

Docket: 2012-808(IT)I

BETWEEN:

RUI DE COUTO C/O ALCO WINDOWS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on May 31, 2013, at Toronto, Ontario  
Before: The Honourable Mr. Justice Randall S. Boccock

Appearances:

Agent for the Appellant: Edita Lomanta  
Counsel for the Respondent: Tony Cheung

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**JUDGMENT**

In accordance with the attached Reasons for Judgment, the appeal from the reassessments made under the *Income Tax Act* (the “*Act*”) for the 2004, 2005 and 2006 taxation years is allowed to the extent of the sum of \$12,000.00 for each of the years on account of a shareholder advance related to the payment of rent on behalf of Alco Windows Inc. for premises.

The reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment.

The gross negligence penalties imposed under subsection 163(2) of the *Act* are rescinded.

There shall be no order as to costs.

Signed at Toronto, Ontario, this 19<sup>th</sup> day of June 2013.

“R.S. Boccock”

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Boccock J.

Citation: 2013 TCC 198  
Date: 20130619  
Docket: 2012-808(IT)I

BETWEEN:

RUI DE COUTO C/O ALCO WINDOWS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

### **REASONS FOR JUDGMENT**

Bocock J.

#### I. Issue

[1] This is a personal tax appeal of Mr. Rui De Couto as sole shareholder, officer and director of Alco Windows Inc. (“Alco”) involving his 2004, 2005 and 2006 taxation years (the “Relevant Years”). Taxation years 2004 and 2005 were assessed outside the normal reassessment period under subsection 152(4) of the *Income Tax Act* (the “Act”). The 2006 taxation year was originally the subject of subsection 152(7) arbitrary assessment, but after the taxpayer filed his return, the Minister reassessed on the basis of the filed tax return.

[2] The three reassessments allocated considerable shareholder benefits to Mr. De Couto, increasing his income by some \$28,791.00, \$32,173.00 and \$23,351.00 for each of the 2004, 2005 and 2006 taxation years, respectively. Gross negligent penalties were also imposed for each of the three years under subsection 163(2) of the *Act*.

## II. Facts

[3] At the hearing, the Appellant's spouse, Edita Lomanta, represented the Appellant. Mr. De Couto also testified, along with an accountant retained by the Appellant to prepare a general ledger for the Relevant Years in anticipation of the Appeal. The general ledger was prepared entirely from information provided by the Appellant and Ms. Lomanta.

[4] Aside from the general argument that the assessments, reopening of the statute barred appeals and imposition of penalties were arbitrary, unfair and lacking in factual foundation, three specific arguments were offered by the Appellant, namely, that:

- i) the Appellant shareholder was previously owed sums by his company Alco Windows Inc. ("Alco") relating to advances he made to Alco well in excess of the reassessed income and the Minister failed to give credit to Mr. De Couto for such advances;
- ii) the creation, in 2012, of a general ledger for the Relevant Years is sufficient evidence to provide a clear delineation between personal benefits, corporate expenditures and shareholder advances and should be relied upon by the Court for the purposes of reconciling the shareholder's account and benefits rather than the assessment of the Minister; and
- iii) the Appellant made cash payments for rent on behalf of Alco to the landlord, Ms. Lomanta, of \$1,000.00 per month for each month during the Relevant Years, but Mr. De Couto has received no offsetting credit to his shareholder's loan account by the Minister.

[5] To summarize, the shareholder benefits assessed by the Minister were either: reimbursed personal expenses of the Alco borne by Mr. De Couto; or, shareholder loan repayments of capital initially advanced to Alco by Mr. De Couto and repaid by Alco on a tax-free basis.

*a) Nature of Business*

[6] Mr. De Couto is the sole officer, shareholder and director of an aluminium door and window installation business known as Alco. Alco was incorporated in 2001 and has operated continuously during the Relevant Years largely on a cash basis.

[7] Ms. Lomanta prepared and kept the books and records for Alco. Mr. De Couto signed all cheques and ran the day-to-day operations of the business.

*b) Books and Records*

[8] The evidence at trial consisted of a sampling of Amex Credit Card statements, bank account statements, rent receipts, a vehicle purchase agreement, premises rental agreement, and a general ledger. These were essentially the only documentary records of expenditures. All of these cards, bank accounts and documents (with the exception of the lease) were personally held in the name of Ms. Lomanta or Mr. De Couto. There were no cross-references to receipts, cheques or class of expense to the general ledger produced by the Appellant at the Hearing. In fact, it was the Respondent who produced complete credit card statements for the Relevant Period.

*c) Bank Accounts*

[9] A sampling of the statements for line of credit bank account held in Ms. Lomanta's name was adduced by the Respondent as an example of the overall confusion related to the differentiation between business and personal expenses.

*d) Nature of Receipts / Entries and Vouchers*

[10] As to shareholder advances, there were no cheques, receipts or a concurrently maintained shareholder loan account ledger reflecting alleged advances. The 2012 prepared general ledgers for the Relevant Years provided entries for debits and credits, but no documentary evidence or cross referencing to actual sums advanced, expended or reimbursed. Money simply flowed in all directions from and to personal accounts, cheques to Mr De Couto, cheques to Ms. Lomanta, cash deposits, electronic payments on personal credit cards and/or cheques for occasional business expenses.

*e) Shareholder Loan Account*

[11] Any reconciliation of a shareholder's loan account was rendered impossible by the absence of any ascertainable flow of funds. Moreover, the taxpayer's T-1 Returns, as filed by Mr. De Couto, actually indicated that shareholder advances or loan accounts decreased in the Relevant Period during which the Appellant claims same increased.

*f) Shareholder Benefit Calculation by the Minister*

[12] The Minister's calculation was straightforward. In each of the Relevant Years, the Minister took shareholder withdrawals payable to Mr. De Couto by Alco, and deducted reported wages claimed by the Appellant and also those allowed business expenses reimbursed to Mr. De Couto by Alco, the amounts of which were \$6,962.38, \$13,980.15 and \$13,635.34 in each of the 2004, 2005 and 2006 taxation years, respectively.

[13] Meaningful books do not exist for Alco or the Appellant, and if they do, they were not produced at the Hearing nor were any source documents regarding actual receipts, vouchers or invoices relevant to specific business expenses. With the possible exception of the rent issue described below, there was no evidence of the advance of shareholder loans or the incurring of business expenses by Mr. De Couto beyond those allowed by the Minister. There were no shareholder benefits declared or referenced in the filing of the Appellant's tax returns nor were there any offsetting increase to the shareholder loan account for such advances. Although this is not a case of the Appellant's deliberately trying to deceive, it nonetheless remains the case where no probative records, evidence or documents could reliably identify the source, recipient or beneficiary of any moneys paid. This is a direct result of the incessant and prolific commingling of personal, business and other accounts, investments and assets without any consistent or reflective record keeping of why, where or to or from whom money, assets or credit flowed.

*g) Rent Expense*

[14] The one possible exception to this maze of accounts and inscrutable flow of funds concerned rent paid on behalf of Alco for offices and storage at Ms. Lomanta's residence. Written receipts from Ms. Lomanta together with a Rental Agreement for the Relevant Years reflect rent paid by Alco of \$1,000.00 per month. More compelling perhaps is the fact that Ms. Lomanta claimed the rental income on her tax returns and Alco did not deduct the rent payments as an expense. These last two facts were submitted by counsel for the Respondent. The payment received by Ms.

Lomanta logically came from someone. On the basis of the consistent testimony of Mr. De Couto, the accountant and Ms. Lomanta on this issue, the Court finds that the Minister's assessment of shareholder benefits did not account for the rental payments made by the shareholder, Mr De Couto, which were otherwise consistently reflected by the landlord and not deducted by the named tenant. Aside from the rental payments, the Court finds that no other documents or records could dislodge the consistent and logical inclusions by the Minister of shareholder benefits.

### III. Statute Barred Assessments

[15] Subparagraph 152(4)(a)(i) of the *Act* requires the Respondent to discharge its onus of proving that the taxpayer has made "a(ny) misrepresentation that is attributable to neglect, carelessness or wilful default" . . . "in filing the return."

[16] The Appellant by delegating, but nonetheless approving, the completion and submission of income tax returns based upon such imprecise expenses, shareholder advances and shareholder benefits committed such a misrepresentation. Even to this day, the amounts remain inscrutable. Deductively, such omissions represented carelessness, if not neglect, giving rise to clear and obvious misrepresentations as to the status of personal versus business expenses, assets and benefits conferred. It was explained by the Court to the Appellant at the Hearing that it is not necessarily a question of honesty or deceit, but one of competence, experience, reliable record keeping, consistent accounting and bookkeeping practice, the absence of which can constitute misrepresentation. In this regard, the Minister has satisfied her burden and the reassessments were properly issued outside the usual period.

### IV. Gross Negligence Penalties

[17] The actions (or omissions) of a taxpayer affording the Minister a subsection 154(4) reassessment outside the normal reassessment period do not necessarily meet the threshold for the imposition of gross negligence penalties under subsection 163(2).

[18] As noted by Strayer J., in *Venne v R*, (1984), 84 DTC 6247 (FedTD) at pages 6256 – 6249.

[...] "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 [...]

[...] By virtue of sub-section 163(3) “the burden of establishing the facts justifying the assessment of the penalty is on the Minister”. It will be noted that for the penalty to be applicable there appears to be a higher degree of culpability required, involving either actual knowledge or gross negligence, than is the case under sub-section 152(4) for reopening assessments more than four years old where mere negligence seems to be sufficient [...]

[19] The Appellant and his spouse have limited business acumen, language facility, education and managerial background. They were clearly confused and failed to understand their obligations. This was manifest in the abysmal state of the records, their own pleadings and their confusion at the Hearing. However, both unquestionably appeared good faith and seemed to have learned during their own appeal process that much more effort is required to accurately reflect accounting records, to delineate between their personal and business expenses and to otherwise fulfill their obligations under the *Act*.

[20] Factually in this case, the Court finds that the lack of records or accounts produced at the Hearing did not factually appear to be the result of advertent acts or deceit, deliberate omissions or culpable intention on the part of the Appellant. The Court is left with the view that had records been better kept, organized and sorted, additional shareholder advances or expenses borne by Mr. De Couto may have been decipherable. The Appellant is likely the primary and largest victim of his own negligence and carelessness. The recognition of this fact by the Appellant also became apparent at the Hearing. Moreover, there is the issue of the rent paid by the shareholder which decreases the magnitude of the amounts of the shareholder benefits attributable by the Minister. With proper accounting advice and support in subsequent years, the taxpayer is likely to correct the considerable deficiencies which gave rise to the errors on the returns. This lack of culpable intention, manifest inaugural business ignorance and the absence of any overt act to mislead all factually distinguish this matter from many others coming before this Court. As such, the Court does not make a finding of gross negligence in this matter.

[21] Therefore, the Minister’s reassessment stands for all Relevant Years, subject to the allowance of \$12,000.00 per year on account of a shareholder advance by the Appellant related to the payment of rent on behalf of his company. Therefore, the penalties imposed under subsection 163(2) of the *Act* are rescinded.

[22] Although there was some success at the Hearing by the Appellant, given the state of records of the Appellant and Alco, there shall be no order to costs. This is in recognition of the fact that the Respondent could not possibly have resolved any part

of this matter on a principled basis without the facts being extracted at a hearing before this Court.

Signed at Toronto, Ontario, this 19<sup>th</sup> day of June 2013.

“R.S. Boccock”

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Boccock J.



CITATION: 2013 TCC 198

COURT FILE NO.: 2012-808(IT)I

STYLE OF CAUSE: RUI DE COUTO C/O ALCO WINDOWS  
INC. AND HER MAJESTY THE QUEEN

PLACE OF HEARING: Toronto, Ontario

DATE OF HEARING: May 31, 2013

REASONS FOR JUDGMENT BY: The Honourable Mr. Justice Randall S.  
Bocock

DATE OF JUDGMENT: June 19, 2013

APPEARANCES:

Agent for the Appellant: Edita Lomanta

Counsel for the Respondent: Tony Cheung

COUNSEL OF RECORD:

For the Appellant:

Name: N/A

Firm:

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