

Docket: 2021-2942(IT)I

BETWEEN:

JONATHAN LAPIERRE,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeal heard on October 24, 2022, at Halifax, Nova Scotia

Before: The Honourable Justice Susan Wong

Appearances:

Agent for the Appellant:

Tony Faulkner

Counsel for the Respondent:

Tanner McInnis

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 2015, 2016 and 2017 taxation years is allowed without costs, and the matter is referred back to the Minister of National Revenue on the following basis:

1. The subsection 163(2) penalties shall be deleted for the 2015, 2016, and 2017 taxation years.
2. The Minister's reassessments are upheld in all other respects.

Signed at Toronto, Ontario, this 25th day of October 2023.

“Susan Wong”

Wong J.

Citation: 2023 TCC 152
Date: October 25, 2023
Docket: 2021-2942(IT)I

BETWEEN:

JONATHAN LAPIERRE,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

REASONS FOR JUDGMENT

Wong J.

I. Introduction/Overview

[1] The Minister of National Revenue used the net worth method to reassess the appellant for unreported business income, levy gross negligence penalties, and open a statute-barred year. The appellant reported negative income (i.e. losses) in two of three years and net income of just under \$5,000 in the third year, to support his family of five.

[2] The appellant says that in using the net worth method, the Minister failed to take into account certain items/credits and that the gross negligence penalties were not justified.

II. Issues:

[3] There are three issues in this appeal:

- a. whether the Minister properly included unreported business income in the amounts of \$78,055, \$48,046, and \$89,706 in the appellant's 2015, 2016, and 2017 taxation years, respectively;

- b. whether the Minister properly applied gross negligence penalties against the unreported business income in each of the three years; and
- c. whether the Minister was justified in reassessing the appellant's 2015 taxation year beyond the normal reassessment period.

III. **Factual background:**

[4] After finishing high school, Mr. Lapierre attended trade school and earned his red seal to become a journeyman carpenter. He then worked at his father's business W&J Carpentry for about 10 years until about June 2014, when he took over from his father. As part of the transition from father to son, his father gifted the business' assets and goodwill to Mr. Lapierre.

[5] Mr. Lapierre ran his general contractor business as a sole proprietorship. The operation consisted of building new homes and renovating existing homes in Nova Scotia and Prince Edward Island. In 2015, he worked on the construction of a new house in PEI and toward the end of that year, he returned to working in Nova Scotia. In 2016 and 2017, he worked primarily in the Newport area, where he also resided. He continues to work as a general contractor.

[6] He got most of his jobs by word of mouth. When customers purchased/supplied the materials for framing, he would charge them by the hour. He stated that when he purchased the materials for a job, he would not mark them up because customers would not return if he did. He was typically paid in installments by way of 50% up front, 25% at the midpoint, and then the remaining 25% at the end of the job. He stated that he conducted no cash transactions, accepting only cheques and e-transfers for work done.

[7] In the years under appeal, he had two employees who were paid by the hour. He explained that carpentry work is weather-dependent such that every week is different, and it is very unlikely to consistently work 40 hours a week. in carpentry. One employee was his father, who earned about \$600 if they had a 40-hour work week, while the other was a labourer who earned about \$325 for a 40-hour work week. He stated that he paid them for their work by e-transfer. He also engaged subcontractors during these years and testified that he paid them by cheque or e-transfer.

[8] Mr. Lapierre testified that with his father's existing clientele, business was steady and profitable during the first two years. However, he also found the first few

years of being in business to be difficult. He stated that it was a big change to go from working for someone to overseeing everything himself. He testified that he used his business Visa plus step-mortgage line of credit to cover shortfalls and that by the end of 2017, he had almost \$21,000 on his business Visa as well as \$31,000 against his line of credit.

[9] Mr. Lapierre has no business or accounting background and when he commenced business in 2014, he used the basement of his home as an office. He kept his expenses, bank deposit information, job quotes, and invoices in folders organized by month, and took them to his accountant to prepare his annual tax returns. He acknowledged that he used his business bank accounts for both business and personal purposes.

[10] Since about 2010, he and his wife sold leadership books and CDs through a multi-level marketing business called Life Leadership. They sold products in 2015 and 2016, and ceased in early 2017. He would help her with Life Leadership sales in the evenings after working at his general contracting business during the day. He testified that she in turn did a small amount of bookkeeping for his business but nothing substantial. They have three children who were six, ten, and twenty years old at the time of the hearing. The main source of income for the family in the years under appeal was the general contracting business.

[11] He stated that in 2021, they sold the family home because they could not keep up with expenditures during the global pandemic. Selling their home allowed them to pay off their step-mortgage line of credit and the business Visa, which was \$42,000 by that point.

[12] The income amounts reported by Mr. Lapierre and adjusted by the Minister are as follows:¹

Year	Reported	Revised	Net adjustment
2015			
(a) Net business income	\$(28,007)	\$50,048	\$78,055
(b) Total income	\$(22,787)	\$55,268	\$78,055
2016			
(a) Net business income	\$14,011	\$62,057	\$48,046
(b) Total income	\$4,927	\$52,973	\$48,046
2017			
(a) Net business income	\$(43,755)	\$45,951	\$89,706
(b) Total income	\$(43,755)	\$45,951	\$89,706

[13] The Canada Revenue Agency auditor Jacklyn Winters testified that she met with the appellant at his residence in order to gauge his lifestyle. She stated that she knew he had a trailer for his business and that it was at a worksite, so she did not tour it. She noted that his books and records were organized into monthly folders, along with monthly business bank account statements. She learned that he kept his day-to-day records at home and dropped off monthly records to the accountant. The accountant would then prepare quarterly GST returns and give him copies; at year-end, she would prepare the income tax return and give him a copy to review.

[14] As an overview, Ms. Winters explained that in the case of sole proprietorships, there is typically an issue with respect to the segregation of duties. She stated that in a sole proprietorship, one individual is responsible for tasks that would ordinarily be performed by separate individuals as an internal control, e.g. receiving payments and depositing monies in the bank.

[15] She stated that she began by doing a bank deposit analysis and a rough net worth calculation to indirectly verify income. She explained that it is typical to test the most recent year so in this case, she tested only 2017 at first. She testified that her analysis of monthly deposits into each bank account showed an initial discrepancy of \$77,575 after reported sales and non-income amounts were

subtracted from total deposits.² She explained that the initial discrepancy only alerts her that there may be unreported income. She also explained that when the initial discrepancy exceeds \$10,000 or \$15,000, it suggests that a full net worth audit should be done.

[16] Her review showed that withdrawals from bank accounts in 2017 totaled \$463,092.77³ and after subtracting transfers between accounts, business expenses claimed by the appellant, GST, mortgage payments, and loan repayments, a balance of \$89,281.64 remained and was assumed to be personal expenditures.⁴ She testified that in doing the rough net worth calculation, she took into account known assets and liabilities to arrive at potential unreported income of \$96,680 for 2017.⁵

[17] In carrying out the full net worth analysis, she went through every withdrawal from the appellant's bank accounts for the three years under appeal and put them in a number of categories such as food, shelter, clothing, household operations, transportation, health care, cash withdrawals, transfers, and payments.⁶

[18] She stated that based on the appellant's reported amounts, there would have been about \$25,464 available for personal expenditures in 2015, \$53,637 in 2016, and \$21,618 in 2017.⁷ She testified that these personal expenditure figures were lower than what would be expected to cover household operations for a family of five. As an example, she noted that her line-by-line analysis of withdrawals showed that \$18,728 was spent on food alone in 2015,⁸ which would leave an unreasonably low amount for everything else. She stated that the amount for 2016 was closer to typical if all transactions were conducted through the bank accounts.

[19] Ms. Winters testified that in arriving at the final amounts for assessment purposes, she used the most conservative approach possible by allocating the largest-dollar categories of withdrawals such as building supplies, cash withdrawals, and transfers as business expenditures, i.e. they were not included as personal expenditures. She also allocated all transportation amounts as business. Her approach resulted in personal expenditures totaling \$55,500 for 2015, \$67,272 for 2016, and \$79,636 for 2017.⁹

[20] She explained that in a net worth analysis, the focus is on the change in net worth from year to year. She stated that the appellant's assets and liabilities remained relatively steady over the three years in question so the annual changes in net worth would have been driven by personal spending. She used the above personal expenditure amounts to calculate the net worth discrepancy for each year, which

became the amounts assessed as unreported business income in 2015, 2016, and 2017.¹⁰

[21] With respect to the specific concerns set out in the notice of appeal, she addressed them as follows:

- a. building supplies were allocated as business expenditures so they were not included in the personal expenditure total for each year;¹¹
- b. vehicles were treated as assets whose value did not change from year to year, so they did not affect the net worth calculation;¹² and
- c. workspace in home – she applied the workspace-in-home credit to her calculation of personal expenditures for 2016 because the appellant had claimed the credit for that year. She did not apply the credit to her personal expenditures calculation for 2015 or 2017 because the appellant had not claimed the credit for those years.¹³ She noted that the appellant likely did not claim the credit in those years because he reported a loss and the credit is non-refundable, i.e. it can only be used to reduce income to zero.

[22] With respect to the gross negligence penalties levied, she stated that the Minister was justified in doing so because: (a) the discrepancies were material, (b) the appellant was a sole proprietor so he had complete control over his bank accounts and should have known that his income was underreported, and (c) he did not maintain adequate books and records. She stated that for similar reasons, the Minister was justified in reassessing the statute-barred year of 2015 after the normal reassessment period had expired.

[23] She noted that the appellant seemed to have some basic understanding of how to report his income and his tax obligations. She observed that he kept organized books and records, which demonstrated that he knew the importance of keeping track of things; however, it became clear during the audit that his books and records were incomplete. She was also of the view that the accountant could not be held responsible because she would have prepared the returns based on the incomplete information provided to her.

IV. Analysis and discussion

[24] I reserved my decision because I wished to review the detailed net worth audit materials in light of the lack of evidence presented by the appellant to rebut the Minister's assumptions.

(a) Unreported business income

[25] I found the appellant to be a credible person. However, he did not introduce any evidence to show that his business income was as reported in his returns, or that it was different from what the Minister later determined it to be. Although he began operating his business in 2014, I would not expect the typical start-up phase for a new business in terms of high costs relative to low net income in the present circumstances. His father gifted him with an established business including the physical assets and existing clientele, plus continued to work there as an employee. The appellant stated that business was steady and profitable in 2015 and 2016, which makes sense with respect to taking over a going concern.

[26] The appellant used an increasing amount of credit to cover shortfalls over the three years in question but it is unclear as to why a steady, profitable going concern had shortfalls in those years. On a balance of probabilities, I believe the appellant's explanation that he found the first few years difficult in terms of the change in responsibility from being an employee to becoming the owner. However, the evidence did not show me how those difficulties might have affected his business income and if so, to what extent. For example, one can see from the auditor's liabilities balance sheet that as the credit debt increased over the three years, the personal expenditures did as well.¹⁴ Therefore, it appears that the increased financial pressure may have arisen from an increase in personal expenditures over the years in question.

[27] The steps taken by the auditor to initially test the appellant's income for discrepancies, followed by conducting the full net worth audit were detailed, logical, and unrefuted by the appellant. She applied a very conservative approach to allocating business versus personal expenditures. For example, all building supplies, cash withdrawals, transfers between accounts, and transportation amounts were categorized as business-related. The value of assets such as vehicles and land was kept constant for the purposes of the net worth analysis, so they would not have contributed to a change in net worth during the period in question.

[28] As a result, I cannot find that the Minister's assumptions have been rebutted with respect to the unreported business income of \$78,055, \$48,046, and \$89,706 assessed for the 2015, 2016, and 2017 years, respectively.

[29] I note that with respect to the workspace-in-home credit under subsection 18(12) of the *Income Tax Act*, the auditor indicated that she did not apply it to 2015 or 2017 because the appellant had not claimed the credit for those years. This credit is non-refundable and could have only been used to bring the appellant's income to zero. The auditor noted that the appellant reported a loss in those years so he would not have been able to use it against income. In light of my finding with respect to his income for 2015 and 2017, it seems that he might be able to claim this credit if he otherwise qualifies.

(b) Gross negligence penalties

[30] It is well-established in the case law that the threshold for gross negligence is high. In examining whether there has been gross negligence, this court must look at the expected conduct of a reasonable person in the circumstances. In addition, the court should consider other factors such as the magnitude of the omission, whether the taxpayer had the opportunity to detect the error, his education, and his sophistication.

[31] A penalty under subsection 163(2) may be levied when a taxpayer "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..." The respondent says that the appellant knew or ought to have known about the underreported income in his returns and is therefore, grossly negligent.

[32] Gross negligence requires a higher degree of neglect than mere failure to take reasonable care.¹⁵ It is a marked or significant departure from what would be expected, and it is more than carelessness or misstatements.¹⁶ It must involve greater neglect than simply a failure to use reasonable care; there must be a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.¹⁷

[33] In the present circumstances, I am unable to find the necessary level of culpability to support a finding of gross negligence. The appellant's education and level of business sophistication were modest. That was especially so in the years under appeal, when he had just taken over his father's business after finishing trade school and working as his father's employee for 10 years. It is reasonable that none of his prior experience prepared him to take over as the owner-operator of a fully functioning, mature business.

[34] Although the net worth audit revealed that his books and records were incomplete, the auditor noted that they were neatly maintained and organized. It suggests that there was some genuine intent to maintain good records, even though the effort failed. He acknowledged his lack of business acumen and I believe it was more evident in the early years when it appears that his ability to manage the flow of funds had not caught up with his new level of responsibility. While he probably should have been able to detect the error, I do not believe his conduct reached the necessary high degree of blameworthiness which incorporates intent and an indifference as to whether the law is complied with.

[35] As a result, I find that the penalties assessed under subsection 163(2) were not justified.

(c) Assessment beyond the normal reassessment period

[36] In order for the Minister to assess a taxpayer after the normal reassessment period, the taxpayer must have “made any misrepresentation that is attributable to neglect, carelessness or willful default... in filing the return.”¹⁸ In other words, there is negligence amounting to a lack of reasonable care¹⁹ It is a lower threshold than that of gross negligence and I believe that the appellant’s conduct in 2015 reaches this level of neglect.

[37] It does not appear that the appellant questioned the negative net income figure in the return which his accountant prepared and provided to him for review. Given that business was steady in 2015, I would expect a reasonable person to question a net income loss in his return for that year. While the appellant does not have an accounting background nor did he have much business experience at the time, it would not have required any specialized knowledge to recognize a negative income figure.

[38] For these reasons, I find that the Minister was justified in reassessing the appellant’s 2015 taxation year after the normal reassessment period had expired.

V. Conclusion

[39] The appeal is allowed without costs, on the following basis:

- a. The subsection 163(2) penalties shall be deleted for the 2015, 2016, and 2017 taxation years.

b. The Minister's reassessments are upheld in all other respects.

Signed at Toronto, Ontario, this 25th day of October 2023.

“Susan Wong”

Wong J.

CITATION: 2023 TCC 152
COURT FILE NO.: 2021-2942(IT)I
STYLE OF CAUSE: JONATHAN LAPIERRE AND HIS MAJESTY THE KING
PLACE OF HEARING: Halifax, Nova Scotia
DATE OF HEARING: October 24, 2022
REASONS FOR JUDGMENT BY: The Honourable Justice Susan Wong
DATE OF JUDGMENT: October 25, 2023

APPEARANCES:

Agent for the Appellant: Tony Faulkner
Counsel for the Respondent: Tanner McInnis

COUNSEL OF RECORD:

For the Appellant:

Name: N/A

Firm: N/A

For the Respondent:

Shalene Curtis-Micallef
Deputy Attorney General of Canada
Ottawa, Canada

¹ Exhibit R-1, Tab 7

² Exhibit R-1, Tab 14, page 90

³ Exhibit R-1, Tab 14, page 92

⁴ Exhibit R-1, Tab 14, page 93

⁵ Exhibit R-1, Tab 12, page 80

⁶ Exhibit R-1, Tab 9, page 67

⁷ Exhibit R-1, Tab 9, pages 70, 72, and 73

⁸ Exhibit R-1, Tab 9, page 70

⁹ Exhibit R-1, Tab 10

¹⁰ Reply to notice of appeal, Schedule III; Exhibit R-1, Tab 13

¹¹ Exhibit R-1, Tab 10

¹² Exhibit R-1, Tab 13, page 82

¹³ Exhibit R-1, Tab 10

¹⁴ Exhibit R-1, Tab 13, pages 83 and 84; Exhibit A-2

¹⁵ *Wynter v. Canada*, 2017 FCA 195 at paragraph 19

¹⁶ *Wynter v. Canada*, 2017 FCA 195 at paragraph 19

¹⁷ *Venne v. Her Majesty the Queen*, 1984 CarswellNat 210 at paragraph 37

¹⁸ *Income Tax Act*, subparagraph 152(4)(a)(i)

¹⁹ *Canada v. Paletta*, 2022 FCA 86 at paragraph 65; *Venne v. Her Majesty the Queen*, 1984 CarswellNat 210 at paragraph 16