Dockets: 2003-796(IT)I
2003-798(GST)I

BETWEEN:

YVETTE MARCHILDON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on common evidence with the appeals of *Nancy Marchildon* (2003-803(IT)I) and (2003-804(GST)I) and *Louis Marchildon* (2003-793(IT)I) and (2003-794(GST)I) on September 29, 2003, at Montreal, Quebec.

Before: The Honourable Judge G. Rip

Appearances:

Agent for the Appellant:	Gilles Gratton, C.A.
Counsel for the Respondent:	Justine Malone

JUDGMENT

The appeals from the assessments under the *Income Tax Act* for the 1996, 1997 and 1998 taxation years and under the *Excise Tax Act* are allowed, without costs, and the assessments are referred back to the Minister of National Revenue ("Minister") for reassessment so that the Minister can reduce the amount of taxable supplies of food and restaurant meals from $9,030.65 to $3,000 and reduce the penalties under section 285 of the ITA pertaining to this amount; the penalties and income for ITA purposes, if applicable, will subsequently be reduced.

Signed at Ottawa, Canada, this 16th day of January 2004.

"Gerald J. Rip"

Rip, J.

Translation certified true
on this 26th day of April 2004.

Sharon Moren, Translator

Dockets: 2003-803(IT)I
2003-804(GST)I

BETWEEN:

NANCY MARCHILDON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on common evidence with the appeals of *Yvette Marchildon* (2003-796(IT)I) and (2003-798(GST)I) and *Louis Marchildon* (2003-793(IT)I) and (2003-794(GST)I) on September 29, 2003, at Montreal, Quebec.

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JUDGMENT

The appeals from the assessments under the *Income Tax Act* for the 1996 and 1997 taxation years and under the *Excise Tax Act* are allowed, without expenses, and the assessments are referred back to the Minister of National Revenue ("Minister") for reassessment so that the Minister can reduce the amount of taxable supplies of food and restaurant meals from $9,030.65 to $3,000 and reduce the penalties under section 285 of the ITA pertaining to this amount; the penalties and income for ITA purposes, if applicable, will subsequently be reduced.

Signed at Ottawa, Canada, this 16th day of January 2004.

"Gerald G. Rip"

Rip, J.

Translation certified true
on this 26th day of April 2004.

Sharon Moren, Translator

Dockets: 2003-793(IT)I
2003-794(GST)I

BETWEEN:

LOUIS MARCHILDON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on common evidence with the appeals of *Yvette Marchildon* (2003-796(IT)I) and (2003-798(GST)I) and *Nancy Marchildon* (2003-803(IT)I) and (2003-804(GST)I) on September 29, 2003, at Montreal, Quebec.

Before: The Honourable Judge G. Rip

Appearances:

Agent for the Appellant:	Gilles Gratton, C.A.
Counsel for the Respondent:	Justine Malone

JUDGMENT

The appeals from the assessments under the *Income Tax Act* for the 1996 and 1997 taxation years and under the *Excise Tax Act* are allowed, without expenses, and the assessments are referred back to the Minister of National Revenue ("Minister") for reassessment so that the Minister can reduce the amount of taxable supplies of food and restaurant meals from $9,030.65 to $3,000 and reduce the penalties under section 285 of the ITA pertaining to this amount; the penalties and income for ITA purposes, if applicable, will subsequently be reduced.

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Citation: 2004TCC47
Dockets: 2003-796(IT)I
2003-798(GST)I

BETWEEN:

YVETTE MARCHILDON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

AND

Dockets: 2003-803(IT)I
2003-804(GST)I

BETWEEN:

NANCY MARCHILDON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

AND

Dockets: 2003-793(IT)I
2003-794(GST)I

BETWEEN:

LOUIS MARCHILDON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Rip, J.

[1] Yvette Marchildon, Nancy Marchildon and Louis Marchildon are filing appeals from tax assessments on income for the 1996 and 1997 taxation years and

from excise tax assessment ("goods and services tax" or "GST") for the period from January 1, 1996 to December 31, 1998.

[2] The three appellants object to inclusion of amounts as undeclared income and contest the assessment of penalties under subsection 163(2) of the *Income Tax Act* ("ITA") for the 1996 and 1997 taxation years. Yvette Marchildon is also claiming for the 1998 taxation year.

[3] The Appellants also object to the assessment by the Minister of National Revenue ("Minister") of GST that was not remitted as well as the assessment of penalties under section 285 of the *Excise Tax Act* ("ETA").

[4] The appeals were heard on common evidence.

[5] In making his reassessment, the Minister relied on the following facts:

(a) The Appellants operated a restaurant;
(b) The restaurant was operated and jointly owned in equal parts by Louis, Yvette and Nancy Marchildon during 1996 and 1997; Yvette Marchildon operated the restaurant as sole proprietor during 1998;
(c) Video poker machines were operated on the premises for the profit of the Appellants Louis and Nancy Marchildon during 1996 and 1997 and for the profit of the Appellant Yvette Marchildon during 1998;
(d) The video poker machines were the property of Grand Prix Amusement Ltd. (hereinafter "the Supplier");
(e) The Appellants did not declare the income pertaining to the video poker machines for the years or the periods when they owned the restaurant;
(f) The Ontario Provincial Police conducted a search of the Supplier's property on February 24, 1998;
(g) The Supplier's books were found during the search;
(h) Income from the video poker machines was registered in the Supplier's books;
(i) The Appellants neglected to declare income from the video poker machines for the years that they owned the restaurant;
(j) The Appellants or the person preparing the income tax returns for the years in which the Appellants owned the restaurant, the Appellants made

a misrepresentation that is attributable to neglect, carelessness or wilful default;[1] and

(k) The Appellants knew or ought to have known that in making false declarations or misrepresentations of the facts, the tax payable would be less than it would have been had the false declarations or misrepresentations of the facts not been made.[2]

[6] In making his reassessment of the excise tax in the files, the Minister also relied on the following facts:

(a) Yvette Marchildon operated the restaurant as sole proprietor for the 1998 taxation year;
(b) The Appellants declared no GST pertaining to their shares of the video poker machines;
(c) The GST amounts attributable to the video poker machines were found in the Supplier's books; and
(d) The Appellants neglected to declare the GST on all taxable supplies.

The Appellants' Position

[7] The Appellants maintain that the amount of undeclared income from the video poker machines is much too high. At the most, the Appellants estimate that the machines generated a total income of from $20,000 to $22,000 for the 1996 and 1997 taxation years. Beyond these amounts, the machines were used only for entertainment and did not involve an actual business transaction.

[8] The Appellants also maintain that the taxable supplies were inadvertently not taxed and were in the order of $3,000 and not $9,030.65. The GST on these taxable supplies should be calculated on this amount.

[9] Furthermore, they state that interest should not be assessed or should be assessed on a lesser amount on the basis of the previous paragraph. The Appellants add that the penalties should not be assessed because they were unaware that certain supplies were not taxed. Their agent, Gilles Gratton, admits that they were negligent, but not grossly negligent.

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[1] Subsection 152(4) of the ITA and subsection 298(4) of the ETA

[2] Subsection 163(2) of the ITA and section 285 of the ETA

The Respondent's Position

[10] In contrast, the Respondent alleges that the Appellants neglected to declare the income from the video poker machines.

[11] The Appellants neglected to pay GST on certain taxable supplies due to errors in the cash register reports, as was the case for the income from the video poker machines. The Appellants admitted that the amount of $3,000 in restaurant sales was taxable and consequently that GST was owed. Counsel for the Minister agrees with this amount.

[12] The Minister agrees that the amount of GST pertaining to income from the video poker machines will depend on my findings with regard to the undeclared income.

[13] The Respondent states that the Appellants were grossly negligent such that penalties are necessary. However, the Respondent acknowledges that there is no gross negligence with regard to the unpaid GST amounts related to errors in the cash register reports and, as a result, the penalties under section 285 of the ITA will not be assessed on these amounts. Moreover, the basic interest and penalties are owed on the full amounts at issue.

Testimony of Nancy and Louis Marchildon

[14] The Appellants Nancy Marchildon and Louis Marchildon testified during the hearing. The Appellant Yvette Marchildon did not testify although she was present at the hearing.

[15] This was Nancy Marchildon's first experience keeping books. In order to do this, she relied on the cash register reports. Some supplies were not taxed by the cash register such as the daily specials. Nancy Marchildon stated that at the time, she did not know that these supplies were not being taxed. She said she knew that the GST is a 7% tax but did not know that the cash register reports should coincide with 7% taxation. Nancy Marchildon admitted that the Appellants owed about $3,000, contrary to the $9,030.65 claimed by the Respondent.

[16] The Appellant testified to the effect that she, Louis Marchildon and Yvette Marchildon knew that the operation of video poker machines was illegal in Ontario because of the bets that were involved in using these machines. She also testified that she and Louis Marchildon regularly played the video poker machines.

They would open the machines with the keys that had been left for their use and play using the monies found in the machines or they would increase the credits from the inside and play until the credits were used up. Nancy Marchildon explained that the Supplier had noted that the amounts found in the video poker machines did not match the readings of the machines. She felt that the Supplier had seemed to be displeased with these inconsistencies.

[17] According to Nancy Marchildon, the income from the video poker machines was separate from the income from the restaurant that the Appellants operated. The profits from the video poker machines stayed in the machines. The Appellants allegedly did not declare receipts from the video poker machines because they were too low. However, the Appellant revealed that she declared income as low as $10 to $20 for a period of eight months for the peanut-vending machines located in the restaurant. She said that if the income from the video poker machines had been higher, it would have been impossible to hide these amounts and they would have had to declare them. Finally, Nancy Marchildon stated that she consulted with their accountant to find out if she had to declare the amounts from the video poker machines. The accountant had told her no. Nancy Marchildon remitted no records pertaining to the video poker machines to the accountant since she had kept no records.

[18] Louis Marchildon testified that he played about three hours in the evening and a few hours during the night on a daily basis. He admitted that it is possible he played for an amount equivalent to $40,000 to $50,000.

[19] Louis Marchildon explained that the receipts from the video poker machines were shared as follows: one week out of five, the Appellants kept all the profits and the other four weeks, the profits were divided between the Appellants and the Supplier of the video poker machines. According to Louis Marchildon, this was not income but in fact gifts from the Supplier to them. When Louis Marchildon was questioned about the nature of the fractions (60/40 and 1/5) handwritten on the contract binding the Appellants and the Supplier of the video poker machines, he stated that he could not explain these fractions.

[20] Louis Marchildon estimated the amount of the Appellants' weekly profit at $200. He acknowledged then that the Appellants owe the amount of $20,000 to $22,000. The Appellants used these amounts to pay minor expenses such as gas for the car.

Testimony of Éric D'Amour

[21] The Minister called one witness only, Éric d'Amour, the investigator from the Canada Customs and Revenue Agency. Mr. D'Amour was the investigator for the Appellants' files. He filed as Exhibit I-2 the working sheets he used during his audit. He testified to the effect that his findings were based on the reconciliation records provided by the Ontario Provincial Police. The Ontario Provincial Police allegedly obtained these documents during the search of the Supplier's property in February 1998. The reconciliation records indicated the income from the video poker machines that was attributable to the merchants and to the Supplier. These records were created using the routing sheets found in the video poker machines' counters. The amount indicated under "money in" was the income generated by the video poker machine. This was the difference between the money coming in and the money going out as a result of wins. These routing sheets were the only means the Supplier had of knowing the amounts the machines should contain, as the merchants had access to the video poker machines.

[22] As well, Mr. D'Amour stated that the abbreviations VS and NS meant [TRANSLATION] "yours" and [TRANSLATION] "ours". "Yours" was the merchant's share, while "ours" was the Supplier's.

[23] Finally, Mr. D'Amour explained that pursuant to his observations, he interviewed the Appellants. This interview confirmed that the income from the video poker machines had not been declared. Consequently, considering the significance of the undeclared amounts, Mr. D'Amour, recommended that an additional penalty be assessed. According to Mr. D'Amour, the Appellants were fully aware of their failure to declare the video poker machine income and thus, they acted voluntarily.

[24] The questions at issue are:

> (a) Are the receipts from the video poker machines income for the Appellants and receipts from the sale of taxable supplies?
> (b) If so, should the penalties under subsection 163(2) of the ITA and section 285 of the ETA be assessed with regard to the receipts from video poker machines?

Receipts from video poker machines

[25] The Appellants acknowledge that they have taken the equivalent of $20,000 to $22,000 from the video poker machines to subsidize their needs. Beyond these amounts, they state that there were no an actual business transactions, as it was only entertainment.

[26] Related to video poker machines, a business transaction occurs when an individual inserts a coin in the machine and, in exchange, receives a virtual poker game with the chance of winning or losing. In the case at bar, the Appellants inserted coins already in the machines or ran up the credits on the video poker machines and would play. The fact that they had the keys giving access to the machines leads the Appellants to believe that there was no business transaction. However, no evidence has been presented explaining why the Appellants had these keys. We only have the testimony of Appellants Louis and Nancy Marchildon who, let us admit, were not very credible. The keys may have been given to them so they could have access to their share of the profits or in the event of mechanical failure. If the Supplier was inclined to allow the Appellants to play for free, why was he unhappy with the fact that the figures did not match the amounts found in the machines? No evidence was brought to this effect by the Appellants. It seems more probable to me that the keys were access to the machines and not access to unlimited play.

[27] The Appellants had to show by the preponderance of evidence that the receipts from the video poker machines were not income for them or that the Minister erred in the calculation of these receipts. The Appellants have not discharged the burden of proof. The counters allow receipts taken from the video poker machines to be determined for the years at issue, while the fractions (60/40 and 1/5) allow the portion of these receipts attributable to the Appellants to be calculated. One week in five, the Appellants kept all of the profits, while the other four weeks, they kept 60% of the profits. In the absence of evidence that the Appellants were permitted to play the video poker machines without paying, it is fair to deem that the readings of the video poker machines' counters correctly depict the income taken from these machines. The Appellants benefited from these profits, partly in cash and partly in playing time. The fact that the Appellants chose to gamble their profits does not change the fact that they benefited from this income.

[28] In *Huot* v. *Canada*, [2000] T.C.J. No. 164 there was also a question of determining whether certain amounts coming from video poker machines were

correctly added to the income of the Appellant, Huot. The undeclared incomes had been set using the accounting books obtained from the video poker machines' owner. The Appellant objected to these books being used to determine the amount of taxable income. According to him, this was not tangible proof of the counter as, for example the readings provided by the video poker machines themselves would have been. Lamarre-Proulx J. concluded as follows, at paragraph 31:

> The allegations made by the respondent in the Reply to the Notice of Appeal have been fully proven by the witnesses who were officers of the Minister, and their testimony was corroborated by the witnesses who were employees of Wiltron. The witnesses were not present during each other's testimony. The appellant was aware of the evidence the respondent was going to adduce, and yet he produced no contrary evidence. For example, he did not ask either Jacques Gosselin or Ronald Miron any questions about the approximate amount of the income from the machines at his convenience store. Mr. Miron, who was the regular collector for the appellant's store for several years, could have recalled the approximate average monthly income amount, but the appellant did not ask him any questions. One can only think that the suggested figure of $117 a month is unreasonable. It is hardly plausible that a business leasing video poker machines would set up an entire leasing and collection system, involving a number of employees, for the meagre income suggested by the appellant.

[29] In the case at bar, not only did the Respondent rely on tangible proof from the counter but the Appellants, just as in *Huot*, were unable to bring proof refuting the figures taken from the counters or explaining the fractions (60/40 and 1/5) added to the contract between the Appellants and the Supplier.

[30] I agree with Counsel for the Respondent. The receipts from the video poker machines are the amounts that the players of these machines paid to play poker. In addition to being undeclared income, these receipts are undeclared taxable supplies.

Penalties

[31] Subsection 163(2) of the ITA and section 285 of the ETA provide that a taxpayer who knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the make of a false statement or omission in a return, claim, form, etc., is liable to a penalty. The burden of proof with regard to the penalties rests on the Respondent.

[32] Did the Appellants act knowingly or under circumstances equivalent to gross negligence?

[33] The Appellants knew that the machines or at least the betting was illegal. Nancy Marchildon testified that if the amounts had been more significant, she would have had to declare them, otherwise, it would have been impossible for them to use these monies. However, the Appellants declared the income from the peanut vending machines that was about $20 over eight months but did not declare an amount of $200 per week. Nancy Marchildon stated that she asked the accountant if she had to include these amounts. This shows at the minimum that she doubted that the amounts were taxable and this gesture in itself does not make the Appellants' behaviour excusable. Finally, believing that the amounts left by the Supplier were not income but, in fact, gifts is certainly behaviour that can be likened to gross negligence. A reasonable individual operating a business would have known that this was not a gift and if this were the case, a reasonable person would have asked for written proof. The Appellants brought no evidence explaining these so-called gifts. It is more likely that this is a share of the profits and not mere gifts.

[34] From all the facts, only the questioning of the accountant could have helped the Appellants. However, no records were remitted to the accountant, because there were no such documents. Did the Appellants provide all the information necessary for the accountant to be able to give an informed opinion? This question remains unanswered. The Appellants brought no evidence besides Nancy Marchildon's testimony to support the statement that they consulted their accountant. At the very most, if the Appellants consulted their accountant, this is a case of wilful blindness amounting to gross negligence. Marceau J. in *Cloutier v. The Queen*, [1978] F.C.J. No. 917 explains at paragraph 10:

> The question before the Court is whether the circumstances in which the omission occurred are such that gross negligence may be attributed to the taxpayer: "gross negligence" being taken to mean a relatively serious act of negligence, which is difficult to explain and socially inadmissible.

[35] It is difficult to explain how three individuals could have sincerely believed that the money they took from the video poker machines was not income for them. In *410812 Ontario Ltd. v. Canada*, [2002] T.C.J. No. 176, Bowman J. is of the opinion that if it is possible that the taxpayer wrongly trusted his accountant and that the assumption is plausible, the Court must give him the benefit of the doubt:

> Reverting to the case of the penalty imposed under section 285 against the appellant there is much merit in Mr. Brown's position that Mr. Crittenden knew or ought to have known that GST was payable on the third party payments and that failure to declare GST was grossly negligent. That hypothesis is reasonable and viable but the evidence is equally consistent with another viable and reasonable hypothesis, that Mr. Crittenden relied - perhaps wrong-headedly or negligently - on his accountant's opinion that no GST was payable or perhaps he formed an erroneous view of the law. I think Mr. Crittenden was negligent but the evidence is consistent with an hypothesis that does not entail gross negligence as described in the cases cited at the beginning of these reasons. Accordingly the appellant is entitled to the benefit of the doubt.

[36] But in these appeals, there is no suggestion that the accountant was part of this serious negligence. The Appellants declared the income from the peanut vending machines, as low as $20 over eight months. It is thus difficult to support the contention that the Appellants believed they did not have to declare the income acknowledged to be $200 per week from the video poker machines and pay, by the same token, the GST on these taxable supplies. Finally, the Appellants' situation is very different from that of Lucien Venne in *Venne v. Canada*,[3] in which the Court refused penalties because the taxpayer trusted his accountant:

> . . . The taxpayer here is a man with a grade five education, working and paying taxes in a language which is not his first language nor that in which he was educated, a man who is more at ease in a garage than in an office. Not only do these factors militate against a finding that the misstatements in his returns were made knowingly by him, but also his entire course of conduct is not consistent with that of a person who had deliberately set out to conceal large amounts of taxable income. He kept what appear to be quite complete records of sales in his business, then turned these over to his bookkeeper. As far as one can judge from the evidence, all or most of the revenues from the business were deposited in the bank where the monies could readily be traced. He also lodged all but one or two of the mortgages on which he lent money with banks and trust companies which kept careful records of the income earned from these "escrow mortgages". It is unlikely that a person planning to conceal income would have handled his affairs in this manner. Further it is hard to believe that he was consciously and effectively supervising his bookkeepers since a number of the errors made in his returns were to his disadvantage, even though more or them were to his advantage. I

[3] [1984] F.C.J. No. 314.

> am therefore not able to conclude that the misstatements in the returns were made "knowingly" by the plaintiff.[4]

[37] With regard to Appellant Yvette Marchildon, she did not testify although she was present at the hearing. I do not know what her duties or responsibilities are at the restaurant. She heard Mr. D'amour's testimony but did not attempt to offer a reply. Thus, I must conclude that her testimony would not help me.

Ruling

[38] The undeclared taxable supplies for the restaurant, or the sale of food and meals, are set at the amount of $3,000 in view of admission on the part of the Appellants. Counsel for the Minister agrees with this amount.

[39] With regard to the inclusion and taxation of the amounts taken from the video poker machines, it is fair to conclude that the Appellants did not discharge their burden of proof. They were unable to prove that the receipts from the video poker machines were not income and taxable supplies or that the income and taxable supplies were a lesser amount than that set by the Respondent. The amounts taken from the video poker machines are thus taxable as income under the ITA and as supplies for the purpose of the ETA. Therefore, the appeals in this regard should be dismissed.

[40] I also find that all the Appellants made a misrepresentation that was attributable to neglect, carelessness or wilful default or committed fraud in preparing their returns under the ITA as well as for the purpose of the ETA. The penalties imposed by both Acts with regard to income and taxable supplies from the video poker machines are proper and correct.

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[4] *Ibid*, at paragraph 36.

[41] Therefore, the Appellants' appeals are allowed but only so that the Minister may reassess, reducing the amount of taxable supplies of food and restaurant meals from $9,030.65 to $3,000 and so that the Minister may reduce the penalties under section 285 of the ETA with regard to this amount; the penalties and income regarding the ITA, if applicable, will be subsequently reduced.

Signed at Ottawa, this 16th day of January 2004.

"Gerald J. Rip"

Rip, J.

Translation certified true
on this 26th day of April 2004.

Sharon Moren, Translator