[OFFICIAL ENGLISH TRANSLATION]

2001-1238(IT)I

BETWEEN:

PIERRE MÉRETTE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on August 1, 2002, at Montréal, Quebec, by

the Honourable Judge Lucie Lamarre

Appearances

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Mounes Ayadi

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* ("*Act*") for the 1996 and 1997 taxation years are allowed, without costs, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the amount of the shareholder benefit of $9,695 shall be reduced to $1,250 for 1997. The appellant is also entitled to automobile expenses of $478 for 1996 and of $435 for 1997, which corresponds to 10 percent of total expenses, which percentage is accepted as attributable to expenses incurred for the

purpose of gaining income from Micronomic Enr. The disallowed expenses of $3,303 will therefore be reduced to $2,825 for 1996 and from $2,613 to $2,178 for 1997.

The appellant is entitled to no further relief.

Signed at Ottawa, Canada, this 10th day of September 2002.

"Lucie Lamarre"

J.T.C.C.

Translation certified true
on this 2nd day of December 2003.

Sophie Debbané, Revisor

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Date: 20020910
Docket: 2001-1238(IT)I

BETWEEN:

PIERRE MÉRETTE,

Appellant,

and

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Respondent.

REASONS FOR JUDGMENT

(Delivered orally from the bench on August 1, 2002, at Montréal, Quebec, and revised at Ottawa, Ontario, on September 10, 2002.)

Lamarre, J.T.C.C.

[1] These are appeals, heard under the informal procedure, from assessments made by the Minister of National Revenue ("Minister") under the *Income Tax Act* ("*Act*") for the 1996 and 1997 taxation years. In assessing the appellant, the Minister made the following adjustments:

	1996	1997
Unreported income	$20,000	
Interest benefit		$384
Automobile benefit	$5,383	$8,584

Shareholder benefit		$9,695
Grossed-up dividends		$27,812
Disallowed expenses	$3,303	$2,613
Total adjustments	$28,686	$49,088

> [the Minister] assessed the penalty provided for under subsection 163(2) of the Income Tax Act (hereinafter the Act) on the unreported income of $20,000 in 1996, for an amount of $2,314.04.

[2] With respect to the unreported income, the appellant admitted that he failed to report the sum of $20,000 that he received on January 15, 1997. At the time of the audit in 1999, he himself requested that this amount be included in his income for 1996 (see the auditor's report: Exhibit A-2, tab 3, page 3, second last paragraph; that same request was made at the provincial level: see Exhibit A-2, tab 5).

[3] In actual fact, Micronomic Enr., which the appellant controls, rendered technical computer services to Transtronic Inc., a corporation in which he and his spouse hold 50 percent of the shares and for which he acts as chairman of the board of directors as well as controller, director of marketing, finance and human resources (see letter from the appellant's accountant to the Canada Customs and Revenue Agency, Exhibit A-1, tab 4, page 1, under the heading "Car Benefit").

[4] A number of invoices were prepared by Micronomic Enr. for services rendered to Transtronic Inc. in 1996 totalling approximately $20,000 (see the auditor's report at page 3, filed as Exhibit A-2, tab 3). In addition, an invoice for $20,000 was prepared by Micronomic Enr. on April 18, 1997 (included in Exhibit I-1), stating that technical and consulting services had been rendered during the period from January 1 to June 1, 1997. There is also a resolution of the board of directors of Transtronic Inc., signed, *inter alia*, by the appellant as chairman and secretary of the board on January 14, 1997, authorizing a budget of $20,000 for computer consulting services concerning [TRANSLATION] "all developments for 1996 which, already started, will be fully completed by Micronomic Enr." (Exhibit I-2). In addition, a cheque for $20,000 made out to the appellant and dated January 15, 1997, referring to a "bonus" and to resolution "R9712" of January 14, 1997, referred to above, was signed by the appellant on behalf of Transtronic Inc. (Exhibit I-3). It is this amount that the appellant admitted that he had not reported in his tax returns and which is at issue in the instant case.

[5] According to the additional information that the appellant's accountant provided at the time of the objection to the assessments in issue and which appears in Exhibit A-1, tab 4, at page 4, under the heading "Penalty and Interest", the amount of $20,000

> [TRANSLATION]
>
> ... represents an amount paid by Transtronic Inc. to Pierre Mérette for services rendered by Mr. Merette's personal business, Micronomic Enr., in exchange for services rendered in 1996. The invoice was struck from the books of Micronomic Enr., with a note entered by Pierre Mérette in the general journal of Micronomic Enr. in computer format. On June 30, 1996, the amount was allocated to the expenses of Transtronic Inc. for its fiscal year ending on December 31, 1996. For Pierre Mérette, the amount was reported in 1996 as a bonus.

[6] Again according to the additional information provided by the accountant, from January to June 1997, the amount of $20,000 was entered in the books of Micronomic Enr. as an invoice for services rendered to Transtronic Inc. In fact, the adjusting entries were not transmitted to Transtronic Inc., and that amount, according to the accountant, was considered as an advance to the appellant until the end of 1997. It subsequently remained forgotten.

[7] The appellant admitted that he had failed to report as part of his income the amount of $20,000, which he had received on January 14, 1997. He explained that he had not reported that amount as part of his 1996 income because he believed it was a bonus that did not have to be declared until 1997. He further explained to the objections officer that that amount had not been reported in 1997 because there had been two computer thefts at Micronomic Enr., as a result of which the note in the general journal that was to be transmitted to Transtronic Inc. was lost (see report on objection, Exhibit A-1, tab 5, page 4). According to the accountant's explanations, the computer thefts occurred in January and March 1997 (see Exhibit A-1, tab 4, page 4). In Court, the appellant said that the thefts had taken place in March 1998 (see also Exhibit A-2, tab 11). He also mentioned that the ice storm in January 1998 was one of the causes of his failure. Lastly, the appellant explained that, with reported income of $111,000 in 1997, he had not noticed that his income was understated by $20,000.

[8] I find that the explanations given by the appellant and his accountant are both confusing and misleading as to the reasons why this amount of $20,000 was not reported and as to the year in which that amount should have been included in the appellant's income. I do not see how the fact that an error occurred in adjusting

the accounting entries between Micronomic Enr. and Transtronic Inc. absolves the appellant of his responsibility to report all his income. Regardless of whether the amount was paid as a bonus in 1997 or for services rendered in 1996, it was up to the appellant to include it in his income for one of those years, depending on the actual source of that income.

[9] The appellant is no doubt partly responsible for the confusion surrounding the nature of the payment of the $20,000 in question. He cannot now contend that, because of such confusion or other reasons which, in my view, are irrelevant (such as the ice storm), he failed to include that amount in his income.

[10] The appellant is the one who controls Micronomic Enr. (an unincorporated entity) and he is the chairman of the board of directors and financial controller of Transtronic Inc. He prepares his income tax returns himself. It was he who signed the cheque for $20,000 that was made out to him. It is inconceivable, in my view, that he should fail to report such income in 1996 or even in 1997.

[11] Having regard to all the documents substantiating the existence of that income, to the appellant's level of education (the appellant is a business executive, an engineer by training, and holds an MBA in marketing and finance from the École des Hautes Études Commerciales), his business knowledge and the fact that he was closely linked to the affairs of Transtronic Inc. and Micronomic Enr., it was for him to take the necessary measures to ensure that he reported all his income either in his 1996 taxation year or in his 1997 taxation year. Regardless of the source of the $20,000 paid to the appellant, the appellant had a duty to include it in his income for one of the years, even if it meant subsequently amending his tax returns if an error was made. The appellant merely kept quiet about the existence of that income.

[12] At the time of the audit, the Minister included the amount in 1996 at the request of the appellant, who benefited as a result since the penalty was smaller in view of his lower income in 1996. Having regard to the confusion surrounding the source of that income, the Minister was able to consider, and this Court is also able to do so, that it was an amount taxable in 1996. Moreover, this course is fully justified considering that the appellant argued through his accountant at the objections stage that the amount of $20,000 had been paid in consideration for services rendered by Micronomic Enr. in 1996 (which may be supported by the resolution of the board of directors of Transtronic Inc. dated January 14, 1997) and that Transtronic Inc. wrote the amount off as an expense in 1996.

[13] I find that the appellant is therefore in a poor position at this point to dispute what was done by the Department of National Revenue ("Department") at his own request and to now argue that the amount should have been included in 1997 to avoid the tax payable on that income as well as the penalty assessed as a result of that failure (since this Court may not increase the amount of the assessment in 1997).

[14] I find that the respondent adequately showed that the appellant knowingly, or under circumstances amounting to gross negligence, failed to report the amount of $20,000 in his income for 1996. In the circumstances, and for these reasons, I therefore find that the assessment made for 1996 is valid with respect to the inclusion of unreported income of $20,000 and with respect to the assessment of the penalty of $2,314.04 under subsection 163(2) of the *Act.*

[15] With respect to the interest of $384 included in 1997, the appellant now agrees that it be included in his income and that amount is no longer in dispute. Therefore, the assessment made for 1997 remains unchanged in this regard.

[16] As to the shareholder benefit, there was a consent to judgment and that benefit is now reduced to $1,250 for 1997.

[17] With respect to the grossed-up dividends of $27,812 received by the appellant and assessed in 1997, subsection 82(3) of the *Act*, to which the appellant referred, clearly does not apply here. Only dividends received by a spouse for which the taxpayer is entitled, *inter alia*, to a married tax credit under paragraph 118(1)(*a*) may be the object of an election under subsection 82(3) of the *Act*. Therefore, if such an election may be made, the spouse with the higher income will include the dividend income of the other spouse in his or her income to enable the couple to maximize the dividend tax credit and the married tax credit and thus reduce the tax payable (see Interpretation Bulletin IT-295R4, Taxable Dividends Received After 1987 by a Spouse, April 27, 1990, Exhibit A-2, tab 19). The appellant did precisely the opposite. He did not include his dividend income in his tax return but added it to the income of his spouse who had a much smaller income.

[18] Furthermore, according to the tax returns that were filed (Exhibit A-1, tabs 1 and 2), the incomes of the appellant and his spouse were too high to entitle them to that election since the appellant did not appear to be entitled to a married tax credit with respect to his spouse for 1997.

[19] In conclusion on this issue, the appellant could not include in his spouse's income the amount of the grossed-up dividend of $27,812, which he received in 1997. The dividend amount must be included in his own income in 1997, and the assessment is confirmed on this point.

[20] With respect to the automobile benefit, the *Act* provides two benefits where a vehicle is made available to an employee by an employer.

[21] First, there are standby charges for an automobile under paragraph 6(1)(*e*) of the *Act*. There is a benefit calculated under paragraph 6(1)(*e*) of the *Act* from the moment a vehicle is made available to the taxpayer, regardless of whether he uses it for personal purposes. There is a presumption in the *Act* that personal use amounts to 12,000 km per year. Thus, there is a benefit that is calculated in accordance with a formula provided for in subsection 6(2) of the *Act*. That benefit may be reduced if the appellant can show on clear evidence, first, that the employer required him to use the automobile in connection with or in the course of his employment and, second, that he drove the vehicle less than 12,000 km per year or less than 1,000 km per month for personal use. Here, the burden of proof is on the appellant.

[22] The appellant admits that he used a 1996 Mazda 626 Cronos that was made available to him by Transtronic Inc. to travel from home to work. These are personal expenses, and that was even acknowledged by Judge Bowman in his decision respecting the appellant for 1991 and 1992 (see *Mérette v. Canada*, [1995] T.C.J. No. 1569 (Q.L.), Exhibit I-5). It was calculated that the travel alone amounted to 11,400 km per year. No other tangible evidence enables me to say that there were any changes on this point. Moreover, the appellant states that he travelled 33,000 km a year in that automobile. This shows us that the appellant used the vehicle for personal purposes at least 34 percent of the time it was used. Thus the appellant does not meet the first condition established by subsection 6(2) to be able to change the calculation of the taxable benefit under paragraph 6(1)(*e*) of the *Act*, that is to say, that all or substantially all the distance travelled by the automobile was not travelled in connection with or in the course of his employment.

[23] In addition, no other solid evidence was brought proving that the Mazda was not used for personal purposes to a maximum of 12,000 km a year. The evidence of the car lease provides that there is a penalty if the Mazda is driven more than 25,000 km a year. This is not really evidence that the appellant used it solely for business purposes. It can only show that the car was driven more than 25,000 km a year.

[24] As a result, I am unable to reverse the presumption of subsection 6(2), and I therefore confirm the benefit, as calculated in Schedule A of the Reply to the Notice of Appeal, that is, $4,414 for 1997 and $2,207 for 1996. That settles the issue of the standby charge benefit.

[25] The second taxable benefit provided for under the *Act* is the one under paragraph 6(1)(*a*), which is connected to the automobile's operating expenses. Here the appellant received an allowance of $5,000 in 1996 and $6,000 in 1997 from Transtronic Inc. to cover the operating expenses of the automobile. The only element in dispute, from what I understand, is the percentage of personal use. The appellant feels he used the Mazda solely for business purposes.

[26] In my view, and as I said earlier, the appellant's claim cannot be accepted. First, travel from home to the office is personal in nature. The appellant said he was required to take the Mazda home because of the insurance; I have no evidence that the insurer required this. At the time of the objection, he explained that the board of directors of Transtronic Inc. had decided that the appellant was to take the automobile to his home in the evening. No document attests to this either. The appellant is the chairman of Transtronic Inc.'s board of directors, and I find that his testimony alone, after the fact, is in itself insufficient to substantiate his claims.

[27] Furthermore, the appellant did not actually provide a record of his business travel. In fact, this is not his first experience before the Court on this issue. He filed documents showing the automobile's operating costs but that does not show me whether he used it for personal purposes or business purposes.

[28] The appellant said that he had leased a 1997 Pontiac Sunfire in the summer of 1996. However, the insurance documents show that the car was not insured until October 1996 (see Exhibit A-2, tab 6). The appellant, I imagine, hoped to show that he had used his Pontiac mainly for personal purposes and the Mazda for business purposes and that his spouse used another car that he owned, a 1989 Ford Escort.

[29] However, I realize that there is no evidence of insurance as well for the Ford Escort either in 1996 or in 1997, which leads me to assume that this automobile was not used very much. Rather, it is highly likely that the Pontiac was used by the appellant's spouse and that the appellant used the Mazda.

[30] I find from all this that the appellant did not show on the balance of evidence that he used the Mazda solely for business purposes. I therefore consider, having regard to the evidence, which was deficient on this point, that the proposal of

50 percent accepted by the Minister and which corresponds to the percentage accepted by this Court in Judge Bowman's decision on the same issue raised by the appellant for 1991 and 1992 seems completely reasonable.

[31] The appellant did not satisfactorily prove otherwise, and I therefore confirm the value of the taxable benefit calculated by the Minister under paragraph 6(1)(*a*), that is, $3,031 for 1996 and $3,879 for 1997; and the total taxable benefit for the year for the use of an automobile, as calculated by the Minister, that is, $5,383 for 1996 and $8,584 for 1997 (see Schedule A of the Reply to the Notice of Appeal).

[32] It now remains for me to consider the expenses of the appellant's personal automobile, which he used for his business, Micronomic Enr. The appellant says that he used his personal car to travel once a week to the head office of Transtronic Inc., which was the main client of Micronomic Enr. He calculated that the business use was between 60 to 69 percent. I find that quite high.

[33] First, starting in June 1996, the Mazda had to be available at the office for the employees of Transtronic Inc. The appellant could therefore not leave it at home once a week in order to use his own car.

[34] The appellant said that he used his car occasionally on weekends for his business. The record for 1997 (there is none for 1996) showing his travel is not very lengthy and does not show many trips (see Exhibit A-6). Furthermore, the appellant received an allowance from Transtronic Inc. for the use of an automobile. The appellant reported income from Micronomic Enr. of $19,675 in 1996 and $150 in 1997. However, the evidence showed that he made $20,000 more and that he did not report that amount.

[35] Having regard to all this, I find that I will set the personal automobile's business use for Micronomic Enr. at 10 percent maximum. The appellant is therefore entitled to 10 percent of the total automobile expenses reported on the T2124 F form of his tax returns, which appear in Exhibit A-1, tab 1, that is, 10 percent of $4,780 for 1996 and 10 percent of $4,355 for 1997—$478 for 1996 and $435 for 1997.

[36] The appeals are therefore allowed solely to reflect the amounts conceded at the start of the hearing and the last two amounts I have just allowed for operating expenses of an automobile for Micronomic Enr. For the rest, the evidence is insufficient and I cannot grant any further relief.

Signed at Ottawa, Canada, this 10th day of September 2002.

"Lucie Lamarre"

J.T.C.C.

Translation certified true
on this 2nd day of December 2003.

Sophie Debbané, Revisor