

Docket: 2005-1240(IT)I

BETWEEN:

ANDRÉ ROY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on February 2, 2006 at Québec, Quebec.

Before: The Honourable Justice P.R. Dussault

Appearances:

For the Appellant:

The Appellant himself

Counsel for the Respondent:

Michel Lamarre

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1999, 2000 and 2001 taxation years are dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 2nd day of May 2006.

"P.R. Dussault"

Dussault J.

Citation: 2006TCC226
Date: 20060502
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ANDRÉ ROY,

Appellant,

and

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REASONS FOR JUDGMENT

Dussault J.

[1] These are appeals from reassessments made under the *Income Tax Act* ("the Act") for the 1999, 2000 and 2001 taxation years.

[2] By virtue of these reassessments, the Minister of National Revenue ("the Minister") revised the Appellant's net business income to \$10,241 for 1999, \$12,983 for 2000, and \$24,042 for 2001. The reassessment for the 1999 taxation year was made after the normal reassessment period. In addition, the reassessments for each of the years include a penalty for gross negligence under subsection 163(2) of the Act.

[3] The facts on which the Minister relied in making the reassessments are set out in paragraphs 7 to 9 of the Reply to the Notice of Appeal, which read:

[TRANSLATION]

7. ...

(a) During the years in issue, the Appellant operated a sole proprietorship whose principal activity was to offer tourists guided tours of

Old Quebec City and the surrounding countryside in minibuses throughout the year.

- (b) During the years in issue, the Appellant operated his business under the name La Tournée du Québec Métro Enr.
- (c) During a tax audit, the Minister realized that there were no books of account, and, during a test using the bank deposit method for the 2001 taxation year, an income discrepancy amounting to approximately \$40,000 was noted.
- (d) Faced with this situation, the Minister audited the Appellant's income using the net worth method; a copy of the Appellant's statement of net worth is attached as an appendix hereto (pages 1-17).¹
- (e) The following additional income amounts were established based on the net worth method audit for the period from December 31, 1997, to December 31, 2000:

Taxation year

(i) 1999	\$23,279
(ii) 2000	\$21,053
(iii) 2001	<u>\$29,910</u>
	<u>\$74,242</u>

- (f) It is clear that the unreported income does not come from the calculation of the personal expenses, the totals of which are as follows:

Taxation year

(i) 1999	\$6,220
(ii) 2000	\$3,581
(iii) 2001	<u>\$3,602</u>
	<u>\$13,403</u>

¹ The appendix is not reproduced.

- (g) Upon the Appellant's request, the Minister granted him non-capital loss carry-forwards every year:

Taxation year

(i) 1999	\$1,075
(ii) 2000	\$7,971
(iii) 2001	<u>\$19,859</u>
	<u>\$28,905.</u>

8. Upon filing his income tax return for the 1999 taxation year, the Appellant presented incorrect facts negligently, carelessly or by voluntary omission, or committed fraud of some kind by providing certain information based on the following criteria:
- (a) the Appellant keeps no records or books of account and reported whatever business income he felt like reporting; and
 - (b) the additional income represents roughly 50% of his reported business income.
9. The Minister determined that the Appellant knowingly, or in circumstances that warrant a finding of gross negligence, made a false statement or omission in the income tax returns filed for the 1999, 2000 and 2001 taxation year, or that he made or participated in, assented to or acquiesced in the making of, the false statement or omission, which resulted in his paying less income tax than was payable for the years in issue based on the information provided in the income tax returns filed for those years:
- (a) The Appellant keeps no books of account, and reported such business income as he felt like reporting.
 - (b) The Appellant's permanent record contains a letter in which the Appellant undertakes to keep an adequate set of accounting records and books.
 - (c) The Appellant stated that he is a former teacher and indicated that he was the shareholder of a corporation whose financial statements he personally prepared.
 - (d) The additional income represents roughly 50% of his reported gross business income.

[4] The Appellant, auditor Richard Paquet, and appeals officer Line Gariepy testified.

[5] Mr. Paquet began his audit of the Appellant's affairs for the 1999, 2000 and 2001 taxation years by asking the Appellant to make his books, records, invoices, banking documents and other relevant documents available to him (Exhibit A-1). His first finding was that the Appellant had no accounting records or books, and did not have sales invoices, or bank deposit slips other than ATM deposit statements. In addition, he obtained all the Appellant's account statements directly from several financial institutions. The Appellant kept several accounts into which amounts paid by customers using Visa, MasterCard and American Express credit cards were directly deposited.

[6] Mr. Paquet began by analysing the deposits into the Appellant's various accounts for the year 2001. From a total of \$87,656 in deposits, he subtracted \$19,693, which, according to his analysis, consisted of transfers between accounts. Then, he added \$15,000 to account for expenses which, in his opinion, had been paid in cash. Based on this first analysis, the Appellant's net business income for the 2001 taxation year was \$82,962, even though he reported only \$43,200, hence the \$32,762 discrepancy for the year (Exhibit I-1).

[7] This initial observation, and the fact that the Appellant did not keep any records or books of account, are what induced Mr. Paquet to determine the Appellant's income for the three years using the net worth method. The detailed calculations are set out in the 17-page appendix to the Reply to the Notice of Appeal. Using this method, Mr. Paquet established that the Appellant failed to report \$74,243 in income for the three years — specifically, \$23,279.36 for 1999, \$21,053.27 for 2000, and \$29,910.58 for 2001. According to Mr. Paquet, these amounts consisted of additional income from the Appellant's business, either in the form of revenues from the actual guided tours, or in the form of tips.

[8] Mr. Paquet also said that the Appellant gave him a box containing invoices. However, Mr. Paquet explained that since the Appellant had no accounting system that could justify the deducted expenses by means of vouchers, he was unable to reconcile the deducted expenses, including the expenses for the 2001 taxation year, based on the documents that the Appellant had submitted to him.

[9] Mr. Paquet further reported that the Appellant told him that he collected sales taxes, which were supposedly included in the tour prices. However, Mr. Paquet was unable to find any registration number, returns or tax

remittances in the Appellant's name. Apparently, the only thing that was found was a GST registration number that was issued to La Tournée du Québec Inc. and was valid until 1998. However, Mr. Paquet stated that there were no amounts in the system. The Appellant apparently incorporated the company in 1983, and the business was operated by the company for an unspecified period.

[10] According to Mr. Paquet, the significant discrepancies determined by the net worth method — discrepancies in the range of 50% to 75% — caused him to make a reassessment in respect of the 1999 year beyond the normal reassessment period and to add a penalty contemplated in subsection 163(2) of the Act. Moreover, in Mr. Paquet's opinion, the amounts deducted for certain expenses were round numbers and represented fictitious expenses that he was unable to reconcile with the documents submitted. Lastly, Mr. Paquet stressed the fact that the Appellant gave his undertaking to keep appropriate records and books for his business as far back as 1982, and yet failed to comply with this undertaking during the three years covered by the audit (Exhibit I-5).

[11] Line Gariepy is an appeals officer. After the Appellant objected to the assessments made by Mr. Paquet, she confirmed them, but concluded that the additional income determined by the net worth method consisted of tips in connection with the tour guide business operated by the Appellant (Exhibit A-3). I should note that it seems unrealistic to believe that the additional income assessed for the 1999, 2000 and 2001 years consisted exclusively of tips that the Appellant received in connection with the operation of his business. However, the assessments were not made on this basis; rather, they were based on the assumption that the income was derived from the operation of the business, whether it consisted of tips or not.

[12] The Appellant is not contesting the set of calculations by Mr. Paquet, which show a \$74,000 discrepancy for the 1999, 2000 and 2001 taxation years. However, rather than representing unreported income earned in the course of these years, he submits that it essentially consists of his savings over the past 20, 25 or even 30 years, which he kept in cash at home and invested in his business.

[13] The Appellant explained that he obtained his first tourist guide permit in 1973 when he was a teacher. He left teaching in 1983, and allegedly received a \$31,000 severance bonus. Then, he incorporated La Tournée du Québec Inc., referred to above. He allegedly operated the tourist guide business through this company for an unspecified number of years, after which he operated the business as a sole proprietor again. It can be seen from the Notification of Confirmation for

the years in question, attached to the Notice of Appeal, that the Appellant reported losses of \$6,419, \$8,541, \$12,688 and \$15,032 for each of the years 1995 through 1998. This represents a total \$42,680 for the four years prior to the three years in issue.

[14] Though the Appellant stated that the permits in his possession cost him nothing (other than the permit acquired in 1973 for \$5,000), he estimated their value at more than \$300,000, which he considers his pension plan (Exhibits A-4 and A-5). According to the Appellant, the permit that he acquired in 1996 following a hearing before the Commission des transports du Québec is the most important permit that he obtained for the operation of his business. The costs of the hearing were the Appellant's only expense for the permit.

[15] The Appellant said that despite the value of his permits, financial institutions would not recognize them as loan collateral, so he had to operate the business using his own savings and therefore needed cash. I understand that the Appellant also criticized the auditor for not taking account of the value of his various permits for the purposes of his assessments. In this regard, I would simply note that the fact that the permits were not included in the Appellant's assets had no bearing on the net worth calculations, because no new permits were acquired between 1998 and 2001, the Appellant made no expenditures with respect to any permits during this period, and he did not dispose of any of his permits.

[16] The Appellant also explained that two of the vehicles that were used to transport tourists were 1979 models that he purchased in 1983, and that a third vehicle was a 1980 model, which enabled him to save money on insurance premiums because he was not insured for damage to these vehicles.

[17] The Appellant stated that the clients of his business were recruited through tourist information offices or directly through his website. He said that most tourists pay by Visa, MasterCard or American Express. Although the tour prices did not include taxes, the Appellant claimed that taxes were added upon payment, that he was a sales tax registrant, and that the taxes were remitted annually.

[18] As far as his lifestyle is concerned, the Appellant said that his expenses were limited, notably because he was single, never went out, never went to restaurants or movies, and did not travel. He added that he owned only one house, which he has never renovated, and which does not even have hot water.

[19] The Appellant reiterated that he reported all his business income, including tips, and that the clients paid this money by credit card or in cash. With reference to Exhibit I-1, which pertains to the deposits, tracked down by Mr. Paquet, into his various bank accounts in 2001, the Appellant stated that these were either deposits from various financial institutions in respect of credit-card payments; deposits of cash from customers; or deposits of money from his own savings, accumulated over approximately 30 years, and kept in envelopes each of which contains \$5,000 in cash. In fact, at the hearing, he displayed one of these envelopes, which contained fifty \$100 bills.

[20] On cross-examination, the Appellant admitted that this was the first time that he provided this explanation regarding the existence and use of the savings that he kept at home in cash. He also said that he had never been asked for explanations before and that in any event, he was told that his explanations were of no interest.

[21] As for his Notice of Objection to the assessments in issue, the sole ground of which is an error in the calculation of the penalty imposed under subsection 163(2) of the Act, the Appellant said that he wrote whatever struck his fancy, and that his accountant told him to keep his best arguments for the judge.

[22] We know that the Appellant incurred \$42,680 in losses during the years 1995 through 1998. According to the Appellant, the \$74,000 discrepancy that the auditor arrived at through his calculations for the 1999, 2000 and 2001 taxation years does not constitute additional income. Rather, he claims, they are losses that he incurred during these years and that he covered by resorting to the savings that he had allegedly accumulated over the previous years. As for the years subsequent to 2001, the Appellant admitted that he has not filed his returns and that it is therefore not possible to ascertain whether his operations during those years resulted in a profit or a loss. However, based on the results of 1995 to 2001 and the explanations provided by the Appellant, he incurred more than \$116,000 in losses, which he covered by resorting to the savings that he had built up over previous years.

[23] It is difficult to imagine how the business operated by the Appellant could have generated enough profits to enable him to accumulate such significant savings in the past, given that all he posted during the years 1995 through 2001, and possibly during the years thereafter, were losses. The explanations provided by the Appellant are even more difficult to accept in view of his assertion that the permit obtained in 1996 was the most important one for his business, since one would normally expect such a permit to improve his returns.

[24] Mr. Paquet, the auditor, used the net worth method to make the assessments for the years 1999, 2000 and 2001. He did so following his initial observation that the total deposits into the Appellant's several bank accounts exceeded the income reported in 2001. He also did so because the Appellant did not keep such records and books of account as would enable the tax payable to be determined, despite his undertaking, back in 1982, to keep such records and books (Exhibit I-5).

[25] At the hearing, the Appellant admitted that he did not keep records and books of account. Moreover, he did not produce invoices or other documents through which the income generated by his activities during the 1999, 2000 and 2001 years could be established or even approximated.

[26] The Appellant is not contesting the discrepancy of more than \$74,000 calculated by the auditor for these three years. He claims that this amount is, indeed, a shortfall, which he offset using the savings he accumulated and kept in cash in the course of the 20, 25 or 30 previous years. The only evidence that he provided was that he did, indeed, possess cash. This evidence alone does not even go part of the way back to the source in such a manner as to permit us to conclude that the funds come from his after-tax savings and are not unreported income. It is certainly not illegal to keep significant amounts of cash. However, it is up to those who keep such cash to show where it comes from when doubts as to its origin have been raised. This case highlights the importance of this obligation, especially where, as here, the Appellant is unable to produce records and books of account and other documents through which the accuracy of his reported income can be verified. The auditor faced the same problem and had to use the indirect net worth method to make the assessments. In *Ramey v. Canada*, 93 DTC 791, [1993] 2 C.T.C. 2119, [1993] T.C.J. No. 142 (QL), Bowman J.T.C.C. noted the difficulties involved in challenging such assessments in the following terms at paragraph 6 of his reasons:

. . . Such assessments may be inaccurate within a range of indeterminate magnitude but unless they are shown to be wrong they stand. It is almost impossible to challenge such assessments piecemeal. The only truly effective way of disputing them is by means of a complete reconstruction of a taxpayer's income for a year. A taxpayer whose business records and method of reporting income are in such a state of disarray that a net worth assessment is required is frequently the author of his or her own misfortunes.

[27] Where there are no records and books of account to speak of, a taxpayer's mere assertion that the discrepancy identified by the net worth method results from

the use of cash savings accumulated by the taxpayer over the course of previous years is markedly insufficient to constitute the evidence necessary to establish on a balance of probabilities that the assessments are erroneous.

[28] I would add that the Appellant's version of the facts concerning the existence and use of his cash savings, which seeks to explain the discrepancy identified by the auditor, was only presented at the hearing of the instant appeals, and that this casts serious doubt on the veracity of the Appellant's statement. Indeed, in his Notice of Objection to the assessment for the 2001 taxation year, the only thing that the Appellant questioned was the calculation of the penalty imposed under subsection 163(2) of the Act:

[TRANSLATION]

I object to your method of calculating the penalty, because you calculated a penalty at a rate of 1,204.52% of net tax payable.

According to the rules set out in 163(2), it is \$100.00 or 50% of the tax payable, that is to say $\$129.00 \times 50\% = \64.50 .

The penalty should be \$100.00, not \$1,297.51.

[29] At the hearing, the Appellant stated that his Notice of Objection amounts to quasi-random musings. This is quite stunning, considering the fact that the assessments had the effect of adding more than \$74,000 to his reported income for the 1999, 2000 and 2001 taxation years.

[30] As for the Notice of Appeal pertaining to these three years, it can be summarized by the following sentence: [TRANSLATION] "The assessment is unfounded."

[31] I will close by stating that it is difficult to understand why the Appellant needed such large amounts of cash to operate his tour guide business, especially since he had eight different bank accounts with financial institutions during the three years for which the reassessments were made (Exhibit I-1).

[32] All in all, I find that the evidence adduced by the Appellant in connection with the use of savings accumulated over the course of previous years in order to cover the gap of more than \$74,000 identified by the auditor for the 1999, 2000 and 2001 taxation years is insufficient to establish, on a balance of probabilities,

that the assessments which added part of this amount to his income for each of these years are erroneous.

[33] With regard to the question of penalties, it is important to begin by recalling subsection 230(1) of the Act, which reads as follows:

230. (1) Every person carrying on business and every person who is required, by or pursuant to this Act, to pay or collect taxes or other amounts shall keep records and books of account (including an annual inventory kept in prescribed manner) at the person's place of business or residence in Canada or at such other place as may be designated by the Minister, in such form and containing such information as will enable the taxes payable under this Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined.

[34] This provision does not articulate a mere right. On the contrary, it prescribes a formal obligation to keep such records and books of account as will enable the taxes payable to be determined. As far back as 1982, the Appellant gave his undertaking to comply with this obligation at the request of the authorities (Exhibit I-5). Despite this undertaking, more than 20 years later, it is clear that no record or book of such kind was kept or could be tendered in evidence. For a taxpayer who has been operating the same business for such a long time, this obstinate refusal to comply with this obligation can only lead to the filing of false tax returns which force the authorities to use another, indirect method, namely the net worth method, to determine his income.

[35] In *Venne v. Canada*, 84 DTC 6247 (F.C.T.D.), [1984] F.C.J. No. 314 (QL), Strayer J. described gross negligence in the following terms, at page 13:

. . . "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.

[36] In my opinion, the foregoing facts establish that the Appellant was guilty of gross negligence, thereby warranting the imposition of the penalty set out in subsection 163(2) of the Act. Moreover, there is no basis to support a finding that the penalty was calculated erroneously. The same facts entitled the Minister to reassess the taxpayer for the 1999 year after the normal reassessment period.

[37] In light of the foregoing, the appeals from the reassessments for the 1999, 2000 and 2001 taxation years are dismissed.

Signed at Ottawa, Canada, this 2nd day of May 2006.

"P.R. Dussault"

Dussault J.

Certified true translation
David Rettie

CITATION: 2006TCC226

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PLACE OF HEARING: Québec, Quebec

DATE OF HEARING: February 2, 2006

REASONS FOR JUDGMENT BY: The Honourable Justice P.R. Dussault

DATE OF JUDGMENT: May 2, 2006

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