Docket: 2007-68(IT)G

BETWEEN:

JEANETTE WACHSMANN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 13 and 14, 2009, at Montreal, Quebec, **and**
telephone conference held on October 22, 2009 at Ottawa, Ontario.
Before: The Honourable Justice Pierre Archambault

Appearances:

Counsel for the Appellant:	Louis-Frédérick Côté
Counsel for the Respondent:	Pierre Cossette

AMENDED JUDGMENT

The appeals for the 1997, 1998 and 2000 taxation years are allowed and the assessments should be referred back to the Minister for reconsideration and reassessment on the basis that the interest amounts that should be disallowed for the first two years are those indicated in the admission filed as Exhibit R-2, and with respect to the appeal for the 2000 taxation year, on the basis that Mrs. Wachsmann was not entitled to the interest expense of $164,680 and that the taxable capital gain and the recaptured depreciation resulting from the disposition of the rental property should be excluded from her income.

The Respondent shall be entitled to all of its disbursements and 50% of its other costs with respect to procedures which occurred after April 8, 2009.

Signed at Ottawa, Canada, this 27th day of October 2009.

"Pierre Archambault"

Archambault J.

Citation: 2009 TCC 420
Date: 20091027
Docket: 2007-68(IT)G

BETWEEN:

JEANETTE WACHSMANN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

AMENDED REASONS FOR JUDGMENT

Archambault J.

[1] This is the sad story of a taxpayer who put too much faith in her brother and who did not give enough attention to her own affairs, especially her tax returns. Mr. Issac Zahler, the father of the taxpayer, Mrs. Jeanette Wachsmann, purchased a rental property (**rental property**) situated in Mississauga, Ontario, on or about December 4, 1980, at a price of $2,5 million. Although the situation is not clear, it appears that the property was paid for in full by Issac Zahler out of his own funds (see Exhibit R-1, Tab 12, par. 7). The rental property was to be held in equal shares for the benefit of Mrs. Wachsmann and her brother, Maurice Zahler. The title to the property was held in trust by a corporation, Carjeane Investments Inc. The father was a diamond dealer living in Belgium, while Mrs. Wachsmann was living at the time in London, England, with her husband. Her brother was based in Toronto. It seems the brother was put in charge of managing the rental property. Mrs. Wachsmann left England in 1989 and moved to Toronto, where she lived for 10 years. Thereafter, she moved to Montreal.

[2] Mrs. Wachsmann claims that she never saw the rental property even when she lived in Toronto and relied completely on her brother for its management. The

financial statements for the property and her tax returns were prepared by her brother's accountant, a Mr. Edward M. Kalkstein of the firm Zeifman & Company.

[3] A series of mortgages were taken out from 1983 to 1990 which aggregated roughly $2 million. In 1995, a $3.5 million mortgage was taken out by Mr. Maurice Zahler. Mrs. Wachsmann claims that she was never told about the existence of these mortgages. The $3.5 million mortgage appears on the rental property's financial statements for the 1996 to 1998 fiscal periods and the most substantial expense in the statement of operations is interest of $324,291 in 1997. This interest expense was deducted in full in computing, for tax purposes, the income from the rental property.

[4] This property was sold in September 2000 for $6,080,000. Mrs. Wachsmann also claims that she was not told of the disposition of the property before March 2002, when informed of it by her brother. Mrs. Wachsmann claims as well that she never received her share of the proceeds of the disposition of the rental property and, in a legal action taken against her brother in April of 2002, she alleged that her brother had appropriated the proceeds of the sale of the property and that the $3.5 million mortgage taken out in 1995 had been used for the acquisition of personal assets by her brother. Surprisingly, that legal action was abandoned by Mrs. Wachsmann in 2006, apparently for lack of funds to pursue it (see Exhibit R-1, Tab 16).

[5] On the basis of these facts, the Minister of National Revenue (**Minister**) reassessed both Mrs. Wachsmann and Mr. Maurice Zahler and disallowed all the mortgage interest claimed from 1997 to 1999 and included in Mrs. Wachsmann's income for 2000 her share of the taxable capital gain, that is, $1,193,333, and of the amount of the recapture of the capital cost allowance (**recapture**) claimed with respect to the rental property, that is, $685,540. The Minister did not disallow the interest on the $3.5 million mortgage claimed in computing the net rental income for the 2000 taxation year.

[6] At the outset of the hearing, the respondent filed an admission whereby she acknowledged that the interest expense amount that should have been disallowed for 1997 and 1998 was as follows:

1997	$162,145.50
1998	$160,892.50

It was further acknowledged that for 2000 the amount of the recapture should be $685,540 and that the amount of the taxable capital gain should be reduced to $1,154,021. The amount of the interest disallowed for 1999 remains at $164,680.

[7] Mrs. Wachsmann filed a notice of objection and, later on, instituted before this Court an appeal contesting the disallowance of the interest deduction on the basis that she had never benefited personally from the money obtained by means of the mortgage and that her brother should be taxed on the interest expense amount. Alternatively, she argued that she should be entitled, in computing her rental income, to a deduction equal to the amount of the income stolen by her brother. She based her argument on Interpretation Bulletin IT-460. A similar argument was made with respect to the taxable capital gain and the recapture for the 2000 taxation year.

[8] It should be pointed out that the Minister reassessed Mrs. Wachsmann outside the normal reassessment period and therefore the respondent has the burden of establishing that Mrs. Wachsmann made in her tax returns a misrepresentation that was attributable to her neglect, carelessness or wilful default, as contemplated by subsection 152(4) of the *Income Tax Act* (**Act**)[1].

Analysis

[9] First, on the issue of the statute-barred taxation years, the evidence disclosed that Mrs. Wachsmann - who had a high school education and who had at one point been a kindergarten teacher in Toronto and later on a sales person in the textile industry - relied completely on her brother to deal with the filing of her tax returns. Her brother used the services of his accountant, who prepared these returns and the financial statements. Mrs. Wachsmann never signed the tax returns for the relevant taxation years and she never reviewed them before they were filed. Nor did she ever review the financial statements that were prepared for the rental property. When she moved to Montreal in 1999, she hired her own chartered accountant, Mr. Ronnie Jakobovits, who prepared her tax returns on the basis of the financial statements prepared by Mr. Kalkstein. Even then, Mrs. Wachsmann never signed the tax returns

[1] That provision reads in part as follows :
The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if
(a) the taxpayer or person filing the return
(i) has made any misrepresentation that is attributable to neglect, carelessness or willful default or has committed any fraud in filing the return or in supplying any information under this Act….

and never reviewed them. She relied completely on her new accountant, who got his information from the previous accountant. With respect to the 2000 taxation year, Mr. Jakobovits testified that he never received the financial statements for the 2000 taxation year. He said that he got the information directly from Mr. Kalkstein, and prepared a statement of income and expenses using the Minister's form.

[10] In my view, a distinction can be drawn between the 1997 to 1999 taxation years and the 2000 taxation year. The fact that Mrs. Wachsmann never reviewed the tax returns that were prepared on her behalf clearly, in my view, disclosed a lack of diligence on her part with respect to the preparation of those returns. This kind of behaviour is a recipe for disaster. Had Mrs. Wachsmann been diligent in the filing of her tax returns, for example, by doing at least a cursory review of the information, she would have realized that there had been a $3.5 million mortgage on the rental property since 1995 and she would have been in a position, as she acknowledged in her cross-examination, to ask questions concerning the purpose of such a substantial loan that not only encumbered the rental property but also affected its profitability. She would have seen also that a significantly greater share of the funds generated by the rental property had been distributed to her brother (or her brother's wife) than to her (see Exhibit R-1, Tabs 8, 9 and 10, Statement of Participant's Deficiency). For example, in 1999, drawings in favour of her brother's wife amounted to $522,827 while those in Mrs. Wachsmann's favour were $19 714. It should be noted that her brother did not contest the Minister's disallowance of the interest deduction in computing his income or the addition of the taxable capital gain and the recapture. Given that the money was used for personal purposes and not for the purpose of earning income from property, the interest expenses were not deductible.

[11] Since the misrepresentation made in her tax returns for the 1997 to 1999 taxation years can be attributed to Mrs. Wachsmann's neglect, the Minister is allowed to reassess those taxation years outside the normal reassessment period. That being so, the burden was on Mrs. Wachsmann to establish that the interest expense could be deductible in computing her income from the rental property. One of the arguments put forward by her counsel was that Mrs. Wachsmann earned substantial investment income in 1998, mainly from the Toronto Dominion Bank, and that the capital used to generate this income may have come from the proceeds of the 1995 mortgage.

[12] However, when Mrs. Wachsmann testified, she consistently claimed that she had not received any of the proceeds from the mortgage taken out by her brother in 1995. Her four children also testified to confirm that they had not received any money from their mother or their uncle, Maurice Zahler, to finance the acquisition of

a home or to help them start their own business. In addition, Mrs. Wachsmann was unable to identify the source of the funds that were used to produce her significant investment income of $17,178 in 1999, $18,082 in 2000 and $27,944 in 2001. Therefore, the Court is not satisfied that Mrs. Wachsmann's share of the interest which she claimed in the computation of her income from the rental property, could be deductible. The evidence is far from clear that she ever received such income, and, even if she did, the Court has no basis for determining what percentage of the mortgage proceeds were used for investment purposes and which portion was used to meet her domestic needs.

[13] With respect to the 2000 taxation year, I am not convinced that the respondent succeeded in establishing that the misrepresentation made with respect to the taxable capital gain and the recapture constituted a misrepresentation attributable to Mrs. Wachsmann's neglect. Although it is clear that in not reviewing her tax return, she was negligent, I am not satisfied that the misrepresentation with respect to the computation of her taxable capital gain and the amount of her recapture is attributable to this neglect. Indeed, I accept her counsel's argument that Mrs. Wachsmann was never told in 2000 or 2001 of the disposition of the rental property that took place in September 2000 and that she could not have known about it.

[14] In addition, there is no evidence that financial statements were prepared for that year. Her accountant was provided with the financial data that were used by him to compute the rental income for the 2000 taxation year. What is peculiar is that the gross rental income amount of $964,317 exceeds the gross rental income amount of $935,881 for the previous year.[2] In my view, the respondent has failed to establish that for the 2000 taxation year the Minister could have reassessed Mrs. Wachsmann with respect to the taxable capital gain and the recapture.

[15] However, the respondent made an alternative argument in support of assessing a lower amount of taxes for 2000. This argument was advanced in an Amended Reply to the Notice of Appeal and a request was made to the Court on the day of the hearing to allow the Minister to file that amended reply. It should be stated that counsel for Mrs. Wachsmann was informed several months before the hearing, by letter dated October 24, 2008, of the Minister's intention to put forward this new argument and to request leave from the Court to file an amended reply. The interest expense deduction of $164,680, representing Mrs. Wachsmann's share of the total

[2] I am not convinced that, had she reviewed the figure she could have realized that the rental property had been sold on September 7, 2000 (see Exhibit R-1, Tab 19). It is difficult to understand how the level of gross income for the 2000 taxation year could have been greater than the amount of gross rental income earned in 1999 given that the property was disposed of in September 2000. A quarter of the gross rental income was earned after the sale!

expense, claimed in computing her net rental income should, according to the respondent, be disallowed for the same reasons as for the 1997 to 1999 taxation years. The Minister had omitted to refuse that expense in reassessing for the 2000 taxation year. Although the 2000 taxation year is also statute-barred, the respondent argues that she has established that Mrs. Wachsmann in preparing and filing her tax returns made a misrepresentation attributable to neglect with respect to the net rental income.

[16] Counsel for Mrs. Wachsmann argued that the respondent cannot be seen to raise an alternative ground in defence of the Minister's assessment given that it constitutes a completely new assessment made by the Minister many years after the 2000 taxation year became statute-barred.

[17] The key statutory provision applicable here is subsection 152(9) of the Act, which reads as follows:

> 152(9) The Minister may advance an alternative argument in support of an assessment at any time after the normal reassessment period unless, on an appeal under this Act
>
> *(a)* there is relevant evidence that the taxpayer is no longer able to adduce without the leave of the court; and
>
> *(b)* it is not appropriate in the circumstances for the court to order that the evidence be adduced.
>
> [My emphasis].

[18] It is well known that this subsection was added to the Act after the decision rendered by the Supreme Court of Canada in *Continental Bank of Canada v. Canada*, [l998] 2 S.C.R. 358. Although the purpose of this provision was to adopt a less restrictive interpretation than the one adopted in *Continental Bank*, counsel for Mrs. Wachsmann still propose a restrictive interpretation of the words used in subsection 152(9). He argues that a distinction should be made between an alternative "argument" and an alternative "ground". For instance, if a benefit had been conferred on a taxpayer and the Minister had taxed that benefit pursuant to section 6 of the Act, the Minister could be seen to advance a new argument to justify the taxation of the benefit by relying on another section of the Act, for example, subsection 15(1) dealing with a benefit conferred on a shareholder or section 246 dealing with a benefit conferred on a person. However, when the tax to be assessed results from a different set of facts, such as a different transaction, then it is not an

alternative argument and the principles in *Continental Bank of Canada* should apply. In Mrs. Wachsmann's counsel's view, such is the situation here. The inclusion of the taxable capital gain and the recapture resulting from the disposition of the rental property in September 2000 constitutes a different ground for taxation than that relied on with respect to the rental income earned prior to the disposition of the rental property.

[19] In reply to this argument, counsel for the respondent cited the reasons for judgment of Rothstein J.A., then of the Federal Court of Appeal, in *The Queen v. Anchor Pointe Energy Ltd.*, 2003 DTC 5512, 2003 FCA 294, at paragraph 38, where he states that he does "not find that semantical argument productive".

[20] Accepting this as the law of land, I do not believe that the respondent is estopped from advancing the new argument based on the refusal of the interest expense in computing the rental income earned from the rental property in the 2000 taxation year. The restrictions are those enunciated in paragraphs 152(9)(*a*) and (*b*) of the Act. Those restrictions are not applicable here. Mrs. Wachsmann does not suffer any prejudice resulting from this alternative argument. The issue raised with respect to 2000 is exactly the same as that raised for the 1997 to 1999 taxation years. The defence advanced by Mrs. Wachsmann for those taxation years, although not successful, was equally applicable for the 2000 taxation year. Moreover, the respondent is not doing indirectly was she could not have done directly. The alternative argument could only be considered by this Court if the respondent had successfully established that Mrs. Wachsmann had made in her tax return a misrepresentation attributable to her neglect. Here I have concluded that the respondent has been successful in so establishing. The respondent is not circumventing subsection 152(4) of the Act. Therefore, leave to file the Amended Reply to the Notice of Appeal is granted. My reasons respecting the refusal of the interest deduction for the 1997 to 1999 taxation years apply equally to the 2000 taxation year and, accordingly, the interest is not deductible from Mrs. Wachsmann's share of the income from the rental property.

[21] For all these reasons, the appeals for the 1997, 1998 and 2000 taxation years are allowed and the assessments should be referred back to the Minister for reconsideration and reassessment on the basis that the interest amounts that should be disallowed for the first two years are those indicated in the admission filed as Exhibit R-2, and with respect to the appeal for the 2000 taxation year, on the basis that Mrs. Wachsmann was not entitled to the interest expense of $164,680 and that the taxable capital gain and the recaptured depreciation resulting from the disposition of the rental property should be excluded from her income. **The Respondent shall be**

entitled to all of its disbursements and 50% of its other costs with respect to procedures which occurred after April 8, 2009.

Signed at Ottawa, Canada, this 27th day of October 2009.

"Pierre Archambault"

Archambault J.

CITATION:	2009 TCC 420
COURT FILE NO.:	2007-68(IT)G
STYLE OF CAUSE:	JEANETTE WACHSMANN V. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montreal, Quebec
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REASONS FOR JUDGMENT BY:	The Honourable Justice Pierre Archambault

DATE OF AMENDED JUDGMENT: October 27, 2009

APPEARANCES:

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Counsel for the Respondent:	Pierre Cossette Annick Provencher

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