

Docket: 2009-320(IT)I

BETWEEN:

BIG BAD VOODOO DADDY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
Big Bad Voodoo Daddy (2009-321(IT)I)
on July 6, 2010, at Montreal, Quebec.

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the Appellant: Richard Dermer

Counsel for the Respondent: Emmanuel Jilwan
Susan Shaughnessy

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2003 taxation year is dismissed, in accordance with the attached Reasons for Judgment.

Signed at Montreal, Quebec, this 28th day of April 2011.

"Réal Favreau"

Favreau J.

Docket: 2009-321(IT)I

BETWEEN:

BIG BAD VOODOO DADDY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
Big Bad Voodoo Daddy (2009-320(IT)I)
on July 6, 2010, at Montreal, Quebec.

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the Appellant: Richard Dermer

Counsel for the Respondent: Emmanuel Jilwan
Susan Shaughnessy

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2004 taxation year is dismissed, in accordance with the attached Reasons for Judgment.

Signed at Montreal, Quebec, this 28th day of April 2011.

"Réal Favreau"

Favreau J.

Citation: 2011 TCC 226
Date: 20110428
Dockets: 2009-320(IT)I
2009-321(IT)I

BETWEEN:

BIG BAD VOODOO DADDY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Favreau J.

[1] These two appeals were heard together on common evidence by way of the informal procedure.

[2] The issues to be decided are if the Minister of National Revenue (the “Minister”) correctly determined, under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) as amended (the “Act”), the taxable income of the Appellant for the 2003 and 2004 taxation years and the Part I tax payable, the Surtax and Part XIV tax payable for the 2003 and 2004 taxation years and the penalties for the late filing of the income tax return for the 2003 taxation year.

Background information

[3] The Appellant filed its income tax return for the 2003 taxation year on March 24, 2005.

[4] By way of the Notice of Assessment issued on April 13, 2005, the Minister determined the Part I tax payable in the amount of \$12,364, by providing a credit for taxes withheld at source of \$17,258, by assessing a late filing penalty in the amount of \$2,500 and by providing a refund in the amount of \$2,394.

[5] By way of the Notice of Reassessment issued on January 3, 2007, the Minister maintained the Part I tax payable and the late filing penalty as assessed on April 13, 2005 and assessed additional Part XIV tax payable in the amount of \$5,968 and interest of \$1,051.68 for a total of \$7,019.68.

[6] By way of the Notice of Objection received by the Minister on January 26, 2007, the Appellant objected to the reassessment of the 2003 taxation year and submitted an amended income tax return for the 2003 taxation year.

[7] On October 31, 2007, the Minister confirmed the reassessment of January 3, 2007 on the basis that the Appellant failed to demonstrate that it had incurred expenses in the amount of \$38,048.

[8] The Appellant filed its income tax return for the 2004 taxation year on July 5, 2005.

[9] By way of the Notice of Assessment issued on October 5, 2005, the Minister determined the Part I tax payable in the amount of \$1,665, by providing a credit for taxes withheld at source of \$1,533 and instalments of \$495.

[10] By way of the Notice of Reassessment issued January 3, 2007, the Minister maintained the Part I tax payable as assessed on October 5, 2005 and assessed additional Part XIV tax payable in the amount of \$880 and interest of \$129.56.

[11] By way of Notice of Objection received by the Minister on January 26, 2007, the Appellant objected to the reassessment of the 2004 taxation year and submitted an amended income tax return for the 2004 taxation year.

[12] On October 31, 2007, the Minister confirmed the reassessment of January 3, 2007 on the basis that the Appellant failed to demonstrate that it had incurred expenses in the amount of \$5,444.

[13] In order to establish the reassessment and the confirmation for the 2003 taxation year, the Minister relied on the following assumptions of fact:

- a) The Appellant is a branch of *Big Bad Voodoo Daddy LLC* a non resident (*sic*), United States of America, Limited Liability Corporation;
- b) The activities of the Appellant in Canada are the performance of jazz concerts located during the year at various locations across Canada;

- c) In filing the Income tax return for the 2003 taxation year the Appellant reported a gross income of \$80,816 and expenses totalling \$44,580 with a net income of \$36,236 (detail per Annex 1);
- d) In filing the amended Income tax return with the Notice of Objection the Appellant revised the gross income to \$36,236 and revised the category and total of expenses to \$38,048 and net income to (\$1,812) (detail per Annex I);
- e) In filing the Income tax return, on which the initial assessment of April 13, 2005 was based, the Appellant had failed to include the Schedule 20 – Part XIV Branch Tax and thereby failed to include the Part XIV tax in the (*sic*) establishing the total tax payable for the 2003 taxation year;
- f) By way of reassessment issued on January 3, 2007 the Minister revised the total tax payable for the 2003 taxation year by assessing the Part XIV tax in the amount of \$5,968 (detail per Annex 1);
- g) Upon the request by the objection agent to provide the documentation in support of the revised expenses, as per amended Income tax return, and the allocation of such expenses to the income earned in Canada, the Appellant failed to provide any supporting documentation or allocation of expenses in support of its revised claims for the income earned in Canada.

[14] In order to establish the reassessment and confirmation for the 2004 taxation year, the Minister relied on the following assumptions of fact:

- a) The Appellant is a branch of *Big Bad Voodoo Daddy LLC* a non resident, United States of America, Limited Liability Corporation;
- b) The activities of the Appellant in Canada are the performance of jazz concerts located during the year at various locations across Canada;
- c) In filing the Income tax return for the 2004 taxation year the Appellant reported a gross income of \$45,476 and expenses totalling \$40,291 with a net income of \$5,185 (detail per Annex 1);
- d) In filing the amended Income tax return with the Notice of Objection the Appellant revised the gross income to \$4,185 and revised the category and total of expenses to \$5,444 and net income to (\$259) (detail per Annex 1);
- e) In filing the Income tax return, on which the initial assessment of October 5, 2005 was based, the Appellant had failed to include the Schedule 20 – Part XIV Branch Tax and thereby failed to include the Part XIV tax in the establishing the total tax payable for the 2004 taxation year;

- f) By way of reassessment issued on January 3, 2007 the Minister revised the total tax payable for the 2004 taxation year by assessing the Part XIV tax in the amount of \$880 (detail per Annex 1);
- g) Upon the request by the objection agent to provide the documentation in support of the revised expenses, as per amended Income tax return, and the allocation of such expenses to the income earned in Canada, the Appellant failed to provide any supporting documentation or allocation of expenses in support of its revised claims for the income earned in Canada.

[15] The litigious points in these appeals concern the deductibility of salaries paid by a Limited Liability Company (“LLC”) to its partners and the lack of supporting documentation for the claims of salary expenses.

Analysis

[16] Ms. Nadine Benny, legal assistant with R.A.M. Management – Attorneys at Law, testified at the hearing. She confirmed that the firm has been taking care of the Appellant’s withholding tax matters in Canada since 2005 which includes the processing of Regulation 105 waivers for their performance dates in Canada and the supervision of their Canadian income tax returns. She was not personally involved in the 2003 and 2004 tax matters of the Appellant and to her knowledge, no Regulation 105 waivers have been obtained by the firm for the 2003 and 2004 taxation years.

[17] In terms of documentary evidence, an e-mail from Mr. Dick Shumaker dated July 5, 2010 was produced as Exhibit A-1, which confirmed that each member of the Big Bad Voodoo Daddy partnership had been drawing a monthly salary of \$7,500 USD since 2003. Examples of Regulation 105 waivers obtained for the 2006 and 2007 taxation years were produced as Exhibit A-2. The 2006 waiver was in respect of expenses for shows in Canada from November 16, 2006 to December 21, 2006 – the salary component for band members amounted to \$52,500 USD (7 members at \$7,500 each). The 2007 waiver was in respect of expenses for the February 24, 2007 show in Brampton, Ontario and the salary component for band members was \$24,500 USD (7 members at \$3,500 each).

[18] In her testimony, Ms. Benny confirmed that the band performed five shows in Canada in 2003 while travelling across the country and performed only two shows in Canada in 2004.

[19] Concerning the amended income tax returns filed for the 2003 and 2004 taxation years by the former U.S. accountant of the band, Ms. Benny considered the additional expenses claimed as clearly not reasonable in the circumstances.

[20] According to her, a salary of \$1,000 USD per day per member for the Canadian events in 2003 and 2004 would be reasonable in the circumstances and would be consistent with the salaries that have generally been allocated to the Appellant's partners over recent years.

[21] Mr. Patrick McIver, an appeals officer with the Canada Revenue Agency (the "CRA") testified at the hearing and stated that the first U.S. accountant of the Appellant forgot to claim the expenses made or incurred with respect to the Canadian shows and that the second U.S. accountant never raised the salary component of the expenses although additional expenses were claimed. He also referred to the fact that the second accountant never substantiated the claim for the additional expenses and that is the reason why the amended income tax returns were not accepted by the CRA.

[22] Mr. McIver also mentioned that a U.S. LLC cannot deduct for Canadian tax purposes, the salaries paid to members of the LLC because a U.S. LLC is a partnership for U.S. federal income tax purposes and a corporation for Canadian tax purposes. Mr. McIver's understanding was that the CRA considers that the salaries paid to members of the partnership represent a distribution of net income from the partnership and are not deductible business expenses.

[23] Business expenses are generally deductible in computing the income of a taxpayer from a business or property to the extent that the expenses were made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property (subsection 9(1) and paragraph 18(1)(a) of the *Act*).

[24] Every person carrying on business is required to keep books and records of accounts to enable the Minister to determine the taxes payable under the *Act* or taxes that should have been deducted, withheld or collected. This requirement is found in subsection 230(1) of the *Act* which reads as follows:

230. (1) Records and books -- 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.

[25] Regulation 105 waiver application authorizes the Canadian taxpayer who is about to make a payment to a non-resident for services provided in Canada, to not withhold the 15% tax on the fees payable to the non-resident. As the waiver request is based on an estimation of income versus expenses directly related to services provided in Canada, any changes to the contracted fees or period of service invalidate the waiver. In such a case, the Canadian taxpayer is then responsible for the 15% withholding at source on the gross amount of any payments to the non-resident unless the non-resident files another waiver request with the CRA. The Canadian taxpayer is required to prepare a T4A-NR slip for each non-resident paid and to give to each one a copy of the slip. The T4A-NR will show the fees paid and taxes deducted for the non-resident.

Conclusion

[26] Contrary to Mr. McIver's understanding, the long-standing position of the CRA is that a U.S. LLC is treated as a corporation for all purposes of the *Act* regardless of whether the LLC is treated as a corporation or a partnership for U.S. tax purposes (see the article published by Mark J. Rosen and Paul R. Delongchamp entitled "*Forming an Operating Limited Liability Companies Canadian and US Tax Considerations*" at the bottom of page 19). Therefore, nothing would prevent the Appellant from deducting, for Canadian income tax purposes, the salaries paid to its members provided that the requirements of the *Act* are otherwise met.

[27] In this case, the determination of the salary component of the expenses has been based on estimates by taking into account the allocations made in subsequent years. The claims for salaries were not substantiated and no supporting documents were provided. There is no evidence of the salaries being paid nor evidence of any bank deposits for such amounts.

[28] Considering the lack of supporting evidence, the salary component of the expenses claimed in the 2003 and 2004 taxation years cannot be deducted in computing the income of the Appellant. Consequently, the Minister correctly determined under the *Act*, the taxable income of the Appellant for the 2003 and 2004 taxation years and the Part I tax payable, the Surtax and Part XIV tax payable for the 2003 and 2004 taxation years and the penalties for the late filing of the income tax return for the 2003 taxation year.

[29] Consequently, the appeals are dismissed.

Signed at Montreal, Quebec, this 28th day of April 2011.

"Réal Favreau"

Favreau J.

CITATION: 2011 TCC 226

COURT FILE NOS: 2009-320(IT)I; 2009-321(IT)I

STYLE OF CAUSE: Big Bad Voodoo Daddy v. Her Majesty the Queen

PLACE OF HEARING: Montreal, Quebec

DATE OF HEARING: July 6, 2010

REASONS FOR JUDGMENT BY: The Honourable Justice Réal Favreau

DATE OF JUDGMENT: April 28, 2011

APPEARANCES:

 Counsel for the Appellant: Richard Dermer

 Counsel for the Respondent: Emmanuel Jilwan
 Susan Shaughnessy

COUNSEL OF RECORD:

 For the Appellant:

 Name: Richard Dermer
 Firm: R.A.M. Management - Attorneys at Law
 Montreal, Quebec

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