[OFFICIAL ENGLISH TRANSLATION]

2000-1317(IT)G

BETWEEN:

LORENZO CARON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on September 4, 2002, and judgment delivered orally from the Bench on September 6, 2002, at Montréal, Quebec, by

the Honourable Judge Pierre Archambault

Appearances

Counsel for the Appellant:	Jules Turcotte
Counsel for the Respondent:	Janie Payette

AMENDED JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1992, 1993, 1994 and 1995 taxation years are allowed, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that: (i) in computing his income for the 1995 taxation

year, the appellant is entitled to a deduction of $1,875 as a business investment loss and to have $57,150 excluded as a taxable capital gain and $31,041 excluded as net recapture; and (ii) the penalties are to be cancelled for the 1992, 1993, 1994 and 1995 taxation years.

The Court awards 25% of the costs to the respondent.

This judgment replaces the one dated September 13, 2002.

Signed at Ottawa, Canada, this 27th day of November 2002.

"Pierre Archambault"

J.T.C.C.

Translation certified true
on this 7th day of April 2004.

Sophie Debbané, Revisor

[OFFICIAL ENGLISH TRANSLATION]

Date: 20030128
Docket: 2000-1317(IT)G

BETWEEN:

LORENZO CARON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT
(Delivered orally from the Bench
on September 6, 2002, at Québec, Quebec,
and subsequently amended for greater clarity)

Archambault, J.T.C.C.

[1] Dr. Lorenzo Caron has appealed from the reassessments made by the Minister of National Revenue (the **Minister**) with respect to the 1992 to 1995 taxation years. First, he challenges the imposition of penalties in respect of the income consisting of unreported fees for the 1992 to 1995 taxation years. In addition, in respect of the 1992 and 1993 taxation years, he contends that the reassessments made after the normal reassessment period are statute-barred. Finally, he contends that he is entitled to deduct an amount of $182,365 as an allowable business investment loss.

Facts

[2] In making his reassessments, the Minister relied on the facts that he set out in paragraph 17 of his Amended Reply to the Notice of Appeal, which are reproduced below:

> [TRANSLATION]
>
> a. During the years at issue, the appellant practised the profession of physician;
>
> b. He worked at the Centre local des services communautaires (CLSC) des Blés d'Or and was compensated for this work by the Régie de l'assurance-maladie du Québec;
>
> c. The Régie de l'assurance-maladie du Québec issued to the appellant, for each of the years at issue, a *relevé 1* (provincial) [Employment and Other Income] reporting the compensation received annually for the services rendered at the CLSC des Blés d'Or;
>
> d. In addition, the RAMQ paid the appellant, as a self-employed worker, the following additional amounts: $15,040 in 1992, $15,079 in 1993, $26,122 in 1994 and $38,256 in 1995;
>
> e. Those amounts were paid to the appellant by cheque;
>
> f. Those amounts do not appear on the *relevés 1* issued annually in the appellant's name;
>
> g. An audit of the RAMQ's information records by the ministère du Revenu du Québec in 1997 indicated that the appellant had failed to report all of his income;
>
> h. As of 1997, the appellant knew that he had failed to report all of his income to the Minister of National Revenue;
>
> i. By failing to report all of his income, the appellant made a representation that is attributable to neglect, carelessness or wilful default, or committed a fraud, justifying the making of a reassessment after the normal reassessment period provided for in paragraph 152(4)(*a*)(i) of the *Act*;

j. The appellant, knowingly, or under circumstances amounting to gross negligence, failed to report this additional income, justifying the application of the penalty provided for in subsection 163(2) of the *Act*;

k. For the 1995 taxation year, the appellant claimed a loss as a business loss [*sic*];

l. At the audit stage, although duly required to do so, the appellant did not submit any document in support of his claim; consequently, his loss was disallowed.

[3] At the outset of the hearing, Dr. Caron admitted the facts set out in subparagraphs 17(a), (b), (c), (d), (f), (h), (k) and (l) of the Amended Reply to the Notice of Appeal. Counsel for the respondent admitted that an amount of $1,875 out of the $182,365 at issue was deductible in 1995 as an allowable business investment loss. As for the rest, it would not be deductible in 1995 because Dr. Caron did not pay the amounts owed under his surety until 1996. Therefore, since the property used for the payment made in 1996 was disposed of in 1996—and not in 1995—the amount of the taxable capital gain and that of the net depreciation recapture resulting from that disposition should not have been added to the 1995 income but rather should have been included with the income of 1996. Consequently, counsel for the respondent agrees that these amounts may be excluded from the 1995 income.

[4] The Court notes in general that the evidence adduced by Dr. Caron was vague, imprecise and incomplete. The evidence, nonetheless, revealed the following facts. Dr. Caron is a doctor who practised from 1957 to 1988 in Sayabec, in the Matapedia Valley. After thirty-one years in medical practice, he retired and moved to Montréal. It is there that, on the recommendation of his lawyer, he invested in two companies: first, in a company known under the corporate name of Docteur Océan, which operated a fish market, and also in 2628-5296 Québec inc. (**5296**), a numbered company, which according to Dr. Caron, was supposed to hold the equipment used in the business of Docteur Océan. Dr. Caron held between 30% and 33 1/3% of the shares of Docteur Océan and four of the six shares of the capital stock of 5296. In order for the two companies to obtain financing, Dr. Caron had to provide letters of indemnity (**surety)**: one in February 1989, for up to $150,000 for the debts of 5296, and one in November 1989, for up to $175,000 for the debts of Docteur Océan. Docteur Océan was operated for just one year, between March 1989 and April 1990, the date on which it sold its business. I assume that 5296 also sold its equipment at that time.

[5] As a result of this bad experience, Dr. Caron decided to return to the practice of medicine in Fortierville, a municipality situated south of the St. Lawrence River, between Trois-Rivières and Québec, as a CLSC employee. His basic annual salary was $76,000. His normal workweek was thirty-five hours. There was a possibility of overtime, which would have made a forty-seven hour week in total. In addition to his work as a CLSC employee, Dr. Caron could render professional services to elderly people in their home, first in Fortierville and, subsequently, in Deschaillons and Saint-Pierre-les-Becquets. He was entitled to fees for these services.

[6] In 1992, the income from employment reported by Dr. Caron amounted to $103,874. This amount corresponds to what is indicated on the T4 slips prepared by the Régie de l'assurance maladie du Québec (**RAMQ**). In addition to this income from employment, Dr. Caron earned fees of $15,040 for house calls. Since those fees did not appear on the T4, Dr. Caron did not report them.

[7] Dr. Caron followed the same course of action in 1993, 1994 and 1995. His income from employment was $110,328 in 1993; $110,263 in 1994; and $105,352 in 1995. His income in the form of fees amounted to $15,079 in 1993; $26,122 in 1994; and $38,256 in 1995. Following a call from an employee of the ministère du Revenu du Québec, who had informed him that he was failing to report the fees that he received, Dr. Caron reported an amount of $26,959 in fees for 1996. His income from employment for 1996 was $101,624.

[8] Dr. Caron explained that he had not amended his income from previous years because of his financial difficulties and the health problems that he was experiencing. In particular, he had heart problems in December 1994 that were followed by a convalescence that lasted until the end of May 1996. However, Dr. Caron said he had changed his way of calculating his fees, *inter alia,* by adding up the deposits made by the Régie to his bank account.

[9] For the preparation of his tax returns, Dr. Caron said he had always given all his documents to his accountant with the firm Raymond Chabot Martin Paré, in Matane. He said he also submitted not only the T4s but also the semi-monthly statements from RAMQ, as well as all the invoices received in order to enable the accountant to prepare his statements of income and expenses. This accountant had handled Dr. Caron’s tax affairs since 1965. He continued to do so even after Dr. Caron settled in the Fortierville area. When it came time to communicate his tax information to his accountant, Dr. Caron took the opportunity to go to Matane and visit family members living in that region.

[10] It was Dr. Caron's accountant who signed the tax returns and he did so without his client's reviewing them first. The accountant subsequently sent Dr. Caron his report in which he urged him to check his returns carefully to be sure they were accurate. Dr. Caron seems to have changed accountants around 1995 or 1996: he then retained the services of a tax expert from the city of Québec.

[11] After a number of lawsuits—at least four—brought by the bank against him beginning in November 1990 for the payment of amounts owed, *inter alia*, because of the sureties and following lengthy negotiations between his lawyer and the bank's lawyers, in September 1995, Dr. Caron agreed to pay $10,000 in twelve monthly payments of $833.37 beginning on October 11, 1995. He also agreed to let the bank exercise the hypothecary remedies of taking in payment under article 2778 of the *Civil Code of Québec* (***C.C.Q.***), on the expiry of the 60-day notice given in December 1995. The notices refer—by implication[1]—only to the surety of $150,000 given for the debts of 5296. The unpaid balance of the bank's claim therefore amounts to $137,000 and the accumulated interest is $81,184 for a total of $218,184.

[12] A judgment of the Superior Court rendered in April 1996 gave effect to the transfers of certain immovables (**the immovables**) on January 3 and 8, 1996. These transfers created a taxable capital gain of $57,150 and a depreciation recapture of $31,041 for Dr. Caron.

Analysis

Unreported income and penalties

[13] It was up to the respondent to prove the facts enabling the Minister to make reassessments after the normal reassessment period. The respondent had to prove that Dr. Caron had made a misrepresentation attributable to neglect, carelessness or wilful default. The same is true, moreover, with regard to the imposition of the penalties, except that with respect to this element, it was necessary to establish that he had made a false statement knowingly or under circumstances amounting to gross negligence. The burden of proof was on Dr. Caron with regard to the deduction of the allowable business investment loss.

[1] See Exhibits A-12, A-13 and I-3 (Tabs E and F).

[14] On the issue of the respondent's burden of proof with respect to the statute-barred taxation years and the imposition of penalties, the classic decision is the one rendered by Judge Strayer in *Venne v. Canada*, [1984] F.C.J. No. 314 (QL). In that decision, Judge Strayer made the following comments regarding the degree of negligence required to enable the Minister to make an assessment after the normal assessment period provided for in paragraph 152(4)(*a*) of the *Income Tax Act* (Act):

> I am satisfied that it is sufficient for the Minister, in order to invoke the power under sub-paragraph 152(4)(a)(i) of the Act to show that, with respect to any one or more aspects of his income tax return for a given year, a taxpayer has been negligent. Such negligence is established if it is shown that the taxpayer has not exercised reasonable care. This is surely what the words "misrepresentation that is attributable to neglects" [*sic*] must mean, particularly when combined with other grounds such as "carelessness" or "wilful default" which refer to a higher degree of negligence or to intentional misconduct....

[15] Judge Strayer relied on the following facts to conclude that there was a misrepresentation attributable to neglect:

> First, there is ample evidence that the taxpayer did not read his returns before signing them.... Secondly, the errors in the income tax returns should have been sufficiently obvious that a reasonable man of even limited education and experience, <u>especially one who was apparently a very successful businessman and investor</u>, should have noticed.
>
> [Emphasis added.]

[16] As for the element of gross negligence that must be present when a penalty is imposed under subsection 163(2) of the *Act*, Judge Strayer had this to say:

> ... "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.

[17] This interpretation of Judge Strayer, as he was then, was adopted by the Federal Court of Appeal in *Findlay v. Canada*, [2000] F.C.J. No. 731 (QL) (2000 DTC 6345).

[18] Two decisions cited by Dr. Caron must also be mentioned, namely, *Johnson v. Canada*, [1993] T.C.J. No. 787 (QL), (94 DTC 1009); and *Glass v. Canada*, [1993] T.C.J. No. 892 (QL), (94 DTC 1091). In *Johnson*, a dentist withdrew from his professional corporation an amount of $181,211 that was recorded as a dividend but was not reported as income in the dentist's tax return prepared by his accountant. In that case, the taxpayer had said that he had completely relied on the accountant. Judge Beaubier of this Court found that there had been negligence on Mr. Johnson's part but it did not involve gross negligence.

[19] Similarly, in *Glass*, Judge McArthur concluded that a farmer, who had forgotten to include in his tax return an amount of $124,500 from the sale of livestock and who had relied on his accountant, had been negligent; however, this negligence did not amount to gross negligence.

[20] In the case at bar, I, too, find that there was clearly negligence on Dr. Caron's part in the preparation of his tax returns. The fact that he did not check the returns before they were sent to the Minister and that he did not do so afterwards, even when his own accountant had urged him to do so, certainly indicates a lack of due diligence on the part of Dr. Caron.

[21] However, although I reach this conclusion with a great deal of hesitation, I have not been satisfied on a balance of probabilities that Dr. Caron had committed gross negligence according to the definition of this concept given in the *Venne* case.

[22] Although Dr. Caron is a doctor and one expects that a person having completed such demanding studies would have a more respectful attitude towards his tax obligations, I believe that there are mitigating circumstances here that justify my giving him the benefit of the doubt. First of all, Dr. Caron was under severe financial stress and it seems that he lost almost everything in the Docteur Océan venture. Moreover, in connection with the 1995 taxation year, which is the year for which the amount of unreported income is the most substantial, that is, approximately $38,256, at the time he filed his tax return, Dr. Caron was convalescing as a result of his heart problems. Dr. Caron said he had never noticed the omission of the unreported income and said he had a fairly poor understanding of figures. His misfortune in the business field leads me to believe that he certainly lacks ability in that regard.

[23] Another reason for giving him the benefit of the doubt is the fact that he relied on his accountant, to whom he had given all the relevant documents, which

should have enabled the accountant to discover the unreported income. It is important to remember the principle adopted by the courts that the negligence of the accountant cannot be attributed to the taxpayer. Here, it is possible that Dr. Caron's accountant did not make all the verifications necessary in order to analyse the statements that were sent to him. See, *inter alia*, the decisions in *Venne*, *Findlay* and *Udell v. Minister of National Revenue*, [1970] Ex. C.R. 176 (70 DTC 6019).

[24] Yet another reason is the fact that Dr. Caron did not default on his obligations towards his creditors, including the tax authorities, when he could have done like certain persons who, in similar circumstances, declare themselves bankrupt. In addition, no evidence was adduced to establish that Dr. Caron had committed tax evasion in the past. The fact that Dr. Caron has changed his way of reporting his income and now reports all of the income that he earns from practicing his profession is a factor favouring his position.

[25] Finally, there are the decisions handed down in *Glass* and *Johnson* that have influenced me. In the circumstances of the instant case, it would be hard to be less generous than my colleagues have been. There would be an injustice in not treating Dr. Caron's appeals in a similar fashion.

Allowable business investment loss

[26] Let us deal now with the matter of the allowable business investment loss. The relevant provisions are those of section 38, paragraph 39(1)(*c*) and subsection 50(1) of the *Act*. In order to be able to claim a business investment loss in this case, there must be a disposition of a debt. The debt in question exists not because of Dr. Caron's liability for it under the sureties but rather because of his paying amounts under these sureties. It is only after paying the amounts owed by Docteur Océan and 5296, for which he was a surety, that Dr. Caron could exercise his remedy against those companies under articles 2356 and 1656 *C.C.Q.* The most relevant portions of these two articles are:

> 2356. A surety who has bound himself with the consent of the debtor may claim from him what he has paid in capital, interest and costs, ...
>
> 1656. Subrogation takes place by operation of law
>
> ...

> (3) in favour of a person who pays a debt to which he is bound with others ...
>
> [Emphasis added.]

[27] Counsel for Dr. Caron submitted that the debt arose at the time the bank served the 60-day notice in December 1995. I believe this interpretation is wrong. So long as Dr. Caron had not paid the amounts owed to the bank and so long as the 60 days had not expired, any person with an interest could pay the amounts owed to the bank. In such a case, the hypothecary remedy could not have been exercised since the bank would have been paid. Therefore, it is clear that Dr. Caron could have a debt on 5296 only from the time when he would have actually paid the bank.

[28] Consequently, in 1995, Dr. Caron had no debt in relation to Docteur Océan and 5296 other than the debt of $2,500 representing the total monthly payments of $833 paid beginning in October 1995. It is the amount that counsel for the respondent agreed to allow as a business investment loss; the allowable amount is $1,875, representing 75% of $2,500.

[29] Accordingly, the payments made on January 3 and 8, 1996, by the transfer of the immovables did not take place in 1995 but rather in 1996, and the debt of Dr. Caron in relation to 5296 did not arise until that time. There could therefore not have been a bad debt in 1995 with regard to those payments.

[30] As for the other debts, two amounts could have been treated as losses. There is the amount of $15,709, referred to in Dr. Caron's Notice of Appeal. The evidence in respect of this amount is too vague and uncertain for me to conclude that there was payment of such an amount in 1995. The only evidence filed with the Court is a letter from Dr. Caron's accountant listing the various amounts for which Dr. Caron could claim a deduction for losses. Even this letter is silent as to when the National Bank seized the proceeds from the sale of a property [TRANSLATION] "in partial settlement of an endorsement". The evidence does not show what endorsement is involved or when the seizure was made. For example, it may have been possible to obtain some date relating to the seizure from the registry office. Given the lack of evidence, the Court is unable to find, in respect of this debt, that there was a loss representing a business investment loss.

[31] As for the amount of $10,000, for which a discharge from the Bank of Montreal was produced in evidence, the discharge is dated November 11, 1994.

Consequently, the payment would have been made in 1994 while the deduction for the loss was not claimed until 1995. In any case, I am not satisfied that this was an amount owed by Docteur Océan, since the defendant in the action brought by the Bank of Montreal was Dr. Caron and it is indicated on the tax return that Dr. Caron was the one who purchased, by an installment sales contract, the vehicle for which the amount of $10,000 was paid. It might have been useful to adduce the defence to this action to support the assertions in Dr. Caron's testimony that the vehicle had been acquired by Docteur Océan. It seems fairly surprising to me that Dr. Caron agreed to pay an amount of $10,000 if the contract indicated, as he claimed, that the purchaser was Docteur Océan. I am not satisfied on a balance of probabilities that it was Docteur Océan who was the owner of this vehicle. Furthermore, there was no reference to the above two amounts in the argument of counsel for Dr. Caron.

[32] In conclusion, Dr. Caron's appeals are allowed in respect of the 1992 to 1995 taxation years, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that all of the penalties should be cancelled and, in respect of the 1995 year, on the basis that (i) the taxable capital gain of $57,150 and the net depreciation recapture of $31,041 are to be excluded from income; and (ii) the amount of $1,875 is to be deducted from income as an allowable business investment loss. In view of the outcome, the Court awards the respondent 25% of its costs.

Signed at Ottawa, Canada, this 28th day of January 2003.

"Pierre Archambault"

J.T.C.C.

Translation certified true
on this 7th day of April 2004.

Sophie Debbané, Revisor