

BETWEEN:

DR. FRANK CH. HOKHOLD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on December 7, 2016,
at Vancouver, British Columbia.
Before: The Honourable Justice B. Paris

Appearances:

For the Appellant: The Appellant himself

Counsel for the Respondent: Geraldine Chen

JUDGMENT

The appeal from a Notice of Loss Determination dated May 22, 2012 made under the *Income Tax Act* for the 2008 taxation year is dismissed, without costs, in accordance with the attached Reasons for Judgment.

Signed at Hamilton, Ontario, this 27th day of October 2017.

“B.Paris”

Paris J.

Citation: 2017TCC217
Date: 20171027
Docket: 2013-2354(IT)G

BETWEEN:

DR. FRANK CH. HOKHOLD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Paris J.

[1] This is an appeal from a Notice of Loss Determination dated May 22, 2012 in respect of the Appellant's 2008 taxation year. A number of matters initially raised in the Notice of Appeal were resolved by a Partial Consent to Judgment filed by the parties, and a Judgment in respect of those matters was issued.

[2] The only question that remains to be determined is whether the Appellant is entitled to a deduction for bad debts for his 2008 taxation year pursuant to paragraph 20(1)(p) of the *Income Tax Act* (the "Act").

[3] The amount of the claim for bad debts set out in the Amended Notice of Appeal is \$166,749.73. However, at the hearing the Appellant reduced the amount of the claim to \$126,214.19.

[4] The Appellant maintains that this was the difference between the amount he reported on his tax returns for his 2005 to 2008 taxation years for work that he performed and billed to patients or their insurers, and the amount he was able to collect for that work.

[5] The only witnesses at the hearing were the Appellant, himself, and his spouse, Maria Hokhold.

Facts

[6] The Appellant is a dentist who operated his dental practice from his family home, in Merritt, British Columbia. His spouse worked for him as a certified dental assistant and did the bookkeeping and general administration for the business. Their children also helped with the work generated by the practice.

Background

[7] In order to understand the Appellant's position concerning his claim for bad debts, it is helpful to set out his business and income tax situation beginning in 2002.

[8] The Appellant began to have income tax difficulties when he failed to file his return for his 2002 taxation year on time. He did not file that return until January 2005 and he did not file returns for his 2003 to 2006 taxation years until September 2008, after having been the subject of arbitrary assessments issued by the Minister of National Revenue (the "Minister") under subsection 152(7) of the *Act*. He filed his return for his 2007 taxation year in June 2008. The filing date of the 2008 return was not put into evidence.

[9] He was assessed by the Minister in April 2005 for the 2002 year, and in January 2006 for the 2003 tax year. He was subsequently assessed and reassessed for the 2004 to 2007 years. He was initially assessed for his 2008 taxation year on July 29, 2009. The Appellant was reassessed to disallow a significant portion of the business expenses he had claimed.

[10] The Appellant appealed those reassessments, and his appeals were heard in 2012. It was determined that he did not file Notices of Objection to the assessments of his 2002 and 2003 taxation years and the appeal in respect of those assessments was quashed. His appeals for the remaining years were allowed in part. This decision was upheld by the Federal Court of Appeal in 2013.

Circumstances Giving Rise to Bad Debt Claim

[11] It appears that since no Notices of Objection for 2002 and 2003 had been filed, the Canada Revenue Agency (the "CRA") began collection action for unpaid

tax relating to those taxation years in late 2005 and early 2006. In January 2006 the CRA garnished the Appellant's business account at the Royal Bank.

[12] The garnishment led to great difficulties in operating the Appellant's business. Cheques that were issued to pay creditors were dishonoured by the bank, including payments for the lease of dental equipment. The Appellant testified that in April 2006 half of his dental equipment and the computers used in the business were seized by creditors. He was left with some old dental equipment and was therefore unable to service as many patients as before.

[13] To avoid the effects of the garnishment orders against his bank accounts and in order to continue operating his practice, the Appellant opened new accounts at different banks and began depositing business revenue into the accounts that were not yet garnished. However, at one point or another, all of his accounts were garnished.

[14] The CRA also garnished amounts payable to the Appellant by the dental insurers who made payments directly to the Appellant on behalf of his insured patients. When a patient was insured (which the large majority were), the business would typically file an insurance claim on behalf of the patient. Insurance companies would pay for the dental services directly to the business. When a patient was not insured, the patient would pay the Appellant when the services were provided.

[15] The Appellant tried to avoid the effects of the garnishment orders served on the insurance companies by asking insured patients to file the insurance claims themselves with their insurer and to bring the cheques they received from their insurer back to the Appellant. He would then deposit those cheques into a bank account that was not yet garnished. This method was not 100% successful because some insured patients would keep the cheque they received from the insurer and would not pay the Appellant for the services rendered.

[16] The Appellant and his spouse also said that, as a result of the collection action, the business was unable to afford employees to maintain records, bill clients, collect payments from clients and file claims to the insurance companies.

[17] The standard practice in the Appellant's business was that after services were performed for a patient, the Appellant would make entries in the patient's

chart for each service performed and initial it while he was still with the patient. Every type of service had a unique code and fee associated with it. The patient's chart was then given to the receptionist, who would bill the patient for the services shown on the chart. This was done before the patient left the office. If the patient was insured, which the Appellant says was most often the case, the receptionist would complete an insurance claim form for the services and have the patient sign it.

[18] When a patient was not insured for the services provided, he would pay for the services at the front desk. When a patient was insured, he would pay the co-insurance amount and the Appellant would file an insurance claim on behalf of the patient. Insurance companies would pay for the insured portion of the dental services directly to the business.

[19] The entries on the patients' charts were used to calculate the daily gross revenue of the practice and those were used to prepare annual summaries. The amounts shown in the annual summary of the gross dental services were the amounts reported by the Appellant in his tax returns.

[20] After the seizure of his computers, and without adequate staff to assist him, the Appellant said that the billing process became problematic. While he would still enter the code relating to the services rendered on the patient's chart, but if no one was working at reception, the Appellant himself would have to fill out the forms and collect the amount owing from the patient. Often he would not have the time to properly bill the patient or complete an insurance claim form with the patient because the next patient would be waiting. In such cases, it became necessary to have the patient return to sign the form once it was filled out.

[21] The Appellant filed insurance claims after hours and on weekends and Mrs. Hokhold and the children helped the Appellant to file the claims when they had the opportunity. Without computers, the billing and filing of insurance claims had to be done manually, which made the process harder and longer and a large backlog of uncompleted claims soon developed.

[22] The Appellant and Mrs. Hokhold also testified that it was very easy to make an error when completing an insurance form. The consequence of such error was that the insurance company would not pay for the services performed. The forms could be resubmitted, but in that case it was necessary to have the patient come

back in to the office to sign the corrected form, which was not always possible given the backlog in claims that had arisen.

[23] Both the Appellant and Mrs. Hokhold testified that their health issues, combined with their long working hours and the thoroughness required to complete insurance claim forms made it very difficult for them to file insurance claims on time. As a result, some services provided to patients in the years in issue went unpaid because insurance forms were not submitted within the 12-month time limit to file the claims. If the claims were not correctly filled out and filed within the time limit, the insurance company would not pay for the services, and the Appellant said he could not ask the patient to pay because it was his fault that the insurance forms had not been submitted in a timely manner.

[24] Throughout the period in issue, the Appellant and his spouse said that their focus was on keeping the practice going and providing quality care to patients.

[25] The Appellant and Mrs. Hokhold also explained that because of their medical problems and a lack of time, they were unable to follow-up on unpaid balances and to keep track of which patients provided payments and the amount of such payments.

[26] Both the Appellant and his spouse testified that the garnishing order also made it difficult for the Appellant to create accounts receivable on a patient-by-patient basis as the CRA refused to provide a breakdown of the amounts collected on the garnishees of the insurance companies. The Appellant only knew the total amounts that were garnished but could not link them to particular patients. However, Mrs. Hokhold later said that the insurance companies provided statements to the Appellant when claims were paid to show what was paid for each patient. It was not clear why no such statement would have been provided by the insurance companies even if the actual payments had been garnished.

[27] According to the Appellant and his spouse, all of the problems with billing and collection meant that the Appellant did not, in fact, receive the amount of revenue he reported in his tax returns for his 2005 to 2008 taxation years.

[28] At the end of May 2008, the Appellant lost his house to foreclosure, which led to the closure of his dental practice. After the foreclosure, the business records of the practice were hastily put into unlabeled boxes. He testified that around the

time of the foreclosure, he had no money to hire anyone to sort through the boxes, organize the business records, or to contact patients to follow up on any amounts owing. The Appellant also testified that he does not know where those records are now stored.

[29] When he subsequently filed his tax returns for his 2005 to 2008 taxation years, the Appellant did not have sufficient records available to him to determine the amount of his bad debts that he incurred because of the billing and collection problems. Both the Appellant and his spouse testified that the CRA auditors handling the Appellant's file suggested that they should make an estimate of bad debts and include that amount on his tax returns. Mrs. Hokhold thought that doing so would be incorrect as she had no idea what the actual amounts of bad debts were for those years.

[30] The Appellant said that up to the time of the hearing he had been unable to recover most of the business records for the years 2005 to 2008.

Appellant's Calculation of the Bad Debt

[31] For the taxation years prior to the ones at issue, Mrs. Hokhold said that the amount of the Appellant's bad debts was approximately 3% of the gross amount of dental services performed and that, prior to 2006, complete records of bad debt calculations were kept. However, the Appellant was only able to produce supporting evidence to that effect for the 2002 taxation year.

[32] In any event, Mrs. Hokhold said that she and the Appellant were always aware that there was a much higher rate of bad debts from the 2005 to 2008 taxation years but which had not been claimed when the returns were filed. She therefore included bad debts from all of those years in the amount claimed in respect of the 2008 taxation year. The calculation of the total of the bad debt claim was made at the time the original Notice of Appeal was filed in this case. It was revised just prior to the hearing to take into account certain additional factors which came to her attention in the course of preparing for the hearing.

[33] Mrs. Hokhold relied on a formula she devised which incorporated the information available for the 2005 to 2008 taxation years. She maintained that the formula provided a reasonably accurate calculation of the bad debts for that period.

[34] Her calculation of the bad debts for the 2005 to 2008 taxation years is set out in the following table:

	2005	2006	2007	2008	
CRA Garnishments	\$14,413.52 ¹	\$18,242.37	\$14,867.60	\$4,661.92	
Bank Deposits at RBC	\$248,031.79	\$0.00	\$0.00	\$1,000.00	
Bank Deposit at Interior Savings	\$0.00	\$149,356.32	\$114,997.84	\$54,686.98	
Cash Payments	\$0.00	\$10,000	\$10,000	\$7,000	
Less: Gross Dental Services	\$283,692.76	\$232,951.12	\$179,287.76	\$77,540.89	
Bad Debt to be Claimed	\$21,247.45	\$55,352.43	\$39,422.32	\$10,191.99	\$126,214.19

[35] As illustrated by the above table, the bad debts are the difference between the amount of the gross dental services provided by the Appellant during that year as reported on his tax returns, and the sum of what Mrs. Hokhold determined to be the total amount received by the Appellant from patients or their insurers for those services (including amounts garnished by the CRA from the dental insurance companies). She added up all bank deposits, payments garnished from insurance companies and her estimate of cash payments from patients. She said that the figures used in this table for bank deposits were taken directly from the bank statements. The cash amounts were an estimate.

[36] As she had no way of determining the proportion of cash payments that were subsequently deposited in bank accounts and garnished, Mrs. Hokhold assumed that none of the cash payments were deposited.

[37] Gross dental services include amounts a patient would have been billed for the services provided, including services provided but not reimbursed by insurance companies due to the fact that appropriate insurance forms were not submitted within the 12-month time limit.

¹ Even though the garnishment started as of January 17, 2006, some of the payments garnished were in respect of services rendered in 2005.

[38] The Appellant and Mrs. Hokhold admitted that they had no idea what proportion of the bad debts claimed was attributable to the failure to submit insurance forms in a timely manner.

[39] Mrs. Hokhold also explained that the reason for the discrepancy between the \$166,749.73 initially claimed and the \$126,214.19 bad debt deduction in the present appeal is that she found additional information to perform an updated calculation. She had forgotten that the insurance forms submitted in December of a given year were subject to payment by the insurance companies in January of the next year. She therefore added January insurance receipts to the prior year's receipts in her calculation. In addition, she realized that some of the cash payments were not deposited in the bank accounts and therefore, as previously explained, assumed that none of the cash payments were deposited.

Appellant's Position

[40] The Appellant maintained that he did not receive payments from patients for services he provided, billed and included in his income for 2005, 2006, 2007 and 2008. While he admitted that the amounts of bad debt claimed in respect of the 2005, 2006 and 2007 taxation years became uncollectible before 2008, he submitted that he was unable to claim these amounts as bad debts in the years they had become uncollectible because he did not have access to the necessary information to calculate the appropriate bad debts deduction. In his view, it is only fair for him to be given the opportunity to claim these accumulated bad debts in 2008, as he would otherwise be taxed on services provided and billed but not paid.

[41] With respect to the calculation of bad debts, the Appellant submitted that the calculations made by Mrs. Hokhold accurately depict the amount of bad debts for the 2005 to 2008 taxation years and are based on the best information available to him now.

Legal Framework for Claiming Bad Debts

[42] The relevant statutory provision dealing with bad debts is found in paragraph 20(1)(p) of the *Act*. The relevant portions of paragraph 20(1)(p) of the *Act* read:

Deductions permitted in computing income from business or property

20 (1) Notwithstanding paragraphs 18(1)(a), 18(1)(b) and 18(1)(h), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto

...

Bad debts

(p) the total of

(i) all debts owing to the taxpayer that are established by the taxpayer to have become bad debts in the year and that have been included in computing the taxpayer's income for the year or a preceding taxation year, ...

...

[43] In order to succeed in a claim under subparagraph 20(1)(p)(i), a taxpayer is required to show the existence of a debt. If it is proved that there is a debt, two further conditions must be met. The taxpayer must show that the debt in issue was included in his income for the year the deduction is claimed or for a preceding taxation year. The taxpayer must also show that the debt became a bad debt in the taxation year in which it is claimed (*Clackett v. The Queen*, 2007 TCC 499).

[44] The generally accepted approach to determining whether a debt is bad was set out by the FCA in *Flexi-Coil Ltd. v. The Queen*, 96 DTC 6350 as follows:

The parties are also agreed as to the learned Tax Court Judge's statement of the case law interpreting this provision (Appeal Book V, 942):

The question of when a debt becomes bad is a question of fact to be determined according to the circumstances of each case. Primarily, a debt is recognized to be bad when it has been proved uncollectible in the year. In *Roy v. M.N.R.*, 58 DTC 676, Mr. Boisvert of the Tax Appeal Board stated at page 680:

As the Act does not define a bad debt, it is necessary to turn to recognized accounting principles of business practice. A debt is recognized to be bad when it has been proved uncollectible in the year.

The question of when a debt is to be considered uncollectible is a matter of the taxpayer's own judgment as a prudent businessman. In *Hogan v. M.N.R.*, 56 DTC 183 at page 193, Mr. Fisher described how this determination should be made:

For the purposes of the *Income Tax Act*, therefore, a bad debt may be designated as the whole or a portion of a debt which the creditor, after having personally considered the relevant factors mentioned above in so far as they are applicable to each particular debt, honestly *and reasonably determines to be uncollectable at the end* of the fiscal year when the determination is required to be made, notwithstanding that subsequent events may transpire under which the debt, or any portion of it, may in fact, be collected. The person making the determination should be the creditor himself (or his or its employee), who is personally thoroughly conversant with the facts and circumstances surrounding not only each particular debt but also, where possibly, [*sic*] each individual debtor . . . (Emphasis is mine)

This approach has been followed in numerous judgments, including *Anjalie Enterprises Ltd. v. The Queen*, 95 DTC 216 (TCC), and *Berretti v. M.N.R.*, 86 DTC 1719 (TCC). In summary, to decide whether a taxpayer is entitled to a deduction for bad debts, the Court must be satisfied that the taxpayer itself made the determination that the debts had become uncollectible and that in making such determination, it acted reasonably and in a pragmatic business-like manner, applying the proper factors.

(at page 6351)

[45] The Court in *Flexi-Coil* also held that a debt becomes bad when the taxpayer determines that the debt is uncollectible and has, in making this determination, acted reasonably and in a pragmatic, business-like manner, applying the proper factors.

[46] The proper factors were summarized by the FCA in *Rich v. Canada*, 2003 FCA 38 as follows:

1. the history and age of the debt;
2. the financial position of the debtor, its revenues and expenses, whether it is earning income or incurring losses, its cash flow and its assets, liabilities and liquidity;
3. changes in total sales as compared with prior years;

4. the debtor's cash, accounts receivable and other current assets at the relevant time and as compared with prior years;
5. the debtor's accounts payable and other current liabilities at the relevant time and as compared with prior years;
6. the general business conditions in the country, the community of the debtor, and in the debtor's line of business; and
7. the past experience of the taxpayer with writing off bad debts.

This list is not exhaustive and, in different circumstances, one factor or another may be more important. (at para 13)

Analysis

[47] The question to be decided in this appeal is whether the Appellant is entitled to a deduction for bad debts for his 2008 taxation year pursuant to paragraph 20(1)(p) of the *Act*.

[48] The onus is on the Appellant to establish, on the balance of probabilities, that there was a debt owing to him, that it was included in the computation of his income for the 2008 taxation year or a previous year, and that it became bad in the year it was claimed.

[49] With respect to the question of whether the amounts claimed had been included in income, the Appellant and Mrs. Hokhold both testified that the charges for all services performed were totalled up on the patients' charts and recorded as revenue of the practice on a daily basis. These amounts were, in turn, added up and reported each year on the Appellant's tax returns as the gross revenue of his practice. Mrs. Hokhold said she used these reported revenue figures in her calculation of the bad debt amounts.

[50] The Respondent did not challenge this testimony and, more importantly, brought no evidence to contradict it. Obviously, the Respondent would have been able to confirm the reported gross revenue figures from the returns filed by the Appellant, and if there was a discrepancy, could have put the Appellant's returns, or the electronic transcription of the information contained in the returns, into evidence. Because the Respondent did not produce any evidence to this effect, I draw the inference that the gross revenue amounts shown on Mrs. Hokhold's bad

debt calculation were accurate. Therefore, it follows that the portions of the gross revenue which the Appellant claims now as bad debts were in fact included in the Appellant's income for his 2008 taxation year or a preceding year.

[51] It remains to be determined however whether the Appellant has shown that the amounts claimed consisted of debts owing to him. On this point, the evidence is far from convincing. It consisted only of the testimony of the Appellant and Mrs. Hokhold. No accounting records of the practice were placed into evidence. The Appellant testified that he no longer knows where the records are.

[52] The calculations made by Mrs. Hokhold were, at best, rudimentary and do not identify any particular debts owing. She has simply aggregated what she believes to have been the total receipts of the practice annually over a four year period and deducted that amount from the total revenue reported by the Appellant in order to compute the bad debt claim. Neither this evidence nor the testimony of the Appellant and his spouse allows for the identification of the specific debtors or the amount that each debtor owed which, in my view, would be essential to proving the existence of the debts. The word "debt" is not defined in the *Act*. It has been judicially defined, however, by the Supreme Court of Canada as "a sum payable in respect of a liquidated money demand, recoverable by action": *Diwold v. Diwold*, [1941] S.C.R. 35. To my mind, in order to have a liquidated money demand, recoverable by action, it would be necessary to know who the debtor was and the amount of the debt.

[53] Furthermore, while the question of when a debt has become uncollectible is for the taxpayer to determine, I cannot see how the Appellant in this case could have made such a determination without knowing who his debtors were or what amount they owed him.

[54] The Appellant asks that the Court accept the general calculation of the bad debt claim because he no longer has the accounting records for his practice. While I recognize that the Appellant and his family have gone through very difficult times, I am unable to take into account equitable considerations in arriving at my decision. The fact remains that there is simply no way of assessing the accuracy of the amount claimed in the absence of the business records from the Appellant's practice. The computation done by Mrs. Hokhold appears to me to be only an educated guess, at best, of the amount of revenue the Appellant did not collect from his patients or their insurers.

[55] Given the nature of this case, which involves a claim for many individual bad debts arising over a considerable period of time, the testimony given by the Appellant and Mrs. Hokhold is not sufficient to satisfy me of the existence of those debts. Their testimony lacked the kind of precision that would be required to overcome the absence of supporting documentation.

[56] As such, the Appellant has not shown on a balance of probabilities that he was owed \$126,214.19 in 2008 for services he rendered to his patients between 2005 and 2008.

[57] Even if the Appellant had proved the existence of the debts, I would have been unable to conclude what part, if any, of those debts went bad in 2008. During the hearing, the Appellant and Mrs. Hokhold each admitted that a portion of the bad debts claimed had become bad in years prior to 2008. This would have certainly been the case for insurance claims not made within one year of the date the services were provided. In any event, the Appellant and his spouse said that no bad debt claims were made in the 2005 to 2007 taxation years because, without the records, they were unable to determine the amount to deduct. Paragraph 20(1)(p) of the *Act* only allows for a deduction in the year during which the debt goes bad. It does not permit a taxpayer to delay the claim due to circumstances unrelated to the collection of the debt.

[58] It also appears to me that the Appellant still had available to him information that would have permitted him to take steps to collect unpaid amounts from his patients or their insurers after the end of 2008. At that time, he still knew the whereabouts of the records from his practice, and therefore he would still have had an opportunity to take collection action on those debts.

[59] For all of these reasons, the Appellant has not shown that he had debts of \$126,214.19 that became bad during his 2008 taxation year.

Conclusion

[60] The appeal is dismissed. No order is made as to costs.

Signed at Hamilton, Ontario, this 27th day of October 2017.

“B.Paris”

Paris J.

CITATION: 2017TCC217
COURT FILE NO.: 2013-2354(IT)G
STYLE OF CAUSE: DR. FRANK CH. HOKHOLD AND HER
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PLACE OF HEARING: Vancouver, British Columbia
DATES OF HEARING: December 7, 2016
REASONS FOR JUDGMENT BY: The Honourable Justice B. Paris
DATE OF JUDGMENT: October 27, 2017

APPEARANCES:

For the Appellant: The Appellant himself
Counsel for the Respondent: Geraldine Chen

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