Docket: 2019-1177(IT)G

BETWEEN:

MF ELECTRIC INCORPORATED,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeal heard on November 21, 22, 23 and 24, 2022,
at Halifax, Nova Scotia

Before: The Honourable Justice Gabrielle St-Hilaire

Appearances:

Counsel for the Appellant:	Derek B. Brett
Counsel for the Respondent:	Tokunbo Omisade

JUDGMENT

In accordance with the attached reasons for judgment, the appeal from the reassessments made under the *Income Tax Act* for the 2010, 2011, 2012, 2013 and 2015 taxation years is dismissed with costs to the Respondent.

Signed at Ottawa, Canada, this 9th day of May 2023.

"Gabrielle St-Hilaire"

St-Hilaire J.

Citation: 2023 TCC 60
Date: 20230509
Docket: 2019-1177(IT)G

BETWEEN:

MF ELECTRIC INCORPORATED,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

REASONS FOR JUDGMENT

St-Hilaire J.

I. Introduction

[1] This is an appeal by MF Electric Incorporated (MF Electric or the Appellant) from reassessments made under the *Income Tax Act*, RSC, 1985, c 1 (5th Supp) (Act), for the 2010, 2011, 2012, 2013 and 2015 taxation years. In reassessing the Appellant, the Minister of National Revenue (Minister) disallowed the deduction of professional, legal and accounting fees as well as management and administrative fees and imposed gross negligence penalties.

[2] The Appellant carries on business as an electrical contractor. Richard MacInnis and Linda MacInnis are equal shareholders and directors of the Appellant and have been involved in the business since its inception in 1995. Douglas (or Doug) Rudolph was the Appellant's accountant for about 20 years from 1996 until 2016, when the Appellant faced an audit by the Minister.

[3] In 2010, Doug Rudolph approached Richard and Linda MacInnis with a tax strategy (the IP Strategy) which he described as a strategy that would help grow their business by generating capital through tax savings. They trusted Mr. Rudolph and believed he was looking out for their best interests so they agreed to pursue the IP Strategy.

[4] Essentially, the IP Strategy required that the MacInnises prepare biographies of their work and life experiences from childhood on. A value was then attached to

their biographies and in computing its income, the Appellant deducted "management and administration fees" (hereinafter referred to as "management fees") based on the value of its shareholders' biographies. The Appellant deducted management fees in the 2010, 2013 and 2015 taxation years. In addition, the Appellant deducted professional, legal and accounting fees (hereinafter referred to as "professional fees") paid for services related to the IP Strategy in the 2010, 2011 and 2012 taxation years.

II. Issues

[5] The issues in this appeal stem from the Appellant's involvement in the IP Strategy and the deduction of the related management fees. On reassessment, the Minister disallowed the deduction of those fees and imposed gross negligence penalties. The Appellant does not dispute that the management fees were not deductible expenses and does not appeal that decision. It does, however, appeal the imposition of the penalties. In addition, the Minister disallowed the deduction of professional fees paid for services related to the IP Strategy. The Appellant has appealed the denial of those expenses. Further, the reassessments for the 2010, 2011 and 2012 taxation years were made beyond the normal reassessment period.

[6] The following table offers a snapshot of the amounts disallowed for the taxation years under appeal and the penalties imposed:

Taxation year	**2010**	**2011**	**2012**	**2013**	**2015**
Disallowed professional fees	$28,354	$43,970	$54,715		
Disallowed management fees	$1,610,000			$160,000	$236,556
Penalties assessed under 163(2)	$127,400			$8,800	$13,010

[7] The issues can be summarized as follows:

i. Was the Minister justified in reassessing the Appellant beyond the normal reassessment period for the 2010, 2011 and 2012 taxation years?

ii. Was the Minister justified in imposing penalties for the 2010, 2013 and 2015 taxation years? and

iii. Was the Minister justified in disallowing the deduction of professional fees for the 2010, 2011 and 2012 taxation years?

III. The Parties' Positions

The Appellant's position

[8] The Appellant's counsel described the Appellant as a victim of a master fraudster, Doug Rudolph, and added that the Appellant's shareholders had been twice victimized by Doug Rudolph. The Appellant acknowledged that it was accountable for the tax owing as a result of the inappropriate deduction of management fees and noted that it had paid the related amount of tax due. However, the Appellant submitted that it did not make misrepresentations attributable to wilful default but rather it got involved with the IP Strategy because of the relationship of abiding trust the MacInnises had built with Doug Rudolph. Nor did the Appellant make false statements in its returns under circumstances amounting to gross negligence or wilful blindness.

[9] I think it is fair to say that, stripped to its bare essentials, the Appellant's position is that any false statements it made in filing its returns are attributable to Doug Rudolph with whom the MacInnises, described by counsel for the Appellant as unsophisticated, working-class, simple people, had built a long-term relationship of trust. Hence, the Minister was not justified in (i) reassessing beyond the normal assessment period; and (ii) nor was she justified in imposing gross negligence penalties.

[10] With respect to the disallowed professional fees, the Appellant submitted they were deductible because, *inter alia*, there was a commercial activity being carried on and the Appellant believed it was paying these expenses for legitimate tax services. Further, the Appellant submitted that the expenses were reasonable, and not unusual, amounts for accounting services.

The Respondent's position

[11] The Respondent argued that the Minister was justified in reassessing the Appellant beyond the normal reassessment period for the 2010, 2011 and 2012 taxation years because the Appellant made a misrepresentation and further that it was attributable to neglect, carelessness or wilful default. The Respondent submitted that the Appellant acknowledged it made a misrepresentation in its return for the 2010 taxation year by claiming a deduction for a management fee it never incurred. The Respondent also submitted that the Appellant made a misrepresentation in its returns for the 2010, 2011 and 2012 taxation years by claiming professional fees related to the IP Strategy. The Respondent argued that the Appellant had been careless or neglectful in making these misrepresentations and further that it was irrelevant that the Appellant's accountant prepared its returns.

[12] With respect to the assessment of penalties, the Respondent submitted that the Appellant made a false statement in its returns for the 2010, 2013 and 2015 taxation years in claiming a deduction for management fees it did not incur. The Respondent submitted that the Appellant made a false statement under circumstances amounting to gross negligence and further, when examining the relevant factors, the Appellant was wilfully blind such that knowledge of the false statement can be imputed to the Appellant.

[13] With respect to the deduction of professional fees, the Respondent submitted that the Appellant did not incur these fees to produce income from its electrical contracting business. Rather, the fees related to the IP Strategy and to invoices indicating they were tied to the tax avoided by the Appellant and its shareholders. Alternatively, the Respondent submitted the expenses were not reasonable in the circumstances.

IV. Background Regarding the IP Strategy

[14] The Appellant is a general electrical contractor doing mostly commercial work. In describing her role in the Appellant's business, Linda MacInnis stated that she was responsible for all the "office work", including managing invoices, filing and answering calls. She acknowledged she was the office manager and had good knowledge of the Appellant's income and expenses. She described Richard MacInnis' role as being responsible for preparing estimates and quotes and doing or supervising the electrical work when he was successful in securing jobs. Mr. MacInnis did not testify.

[15] The MacInnises and Doug Rudolph all came from a small community where everyone knew each other and further, they knew him from having attended the same

high school. The MacInnises hired Doug Rudolph in 1996 on the recommendation of their insurance agent and throughout the next 20 years, he was the Appellant's accountant to whom they entrusted the preparation of its income tax returns. Linda MacInnis used accounting software to keep the Appellant's books and at the end of each year, she handed a copy of the books over to Mr. Rudolph who would prepare the Appellant's returns and T4 information slips as well as the MacInnises' personal returns. In January of each year, the MacInnises met with Mr. Rudolph to review their returns. Linda MacInnis stated that Doug Rudolph explained their returns briefly without going into any great detail. She assumed he was preparing the Appellant's returns properly and felt supported in this belief by the fact that the Appellant had never been audited, until 2016.

[16] In 2010, Doug Rudolph approached the MacInnises with a tax strategy he called an intellectual property strategy. He explained that the Appellant needed the MacInnises to grow such that they were worth something to the company; if he "went back and restructured" their taxes, they could take advantage of tax savings. In putting the IP Strategy in place, Doug Rudolph was working with Rudy Terracina and what appeared to be his company, Agemo Corporation (Agemo).

[17] Mr. Rudolph asked the MacInnises to prepare their biographies from birth to 2010 to "assist in the re-filing" and instructed them as follows (Exhibit A-6):

> Create a biography for both you and Richard from date of birth to December 31st, 2010. Add as much detail about education, employment and any trips or vacations taken over that time – basically, anything that would have increased your personal value or expanded your personal horizons. Also, offer as much detail about the cost of anything for the timeframe referenced. All this assists in creating the value we will use;

[18] Doug Rudolph told the MacInnises that their biographies comprised the "intellectual property" that had value for the Appellant and Mr. Terracina would assign a value to their biographies. Linda MacInnis testified that she did not really understand the IP Strategy but trusted Doug Rudolph. He would convey any requested information from the MacInnises to Rudy Terracina.

[19] Linda MacInnis testified that she and Richard MacInnis found it difficult to prepare their biographies because they were not sure what they were supposed to do. The only biography entered into evidence was that of Richard MacInnis (Exhibit A-9). It is comprised of some handwritten notes indicating that Richard had been a boy scout, had taken swimming lessons, had built his own go-kart, had taken a hunter's safety course and provided information about various jobs he held over the years

including summer jobs as a teenager and jobs working for electrical contractors before starting his own business.

[20] On December 9, 2010, Linda MacInnis and Douglas Rudolph signed an engagement letter (Exhibit A-2) which provided as follows: "I hereby engage Agemo to implement a tax avoidance strategy utilizing its proprietary knowledge to recover taxes paid corporately for the years ***2003 through 2009***"; in addition, the engagement letter specified that the fee was "30% of recovered taxes". Doug Rudolph followed up with an email on December 10, 2010, explaining that there was a calculation error and that the tax refund would be greater than originally thought. Linda MacInnis stated that she understood this meant that the Appellant would end up paying a higher amount to Agemo because they were providing a greater tax saving.

[21] On April 1, 2011, Linda MacInnis emailed Doug Rudolph to inquire further about a warranty he had previously mentioned. In her email, Ms. MacInnis wrote as follows (Exhibit A-10; Transcript, Vol 1 at 140):

> Richard has mixed feelings again about doing this. You had mentioned that there is a guaranty that we can have if we pay a larger percentage (40%). We will go with the guaranty, can you send us a copy of the guaranty so that we can read it over?

[22] On the same day, Mr. Rudolph responded by email and attached a copy of the warranty which reads, in part, as follows (Exhibit A-8; Transcript, Vol 1 at 141):

> In the event of any reassessment which results in tax owing arriving (sic) from the participation in the Partners in Research Joint Venture, the taxes owing will be paid by Partners in Research.

[23] Mr. Rudolph provided no information about "Partners in Research". Nonetheless, Linda MacInnis testified that they took the warranty so that if any concerns came up, in the context of an audit or otherwise, Doug Rudolph would take care of it. The warranty gave her comfort and she acknowledged that if anything went wrong, the worse that would happen would be that the warranty would cover the taxes resulting from the disallowed expenses. By adding the warranty, the Appellant was required to pay an additional 10% of any tax savings for a total fee of 40% of tax savings resulting from the IP Strategy.

[24] The Appellant entered into evidence several quotes from Doctor Tax regarding the fees to be paid for the IP Strategy (Exhibits A-12, A-14, A-16 and A-

18) as well as some bank drafts for amounts paid to Doctor Tax (Exhibits A-11 and A-15). Linda MacInnis testified that she treated the quotes as invoices and paid the amounts to Doctor Tax immediately. It is difficult to reconcile the quotes from Doctor Tax with the payments made by the Appellant and the professional fees deducted and disallowed and the Appellant did not attempt any reconciliation at the hearing. It is sufficient to note the following information regarding the quotes:

i. one quote refers to Estimated refunds for 2007, 2008 and 2009;
ii. one quote refers to Estimated T1 Avoided Tax – 2011;
iii. one quote refers to T1 Avoided Tax – 2011 and T2 Avoided Tax – 2011; and
iv. one quote refers to Estimated benefit (T1) – 2012 and Estimated Benefit (T2) – 2012.

[25] In 2016, Canada Revenue Agency (CRA) officers from the Criminal Investigations Program met with the MacInnises to ask questions about their involvement with Doug Rudolph and the IP Strategy. Linda MacInnis testified that the CRA officers concluded there was no criminal wrongdoing. Shortly thereafter, the Appellant was the subject of an audit which led to the reassessments that are the subject of this appeal. At the time of the audit, the MacInnises hired counsel and a new accountant, Earl MacLeod, to review the Appellant's returns and advise them going forward. They all met with the auditor, Ryan Sampson. I note that Mr. Sampson testified that he conducted his audit without accessing the criminal investigation file. Mr. Sampson did not reach out to Rudy Terracina as it appears he had passed away by then but he did reach out to Doug Rudolph who referred him to his counsel. Counsel did not return Mr. Sampson's call to their office.

[26] During his testimony, Mr. MacLeod stated that he advised the MacInnises and MF Electric that they should repay the amounts that were refunded as a result of the deduction of the management fees because he did not find their deductibility could be justified. The MacInnises acknowledged that the management fees were not properly deductible and on the advice of Mr. MacLeod and based on his calculations, the Appellant paid an amount over $400,000. However, as mentioned earlier, the Appellant is disputing the denial of the deductibility of the professional fees and the imposition of the penalties.

[27] As part of the context of this appeal, it is relevant to mention that in 2006, the MacInnises had personally invested $25,000 through Doug Rudolph. Linda MacInnis testified that Doug told her and Richard that they would be investing in in a bridge loan with CanGlobe. It was to be a one-year investment with a 25% return

– but that never materialized. Doug told the MacInnises that there were problems with the banks overseas and kept promising they would get their money. They never did. In December 2010, the MacInnises were summoned to attend at an examination before the Nova Scotia Securities Commission regarding an investigation involving Douglas Rudolph and the CanGlobe investments (Exhibit R-1). Linda MacInnis testified that they defended Doug because when they asked him about the Securities Commission investigation, he told them it was all a misunderstanding, he was the subject of false accusations and they would get their money.

[28] The Appellant called David Worrell, a retired police detective, to testify about his involvement with Doug Rudolph. In summarizing his testimony, it suffices to state that Mr. Worrell serves as an example of another person who participated in the CanGlobe bridge loan scheme. I would add that, on the recommendation of Mr. Rudolph, he also made donations to the Global Learning Gifting Initiative in 2006 and 2007 and received a tax receipt for five times the amount donated. He testified that he found Mr. Rudolph to be very persuasive and appeared to be knowledgeable, "plus it was a very attractive return on the money" (Transcript, Vol 3 at 23). The fact that Mr. Worrell was persuaded to invest in CanGlobe, as many others were, does not assist the Appellant with respect to the separate issues raised in this appeal in relation to its participation in the IP Strategy.

V. Analysis

Reassessment beyond the normal assessment period

[29] In addressing the first issue in this appeal, the Court must determine whether the Minister was justified in reassessing the Appellant beyond the normal reassessment period for the 2010, 2011 and 2012 taxation years.

[30] Subsection 152(4) of the Act sets out the Minister's right to assess beyond the normal reassessment period determined under subsection 152(3.1). More specifically relevant to this appeal, subparagraph 152(4)(a)(i) provides as follows:

152 (4) 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	**152 (4)** Le ministre peut établir une cotisation, une nouvelle cotisation ou une cotisation supplémentaire concernant l'impôt pour une année d'imposition, ainsi que les intérêts ou les pénalités, qui sont payables par un contribuable en vertu de la présente partie ou donner avis par écrit qu'aucun impôt n'est payable pour l'année à toute personne qui a produit une déclaration de revenu pour une année d'imposition. Pareille cotisation ne peut être établie après l'expiration de la période normale de nouvelle cotisation applicable au contribuable pour l'année que dans les cas suivants :
(a) the taxpayer or person filing the return	**a)** le contribuable ou la personne produisant la déclaration :
(i) has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under this Act, or	**(i)** soit a fait une présentation erronée des faits, par négligence, inattention ou omission volontaire, ou a commis quelque fraude en produisant la déclaration ou en fournissant quelque renseignement sous le régime de la présente loi,

[31] The wording of subparagraph 152(4)(a)(i) is such that it is sufficient for the Minister to establish neglect or carelessness without having to consider whether there was wilful default or fraud (see *Deyab v Canada*, 2020 FCA 222 at paras 58-61 [*Deyab*]). Having said this, the burden is on the Minister to establish both that the taxpayer or the person filing the return has made a misrepresentation *and* that it is attributable to neglect, carelessness, wilful default or fraud (see *Vine v R*, 2015 FCA 125 at paras 23-24).

[32] The Minister's burden is to establish that there has been a misrepresentation at the time the return is filed. In commenting on the issue of timing in *Nesbitt v Canada*, 96 DTC 6588 at para 8, the Federal Court of Appeal expressed its view of the purpose of subsection 152(4) as follows:

> It appears to me that one purpose of subsection 152(4) is to promote careful and accurate completion of income tax returns. Whether or not there is

> misrepresentation through neglect or carelessness in the completion of a return is determinable at the time the return is filed. A misrepresentation has occurred if there is an incorrect statement on the return form, at least one that is material to the purposes of the return and to any future reassessment. It remains a misrepresentation even if the Minister could or does, by a careful analysis of the supporting material, perceive the error on the return form. It would undermine the self-reporting nature of the tax system if taxpayers could be careless in the completion of returns while providing accurate basic data in working papers, on the chance that the Minister would not find the error but, if he did within four years, the worst consequence would be a correct reassessment at that time.
>
> [Underlining added]

[33] Courts have consistently held that the threshold for establishing misrepresentation is low. In support of this view, in *Francis & Associates v R*, 2014 TCC 137 at para 20, Justice Bocock wrote as follows:

> A misrepresentation is any statement that is "incorrect.": *Minister of National Revenue v. Foot*, [1964] C.T.C. 317 (Can. Ex. Ct.). Also, several cases have indicated that "any" error made in a return filed is tantamount to a misrepresentation, *Minister of National Revenue v. Taylor*, [1961] C.T.C. 211 (Can. Ex. Ct.), *Nesbitt v. R.*, and *Ridge Run Developments Inc. v. R.*, [2007] 3 C.T.C. 2605 (T.C.C. [General Procedure]). Therefore, the threshold to establish a misrepresentation is low.

[34] In filing its return for 2010, the Appellant deducted management fees of $1,622,000 (Exhibit A-5), $1,610,000 of which related to the IP Strategy. Linda MacInnis testified that she did not recall reviewing the return in detail but stated that Mr. Rudolph would have shown her the Appellant's balance sheet. When asked about the Appellant's financial statements for 2010 (Exhibit A-4), Linda MacInnis stated that she did not understand the specifics but she understood that the 2010 current liabilities were significantly larger than those for 2009 due to the deductions related to the IP strategy. Ms. MacInnis may not have understood the intricacies of the IP Strategy but as the office manager and bookkeeper, she knew that the Appellant had not incurred or paid any management fees in relation to the IP Strategy. In addition, the Appellant acknowledges that it was incorrect to deduct the management fees related to the IP strategy and, on the advice of its current accountant, has now paid over $400,000 to cover all or part of the taxes owed in relation to the inappropriate deduction. Hence, the Appellant, through its director and office manager, knew that it was deducting an expense it did not incur and made no inquiries to confirm the appropriateness of the deduction.

[35] The Appellant did not deduct any management fees related to the IP Strategy in 2011 and 2012 but it did deduct professional fees related to the IP Strategy. As discussed earlier, the Appellant was required to pay 30% of the tax savings resulting from the IP Strategy. Ms. MacInnis received quotes relating to these fees and, treating them as invoices, paid them quickly. As described earlier, some of the quotes from Doctor Tax referred to tax avoided and further, to tax avoided relating to both a T1 and a T2. Courts have found that "where a taxpayer thoughtfully, deliberately and carefully assesses the situation and files on what he believes *bona fide* to be the proper method there can be no misrepresentation as contemplated by section 152" (see *Regina Shoppers Mall Ltd v R* [1991] F.C.J. No 52 (FCA) at para 7 [*Regina Shoppers*]). I find that the Appellant and its directors did not 'thoughtfully, deliberately and carefully assess the situation' before filing the Appellant's returns; they were content to rely on the trust they had in Mr. Rudolph. I would add that by then, the MacInnises had already been summoned to testify before the Nova Scotia Securities Commission regarding an investigation of Douglas Rudolph.

[36] To borrow the words of Justice Muldoon in *Reilly v R*, [1984] CTC 21 at para 51 (FCTD), "wisdom is not infallibility and prudence is not perfection". However, in the present case, the Appellant has fallen far short of exercising reasonable care (see *Venne v R*, [1984] FCJ No 314 (FCTD) at para 16). In *Regina Shoppers, supra* at para 7, the Federal Court of Appeal agreed that it had been established "that the care that must be exercised must be that of a wise and prudent person and that the report must be made in a manner that the taxpayer truly believes to be correct". At the hearing, Linda MacInnis repeatedly stated that the Appellant simply trusted Doug Rudolph and consequently, no questions were asked, no further inquiries were made. The Appellant cannot shield itself from the consequences of subparagraph 152(4)(a)(i) by shifting the blame to Doug Rudolph (see for example *Snowball v R*, [1996] T.C.J. No. 276 at para 18).

[37] In light of the above, I find that the Appellant made a misrepresentation in filing its returns for the 2010, 2011 and 2012 taxation years *and* that it was attributable to neglect or carelessness. Hence, the Minister has met the burden to reassess beyond the normal reassessment period for the 2010, 2011 and 2012 taxation years.

Penalties pursuant to subsection 163(2)

[38] In addressing the second issue in this appeal, the Court must determine whether the Minister was justified in imposing penalties pursuant to subsection 163(2) of the Act with regards to the claim for management expenses made in the

2010, 2013 and 2015 taxation years. No penalties were assessed in relation to the amounts deducted as professional fees.

[39] Subsection 163(2) reads as follows:

(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of $100 and 50% of the total of…	(2) Toute personne qui, sciemment ou dans des circonstances équivalant à faute lourde, fait un faux énoncé ou une omission dans une déclaration, un formulaire, un certificat, un état ou une réponse (appelé « déclaration » au présent article) rempli, produit ou présenté, selon le cas, pour une année d'imposition pour l'application de la présente loi, ou y participe, y consent ou y acquiesce est passible d'une pénalité égale, sans être inférieure à 100 $, à 50 % du total des montants suivants…

[40] Hence, the Minister must show that the Appellant made, or participated in, or assented to, or acquiesced in, the making of a false statement *and* did so knowingly or did so under circumstances amounting to gross negligence. As provided by subsection 163(3), the Minister bears the burden of establishing the facts that justify the assessment of the penalty.

[41] In claiming a deduction for management fees it never incurred, the Appellant made a false statement. It is worth reiterating that the Appellant has acknowledged that the management fees were not deductible. Thus the first element of subsection 163(2),that of making a false statement, has been established. In the circumstances, the more pressing question is whether the Appellant made the false statement "knowingly" or "under circumstances amounting to gross negligence".

[42] Since the seminal case in *Venne*, *supra*, courts have consistently held that "gross negligence" requires greater neglect than simply failing to exercise reasonable care, which might otherwise be sufficient for the application of subparagraph 152(4)(a)(i) discussed earlier. In *Venne*, *supra* at para 37, the Federal Court stated that gross negligence "must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not". This was found to mean "akin to burying one's head in the sand" (see *Guindon v Canada*, 2015 SCC 41 at para 60). A considerable body of case law has

developed over the years since the decision was rendered in *Venne* in 1984, unsurprisingly, in light of the importance of the findings of fact regarding a taxpayer's role in the making of a false statement in each appeal. The parties referred to many of those cases at the hearing of this appeal. It is not necessary, nor useful, to discuss them all and I will not do so.

[43] In *Wynter v Canada*, 2017 FCA 195 [*Wynter*], the Federal Court of Appeal asserted that the Minister could meet its burden of showing that the false statement was made knowingly by demonstrating that the taxpayer was wilfully blind such that knowledge could be imputed to the taxpayer. In distinguishing between wilful blindness and gross negligence, the Court stated as follows (at para 13):

> A taxpayer is wilfully blind in circumstances where the taxpayer becomes aware of the need for an inquiry but declines to make the inquiry because the taxpayer does not want to know, or studiously avoids, the truth. The concept is one of deliberate ignorance: *R. v. Briscoe*, 2010 SCC 13 at paras. 23-24, [2010] 1 S.C.R. 411 (*Briscoe*); *Sansregret* at para. 24. In these circumstances, the doctrine of wilful blindness imputes knowledge to a taxpayer: *Briscoe* at para. 21.

[44] While gross negligence is determined by an objective assessment, wilful blindness requires a subjective assessment of the comportment of the taxpayer (see*Wynter* at para 12). I want to make it clear that counsel for the Appellant was correct when he asserted that wilful blindness was to be appreciated from a subjective point of view.

[45] In addition, the Federal Court of Appeal asserted that gross negligence, which is distinct from wilful blindness, "arises where the taxpayer's conduct is found to fall markedly below what could be expected of a reasonable taxpayer. Simply put, if the wilfully blind taxpayer knew better, the grossly negligent taxpayer ought to have known better" [*Wynter, supra* at para 18].

[46] I turn now to the question of whether the Appellant had actual or subjective knowledge that it made false statements in its returns. Linda MacInnis testified that when Doug Rudolph attended the Appellant's office to finalize its returns, she did not review them in any great detail (see for example, Transcript, Vol 1 at 20 and 121). Ms. MacInnis added that she did not have an accounting background and did not feel she needed to go through the returns in detail because she assumed Mr. Rudolph was completing their returns properly. Although I believe Ms. MacInnis when she states she did not understand the tax implications of the IP Strategy, this provides no exoneration to the Appellant (see *Tomlinson v R*, 2016 TCC 246 at para

19). The relevant question becomes whether the Appellant was wilfully blind in the making of a false statement.

[47] I find the remarks of Justice Owen, in *Peck v R*, 2018 TCC 52 at paras 50 and 51 instructive regarding the relevance of a taxpayer's personal attributes. He wrote as follows:

> [50] The subjective nature of the wilful blindness standard also means that the personal attributes of the individual may be considered in determining whether the individual is wilfully blind.
>
> [51] In contrast, the objective nature of the gross negligence standard means that the personal attributes of the individual are not relevant unless the individual establishes that he or she is incapable of understanding the risk the individual has failed to avoid (see *R. v. Beatty*, 2008 SCC 5, [2008] 1 S.C.R. 49 at paragraph 40).

[48] In cases dealing with penalties assessed under subsection 163(2), and although not an exhaustive list, the courts have considered the following personal attributes and particular circumstances to be relevant: education, intelligence, knowledge and experience of the taxpayer; the magnitude of the advantage or omission; the opportunity to detect the false statement; the explanations provided by a tax preparer (see for example *Torres v R*, 2013 TCC 380, conf. *Strachan v Canada*, 2015 FCA 60).

[49] In determining whether the Appellant was wilfully blind in making false statements in its returns, we must look at the conduct of its principals who were making decisions on its behalf. Counsel for the Appellant presented the MacInnises as unsophisticated, simple people, even referring to them as working-class schlumps, who lacked the education to know or understand what was happening. I do not agree.

[50] Ms. MacInnis finished high school, held a number of jobs including working for a temporary agency doing office work, as well as working for a collection agency and the Dartmouth Free Press. More importantly, Ms. MacInnis was the Appellant's bookkeeper; she prepared invoices, received and paid the business's bills, managed the employees' time sheets, paid their salaries and ensured they received their T4 slips. She admitted she had "good knowledge" of the Appellant's income and expenses.

[51] Although Richard MacInnis did not testify, I accept Linda MacInnis' description of his education and involvement in the Appellant's business. Richard completed a 2-year college program to train as an electrician and went back to school

each year for four years to attend a 7-week course to become a journeyman. He worked for small electrical companies for a few years and at Seaboard Electric for 8 or 9 years. In the Appellant's business, he was responsible for preparing estimates and quotes and doing or supervising the electrical work when he was successful in securing jobs.

[52] I accept that the MacInnises did not have any sophisticated tax knowledge. Nevertheless, they were intelligent people running a successful business, in an industry where safety is of utmost importance, earning income well over a million dollars and actually, at times, over 1.5 million dollars during the relevant taxation years.

[53] The Appellant deducted management fees in the amounts of $1,610,000, $160,000 and $236,556 in the 2010, 2013 and 2015 taxation years respectively. For the Appellant's 2010 taxation year, the amount is of such magnitude that it created a loss of more than one million dollars. By 2010, the Appellant had been in business for 15 years and had never reported a loss (Transcript, Vol 1 at 125). Linda MacInnis testified that she would have had invoices or receipts for the expenses listed in Schedule 125 of the T2 return for 2010 and she would have paid the expenses on behalf of the Appellant. She had no such invoice for the management fees. She acknowledged that the only support for the management fees in the amount of $1,610,000 was the shareholders' biographies and the IP Strategy. Linda MacInnis testified that she never saw any calculations showing how the value of the shareholders' biographies was established. Although the amounts deducted in the 2013 and 2015 taxation years are much lower than that in 2010, they are significant amounts representing more than half the total operating expenses claimed.

[54] All returns for the taxation years in which the Appellant deducted the management fees were filed after the MacInnises had been summoned to appear before the Nova Securities Commission in an investigation of Douglas Rudolph. In addition, by the time the Appellant filed its returns for the 2013 and 2015 taxation years, they had attended a meeting with their friend and competitor, Tim Jones, at the office of his accountant Boyd Hunter. Doug Rudolph was also in attendance at this meeting which took place in August 2011. In his testimony, Mr. Hunter stated that he was not impressed with the idea pitched by Doug Rudolph; in his view, it did not pass the smell test. He was adamant that he would not have told the Appellant that the proposed strategy was a good idea. Mr. Hunter could not remember what he said at the meeting but was quite certain that, after the meeting, he would have told Tim Jones that he did not recommend pursuing the concept (Transcript, Vol 3 at 38). He testified that he would have told Tim Jones, "But if you want, I can still ask them

for some actual case references, and et cetera, and it will be up to you whether you want me to actually spend time on that if they send it back to us" (Transcript, Vol 3 at 40).

[55] On the same day of the meeting that took place in August 2011, Mr. Hunter sent an email to Doug Rudolph asking him to provide case law in support of the IP Strategy. Doug Rudolph responded to the email including the Appellant and Tim Jones in the reply but excluded Mr. Hunter. Doug Rudolph did not provide any support for the IP Strategy, writing only that he had forwarded the message to head office and adding that "CRA will often harass all the way to Court, but will settle before Court as they do not want to lose nor do they want to set precedent" (Exhibit R-2). Mr. Jones changed accountants at one point and in early 2014, he exchanged emails with Doug Rudolph about the IP Strategy. However, when Tim Jones saw an article published in the Chronicle Herald reporting on an RCMP investigation resulting in charges laid against Doug Rudolph (see Exhibit R-3), he emailed Doug Rudolph thinking the article was about someone else with the same name. After Mr. Rudolph confirmed it was about him, Tim Jones stated that he "was done" at that point and no amount of explaining or justifying by Mr. Rudolph would have changed that. Mr. Jones testified that he would have communicated this information to the Appellant.

[56] I note that the Appellant did not deduct management fees in its return for the 2014 taxation year, but it did so again in the 2015 taxation year, after the article appeared in the Chronicle Herald and after Tim Jones would have communicated with the MacInnises about this.

[57] Having reviewed the MacInnises' personal attributes and the particular circumstances in which the Appellant made false statements, I find that the Appellant was wilfully blind in deducting management fees without having incurred the fees and without inquiring further about any clear basis for how those amounts were established. At no point did the Appellant, through the MacInnises, see the red flags indicating a need for further inquiry from Doug Rudolph or even from Rudy Terracina who was the one to attach a value to the shareholders' biographies for the purposes of the IP Strategy. Linda MacInnis repeatedly stated that they trusted Doug Rudolph and did not ask any questions.

[58] To borrow the words of the Federal Court of Appeal in *Wynter*, the Appellant, through the MacInnises, deliberately chose not to make inquiries in order to avoid what might be such an inconvenient truth. In spite of Mr. MacInnis' mixed feelings about the IP Strategy, the Appellant chose to purchase a warranty, which in my view

connotes a process of suppressing a suspicion (see *Wynter* at para 17). In my view, this is sufficient to establish wilful blindness such that knowledge can be imputed to the Appellant. Hence, based on the teachings of the Federal Court of Appeal in *Wynter*, the Minister has met its burden of establishing the knowledge requirement under subsection 163(2) for the 2010, 2013 and 2015 taxation years.

[59] As mentioned earlier, gross negligence, which is separate from wilful blindness, arises when a taxpayer's conduct is found to fall markedly below what could be expected of a reasonable taxpayer. In my view, the findings above regarding wilful blindness also support a finding that the Appellant's conduct represents a marked departure from what could be expected of a reasonable person in the same circumstances. A reasonable person in the circumstances of the Appellant and its shareholders would have made inquiries from an independent person about the IP strategy and the nonsensical explanations provided by Doug Rudolph. A reasonable person would have been suspicious of the huge value assigned to their biographies and of Rudy Terracina who was evaluating their biographies without providing any basis for his calculations. A reasonable person would have been suspicious of the extraordinary tax result, the huge loss that resulted from the deduction of the management fees. A reasonable person would have sought independent accounting advice about these extraordinary tax advantages. A reasonable person would have made further inquiries about the quotes and invoices and the entities to whom they were making payments. A reasonable person would have made further inquiries after being approached by the Nova Scotia Securities Commission and finding out that Doug Rudolph was being investigated.

[60] In my view, the conduct of the Appellant in these circumstances represented a marked departure from the conduct one would expect from a reasonable person placed in the same circumstances. Like the taxpayer in *Peck*, *supra*, the Appellant cannot simply throw its hands up and say that it, through the MacInnises, blindly relied on their accountant, without making any attempt at seeking a better understanding of the IP Strategy and without making any effort to verify the accuracy and justifiability of the deduction claimed. All, in spite of the many red flags referred to above (see for example *Peck*, *supra* at para 79).

[61] For these reasons, I find that the Minister has established that the Appellant was wilfully blind in making false statements in its returns for the 2010, 2013 and 2015 taxation years *and* did so under circumstances amounting to gross negligence.

The deductibility of the professional fees

[62] The third issue raised in this appeal concerns the deductibility of the professional fees the Appellant claimed in its returns for the 2010, 2011 and 2012 taxation years. In addressing this question, the Court must determine whether the expenses meet the criteria for deducting business expenses.

[63] I do not dispute the Appellant's assertion that the Appellant is an operating electrical business that has been in existence for almost 30 years at this stage, a legitimate, established business, and not a fly-by-night operation. However, in my view, that is not determinative of whether a particular expense is deductible. Rather, the question is whether the expenses were incurred for the purpose of earning income from the Appellant's business without which the deductibility of the expenses is prohibited pursuant to paragraph 18(1)(a) of the Act.

[64] As mentioned earlier, the Appellant paid fees based on quotes it received from Doctor Tax, quotes referencing tax avoided for T1 and T2s. We know that the amounts were based on 30% of what was established to be tax avoided and that they were related to the IP Strategy. There is no other information about what services were actually provided to the Appellant. In addition, in light of the reference to T1 avoided tax, I would add that there is no information about which proportion of the expenses relates to tax savings for the MacInnises' personally. Clearly, any amounts paid in relation to the MacInnises' personal returns are not properly deductible by the corporate Appellant. I would also note that Linda MacInnis testified that Doug Rudolph never charged her for preparing her personal returns (Transcript, Vol 1 at 162).

[65] The Appellant's counsel described the "service" for which the Appellant paid professional fees as "the service of pursuing the tax – the IP Strategy regarding management fees" (Transcript, Vol 3 at 159). In arguing in support of the deductibility of the professional fees, the Appellant relied on cases involving the issue of whether a business was actually being carried on (such as *Hammill v Canada*, 2005 FCA 252) or whether there was a source of income (such as *Johnson v Canada*, 2012 FCA 253, application for leave to appeal to the SCC dismissed, no 35090). I do not find that these cases support the Appellant's argument that the professional fees deducted by the Appellant meet the legislative criteria for deductibility.

[66] I find that the professional fees paid by the Appellant were not expenses incurred for the purpose of earning income from the activities of the electrical business of the Appellant. Those fees were not incurred for business purposes. The Appellant could not explain clearly to the Court what those expenses were for, how

the amounts were established and who exactly they were paid to. Documentary evidence showed that the Appellant paid amounts to Doctor Tax (see for example, a bank draft, Exhibit A-11) and to a numbered company (see accounting entry, Exhibit A-16). Linda MacInnis believed that the numbered company was Doug Rudolph's corporation and she was unclear on whether Doctor Tax was linked to Doug Rudolph or to Agemo/Rudy Terracina (see for example Transcript, Vol 1 at 59). The professional fees do not meet the legislative criteria for the deductibility of business expenses.

VI. Conclusion

[67] For all the above reasons, I conclude that the Minister was justified:

i. in reassessing the Appellant beyond the normal reassessment period for the 2010, 2011, 2012 taxation years;

ii. in imposing gross negligence penalties on amounts related to the management fees for the 2010, 2013 and 2015 taxation years; and

iii. in disallowing the deduction of professional fees for the 2010, 2011 and 2012 taxation years.

[68] The appeal for the 2010, 2011, 2012, 2013 and 2015 taxation years is dismissed with costs to the Respondent.

Signed at Ottawa, Canada, this 9th day of May 2023.

"Gabrielle St-Hilaire"

St-Hilaire J.

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APPEARANCES:

Counsel for the Appellant:	Derek B. Brett
Counsel for the Respondent:	Tokunbo Omisade

COUNSEL OF RECORD:

For the Appellant:

Name:	Derek B. Brett
Firm:	Burnside Law Group 202 Brownlow Avenue, Suite 400, Dartmouth, Nova Scotia B3B 1T5

For the Respondent:	Shalene Curtis-Micallef Deputy Attorney General of Canada Ottawa, Canada