

BETWEEN:

DENIS LAUZON,	Appellant,
and	
HER MAJESTY THE QUEEN,	Respondent,
and	
FUTON INTERNATIONAL INC.,	Third Party,
and	
DISTRIBUTION MAGO INC.,	Third Party.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on May 6, 7 and 8, 2013, at Québec, Quebec.

Before: The Honourable Justice Gaston Jorré

Appearances:

Counsel for the appellant:	Louis Sirois
Counsel for the respondent:	Dany Leduc
Counsel for the third party Futon International Inc.:	Étienne Retson-Brisson
For the third party Distribution Mago Inc.:	No one appeared

JUDGMENT AND DETERMINATION

In accordance with the attached Reasons for Judgment:

The appeal from the reassessment made under the *Income Tax Act* for the 2002 taxation year is dismissed.

The appeal from the reassessment for the 2003 taxation year is allowed, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the furniture sales in 2003 must be reduced by

\$11,751 and that the penalty issued under subsection 163(2) of the *Income Tax Act* must be recomputed accordingly. No other adjustment shall be made to the appellant's income for 2003.

As for the six questions to be determined in accordance with the order of June 8, 2011, the answer to each question is no.

The appellant shall pay the respondent's and third parties' costs.

Signed at Ottawa, Canada, this 9th day of January 2014.

“Gaston Jorré”

Jorré J.

Translation certified true
On this 18th day of March 2014

François Brunet, Revisor

Citation: 2014 TCC 3
Date: 20140109
Docket: 2009-870(IT)G

BETWEEN:

DENIS LAUZON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

and

FUTON INTERNATIONAL INC.,

Third Party,

and

DISTRIBUTION MAGO INC.,

Third Party.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Jorré J.

Introduction

[1] The appellant operated a furniture business in the Drummondville region for about forty years. He sold the business to his daughter in 2005.

|

[2] In his income tax returns for the 2002 and 2003 taxation years, the appellant reported the following:

		2002		2003
Taxable capital gains		—		\$12,500
Gross rental income ¹	\$14,550		\$41,837	
Net rental income ²		\$1,489		—
Gross business income	\$429,785		\$428,680	
Net business income		\$40,627		\$25,555
TOTAL INCOME		\$42,116		\$38,055

[3] The Minister of National Revenue (Minister) conducted an audit of the appellant's 2002 and 2003 taxation years; he used an alternative method for estimating income. In making the reassessments, the Minister added the following amounts to the appellant's income:

Adjustments	2002	2003
Unreported furniture sales	* \$128,844	*\$114,994
Non-deductible expenses	*\$29,350	\$3,478
Unreported rental income	*\$5,886	*\$13,162
Non-deductible interest (rental property)	*(\$399)	\$6,373
Non-deductible insurance (rental property)	\$728	—
Disallowance of personal expenses	—	(\$5,000)
Costs allowed for personal vehicle use	(\$2,825)	(\$2,825)
Costs allowed for use of home	(\$611)	(\$611)
TOTAL	\$160,973	\$129,571

[4] The Minister also imposed penalties under subsection 163(2) of the *Income Tax Act* (Act) on the amounts preceded by an asterisk.

[5] The appellant acknowledges that there were unreported furniture sales and rental³ income. His challenge is based on three points only:

- (a) He submits that he is entitled to additional deductions for the cost of goods sold, in particular:
 - (i) \$109,765 in 2002 and \$89,119⁴ in 2003, amounts paid to Futon International Inc. for the purchase of furniture;

¹ Note that the appellant received rent for an apartment above the store. The rent, and only the rent, was included in the business income.

² See previous note.

³ The third issue raised by the appellant is related to rental income in 2003.

⁴ And not \$89,549. See the end of Gérald Morin's testimony at pages 183 and 184 of the transcript of May 6, 2013.

- (ii) \$40,023 in 2002 and \$30,683 in 2003, amounts paid to Distribution Mago Inc. for the purchase of furniture.

According to the appellant, the amounts were allegedly paid in cash and were not claimed by the appellant in his income tax returns.

- (b) He submits that no penalty is warranted.
- (c) He submits that his income should be reduced by \$11,751, because it is a clerical error on the part of the accountant in 2003.

Section 174

[6] Following a reference application by the respondent under paragraph 174(3)(b) of the Act, Justice Archambault of this Court ordered on June 8, 2011, that Futon and Distribution Mago be bound by the determination of this Court in the appellant's appeal pertaining to the 2002 and 2003 taxation years.⁵

[7] This appeal was heard under the general procedure. The hearing lasted three days.

Facts

[8] This case turns on issues of facts, and credibility plays a key role.

[9] The audit began in late March 2005 when the auditor, Manon Goudreault, telephoned the appellant. By a letter dated April 1, 2005, the auditor asked for all of the appellant's documentation.

[10] When the auditor met with the appellant's accountant in May 2005, she was informed that most of the documents were not available following water damage at the appellant's residence.

[11] It was not until the meeting of July 17, 2007, between the appellant, his representatives and the auditor in Sherbrooke that the appellant informed the auditor for the first time that he had made additional purchases under the table.

[12] The appellant also submitted documents which, according to him, proved that he had made the purchases.

⁵ The questions to be determined in the application are reproduced in the appendix to these reasons.

[13] The appellant had found the documents while cleaning a building that he was selling. The building was used for storage. First, he thought the documents had been lost with the others in the flood at his residence.⁶ The sale of the building took place in mid-January 2007, six months prior to the meeting in Sherbrooke.

[14] The appellant submits that he purchased, in cash, under the table, \$149,788 worth of inventory in 2002 and \$119,802⁷ worth of inventory in 2003.

[15] These submissions have no credibility for three reasons.

[16] First, in 2002 the Minister added \$128,844 in sales. However, if the appellant also purchased \$149,788 worth of inventory that would have to be deducted, the net effect of the two adjustments would be a reduction of the net business income by close to \$20,000. Instead of having a reported net business income of just over \$40,000, the appellant would have a real net business income of approximately \$19,000.⁸

[17] If I were to accept the appellant's submissions, then he, while conducting part of his operations under the table, would have reported as profit an amount of approximately double his real profit in 2002. That is not believable.

[18] Also, in 2003 the Minister added \$114,994 to the sales and, according to the appellant, he made \$119,802 in additional purchases. That would reduce the profit by approximately \$5,000. Once again, the effect is that the appellant would have reported profits higher than his real profits. That is not believable.

⁶ The documents are identified as A-2 to A-5. It is surprising that the appellant found these documents more than two years after the start of the audit; it is even more surprising that the receipts for the under-the-table-purchases were kept separately from all other documentation pertaining to the business, notably documentation related to unreported sales. It is difficult to imagine that a business with a portion of its sales occurring under the table could not operate without administering the overall accounting of transactions, including under-the-table transactions. This accounting system can be very simple. I can easily imagine that such a business would decide to store documents related to under-the-table transactions in a different location from the other official accounting records. However, it is surprising that only a portion of the documentation of under-the-table transactions would be kept in a separate location.

During his cross-examination by Mr. Randson-Brisson, counsel for Futon, the appellant testified that there were other documents in the same metal filing cabinet which contained the documents showing cash purchases, but that they were not documents related to his business.

⁷ This is the total of \$89,119 and \$30,683.

⁸ Note that the \$29,350 in expenses that the Minister disallowed in 2002 represented purchases paid by credit card that cannot, therefore, be purchases that were paid in cash (see 2000 worksheet at page 12 of Exhibit I-13). The change has not been contested.

[19] I cannot accept that the appellant, who conducts a large portion of his business under the table, filed tax returns with business income higher than it really was.⁹

[20] Second, the auditor evaluated the the amount of cash available to the appellant to make payments and concluded that the appellant had a maximum of \$65,201 in cash in 2002 and \$55,584¹⁰ in 2003. It is impossible to have made purchases of \$149,788 in 2002 and \$119,802 in 2003 with only \$65,201 and \$55,584, respectively.

[21] I will come back to the liquidity analysis, but would like to note at this stage that the liquidity calculation by the auditor was not contested by the appellant.

[22] These two reasons lead me to conclude that the appellant has very little credibility with respect to the question of additional purchases.

[23] Therefore, with respect to the additional purchases claimed, the question that remains to be determined is this: despite the appellant's overall lack of credibility, is there enough persuasive and credible evidence to reach the conclusion that there are, nonetheless, certain limited amounts of additional purchases that should be allowed?

[24] If such evidence exists, it is mathematically impossible that the appellant could have made purchases of over \$65,201 in 2002 and \$55,584 in 2003.

[25] In and of itself, that mathematical impossibility raises serious doubts as to the documents the appellant produced in support of his submissions relating to the additional purchases,¹¹ as this means that in the documents totalling \$149,788 in respect of 2002, there are documents totalling \$84,587¹² that cannot be valid.

[26] Also, with respect to the documents produced by the appellant totalling \$119,802 in respect of 2003, there are documents totalling \$64,218¹³ that cannot be valid.

[27] Accordingly, for 2002 and 2003, more than half of the value of the documents submitted cannot be valid.¹⁴

⁹ Obviously, it is possible that a portion of the additional purchases, insofar as such purchases exist, could increase year-end inventory and accordingly the deductible portion would be less than the whole. However, the appellant does not submit that there was an increase in year-end inventory. There is no evidence, tending to establish that the year-end inventory increased.

¹⁰ See Note 41.

¹¹ Exhibits A-2 to A-5; these documents are also reproduced in Exhibit A-6.

¹² The amount of \$84,587 is the result of the amount claimed of \$149,788 – \$65,201 in cash.

¹³ The amount of \$64,218 is the result of \$119,802 – \$55,584.

¹⁴ The calculation is $(\$84,587 + \$64,218) \div (\$149,788 + \$119,802) = 55\%$ that cannot be valid.

[28] Another element that significantly undermines the appellant's credibility is the following.

[29] According to the appellant, it was about 2002 when he started making part of his purchases from Futon in cash.¹⁵ We do not know what amount of the purchases from Futon is part of the amounts of \$257,246 in 2002 and \$272,792 in 2003 for inventory purchases in the appellant's income tax returns.¹⁶

[30] As for Futon, it included \$67,982 in sales to the appellant in its sales for 1999, 2000 and 2001, an average of a little less than \$23,000 per year.¹⁷ In 2002 and in 2003, Futon included \$30,194 in sales to the appellant, an average of approximately \$15,000 per year.¹⁸

[31] According to the appellant, in 2002 and in 2003 he made under-the-table purchases of \$198,884 from Futon, or close to \$100,000 per year on average. If we add official purchases of \$15,000 per year, this brings the total to approximately \$115,000 per year compared to an average of approximately \$23,000 per year in the previous three years.

[32] As a result, during the two years in question, according to the appellant, the purchases from Futon were five times higher than the average of the previous three years. This would represent an explosive growth in the sale of Futon furniture by the appellant and there is nothing in the evidence that would explain this.

Testimony of the appellant

[33] The appellant completed grade seven and began to work at age 13 as a courier delivering telegrams for the Canadian Pacific Railway. He had his furniture store for about forty years.

[34] His largest supplier was Futon. As of 2002, he had been doing business with Futon for four or five years. His contact at Futon was Joe D'Amico.

[35] He made part of his purchases by cheque and the other part in cash. The cash purchases began in 2002.

¹⁵ Cross-examination of the appellant by Mr. Randson-Brisson, page 361 of the transcript May 7, 2013.

¹⁶ Exhibits I-2 and I-3, Form T1, line 8320.

¹⁷ In the absence of the appellant's figures, I use Futon's figures (Exhibit M-1, tab 2, page 1: $\$67,982 \div 3 = \$23,000$ approximately—note that the first transaction on the first page is in 1998) considering that, according to the appellant, it was not until 2002 that he started making cash purchases, Futon's sales prior to 2002 should be the same amounts as his inventory purchases from Futon.

¹⁸ Exhibit M-1, tab 2, page 2.

[36] A sales representative would get furniture from Futon approximately every 15 days. During the two years in question, the appellant travelled 15 to 20 times with the truck. At other times, Pierre Vincent or Éric Roy went to Futon with the truck.

[37] Typically, transactions paid in cash would be processed as follows:¹⁹

- (a) The appellant would bring a sheet of paper prepared by his spouse, Monique Houle. The sheet would indicate the furniture he required. Then, Mr. D'Amico would prepare the order with the description of the items purchased without stating a price.
- (b) Later, after the appellant had returned to his business, Ms. Houle would write the price on the new invoice based on a price list she had.²⁰
- (c) Also during his visit to Futon, the appellant would pay Mr. D'Amico for the previous order after Mr. D'Amico had verified the prices indicated on the invoice.
- (d) Finally, the appellant would take in the truck the furniture that had been ordered during the last visit.

[38] There could be variations. At times, Mr. D'Amico wrote down the price. At times the purchase order was sent by fax or done over the telephone.²¹

[39] When the appellant paid Mr. D'Amico, the latter would indicate "paid" on the invoices and, then, on the corner of his desk, he would tear off the upper portion of the invoices.²²

¹⁹ Transcript of May 6, 2013, pages 198 and 199, testimony of the appellant.

²⁰ Note that the appellant at times uses the words "purchase order" and at times "invoice" interchangeably, in referring to the same document.

²¹ At the discovery, the appellant stated that it was mainly Mr. D'Amico who wrote down the prices, whereas at trial it was mainly Ms. Houle.

²² Transcript of May 6, 2013, page 200.

Documents

[40] The documents produced by the appellant relating to the additional purchases claimed are included in Exhibits A-2 to A-6.²³

[41] If I consider Futon's documents for 2002, numerous pages do not have a header. Other pages have neither a header nor a footer. A number of pages do not have the dates indicated on them. The only two documents bearing Futon's name are purchase orders and not invoices.²⁴

[42] In general, these documents do not bear either the appellant's name or Futon's name.

[43] The situation is similar with respect to the documents pertaining to Futon in 2003.²⁵

[44] It is also important to note that there is typically one portion of the documents written in ink and another portion written in pencil, and prices in particular are generally written in pencil. There is sometimes a second ink colour. In general, there is more than one handwriting.²⁶ Many of the original documents of Exhibits A-2 to A-5 seem to be photocopies with sometimes additional writing on the photocopy.

[45] On cross-examination, the appellant admitted that he could not be sure that the documents without a date did not relate to subsequent years.²⁷

²³ Exhibits A-2 to A-5 are the documents that the appellant found and Exhibit A-6 contains photocopies of the same documents. Exhibits A-2 and A-3 and tabs 1 and 2 of Exhibit A-6 pertain to Distribution Mago and the years 2002 and 2003, respectively. Exhibits A-4 and A-5 and tabs 3 and 4 of Exhibit A-6 pertain to Futon in the years 2002 and 2003. Exhibits A-2 to A-5 were filed in a bundle and are not completely identical to tabs 1 to 4. For example, Exhibit A-4 has one less document than tab 3 of Exhibit A-6 and, also, one of the documents of Exhibit A-4 does not seem to appear in tab 3. Many of the documents the appellant had were also missing parts of the pages that were torn; this is less visible in Exhibit A-6 because all the photocopies were made on letter size paper.

²⁴ Specifically, in tab 3 of Exhibit A-6:

- (a) pages missing the top: 3, 4, 5, 10, 11, 12, 13, 16, 17, 19, 20, 21, 23, 24, 25, 26, 29 and 30;
- (b) pages missing the top and bottom: 2, 14, 15, 18, 27 and 28;
- (c) pages missing the top and the far right of the page: 6 and 8;
- (d) pages without a date: 6, 8, 21, 24, 25, 26, 27, 28, 29 and 30;
- (e) page on which the date is illegible: 23 because of the tearing.

Note that pages 6 and 7, 8 and 9, and 11 and 12 seemed to be related. Page 1 is simply a cover page for what follows with a photocopy of calculator tape.

²⁵ Exhibit A-6, tab 4; the only discernable variation is a document on page 20, namely, a notepad paper on which appeared the name "Sofa Maximum" and which does not pertain to Futon.

²⁶ All this can be better seen with the originals of Exhibits A-4 and A-5.

²⁷ Transcript of May 7, 2013, pages 361 and 362.

[46] Often on the documents pertaining to Futon there is something written across in a different ink colour that could be a signature or a word beginning with the letter “p”; in some cases it looks like it may be the word [TRANSLATION] “paid”.²⁸

Distribution Mago

[47] The appellant testified that he would order furniture from Distribution Mago by telephone and sometimes by fax.

[48] At delivery, the appellant would sign a travel voucher to acknowledge receipt; he would also sign another voucher that would be kept by the delivery person and would be submitted to the appellant at the following delivery. At the following delivery, the invoice would be paid in cash.

[49] Occasionally, the invoice would be sent by mail.

[50] The documents submitted by the appellant relating to Distribution Mago²⁹ are dated. Apart from a few exceptions, the documents are written on white paper that does not bear the name of Distribution Mago.

[51] Many of these documents, but not all, are marked what appears to be [TRANSLATION] “paid cash”. Among the documents that appear to be so marked, there is signature that looks like “R. Brouillard”. Distribution Mago employed a delivery person named Réjean Brouillard.³⁰

[52] There are two purchase orders from Distribution Mago and two delivery orders from VA Transport related to the purchase orders.³¹

Testimony of Pierre Vincent

[53] Mr. Vincent is a retired police officer. He is a friend of the appellant and of the appellant’s daughter. He has known the appellant for about forty years and the appellant’s children and Mr. Vincent’s children grew up together.³²

²⁸ Sometimes there seems to be no acute [aigu] accent on the “e” of the French word “paye”, if that is indeed the word.

²⁹ Exhibits A-2 and A-3; Exhibit A-6, tabs 1 and 2.

³⁰ No one called Mr. Brouillard as a witness or asked Mr. St-Pierre, the founder of Distribution Mago, if he recognized the signature of Mr. Brouillard. He may have recognized the name of Mr. Brouillard; see pages 120 and 121 of the transcript of May 6, 2013.

³¹ Exhibit A-6, tab 2, pages 4 and 5, and 17 and 18. It appears that the document at page 3 deals with the same order as that on page 4; it appears that the document on page 16 is the same order as that on page 17.

³² Transcript of May 7, 2013, page 427, testimony of Ms. Houle.

[54] In addition to driving the truck, Mr. Vincent did business with the appellant; they purchased a building together in 1998.³³

[55] Mr. Vincent drove the appellant's truck 20 to 30 times in all during 2002 and 2003 to pick up furniture at Futon, an average of 10 to 15 times per year.

[56] He received \$25 to \$35 per trip but never reported those amounts in his income tax returns.

[57] According to Mr. Vincent, before he left to pick up the purchase order, Ms. Houle faxed the purchase order to Futon and he brought with him a copy of the purchase order when he went to Futon.³⁴

[58] Mr. Vincent always left with money in an envelope, money that was counted in front of him. He gave the envelope to Mr. D'Amico; the money was used to pay the previous delivery.

[59] Each time he took furniture, he signed to confirm that he had received them.³⁵

Testimony of Monique Houle³⁶

[60] Ms. Houle has been the appellant's spouse for 47 years and has always worked with him at his furniture business. She was in charge of the [TRANSLATION] "paperwork" in addition helping in sales.

[61] She testified that Futon and Distribution Mago were paid primarily in cash.³⁷ She also testified with respect to the documents in Exhibits A-2 to A-5.

[62] According to Ms. Houle, the purchase orders with Futon were generally made as follows:³⁸

³³ Exhibits I-5 and I-6.

³⁴ Transcript of May 6, 2013, page 43.

³⁵ In the documents in Exhibits A-4 and A-5, there were far fewer than 20 to 30 documents signed by Mr. Vincent.

³⁶ A witness exclusion order was issued with some exceptions. Ms. Houle was not exempted from the order, but she remained in the room considering that, originally, the appellant had not planned on his wife testifying. Later, the appellant decided to have her testify.

Her testimony was objected to considering that she was in the room. I allowed Ms. Houle to testify while recognizing that her presence was going to affect the scope of her testimony. See the decision of the Superior Court of Québec in *Syndicat des travailleuses et travailleurs de l'Hôtel Méridien de Montréal c. Guilbert*, 2012 QCCS 1984 (paragraphs 18 to 21), which refers to the decision of the Supreme Court of Canada in *Dobberthien v. The Queen*, [1975] 2 S.C.R. 560 (page 571). *Dobberthien* is a criminal law case. In *Syndicat des travailleuses et travailleurs*, the Superior Court of Québec had a second reason at paragraphs 16 and 17; that second reason is not relevant in this case.

³⁷ Transcript of May 7, 2013, page 417.

³⁸ Transcript of 7 May 2013, pages 402 to 404, and 427 to 430.

- (a) She would telephone Futon to place the purchase order and most of the time she would speak with the secretaries.
- (b) When the furniture was ready, Futon would fax a purchase order document to Meubles Denis Lauzon. No prices appeared on that document.
- (c) With the purchase order document that Futon had faxed, the driver of the truck would pick up the furniture.
- (d) After returning to the store, Ms. Houle (or her daughter) would add the prices.
- (e) Finally, the furniture taken during the previous trip would be paid for during the following trip.

Testimony of Giuseppe (Joe) D'Amico

[63] Mr. D'Amico testified that Futon did not make under-the-table transactions and that all the sales were included in the business's accounting.

[64] Generally speaking, Mr. D'Amico did not recognize the hand-writing on the documents pertaining to Futon (Exhibit A-6, tabs 3 and 4). On a limited number of documents, he testified that he recognized his hand-writing, or that it was perhaps his handwriting, on a portion of the document, but that he did not recognize all of the handwriting on the document.

[65] He denied having torn documents and stated that he personally never received cash.³⁹

[66] Mr. D'Amico recognized certain documents as being purchase orders. He also stated that a purchase order is not necessarily an invoice, as an invoice could be used as a bid solicitation with the result that, depending on the proposal, at the end of the day there can be a very different transaction.

Testimony of Claude St-Pierre

[67] Mr. St-Pierre founded Distribution Mago and managed it until 2007. He described himself as the owner. He was in charge of developing products, sales, supplies, and so forth.

³⁹ He testified that the company sometimes makes cash sales, but that he personally never received money; the money from those sales is given to the office and deposited into the company's account, according to Mr. D'Amico.

[68] According to Mr. St-Pierre, Distribution Mago made sales of approximately \$11,000 to the appellant, that is to say, the amount of the three sales appearing in the books of Distribution Mago.⁴⁰

[69] He acknowledged that Distribution Mago had a delivery person named Réjean Brouillard.

[70] Distribution Mago accepted all forms of payment, i.e., cheque, credit card and cash.

[71] Mr. St-Pierre did not recognize the handwritten documents and stated that Distribution Mago did not use that type of document.

[72] While acknowledging that the fax number on certain documents was that of Distribution Mago, he did not recognize those documents as originating from said company. He was unable to explain why the number of Distribution Mago was on those documents.

Liquidity test

[73] The auditor performed a liquidity test, that is to say she determined the maximum amount of cash the appellant had available to him in 2002 or in 2003 to pay for furniture purchases in cash. She obtained a total of \$65,201 for 2002 and \$55,584 for 2003 in cash available to purchase furniture.

[74] This was done by adding all cash withdrawals from back accounts, cash advances on credit cards and not deposited and amounts withheld on cheque deposits. From that, the auditor deducted an amount for personal expenses paid for in cash.⁴¹

[75] Considering that the appellant does not contest that calculation and that he did not suggest that there were other sources of cash, it is impossible, as I stated at the beginning of these reasons, that the appellant made all the additional furniture purchases he claims to have made.

⁴⁰ Exhibit I-1.

⁴¹ See Worksheet 2300 in Exhibit I-14, page 13, and the transcript of May 8, 2013, at pages 643 to 645. The total of those additions is \$79,428 for 2002 and \$61,836 for 2003.

Of those amounts, she subtracted an amount for personal expenses paid in cash, that is, \$13,853 for 2002 and \$12,252 for 2003. Also, for 2002 she deducted an amount of \$374 for a business expense paid for in cash. The result of all this is \$65,201 for 2002 and \$49,584.04 for 2003.

Finally, at the hearing the respondent conceded that there was another amount of \$6,000 that had to be added in 2003 for a total of \$55,584. See transcript of May 8, 2013, at pages 645 and 646.

[76] In oral submission, the appellant appeared to take the position that the liquidity test justified a deduction representing at least the amount of liquidity available. The appellant characterized the result of the test as an admission on the part of the respondent.⁴²

[77] It is not an admission on the part of the respondent. It is an effort on the part of the auditor to determine whether it was even possible for the appellant to make the purchases claimed in cash. That effort, as I have already explained, led to the conclusion that the appellant could make maximum cash purchases of approximately \$65,000 in 2002 and \$55,000 in 2003. It is a possible maximum assuming that the appellant did not hide the money in a location unknown to the auditor and that he did not incur any more cash personal expenses other than the amount estimated by the auditor.

[78] However, the fact that the amounts of \$65,201 and \$55,584 are available in cash does not in and of itself prove that an expense was made to purchase inventory.

[79] The evidence revealed that the auditor was willing to settle the matter on the basis that the appellant had made additional purchases of \$65,201 and \$54,712⁴³ provided that the appellant waive all rights of objection or appeal.

[80] A settlement offer is not an admission and I will not take it into account.⁴⁴

Assessment of the appellant's evidence relating to the additional purchases claimed

[81] I do not believe the appellant and do not accept his evidence for the following reasons.

[82] First, as I stated in the beginning, I accept the result of the liquidity test, a result that is not contested. Accordingly, I cannot believe the appellant when he submits that he made additional purchases of \$149,788 in 2002 and \$119,802 in 2003. This is mathematically impossible.

[83] Second, there is a major contradiction between the appellant, Ms. Houle and Mr. Vincent. According to the appellant, the general procedure for purchases from

⁴² Transcript of May 8, 2013, top of page 717.

⁴³ The amount for 2003 is different (Exhibit I-15, Worksheet 9300, near the bottom of the page). I do not know why it is \$54,712 rather than \$55,584.

⁴⁴ Paragraph 12 of *Leonardis v. Leonardis*, 2003 ABQB 577, is highly relevant with respect to the effect of a proposal.

No one objected to the evidence of this settlement offer. I considered whether there was a privilege with respect to this offer. I need not answer this question. Without deciding the matter, assuming that there is a privilege, the two parties can always be waived. See the decision of the Court of Appeal of Alberta in *3058354 Nova Scotia Company v. On*Site Equipment Ltd.*, 2011 ABCA 168, at paragraph 50, and *Leonardis*, at paragraphs 5 and 6.

Futon was to bring to Futon a sheet of paper prepared by Ms. Houle and, once there, Mr. D'Amico prepared the purchase order. However, according to Mr. Vincent, Ms. Houle faxed the purchase order to Futon and he brought a copy. Finally, according to Ms. Houle, the general procedure was that she would place the purchase order over the telephone with Futon, that Futon would fax her the purchase order document when the furniture was ready and that the driver of the truck would bring the document with him to Futon. It is not possible that the three different procedures all constituted the general procedure.⁴⁵

[84] Third, a majority in value of the amounts claimed and contained in the documents in Exhibits A-2 to A-5 cannot be valid in the absence of cash to make the purchases. When I look at the documents and consider all the appellant's evidence, I do not see anything that would allow me to conclude that some of the documents (i) are clearly separate from the majority in value and (ii) represent valid purchases resulting in additional deductions.

[85] Fourth, Mr. D'Amico and Mr. St-Pierre both testified that their respective firms reported all their sales. I accept both testimonies.⁴⁶

[86] Accordingly, the appellant has not shown that he made additional purchases.

Clerical error of \$11,751

⁴⁵ The procedure described by Ms. Houle is quite surprising with respect to when prices are entered on the purchase order. The steps are as follows:

- (a) Ms. Houle would place the order over the telephone.
- (b) When the order was ready, Futon would fax to Meubles Denis Lauzon the order form (or purchase order).
- (c) The appellant or the driver of the truck would bring the order form to Futon.
- (d) The appellant or the driver would return with the furniture.
- (e) Following the furniture's arrival, Ms. Houle would enter the prices.
- (f) Finally, during the next trip, the order form with the prices and cash are brought to Futon.

⁴⁶ The fact that Mr. D'Amico recognized part of the information entered on the documents does not prove that they were unreported sales. The fact that Mr. St-Pierre may have recognized the name of Mr. Brouillard does not prove that it was not an unreported sale.

Also, if we add all the amounts of Exhibit A-2 where there is a signature that could be that of Mr. Brouillard to the amount of \$1,699 next to which the initials "R.B.", presumably Réjean Brouillard, appear to be, we obtain the total amount of approximately \$37,000, more than half of the maximum amount of cash available for additional purchases. However, if we are to assume that more than half of the additional purchases paid in cash came from Futon, as the appellant claims, more than half of the maximum amount of \$65,201 would have hypothetically been spent at Futon and less than \$32,000, maximum, would have been available to make cash purchases at Distribution Mago. There is still a logical problem: either Futon was not the largest supplier paid in cash in 2002, or the fact that a document with what appears to be the signature or the initials of Mr. Brouillard and [TRANSLATION] "paid cash" on it cannot logically be evidence that the appellant paid Distribution Mago cash for all the amounts entered on the documents that appear to be signed by Mr. Brouillard and which are marked [TRANSLATION] "paid cash".

[87] According to Gérald Morin, the appellant's accountant, the amount of \$11,751 is a clerical error on his part. He testified at length on the subject.⁴⁷

[88] I accept his testimony that he increased the rental income by \$11,751 in 2003 and that, in error, when he intended to reduce the sales by the same amount, he put that amount in the withdrawals account.

[89] Accordingly, the income from the furniture sales must be reduced by \$11,751 in 2003.

Penalties

[90] Subsection 163(2) of the Act provides that:

(2) [e]very 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 . . . is liable to a penalty. . . .

[91] The burden of proof, with respect to penalties, is on the Minister:

. . . "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. . . .⁴⁸

[92] There is no doubt that there is an omission for the two years in question.

[93] For each of the years 2002 and 2003, the appellant omitted gross income amounts exceeding one quarter of the gross income amounts included in his income tax returns. His real net income is much higher than his reported net income.

[94] The circumstances are such that there cannot any conclusion other than the following: the appellant knew that he had not included all his income; the penalties imposed are therefore warranted.

⁴⁷ Transcript of May 6, 2013, pages 171 to 175, 178 to 182 and 184 and 185.

⁴⁸ According to Justice Strayer in *Venne v. Canada*, [1984] F.C.J. No. 314 (QL).

In *Panini v. Canada*, 2006 FCA 224, Justice Nadon stated as follows:

43 . . . the law will impute knowledge to a taxpayer who, in circumstances that dictate or strongly suggest that an inquiry should be made with respect to his or her tax situation, refuses or fails to commence such an inquiry without proper justification.

Conclusion

[95] Consequently:⁴⁹

- (a) The appeal from the reassessment for the 2002 taxation year is dismissed.
- (b) The appeal from the reassessment for the 2003 taxation year is allowed, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the furniture sales in 2003 must be reduced by \$11,751 and that the penalty issued under subsection 163(2) of the *Income Tax Act* must be recomputed accordingly. No other adjustment shall be made to the appellant's income for 2003.
- (c) As for the six questions to be determined in accordance with the order of June 8, 2011, the answer to each question is no.
- (d) The appellant shall pay the respondent's and third parties' costs.⁵⁰

⁴⁹I considered the comments from Justice Sharlow in *Tossell v. Canada*, 2005 FCA 263, and, accordingly, whether at this stage I simply had to issue the determination and not the judgment on the appellant's appeal in such a manner as to prevent the procedural difficulties that arose in *Tossell* when the decision was appealed from. However, I concluded that this was not an issue in the present case for the following reasons:

- (a) The respondent sought to have the appellant and the two third parties bound pursuant to section 174 of the Act. The application was granted by order of Justice Archambault.
- (b) The appellant is therefore bound by the determination.
- (c) I will issue only one order that includes both the judgment on the appeal and the determination.

Accordingly, if the judgment is appealed from, the determination will necessarily be appealed from.

⁵⁰ See Rule 147 of the *Tax Court of Canada Rules (General Procedure)*. *Canada v. Dalton*, 2004 FCA 173, illustrates the fact that costs also apply to third parties. In *Dalton*, the Federal Court of Appeal ordered a third party to pay costs.

Signed at Ottawa, Ontario, this 9th day of January 2014.

“Gaston Jorré”

Jorré J.

Translation certified true
On this 18th day of March 2014

François Brunet, Revisor

Appendix¹

Questions in respect of which a determination is requested

1. Did the appellant pay, in whole or in part, to Futon International Inc., the amounts of \$109,765 for 2002 and \$89,518 for 2003, under purchase contracts for property in inventory?
2. Can the appellant deduct, in whole or in part, the amounts of \$109,765 for 2002 and \$89,518 for 2003 in computing his business income?
3. Is Futon International Inc. required to add, in whole or in part, business income of \$109,765 for 2002 and \$89,518 for 2003 in computing its business income?
4. Did the appellant pay to Distribution Mago Inc., in whole or in part, the amounts of \$40,023 for 2002 and \$30,683 for 2003, under the purchase contracts for property in inventory?
5. Can the appellant deduct, in whole or in part, the amounts of \$40,023 for 2002 and \$30,683 for 2003 in computing his business income?
6. Is Distribution Mago Inc. required to add, in whole or in part, business income of \$40,023 for 2002 and \$30,683 for 2003 in computing its business income?

¹ The respondent's application of June 30, 2010, sought to have the appellant, Futon International Inc. and Distribution Mago Inc. bound by the questions itemized in the appendix. The order of Justice Archambault dated June 8, 2011, granted said application.

CITATION: 2014 TCC 3
COURT FILE NO.: 2009-870(IT)G
STYLE OF CAUSE:: DENIS LAUZON v. THE QUEEN
PLACE OF HEARING: Québec, Quebec
DATES OF HEARING: May 6, 7 and 8, 2013
REASONS FOR JUDGMENT BY: The Honourable Justice Gaston Jorré
DATE OF JUDGMENT: January 9, 2014

APPEARANCES:

Counsel for the appellant: Louis Sirois
Counsel for the respondent: Dany Leduc
Counsel for the third party
Futon International Inc.: Étienne Randson-Brisson
For the third party
Distribution Mago Inc.: No one appeared

COUNSEL OF RECORD:

For the appellant: Louis Sirois
Firm: Sirois & Champagne, lawyers
Québec, Quebec
For the respondent: William F. Pentney
Deputy Attorney General of Canada
Ottawa, Ontario
For the third party
Futon International Inc.: Étienne Randson-Brisson
Firm: BCF, LLP.
Montréal, Quebec