Federal Court of Appeal | Cour d'appel fédérale

Date: 20161216

Docket: A-362-15

Citation: 2016 FCA 315

CORAM: **DAWSON J.A.**
WEBB J.A.
BOIVIN J.A.

BETWEEN:

PAUL LUBEGA-MATOVU

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on September 28, 2016.

Judgment delivered at Ottawa, Ontario, on December 16, 2016.

REASONS FOR JUDGMENT BY: WEBB J.A.

CONCURRED IN BY: DAWSON J.A.
BOIVIN J.A.

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REASONS FOR JUDGMENT

WEBB J.A.

[1] The Appellant is a former auditor with the Canada Revenue Agency (CRA). During the years 2006, 2007 and 2008 (the years under appeal) he was working as a CRA auditor and earning employment income of $70,000 to $80,000. He also claimed business and rental losses of $52,748 for 2006, $61,625 for 2007 and $67,768 for 2008. These losses were denied by the CRA and penalties were imposed under subsection 163(2) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) (the *Act*). The Appellant appealed to the Tax Court of Canada and his appeal was

dismissed (2015 TCC 147). The Appellant has appealed this decision of the Tax Court of Canada.

[2] For the reasons that follow, I would dismiss this appeal.

I. Background

[3] The Appellant claimed losses in relation to three activities – from his commission arrangement with PanelForm International Ltd. (PanelForm); from a partnership that was a distributor of nutritional products for a business called Market America; and rental losses related to a purported rental of part of his principal residence. The Appellant claimed the losses from the partnership on the basis that he held an 80% interest in the partnership and Rose Lukwago claimed losses from the partnership on the basis that she held the remaining 20% interest in the partnership. Rose Lukwago was an appellant before the Tax Court of Canada but she is not an appellant in this appeal.

[4] PanelForm was attempting to sell equipment that would make panels for use in low cost housing. The Appellant's arrangement with PanelForm was that he would market PanelForm's equipment in Africa for a 10% commission. There was no indication that any such equipment was sold by the Appellant during any of the years under appeal.

[5] Market America was described by the Tax Court Judge as "a typical pyramid selling arrangement." The Appellant indicated that he would receive revenue from the sale of products and from managing others who would be involved with this arrangement.

[6] The Appellant submitted over 1,200 pages of documents during his Tax Court hearing including copies of bank statements, schedules prepared by the Appellant showing the allocation of amounts to various activities, copies of credit card statements, copies of various invoices, and copies of various e-mails. Although the Appellant submitted a large quantity of documents, the problem was linking these documents to any particular activity.

[7] The Tax Court Judge noted that the Appellant had been unsuccessful in challenging reassessments issued for his 2004 and 2005 taxation years in relation to the denial of business expenses that the Appellant had claimed in relation to five different business endeavours, including PanelForm and Market America (2010 TCC 291). The Appellant was successful, on appeal to this Court (2011 FCA 265), in having the assessment of penalties vacated but not in relation to the denial of the amounts that he had claimed as business expenses.

[8] In assessing the Appellant's evidence in his Tax Court case related to the reassessments issued for his 2004 and 2005 taxation years, Campbell J. stated that:

> **17** The type of issues in this appeal are generally straightforward; they are certainly not complicated legal issues. Such appeals generally involve a taxpayer providing the documentation they have in their possession to support the expenses they are claiming. When there are missing links in the documentation, the taxpayer may provide oral testimony to substantiate the claims.
>
> **18** The present hearing lasted a full day and I must confess that, at the end of the hearing, I was left with the impression that I had only partial truths, conflicting evidence and still not a particle of proof from the Appellant to substantiate that these expenditures were actually related to his business activities.

[9] In this case, the Appellant's testimony suffered from the same problems. After quoting paragraph 18 from the reasons of Campbell J., the Tax Court Judge noted that:

> **7** The activities that are at issue in these appeals were also at issue in the prior appeal. It appears that Justice Campbell was not happy with the length of the earlier proceeding, which lasted a full day. These appeals also lasted far too long at 5 1/2 days, mainly due to disorganization on the part of Mr. Lubega-Matovu who represented both appellants.
>
> **8** At this hearing, a large volume of documentary evidence was introduced on behalf of the appellants. In addition, I heard oral testimony from the appellants and two business acquaintances, John Clark and Eric Alexander. For the Crown, the only witness was the appeals officer, Karol Maar.
>
> **9** I would comment in particular about the reliability of the testimony of the witnesses. I found the testimony of Mr. Lubega-Matovu and Ms. Lukwago to be so vague and conflicting as to be unreliable except to the extent the testimony was supported by other evidence. I found the testimony of the other witnesses to be generally reliable, but the questions asked of Mr. Clark and Mr. Alexander by Mr. Lubega-Matovu did little if anything to support the losses that were claimed.
>
> **10** Notwithstanding that a large amount of evidence was presented at this hearing, my conclusion is similar to that of Justice Campbell in the prior appeal.

[10] As a result, the Appellant's appeal to the Tax Court of Canada was dismissed.

II. Issues

[11] The Appellant raised a number of issues in his memorandum of fact and law. These can be consolidated and summarized as:

(a) Did the Tax Court Judge breach any rule of procedural fairness?

(b) Did the Tax Court Judge err in determining that the issue was whether the Appellant could establish that he had incurred the amounts claimed as expenses for the purpose of earning income rather than whether he had a source (or sources) of business or property income?

(c) Did the Tax Court Judge err in concluding that the Appellant had not established that he had incurred the amounts in question as expenses for the purposes of earning income from a business (or businesses) in relation to PanelForm and Market America?

(d) Did the Tax Court Judge err in concluding that the Appellant had failed to establish that he was entitled to claim the rental losses that he had reported in his tax returns?

(e) Did the Tax Court Judge err in dismissing his appeal in relation to the penalties that were imposed under subsection 163(2) of the *Act*?

III. Standard of Review

[12] The standards of review will be correctness for questions of law and palpable and overriding error for questions of fact or mixed fact and law where there is no extricable question of law (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235). For any alleged breach of procedural fairness by the Tax Court Judge, the question is simply whether there was such a breach (*Carleton Road Industries Association v. Sanford*, 2015 NSCA 95, 366 N.S.R. (2d) 104, at para. 22).

IV. Analysis

A. *Procedural Fairness*

[13] The Appellant's allegation of procedural unfairness relates to the conduct of the hearing. In paragraph 5 of his memorandum, the Appellant states that "one of the grounds of Appeal upon which the Appellants rely is a breach of natural justice in the sense that the Appellants did not

have their day in Court." The hearing before the Tax Court Judge lasted five and one-half days and the Appellant did not point to any time during those five and one-half days when the Appellant was denied any opportunity to present his case. This allegation is without any merit.

[14] The Appellant submitted that the Tax Court Judge was impatient with him because his documents were disorganized. He also submitted that the reason that his documents were disorganized is that he was denied the opportunity to present his documents as he had prepared them and on the first day of the Tax Court hearing he had to find a set of his documents for the Crown. The Appellant provided no explanation of how his documents were organized, how he was prevented from presenting his documents as he had prepared them, or why this resulted in his being disorganized. Nor did the Appellant indicate that he was prevented from introducing any document that he wanted to introduce – only that he was not able to introduce his documents as he had prepared them.

[15] This was not the first time that the Appellant had been in Tax Court and he should have known that he would have to give the Crown a copy of any documents that he would be submitting to the Court and how documents would be presented during a Tax Court hearing. The Appellant's bald assertion that the Tax Court Judge was impatient with him does not give rise to a claim of procedural unfairness.

[16] The Appellant includes, as part of his alleged "ground of natural justice", a purported error on the part of the Tax Court Judge related to the financing of his expenditures. In paragraph 8 of his memorandum the Appellant states that:

> **8** In the Appeal, the Appellant raises the ground of natural justice which, in addition, to the issue of the Trial Judge impatience, includes the procedural issues surrounding the Respondent's failure to set out appropriate assumptions and pleading of the issues raised in the trial. One such assumption is when the Trial Judge has stated in paragraph 2 of the reasons for the judgment that the Appellants paid for their business expenses from their employment income during the appeal period which was in the neighbourhood of $70,000 and 80,000. This is not correct. The Judge has stipulated that against this income the Appellants deducted the following amounts of business and rental losses: $52,748 in 2006, $61,625 for 2007 and $67,768 for 2008. The judge does not disclose the fact that the losses she is referring to are the result of expenses paid for using cash and this was disclosed by preparing the bank and credit card transaction records which the Appellants referred to as in his books and records. Most of the money that the Appellants spent on these expenses was borrowed. Currently the Appellants debt load is over $300,000. This does not include the two mortgages and the credit card debts.
>
> (emphasis added)

[17] The Appellant asserts that the Tax Court Judge indicated in paragraph 2 of her reasons that the Appellant had paid for the amounts incurred from his employment income. However, there is no such statement in paragraph 2 of her reasons:

> **2** Mr. Lubega-Matovu is a retired auditor with the Canada Revenue Agency (CRA), and in the taxation years at issue he had a senior position with the CRA with responsibility for auditing large corporations. His employment income in these years, as disclosed in his income tax returns, was in the neighbourhood of $70,000 to $80,000.

[18] Paragraph 2 is simply a statement of his prior employment with the CRA and his level of income from employment in those years. As well, the source of any financing of any expenditure incurred by the Appellant was not the issue in the appeal. The issue was whether the Appellant had incurred the amounts in question and, if so, whether he had incurred these for the purpose of earning income from a business or property. How such expenditures were financed was simply

not relevant nor was it discussed by the Tax Court Judge. The Appellant's allegation in relation to this issue is incorrect.

[19] As a result, there is no merit to any of the Appellant's procedural fairness arguments.

B. *Determination of the Issue that was Before the Tax Court of Canada*

[20] In paragraph 9 of his Memorandum of Fact and Law, the Appellant states that:

> **9** Furthermore, the Appellant submits that the Trial Judge's treatment of his case reflected a fundamental misunderstanding of what was at issue. He submits that from the pleadings the issue was whether there was a business of Market America or PanelForm. The issue was not substantiation of losses. However the Reasons the Trial Judge decided the case on was whether the Appellants substantiated the expenses that were claimed or not. This was procedurally unfair and constituted a reviewable error. Additionally, she unconditionally adapted [*sic*] the Respondent's evidence and submissions.

[21] I do not agree that the Tax Court Judge misunderstood the issue that was before her.

[22] The Appellant's tax returns for 2006, 2007 and 2008 were initially assessed as filed, which would mean that initially he was allowed the losses that he had claimed. By notices of reassessment dated March 21, 2011 he was reassessed to:

(a) disallow a portion of the expenses claimed in relation to the PanelForm and Market America activities for 2006, 2007 and 2008;

(b) disallow all his expenses claimed in relation to the rental of his house and reduce his rental income for 2006 to nil; and

(c) assess gross negligence penalties.

By disallowing a portion of the expenses (and not all of the expenses) related to the PanelForm and Market America activities CRA was recognizing these activities as sources of business income.

[23] The Appellant objected to these reassessments. By notices of reassessment dated November 5, 2012, the Appellant's losses from the PanelForm and Market America activities for 2006, 2007 and 2008 were reduced to nil and his rental income for 2007 and 2008 was also reduced to nil. The gross negligence penalties were also adjusted. The CRA in the letter dated October 5, 2012 stated that the losses related to the PanelForm and Market America activities were being reduced to nil because, in its view, the Appellant did not have a source of income in relation to either the PanelForm or the Market America activities. The CRA also indicated that, in the alternative, if the PanelForm and Market America activities were sources of business or property income, then it did not accept the documentation submitted by the Appellant as establishing that he had incurred the amounts claimed for the purpose of earning income from business or property. The CRA also stated that, in its view, the rental activities were personal and not a source of income from property.

[24] In *Stewart v. The Queen*, 2002 SCC 46, [2002] 2 S.C.R. 645, the Supreme Court of Canada described the concept of "source of income" as "fundamental to the Canadian tax system" (at paragraph 5). If the PanelForm and Market America activities are not sources of business or property income to the Appellant, then no amount received (or receivable) by the Appellant in relation to such activities and no amount incurred in relation to such activities

would be considered in determining the Appellant's income for the purposes of the *Act*. This is reflected in the reassessments that are under appeal as no amount was included in determining his income for any of the years under appeal in relation to the PanelForm or Market America activities even though there was revenue reported by the partnership for the Market America activity of $8,400 for 2006, $8,900 for 2007 and $7,800 for 2008 and some modest revenue was reported from the PanelForm activity of $1,000 in 2007 and $189 in 2008.

[25] In paragraph 50 of *Stewart*, the Supreme Court of Canada set out a two-stage approach to be employed to determine if a taxpayer has a source of income for the purposes of section 9 of the *Act*:

> **50** It is clear that in order to apply s. 9, the taxpayer must first determine whether he or she has a source of either business or property income. As has been pointed out, a commercial activity which falls short of being a business, may nevertheless be a source of property income. As well, it is clear that some taxpayer endeavours are neither businesses, nor sources of property income, but are mere personal activities. As such, the following two-stage approach with respect to the source question can be employed:
>
> (i) Is the activity of the taxpayer undertaken in pursuit of profit, or is it a personal endeavour?
>
> (ii) If it is not a personal endeavour, is the source of the income a business or property?
>
> The first stage of the test assesses the general question of whether or not a source of income exists; the second stage categorizes the source as either business or property.

[26] If the PanelForm and Market America activities were undertaken in pursuit of profit (and hence sources of income from a business or property), any expenses claimed must still satisfy the requirement that such expenses were incurred by the Appellant for the purpose of gaining or producing income from the business or property (paragraph 18(1)(*a*) of the *Act*). Assuming that

the PanelForm and Market America activities were sources of business or property income and that the Appellant had failed to establish that any expenses that he claimed were expenses that had been incurred for the purpose of earning income from such sources, this would result in an increase in his assessment since there was revenue from these activities. However, the Tax Court of Canada cannot increase the amount assessed against the taxpayer (*Harris v. Minister of National Revenue*, [1965] 2 Ex. C.R. 653, [1964] C.T.C. 562 at para 17). Therefore, in effect, the only expenses that were before the Tax Court of Canada were those that were in excess of the revenue for each activity as he was reassessed on the basis that his net income for each activity was nil.

[27] The net effect of the decision of the Tax Court of Canada would be the same regardless of whether it was determined that the Appellant did not a have a source of business or property income in relation to the PanelForm or Market America activities or that the expenses in dispute before the Tax Court of Canada were not incurred by him for the purpose of gaining or producing income from a business or property (with the result that the revenue for each activity would be equal to the expenses allowed for each activity). In either case his net income from these activities would be nil.

[28] In the Reply that was filed by the Crown at the Tax Court of Canada, both issues were raised by the Crown. The argument that neither the PanelForm nor the Market America activity was a source of business or property income was raised in paragraph 21 of the Reply. The assumptions made by the Minister in reassessing the Appellant also included the following:

Panelform International

f) for the 2006, 2007 and 2008 taxation years, the Appellant claimed amounts as business and commission expenses in connection with the alleged operation of Panelform International as set out in Schedule "A" to this Reply;

g) the Appellant did not incur the amounts claimed as Panelform International business and commission expenses as set out in Schedule "A" to this Reply;

h) the disallowed Panelform International amounts, if made or incurred, were not made or incurred for the purpose of gaining or producing income from a business or property but were rather the personal or living expenses of the Appellant;

…

Market America

r) the Appellant did not incur the amounts claimed as Market America business expenses as set out in Schedule "A" to this Reply;

s) the disallowed Market America amounts, if made or incurred, were not made or incurred for the purpose of gaining or producing income from a business or property but were rather the personal or living expenses of the Appellant;

[29] From these assumptions it is clear that whether the Appellant had incurred the amounts in question was in issue and if the amounts were incurred, the next question was whether the amounts were incurred for the purpose of earning income from a business or property. Whether the amounts in question were incurred, and if so, whether they were incurred for the purpose of earning income are also confirmed as issues before the Tax Court of Canada in paragraphs 19, 20, and 23 of the Reply. Therefore, these issues were clearly before the Tax Court Judge.

[30] In this case the Tax Court Judge focused on the amounts claimed as expenses (which resulted in the losses claimed). The Tax Court Judge also referred to "PanelForm's business" in paragraph 12 and to "this business" in paragraph 15 and to the "business losses" of Market America in paragraph 31. Although there was no explicit finding that the PanelForm and Market

America activities were sources of business or property income, it is implicit that the Tax Court Judge either assumed that the PanelForm and Market America activities were sources of business or property income or made such a finding.

[31] Since the result would be the same whether there was a finding that:

(a) the PanelForm and Market America activities were not sources of business or property income; or

(b) the Appellant had not established that he had incurred the expenses that were before the Tax Court or that any such expenses that were incurred were not incurred for the purpose of gaining or producing income from a business or property,

the Tax Court Judge did not commit any error by focusing on the issue of whether the Appellant had substantiated the amounts claimed as losses.

C. *Amounts in Dispute*

[32] The Appellant alleges that the Tax Court Judge erred in finding that he had not substantiated that he had incurred the various amounts in dispute as expenses for the purposes of gaining or producing income from a business or property. What amounts were incurred by the Appellant and the purpose for such expenditures are questions of fact. As noted above, alleged factual errors are reviewed on a standard of palpable and overriding error. In *Benhaim v. St-Germain*, 2016 SCC 48, [2016] S.C.J. No. 48, Wagner J., writing on behalf of the majority, described a palpable and overriding error:

> **38** It is equally useful to recall what is meant by "palpable and overriding error". Stratas J.A. described the deferential standard as follows in *South Yukon Forest Corp. v. R.*, 2012 FCA 165, 4 B.L.R. (5th) 31, at para. 46:
>
> > Palpable and overriding error is a highly deferential standard of review ... . "Palpable" means an error that is obvious. "Overriding" means an error that goes to the very core of the outcome of the case. When arguing palpable and overriding error, it is not enough to pull at leaves and branches and leave the tree standing. The entire tree must fall.
>
> **39** Or, as Morissette J.A. put it in *J.G. v. Nadeau*, 2016 QCCA 167, at para. 77 (CanLII), [TRANSLATION] "a palpable and overriding error is in the nature not of a needle in a haystack, but of a beam in the eye. And it is impossible to confuse these last two notions."

[33] Palpable and overriding error is a high standard.

[34] In this case, the Appellant produced over 1,200 pages of various documents. The problem was not with the quantity but with what the documents established or did not establish. The link between any amounts spent and the purpose for such expenditure was missing. The Appellant attempted to fill in this link at the Tax Court hearing with the testimony of four witnesses – the Appellant, Ms. Lukwago, John Clark and Eric Alexander.

[35] It appears that the Appellant is claiming that he paid for Mr. Clark's trips to Africa as part of his PanelForm business. However, Mr. Clark did not take these trips until 2009 or later and therefore any expenditure related to these trips would not be relevant for the taxation years under appeal, which are 2006, 2007, and 2008.

[36] With respect to Eric Alexander, in his memorandum, the Appellant acknowledges that he did not meet him until sometime in 2012. Since the taxation years in issue were 2006, 2007 and

2008, the testimony of someone whom the Appellant only met several years later is of little, if any, assistance in establishing that the Appellant had incurred the amounts during the years in issue or why the amounts were incurred.

[37] The Appellant stated that, during the years in issue, Dr. Bisase had travelled to Africa on behalf of the Appellant and at the Appellant's expense. However, Dr. Bisase was not called to testify at the Tax Court hearing. The documents to which the Appellant directed the attention of this Court during the hearing of his appeal, failed to establish that Dr. Bisase was taking any trip on behalf of the Appellant for the purpose of gaining or producing any income from a business or property.

[38] The Appellant, at the hearing of his appeal, failed to establish that the Tax Court Judge committed any palpable and overriding error in determining that the documents produced by the Appellant did not substantiate his claim that the amounts expended were incurred for the purpose of gaining or producing income. The Appellant also did not point to any part of the transcript of the hearing to show that any error was committed by the Tax Court Judge in determining that his testimony and that of Ms. Lukwago was "so vague and conflicting as to be unreliable except to the extent the testimony was supported by other evidence".

[39] The Appellant has failed to establish that the Tax Court Judge committed any palpable and overriding error in relation to her determination that the Appellant had not substantiated the amounts that he had claimed as expenses (which gave rise to the losses claimed).

D. *Rental Losses*

[40] At the hearing of this appeal, the Appellant did not address the amounts claimed as rental losses. The validity of this claim would have relied largely on the testimony of the Appellant and Ms. Lukwago. As noted by the Appellant, a significant finding by the Tax Court Judge is that Ms. Lukwago was not a tenant of the Appellant but rather a common-law partner of the Appellant during the years in issue. The statement, by the Appellant in his memorandum, that he did not get a divorce from his then wife until 2013 does not necessarily lead to a conclusion that Ms. Lukwago could not have been his common-law partner in 2006, 2007 and 2008. The Appellant did not establish that the Tax Court Judge committed any palpable and overriding error in denying the amounts claimed as rental losses in the years under appeal.

E. *Gross Negligence Penalties*

[41] The Appellant also did not establish that the Tax Court Judge committed any error in upholding the assessment of the gross negligence penalties.

V. Conclusion

[42] As a result, I would dismiss the appeal with costs.

"Wyman W. Webb"
J.A.

"I agree
Eleanor R. Dawson J.A."

"I agree
Richard Boivin J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

APPEAL FROM A JUDGMENT OF THE TAX COURT OF CANADA DATED June 12, 2015, NO. 2012-4553(IT)G

DOCKET:	A-362-15
STYLE OF CAUSE:	PAUL LUBEGA-MATOVU v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	SEPTEMBER 28, 2016
REASONS FOR JUDGMENT BY:	WEBB J.A.
CONCURRED IN BY:	DAWSON J.A. BOIVIN J.A.
DATED:	DECEMBER 16, 2016

APPEARANCES:

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