale audit, it would have been wiser for Mr. Dion to question the existing situation or for someone else to visit the site to collect more information to confirm his initial impression.

[74] Lastly, the Respondent disregarded the Appellant's submissions on the grounds that their basis was subsequent to the period targeted for audit. The Respondent fails to note that Maria had indicated the 75% percentage of boxes at the start of the audit.

[75] Mr. Dion's report was interpreted not as a doubt or suspicion but rather as a reality the presumable objective of which was to hide income in disregard of all tax responsibilities.

[76] Although the Respondent has never admitted to being biased against the Appellant from the start, the approach taken with respect to the file from start to end points toward the contrary.

[77] Indeed, that situation might raise certain doubts, particularly since it involves a business sector in which, unfortunately, too many companies abuse and defraud the system by failing to live up to their tax obligations.

[78] That being said, bad faith is not presumed, and when it comes to QST and GST, the registrants are Crown agents. Now, an agent is expected to fulfil its obligations arising from the law but also to be able to count on the cooperation of the principal so that a harmonious relationship might ideally exist between the two. In this context, mutual respect is absolutely essential.

[79] Mr. Toth, the representative in charge of the file, was clearly biased against the Appellant; that is a serious assertion, but confirmed by a whole series of factors, in particular :

- He asked very few questions despite the admitted and acknowledged cooperation of the Appellant's representatives; from the start, the shareholders and their accountant offered their fullest cooperation;

- He raised few to no questions concerning the various observations made subsequent to questioning at the first meeting;

- Although the audit work was carried out at the office of the company's accountants, once again the exchanges were minimal to nonexistent with the accountant thoroughly familiar with the matter;

- Following review and audit of the file, in his rush to proceed with assessment, he completely forgot to take into account the cash register tapes at the takeout counter, an oversight that the Appellant's representatives happened to notice in the presence of his supervisor at the meeting to present the first proposed assessment;

- That oversight was significant and could surely have discredited the entire quality and reliability of Mr. Toth's work on his first file of this type. Was Mr. Toth's ego possibly hurt?

- When presenting the second proposed assessment, the auditor was generally unreceptive to the Appellant's arguments and submissions;

- Despite the colossal and very thorough work prepared by the Appellant's agents, the auditor was not at all receptive;

- The Appellant then invested considerable money and energy to confirm the quality of its submissions by putting in place a log in which to collect relevant data;

- The auditor rejected all of this work outright on the pretext that the data collected were subsequent to the period in question;

- Auditor Toth's interactions with the objection officer who apparently urged him to confirm the quality of his work;

- The lack of consideration of advice from more experienced colleagues;

- The auditor maintained authority and control over the file even during the objection phase, which ultimately proved mainly an academic exercise;

- Despite the outright refusal to take into account the work undertaken by the Appellant, the Respondent deliberately held onto the file for months for no apparent reason. The file was open for a period of 1,689 days (from November 7, 2011, to June 22, 2016). Notice of appeal to the Tax Court of Canada was issued on July 4, 2014;

- Finally, the auditor's memo to counsel for the Respondent prior to trial reads as follows:

> [TRANSLATION] In conclusion, I can state that there is nothing new in the boxes submitted and that **I would be very disappointed if an agreement were reached since we have an ironclad case and it would be a shame for the restaurant to get out of it in any way**"
>
> [My emphasis.]

[80] The Court accepts the following excerpt from pages 33, 34 and 35 of the Appellant's written argument:

> g) [TRANSLATION] On April 3, 2014, Ms. Latendresse confirmed that she was rejecting the submissions and upholding the assessments;
>
> h) the objection decision was rendered on April 29, 2014;

i) following a procedure in place at the Direction des oppositions, the objection officer completed a risk detection and assessment questionnaire to ensure that the Appellant's file could be closed without concern. According to Ms. Latendresse, there was no risk in closing the Appellant's file since the latter did not evince any of the following characteristics:

   i. it did not raise a sensitive issue ("examples: impact on taxation policy, perception of inequity, lack of integrity or bias, insinuation concerning violation of confidentiality guidelines, possible media coverage . . .");

   ii. the financial consequences were not deemed "significant" by Revenu Québec (the amount in dispute was less than $1 million and the objecting party was not a large company on the verge of bankruptcy);

   iii. the Appellant's file had no incidence on other agents;

   iv. the matter in dispute in the file at hand did not appear on the list of significant disputes;

   v. the matter in dispute did not appear on the "list of topics on the monitoring of trends, maintenance of the administration's consistency and law enforcement . . .";

   vi. the Appellant's file was not subject to media coverage and did not involve any individuals involved in politics;

   vii. there was no risk of significant impact on other files of the decision rendered concerning the Appellant's file;

j) based on the responses provided on the questionnaire, Ms. Latendresse could close her file with peace of mind knowing there was "no risk";

k) when questioned concerning the grounds for rejecting the submissions, Ms. Latendresse asserted as follows:

i. she did not consider the information provided by the Appellant because it was based on data subsequent to the period targeted for audit;

ii. Ms. Latendresse asserted further that some data were not accompanied by supporting documentation; for example, the inventory of pizza boxes purchased was not accompanied by invoices for the purchase of pizza boxes;

iii. when asked whether she had contacted the Appellant's representatives to request the documents she deemed missing, Ms. Latendresse stated that in keeping with procedure, an objection officer reviews a file assigned to him or her once the taxpayer has definitively made all submissions and supplied all supporting documentation;

iv. Ms. Latendresse asserted that it was up to taxpayers to ensure that they make complete, exhaustive and final submissions;

v. according to Ms. Latendresse, an objection officer is under no duty whatsoever to interact with taxpayers to request relevant missing information not included in their submissions;

vi. despite the thorough submissions by the Appellant (23 pages of text and 18 pages of schedules), Ms. Latendresse decided that the lack of certain documents justified the closing of the file without first contacting the Appellant;

l) the rigid, circular approach taken by Ms. Latendresse in reviewing this case is deplorable and leads to an undesirable increase in the judicialization of numerous files that could be resolved by the Direction des oppositions;

m) the Appellant's file was not handled in compliance with basic guidelines in this regard as set out in the brochure "Filing an objection: it's your right. Make it work for you![1] " According to the

[1] Revenu Québec, "Filing an objection: it's your right. Make it work for you!", Revenu Québec, February 2013, online: http://www.revenuquebec.ca/documents/en/publications/in/in-308-v(2013-02).pdf (consulted July 14, 2016).

Appellant, the Direction des oppositions did not follow the following requirements;

i. "have your notice of assessment reviewed by a work team other than the one that issued the notice in order to ensure the impartiality of the process."[2] By handing the file back to Mr. Toth, Ms. Latendresse abdicated her duty to conduct an impartial analysis of this file and assigned her powers as objection officer to the auditor. Ms. Latendresse's conclusions concerning the Appellant's submissions are, in fact, Mr. Toth's conclusions. Ms. Latendresse's analysis, to the extent that there was one, was distorted by the position of the auditor;

ii. "give you the opportunity to be heard"[3] and "allow you to discuss your file."[4] By failing to contact the Appellant's representatives at any time or to give any indication concerning the submissions made, the Direction des oppositions did not give the Appellant the opportunity to be heard.

[81] Marginalizing a file such as the Appellant's shows a lack of responsibility.

[82] As for the burden of proof, the Court accepts the Respondent's position that the burden of proof was on the Appellant.

[83] However, surprisingly, the Respondent refers to the case law, which holds that the burden of proof may be reversed. I refer in particular to the excerpts from pages 25 and 26 of the Respondent's written argument:

> . . .
>
> - [TRANSLATION] The tax assessment has a presumption of validity (s. 1014 *Income Tax Act*), which may be rebutted by the taxpayer.
>
> - The taxpayer's initial burden involves "demolishing" the veracity of this presumption by establishing a *prima facie* case.
>
> - Where the taxpayer makes such a case, the burden of proof is reversed.

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[2] Id., p. 2.
[3] Id.
[4] Id.

> - The tax authorities must then refute the *prima facie* case and prove the assessment issued by presumption.[5]
>
> . . .
>
> [24] While the evidence may not be conclusive, the burden of proof put on the taxpayer is not to be lightly or arbitrarily shifted taking into consideration the fact that it is the taxpayer's business (*Orly Automobiles Inc. v. Canada*, 2005 FCA 425 at paragraph 20). This Court clarified that it is the taxpayer who knows how and why his business is run in a particular fashion rather than in some other ways. He knows and possesses information that the Minister does not. He has information within his reach and under his control.[6]
>
> . . .
>
> [44] I therefore constantly had to remind him that the burden of proof was upon the Appellant. To meet this burden, it is not sufficient to criticize or attack the quality of the audit; this may be useful and necessary, but most certainly is insufficient. It is essential to demonstrate that the complaints laid or the errors revealed had a direct effect on the well-foundedness of the assessment.
>
> [45] On the other hand, it is equally important to demonstrate what the assessment should have been, based on the available and verifiable accounting data, not on intuitive assessments or arguments based on reasonableness. [7]

[84] In this case, the Appellant's attacks and criticisms are not trivial. The attacks are substantial and also discredit entirely the quality of work on the basis of entirely unjustified assumptions and an intuition clearly shaped by the objective, from the start of the audit process, to assess the Appellant.

[85] The basis of the assessment being appealed is estimative, arbitrary and even essentially intuitive; it has absolutely nothing to do with the real facts described by the Appellant's representatives.

[86] The Appellant's officers are perfectly familiar with every aspect of their business. They are earnest, determined and committed to building their business on a solid foundation. They are open and receptive to anything that is likely to have

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5 *Hickman Motors Limited v. Her Majesty the Queen*, [1997] 2 S.C.R. 336 (Tab 2 of Respondent's book of authorities).
6 *Amiante Spec Inc. v. Her Majesty the Queen*, 2009 FCA 139 (CanLII) (Tab 3 of Respondent's book of authorities).
7 *9036-9695 Québec Inc. v. the Queen*, 2004 TCC 222 (CanLII) (Tab 4 of Respondent's book of authorities).

transparent, reliable and effective results. Any advice or suggestion that might improve the situation is rapidly implemented.

[87] The poor quality of the work performed by both the auditor and the objection officer arises directly from the selection of the estimation method. Indeed the results thus obtained are entirely and quickly discredited by the evidence and by the reliability of the Appellant's submissions, the basis of which is neither hypothetical nor arbitrary, intuitive nor speculative. They are instead founded on thoroughness, objectivity and reliability confirmed by reasonableness.

Estimation method

[88] The auditor's decision to follow an estimation method was unwarranted due to the fact that the Appellant had in its possession all documents, logs and information required to allow for a classic approach to the audit.

[89] The Appellant did not merit perfect marks; on the other hand, the accountant's eagerness to cooperate and willing involvement had to compensate for certain deficiencies, which were also corrected in full even prior to issuance of the auditor's written recommendations.

[90] The quality of the evidence submitted is based in part on the logs put in place to count and track the distribution of pizza boxes, mainly the nine-inch boxes. That exercise confirmed the accuracy of the information conveyed orally to the auditor at the start of the audit process.

[91] The conclusions were once again proven correct following the implementation of the system linking all the operations.

[92] Moreover, neither the auditor nor the objection officer made any attempt whatsoever to attack or discredit the quality or credibility of the data garnered by the Appellant.

[93] The sole motive and reason for which they rejected outright and refused to take into account this data is the fact that it was collected subsequently to the period targeted for audit.

[94] What makes this all the more odd is that the auditor's more experienced colleagues also advised and suggested that he follow that very approach to prove or disprove the assertions made by the Appellant at the start of the audit process.

[95] It would have been entirely logical for the auditor to question and analyze the work performed by the Appellant's accountant. Despite the fact that he posed few questions from the start, that he felt the need to consult one or more colleagues, that he was working on his first file in this field, that he committed a serious error early in the process by failing to take into account transactions conducted at the takeout counter and that he took only five days to complete his analysis of the file; despite the fact that the initial audit resulted in an overpayment on the part of the Appellant; and despite the fact that the Appellant turned over all information during the auditor's first visit to Sainte-Marie-de-Beauce and the Appellant's and the Appellant's accountant's representatives offered their fullest cooperation, which the Respondent has admitted, the Respondent persisted in maintaining that it had valid grounds for disregarding the reliability and credibility of the evidence submitted by the Appellant.

[96] At the commencement of the audit, Maria had informed the auditor that 75% of all nine-inch pizza boxes were given out to guests in the dining room to use as doggy bags.

[97] According to the auditor, however, only around 4% of boxes were used for that purpose. This figure is not only arbitrary but also completely unreasonable.

[98] He then increased the proportion of boxes used in the dining room from 4% to 10%, once again without ground or verification.

[99] The evidence submitted by the Appellant meets the requirements defined by the case law as to the reversal of the burden of proof. This is because the putting in place of a comprehensive log under the specific instructions of the company's accountant confirmed and proved the Appellant's submissions.

[100] Indeed, the facts at the origin of the audit were particular, and the file in question certainly called for an audit. The Respondent was consequently fully justified in taking the matter seriously and verifying whether the Appellant was complying with the law and observing fully its fiscal duties.

[101] This file highlights a serious shortcoming in our judicial system: it is no secret that the cost of going to trial is frequently prohibitive to the point that frequently, and unfortunately, reasonable persons without great ability to pay conclude that they are better off simply paying what is being sought from them rather than standing up for their rights.

[102] Other persons may decide that they do not care whether or not they can pay and go to trial on principle, in which case failure can have dramatic impact on their lives or the existence of the companies they lead.

[103] In the present case, the Appellant's shareholders are young, intelligent, driven to succeed and committed to a business venture in which the obstacles are many and significant. They are operating within very strict financial constraints and have to report regularly to their financial backer.

[104] These observations lead me to raise the following question. Is it possible that three intelligent young people would agree to take on a judicial challenge likely to jeopardize their future based on a dubious and uncertain case? First of all, they were confident that their arguments were sound and were determined to show that they had properly fulfilled their fiscal obligations. According to he preponderance of the evidence, they were correct.

[105] The Respondent, meanwhile, argued that all conditions required for the use of this method were present to the point that it was the only viable approach to carrying out the audit.

[106] The use of that type of method is evidently not ideal in that the results obtained are based on assumptions and speculation marked by arbitrariness.

[107] When using this type of method, it is consequently essential to be able to confirm and prove the reliability of the assumptions.

[108] The auditor opted for hearsay, speculation, assumptions and arbitrariness over the simplicity, reliability and reasonableness argued by the Appellant.

[109] The fact that three young people with little experience, but with a clear sense of commitment, determination and responsibility, were able to obtain $700,000 in funding to operate a restaurant, which most financial backers would classify as a high-risk investment, testifies to their financial and moral credibility.

[110] The accountant testified at length. She was perfectly familiar with the file and able at all times to supply simple and clear responses, revealing the thoroughness of her work. Each of the arbitrary and speculative assumptions used by the auditor was rejected on the basis of convincing arguments.

[111] In the light of the accountant's testimony, it is reasonable to conclude that the exercises and scenarios put in place to quantify the number of boxes and their use generated results that were tangible and reliable as well as reasonable in terms of representing the reality that should be accepted.

[112] The testimonies of the accountant, Nicola Buffolino Jr. and Maria Buffolino, have revealed the following facts:

- In the dining room, nine-inch boxes are mainly used for doggy bags; maintaining that it is necessary to apply the same percentage distribution to all box sizes is quite simply unreasonable;
- A log was put in place to track boxes and box sizes over a two-month period and proves the accuracy of the Appellant's assessment of the situation at the commencement of the audit;
- The data garnered concerning the average number of pizza boxes used per transaction following installation of the new cash register system produced the following result:

2012	2013	2014	2015	
July 31	July 31	July 31	July 31	Average
1.23	1.31	1.22	1.22	1.25

- According to the Respondent, one pizza box per transaction is given out to customers at the takeout counter based on an analysis of the cash register tapes. It submitted that the same analysis revealed the occurrence of approximately 3,000 transactions under $7 each for the period ended July 31, 2009.
- During her testimony, Ms. Laflamme completely contradicted the data garnered by the auditor. Based on her analysis, she showed that there were an average of six transactions under $7 each per week, which would yield a total of approximately $325 in place of the 3,000 used by the auditor.
- All demonstrations submitted by the accountant were supported by comprehensive, and highly credible, tables.
- I do not find it necessary to reproduce these tables.

- According to the auditor, the Appellant generated net profit of between 16.19% and 23.33% for the period between 2009 and 2011. This was in the early days of the business, when certain challenges are inevitable. Since installation of the SRM, however, net profit has ranged between 7.76% in 2015 and 14.69% in 2012.

[113] The Appellant destroyed the basis determined by the auditor, Bernard Toth, given thorough and reliable grounds as well as common sense, leading to reversal of the burden of proof, which, in accordance with certain casuistic authorities, results in the vacation of the assessment.

[114] Through this convincing demonstration and the use of the numerous tables, which the Tribunal did not find it necessary to reproduce, it also established and shown that its own submissions and arguments were those to be used by the Tribunal as justification for vacating the assessment.

[115] Additional individuals apparently also visited the site. They did not testify, as the Respondent chose to call Ms. Doucet only to testify.

[116] Any audit should be initiated from a calm, open and objective viewpoint. Certain facts and contexts may not allow for this type of climate or approach.

[117] In the present case, there might have been grounds for having certain suspicions concerning the specific practice followed for takeout orders. That is evident in view of Mr. Dion's and Ms. Doucet's observations.

[118] However, it would have been logical and reasonable to start by questioning this particular aspect; the auditor could then have heard the same explanations submitted by Nicola Buffolino Jr. to the Court. Rather than proceeding in this manner, the auditor, Bernard Toth, chose instead to reinforce his own clearly negative suspicions and biases. He then developed a game plan that left no room for any meaningful cooperation or exchange with the Appellant's representatives.

[119] For these reasons, the appeal is allowed in that the notices of assessment are vacated. The associated penalties are also vacated with costs in favour of the Appellant.

Penalties

[120] Carelessness, indifference, bad faith, mismanagement, a lack of accounting and a significant gap between reported income and actual income are all aspects logically demonstrating gross negligence justifying the imposition of penalties. In the present case, the burden of proof is on the Respondent.

[121] To justify the imposition of a penalty, the Respondent is relying on assumptions that auditor Bernard Toth developed and upheld in establishing notices of assessment based on the estimation method. Now, according to the preponderance of evidence, the assumptions in question have been discredited.

[122] The management of the "takeout orders" component was not entirely beyond reproach. In this regard, the evidence has shown that the Appellant was going through a transition period while also experiencing notable growth in sales.

[123] The dining room component needed to incorporate into its processes a new approach supporting more reliable tracking of sales as is imposed by the tax authorities.

[124] In any case, the Appellant implemented the new approach within the prescribed time frame. In addition to complying with tax requirements, the new system confirmed the Appellant's claims, which on its own should have led the auditor to question the validity of his conclusions.

[125] Despite their good faith and cooperation, the company's administration and management did not deserve a 10 out of 10 score. However, their cooperation and good faith largely shown, along with the genuine and clear willingness to take appropriate corrective action, should have produced a climate of mutual or reciprocal trust, exchange and cooperation leading the auditor to take a more objective approach to the file. On the contrary, the auditor and the objection officer adopted an approach based on mistrust, doubt and great suspicion of the Appellant that was unfounded and inappropriate.

[126] Nicola Buffolino Jr.'s testimony was clear and unrehearsed. His responses were accurate and consistent.

[127] Some explanations appeared questionable at first; I refer notably to a flooding problem that was cited repeatedly to justify the loss of important documents.

[128] The witness confirmed that information by producing a bill for repairs to the roof. He explained further that the basement area was so large, and so rarely used, that the boxes moved there following the flood were subsequently forgotten. In short, the evidence dispelled any possibility that his explanations may have been misleading.

[129] The accounting was certainly not perfect at the time of the audit, but there is nothing to show that it was deficient to the point of calling for outright rejection to the benefit of an arbitrary estimation approach.

[130] Indeed, adequate tax accountability depends on two basic elements: the first is the existence of adequate records, and the second, just as important, is the availability of relevant and reliable documents and information provided by persons of faultless credibility.

[131] As such, it is possible for the accounting to be faultless but for the individuals involved in a matter of this nature to be incredible, in which case an alternative method would be entirely warranted and appropriate.

[132] In the present case, the accounting was perhaps somewhat flawed but did not preclude the taking into consideration of reasonable, factual explanations, which in itself was sufficient to prevent the need for the arbitrary estimation approach.

[133] Auditing is demanding work. It is to be performed in a serious, professional and objective manner. It is also to be performed with respect.

[134] Taxpayers have a right to respect at all times, which implies that their explanations merit analysis, particularly if they are credible and backed up by an objective approach.

[135] The event having triggered the audit is not in issue; Mr. Toth acknowledges that the Appellant's shareholders cooperated fully from the start. They made themselves available and ensured that the auditor had a proper workspace, including space directly at the office of their accountant, who was also highly cooperative. They responded promptly without hesitation or holding back information.

[136] The fact that the auditor asked very few questions leads one to wonder whether he was concerned that the responses might discredit his perception or intuition.

[137] This being his first file, he consulted a colleague but then did not follow the colleague's recommendations, which consisted in the implementation of a post-audit system.

[138] He was present on site for a very short time, taking only five days to complete his analysis of three boxes of documents. He returned all documents in question at the end of the five days. He then presented an initial proposed assessment that failed to take into account sales at the takeout counter, which is at the root of the dispute.

[139] It is very important to note and emphasize that the Appellant supplied to the auditor exactly what a colleague of his had suggested, in fact provided a better sample that covered a longer period.

[140] That is sufficient information to conclude that the auditor was biased against the Appellant from the start. The auditor acted in a tendentious manner toward the Appellant. That view and that harsh conclusion are confirmed, at the very least in part, by the content of the memo the auditor forwarded to counsel for the Respondent prior to trial.

[141] Where the use of an estimation method is warranted, that does not mean that an auditor can take a shotgun approach and then pick and choose the information that suits him according to a clearly predetermined objective. The use of an estimation or alternative method requires great discipline and the consideration of all substantial information, which the Appellant provided to him.

[142] I accept the Appellant's argument as being more reliable, reasonable and convincing with respect to the results. The penalties will be vacated as they are in no way justified in view of the quality of the Appellant's evidence :

- the good faith of the Appellant's shareholders;
- the highly acceptable quality of their bookkeeping and accounting;
- the quality and credibility of all of the Appellant's witnesses;
- the preponderance of the evidence;
- the willing and unlimited cooperation of the Appellant's representatives with the auditor and the objection officer;

- the very close management of the administration;
- the involvement of the highly competent accountant.

[143] The Respondent questioned and disputed the Appellant's decision to delay the purchase of an ideal electronic system for the "takeout orders" component on the pretext that that purchase would cost very little in comparison to the overall investment in the business.

[144] Were the context disregarded, this criticism might be valid and be recorded as a point on the negative side.

[145] Considered in context, however, that criticism is not as significant as argued by the Respondent.

[146] The only fact that might call for the imposition of a penalty is the observations of Mr. Dion and Ms. Doucet. However, those were isolated transactions conducted by an operation whose management was highly acceptable overall. Moreover, the laws and regulations governing the management of billing in restaurants were not in force at the time of the mandatory audit.

[147] Additionally, vacating the assessment constitutes a fundamental event resulting necessarily in vacation of the penalties.

[148] For these reasons, the Court allows the appeal and vacates the assessment subject to appeal; the Court also vacates the penalties, with costs in favour of the Appellant.

Signed at Ottawa, Canada, this 28th day of October 2016.

"Alain Tardif"

Tardif J.

Translation certified true
On this 23rd day of June 2017

François Brunet, Reviser

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