

Docket: 2001-3337(GST)G

BETWEEN:

BRASSERIE FUTURISTE DE LAVAL INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

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Appeal heard on July 4 and 5 and December 15 and 16, 2005,  
at Montréal, Quebec.

Before: The Honourable Justice Pierre R. Dussault

Appearances:

Counsel for the Appellant: Alain Longval

Counsel for the Respondent: Jean-Philippe Dumas and  
Benoît Denis

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**JUDGMENT**

The appeal from the assessment made under Part IX of the *Excise Tax Act*, notice of which is dated April 11, 2000, and bears the number 9135003, for the period from May 1, 1994, to January 31, 1999, is allowed, without costs, and the assessment is referred back to the Minister of Revenue for reconsideration and reassessment on the basis that the Appellant's meal sales amounts must be limited to the amounts set out in the financial statements for the fiscal years from May 1, 1994, to April 30, 1998, and in the general ledger for the period from May 1, 1998, to January 31, 1999, and that the cover charge amounts must be reduced as a consequence of the reduction of the meal sales amounts, using the same formula that was used to make the assessment under appeal.

The penalties and interest must be adjusted as a consequence of the reduction of the meal sales and cover charge amounts.

The whole in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 19th day of October 2006.

"P.R. Dussault"

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Dussault J.

Translation certified true  
on this 19th day of February 2008.

François Brunet, Revisor

Citation: 2006TCC503  
Date: 20061019  
Docket: 2001-3337(GST)G

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### **REASONS FOR JUDGMENT**

Dussault J.

[1] This is an appeal from an assessment made under Part IX of the *Excise Tax Act* for the period from May 1, 1994, to January 31, 1999.

[2] By this assessment, the Goods and Services Tax (GST) reported by the Appellant was increased by \$325,480.30 and the input tax credit (ITC) was increased by \$10,647.79, which represents a \$314,832.51 adjustment to the net tax. The assessment also includes a \$52,428.74 penalty, \$38,818.36 in interest and a \$78,708.13 penalty for gross negligence, for a total of \$484,787.74.

[3] The additional ITC amount is not in dispute. Furthermore, the Appellant admits that \$79,604.44 in net tax was collected but not remitted (Exhibit A-10). In addition, Marc Bélanger, the Appellant's expert, established that the Appellant owed an additional net amount of \$14,542 in GST (Exhibit A-28, at pages 6 and 7).

[4] The Appellant operates a pub, which is also referred to as a restaurant pub, on Labelle Boulevard in Ste-Thérèse-de-Blainville, Quebec. The Appellant's shareholders are Raymond and Michel Légaré.

[5] The Appellant purchased the pub in 1989. Its fiscal years begin on May 1 and end on April 30.

[6] The audit of the Appellant's business was done by H el ene Morand. It began in October 1998. From the outset, Ms. Morand noticed discrepancies between the tax that was reported, and the tax that should have been reported based on the sales stated in the financial statements (Exhibit I-7).

[7] As far as the GST is concerned, the total discrepancy for the audited period, factoring in the additional ITCs that were allowed, is \$79,604.44. As stated above, the Appellant is not challenging this discrepancy between the GST that was reported, and the GST that should have been reported having regard to the financial statements that were filed.

[8] In order to begin her audit, Ms. Morand obtained information from beer breweries and the Soci et e des alcools du Qu ebec (SAQ) concerning all the Appellant's alcoholic beverage purchases. I should immediately point out that the Appellant has admitted to Ms. Morand's determinations regarding both the quantities and costs of those purchases.

[9] On October 7, 1998, Ms. Morand and a colleague paid a surprise visit to the Appellant's establishment and met with Michel L egar e, one of the shareholders. Mr. L egar e gave them some explanations regarding the operation of the pub, and, in particular, the tracking of sales and the sales reports that the business produced. The Appellant did not keep any copies of bills for food sales. The Appellant used the "Squirrel" computer system and software. The only report produced by the computer was a report which each employee obtained at the end of his or her shift and which enabled the employees to keep track of their sales. The report stated the employee's overall sales and the amounts paid by credit card and in cash. The report was attached to the cash that each employee remitted in an envelope at the end of his or her shift. It provided no details regarding the items sold, the unit prices or the quantities sold. Based on the information obtained by Ms. Morand during her first visit, there were no reports based on the individual bills either.

[10] As far as alcoholic beverages were concerned, each waiter or waitress produced a handwritten report setting out the quantities sold, the prices, and the total. Bottled beer and wine sales were recorded by the unit, and special meters were used to keep track of the sales of draft beer and wine on tap. The same person could produce more than one report at the end of his shift because employees had to produce a report each time the prices changed in order to take account of the

many promotions. Michel Légaré submitted a blank version of one of the reports (Exhibit I-9) to Ms. Morand. According to Mr. Légaré, none of these daily reports of alcoholic beverage sales which the employees filled out had been kept; they were all destroyed. Since Ms. Morand considered these reports to be the proof of alcoholic beverage sales, and since no bills were handed to patrons, Ms. Morand said that she asked Michel Légaré to keep them at her very first meeting with him.

[11] At the same meeting, Mr. Légaré also gave Ms. Morand a copy of a menu printed on a paper place mat, based on which Ms. Morand confirmed that the 200% markup that she used to determine the dollar amount of food sales was valid.

[12] Having obtained his name, Ms. Morand contacted Robert Richard, the Appellant's accountant, on October 21, 1998, to ask him to prepare all the documents necessary for her audit in connection with the fiscal year from May 1, 1997, to April 30, 1998, namely the general ledger, the general journal, the spreadsheet, the bank statements, the purchase invoices and the vouchers used to track sales — in short, all the relevant accounting documents along with the GST and QST returns.

[13] Ms. Morand contacted Mr. Richard again one week later to set an appointment for November 5, 1998, in order to begin her audit.

[14] On November 4, 1998, Ms. Morand returned to the pub to ensure that Michel Légaré was actually keeping the detailed reports of alcoholic beverage sales filled out by the employees, as she had requested that he do upon her first visit to the business. She says that Michel Légaré told her that his father, Raymond Légaré, had thrown them all out. Ms. Morand emphasized the importance of keeping these reports, repeated her request that they be kept, and notified Michel Légaré that she would be returning to ensure that they were indeed being kept.

[15] Thus, when Ms. Morand commenced her audit at the office of Mr. Richard, the accountant, on November 5, 1998, she had no reports concerning sales of alcoholic beverages, and no detailed reports concerning meal sales. Indeed, on December 1, 1998, letters of requirement (Exhibits I-14 and I-15) were sent to Raymond and Michel Légaré directing them to produce these documents.

[16] Ms. Morand explained that she began her audit at Mr. Richard's office with the accounting records for the period from May 1, 1997, to April 30, 1998, and the purchase invoices that were filed by month in envelopes. She said that she found

invoices related to expenses paid by cheque and expenses paid in cash, and many — literally hundreds, in fact — of [TRANSLATION] "small papers and bits of place mats" referring to cash payments, including wage payments (Exhibits I-11, I-12 and I-13). Indeed, some of these "bits of paper" bear no names or refer only to a first name or to the "DJ" or "doorman" and the amount paid. One of these documents adduced in evidence actually states very explicitly that the payment was made [TRANSLATION] "under the table" (Exhibit I-13, at page 7.191).

[17] According to Ms. Morand, certain documents also show that the Appellant collected cover charges some nights, such as Thursdays, when there would sometimes be a singer or other entertainment, and that certain people were paid from these cover charges (Exhibit I-11, at pages 7.162 and 7.164). These documents refer to cover charge receipts of \$2,880 and \$2,790, but other documents, namely weekly reports called [TRANSLATION] "deposit controls", state that these cover charges, called [TRANSLATION] "door revenues", consistently amounted to \$2,000 per week over several weeks (Exhibit I-28, at pages 35 to 38), whereas others, still, make no reference to income of this type (Exhibit I-28, at pages 31 to 34). But these are not the only startling features of these sample reports. For example, reports concerning sales of alcoholic beverages state round figures such \$1,500, \$2,000, \$2,500 or \$3,500 (Exhibit I-28, at pages 35 to 38). Two reports for two different one-week periods are even more surprising; they contain exactly the same amounts for five different line items (Exhibit I-28, at pages 33 and 34). Both of these reports were prepared by Raymond Légaré and were tendered in evidence, during his testimony, as examples of reports that he filled out and submitted to the accountant Robert Richard (Exhibits A-3 and A-4).

[18] As far as wages are concerned, Ms. Morand explained that she asked the accountant Mr. Richard for the payroll journal, and that Raymond Légaré came to meet her at Mr. Richard's office one day and showed her the journal but did not leave it with her so that she could inspect it. Thus, she could not verify what had been entered and what had not been. As for the other expenses that were paid in cash and entered on the "bits of paper", sometimes stapled together with a descriptive sheet (Exhibit I-12, at pages 7.168 and 7.169), Ms. Morand says that she was generally unable to reconcile them with the accounting records provided. Ms. Morand also said that she found invoices for personal expenses (Exhibit I-12, at pages 7.172 and 7.185).

[19] In November 1998, Ms. Morand continued her audit on Mr. Richard's premises. In early December, she received the first daily reports prepared by

employees in connection with the sale of alcoholic beverages over the course of approximately four weeks (Exhibit I-9). Along with these reports, she received a few printouts from the BERG metering system that was used to track sales of spirits, despite having asked for all of them (Exhibits I-16 and I-17).

[20] Ms. Morand decided to extend the audit period by three months — that is to say, until January 31, 1999 — so that she could obtain all of the daily beverage sales reports and audit them for this period rather than for a single month. Having commenced her work and discovered what she called [TRANSLATION] "substantial discrepancies" in relation to the reported taxes, Ms. Morand also decided that her audit would cover a period commencing May 1, 1994.

[21] Ms. Morand always contacted Mr. Richard, the accountant, to obtain the documents necessary for her audit (Exhibits I-17 and I-18). Although the detailed meal sales reports produced with the Squirrel software were requested in a letter of requirement dated December 1, 1998 (Exhibits I-14 and I-15), Ms. Morand asked for them again on December 4 and December 22, 1998 (Exhibits I-17 and I-18). She explained that she did so because Michel Légaré told her that he had no detailed daily computerized food or meal sales reports generated by the Squirrel software, but gave her the name of the person responsible for the system for the pub, and said that this person had told him that such reports could be generated with the software. Ms. Morand was initially thinking of asking for 30 days' worth of such documents, but since they were equivalent to detailed bills for each day, at the end of the day she decided to limit her request to 10 days chosen at random for each of the periods of April 1997 and April 1998, because the material she had initially thought of requesting would have been too voluminous.

[22] Ms. Morand said that she was never able to obtain what she needed in order to verify exactly what food had been sold, and at what price. She explained that she obtained 26 daily computerized reports in the course of her audit, namely the reports from August 6 to August 31, 1996 (Exhibit I-19). These reports only break down the total sales for each day by general category, such as breakfasts, salads/appetizers, main dishes, pizza, *table d'hôte* or desserts, and state the total food sales for the day, so it is, in fact, impossible to know what items were sold, how many of each item were sold, and at what price each item was sold. The daily reports also state the total amount of alcoholic beverage sales by category: beer, wine and spirits. Ms. Morand explained that she had initially been told that the computer system was used only for meal sales.

[23] Since Ms. Morand was unable to obtain the detailed bills or reports for food sales, she decided to reconstruct the sales by marking up the food purchases by 200%, minus 5% for losses, and she validated this method using documents that she was able to obtain. By applying this method, she determined that, for the fiscal year ended April 30, 1997, the \$442,044 in purchases generated \$839,884 in sales, whereas the Appellant reported only \$547,672 in sales for that fiscal year.

[24] Moreover, according to the 26 computerized daily reports, the food sales for the 26 days of August 1996 totalled \$61,232.31. Ms. Morand explained that by extrapolating this total to 365 days, she determined that the food sales must have amounted to roughly \$859,000 for the fiscal year ended April 30, 1997 (Exhibit I-20). In fact, this amount tended to confirm that the 200% markup that she used was not [TRANSLATION] "outside the norm."

[25] According to Ms. Morand, the 200% markup of food purchases was the minimum markup applied to the restaurant industry by the auditor groups specialized in restaurants (she was a member of such a group) to determine the amount of taxes due in cases where an agent did not have the requisite documents.

[26] Using the menu that Michel Légaré had given her upon her first visit to the pub, Ms. Morand also determined that the selling prices of certain easily determinable items were higher than the 200% markup on cost, and she made this determination in order not to penalize the Appellant by uniformly applying such a markup to food (Exhibits I-10, and I-24 to I-28).

[27] Thus, since she was unable to obtain meal bills or other documents (computerized or otherwise) on the basis of which the items sold and the quantities and prices could be ascertained, Ms. Morand had to settle for a uniform markup rate because she was unable to determine a specific markup rate for each food item sold. Hence, the same markup of 200% minus 5% for losses was applied to the purchases for each year within the period from May 1, 1994, to January 31, 1999. This purchase amount was adjusted to take account of inventory variations. As I have stated, the total purchases for the entire period, as determined by Ms. Morand, were admitted to by the Appellant.

[28] For the last nine months, that is to say, from May 1, 1998, to January 31, 1999, Ms. Morand noticed that the meal revenues reported in the Appellant's books amounted to \$764,562 (Exhibit I-28, at page 24), while she herself had determined that those revenues amounted to \$782,437.86 using the 200% markup on purchases less 5% (Exhibit I-28, at page 1). Thus, the sales



amount that resulted from the method used was close to the sales amount entered in the books for this nine-month period.

[29] The situation that Ms. Morand faced in connection with alcoholic beverage sales was different because, after making her second request to Michel Légaré, she finally obtained close to three months' worth of daily reports filled out by the employees, that is to say, the reports filled out from November 7, 1998, to January 31, 1999. As stated above, at the commencement of her audit, Ms. Morand had obtained the exact amount of the Appellant's purchases directly from breweries and the SAQ. This led to her finding that not all the Appellant's purchases from the SAQ were to be found in its financial statements. The SAQ purchases that were not entered into the statements were paid for in cash, and no ITCs were claimed in respect of them. As I also stated, additional ITCs were granted to the Appellant, who admitted that it made these additional purchases at the SAQ.

[30] In order to obtain a 14-day sample, Ms. Morand used some 146 daily alcoholic beverage sales reports filled out by the Appellant's employees and submitted in respect of the period from November 7, 1998, to January 31, 1999. By choosing one day from each week on a rotating basis — for example, Monday the first week, Tuesday the second week, Wednesday the third week, and so on — she made sure that she chose two instances of each day of the week during this period, which was just short of three months in duration. For each of these days selected, she compiled the details regarding the sales of each item sold, as well as the price and quantity sold, in order to determine the average prices of beer sold in different forms and the average markup percentages for wine and spirits. This process made it possible to account for the frequent price variations in the course of a single day or from one day of the week to another, and thereby reflected the many promotions offered by the Appellant, such as happy hours, which was from 4:00 to 7:00 p.m. Once the average prices or markup percentages were calculated on the basis of this sampling, Ms. Morand reconstructed the sales for each fiscal year in the audit period on the basis of purchases made during each period, since she had no documents on the basis of which the average prices or markups for these periods could be determined. However, adjustments were made to take account of inflation during each fiscal year or part thereof (Exhibits I-24 to I-28).

[31] During her testimony, Ms. Morand provided a detailed explanation of all the calculations that were done, and said that, based on her experience, the markups that were decided upon were not too high. Thus, for example, she arrived at a

weighted markup of 345.26% for liquor, but said that an "ordinary" restaurant would have a 500% markup.

[32] As mentioned above, Ms. Morand discovered some evidence suggesting that not all cover charge revenue, or [TRANSLATION] "door income", had been reported. She increased this revenue by the same factor by which she had increased alcoholic beverage and meal sales in relation to the amounts reported in the financial statements for the fiscal years that ended on April 30, 1996, 1997 and 1998, and the amounts posted to the general ledger for the period from May 1, 1998, to January 31, 1999 (Exhibits I-25 to I-28). The Appellant did not charge a cover during the fiscal year that ended on April 30, 1995 (Exhibit I-24).

[33] After reconstructing the total sales, Ms. Morand determined the difference between the GST actually payable on the sales and the GST payable according to the financial statements, as well as the difference between the GST payable according to the financial statements and the GST reported by the Appellant (Exhibit I-22).

[34] The draft assessment was submitted to Michel Légaré and to Mr. Richard, the Appellant's accountant, on June 29, 1999 (Exhibit I-21).

[35] On cross-examination, Ms. Morand said that when she submitted her draft assessment, Mr. Richard reacted by saying: [TRANSLATION] "This is beyond reason." She explained that she had told them that the Appellant's accounting records were incomplete and that she was therefore going to have to use substitute techniques. She gave them 21 days to provide any new facts. She said that Mr. Légaré and Mr. Richard responded to this offer by saying that they were prepared to provide her with the requested documents from the Squirrel software; however, she said that no new documents were provided to her during that time, nor during the additional time which Mr. Richard requested in July and which she granted on account of the summer holidays. Ms. Morand said that she would have analyzed any documents provided, instead of using those substitute methods, which disclosed that approximately \$3.3 million in sales had not been reported during the period from May 1, 1994, to January 31, 1999.

[36] Ms. Morand said that she used the documents that she was given, documents that covered 26 days in August 1996, to determine that the sales of meals over a 365-day period would have been \$859,607.43, but that this amount was not actually used, except to confirm her calculations, which were based on a 200% markup on food purchases, less 5% for losses (Exhibits I-19 and I-20).

[37] Counsel for the Appellant tried to make Ms. Morand admit that the Appellant cannot possibly have sold certain items for 200% of cost — for example, two hot dogs for \$0.25 on Mondays, chicken wings for \$0.25 a piece on Thursdays, pizza for \$1.99 on Tuesdays, or all-you-can-eat *fondue chinoise* for \$9.95 on Sundays. Ms. Morand admitted that not all items were necessarily sold at 200% of cost, and that the \$0.25 for two hot dogs might be an illustration, but she said that, generally, she could not answer the question because, first of all, she never obtained the documents that would have made it possible to check into this, and secondly, she was never told about these reduced prices, and therefore proceeded to audit certain items based on the menu prices that she was provided with upon her first visit (Exhibit I-10), having received no other documents. Thus, Ms. Morand was unaware of the reduced prices stated on Exhibits A-23 and A-24, as confirmed by the note at the bottom of the first page of Exhibits I-24 to I-28. When Ms. Morand was asked the hypothetical question whether the results would have been different if she had received all the required documents, she simply answered that she did not know, but that if those documents had been available, she would surely have used them instead of applying a 200% markup less 5% for losses.

[38] When counsel for the Appellant asked Ms. Morand why she did not account for thefts of drinks or food, Ms. Morand explained that she was never told about any thefts from the Appellant's establishment, was never given a shred of evidence of such thefts (such as police reports) and was not going to create any. In her submission, the 5% reduction of the meals markup took "complimentary items", losses and promotions into account. With respect to alcoholic beverage sales, she said that the average prices that she determined took all of these factors into account. As for her 14-day sampling to determine the average drink prices, she noted that she used each day of the week twice over a roughly 12-week period for which the Appellant had kept the relevant documents, which represented 16%, 17% or 18% of the days during this sole period that could be checked.

[39] On the subject of cover charges, Ms. Morand reiterated that since she was given no control documents or other records, she increased the amounts posted to the financial statements by the same factor applied to the total food and beverage sales, in order to increase those amounts in relation to those entered into the financial statements.

[40] With respect to her request for detailed meal sales reports produced with the Squirrel software, Ms. Morand explained that she ultimately requested detailed

reports for only two ten-day periods selected at random from two different fiscal years, because it would have been unthinkable for her to ask for a copy of an individual bill or report for each transaction during the four years since the Appellant began using the software (Exhibit I-18). However, she said that, using such sampling, these detailed bills or reports, which she never obtained, would have allowed her to ascertain exactly what was sold and at what prices.

[41] Ms. Morand said that she had audited just one other pub, which was located near a university in Montréal. She said that the only difference that she noticed was that there were more parking spaces at the Appellant's pub in Ste-Thérèse.

[42] The following people testified for the Appellant:

- Raymond Légaré, a shareholder of the Appellant,
- Robert Richard, a chartered accountant, and the Appellant's accountant until the year 2000,
- Annie Latreille, an employee of the Ministère du Revenu du Québec,
- Mario Gratton, the Appellant's accountant since the year 2000,
- Michel Légaré, a shareholder of the Appellant,
- Marc Bélanger, a chartered accountant and the Appellant's expert witness.

[43] In his testimony, Raymond Légaré discussed his experience in the tavern and pub business. Having worked weekends in taverns owned by his father and brother while employed on a permanent basis by Molson as a delivery person, he purchased his first pub in Laval through the Appellant in 1973. The pub was kept for about 15 years and then resold, and the Appellant purchased a new establishment in Dorval which was only kept for two years. The Appellant's current place of business was purchased in 1989. It was the interest shown by his son Michel that prompted Raymond Légaré to purchase the most recent pub, located on Labelle Boulevard in Ste-Thérèse, not far from highways 13, 15 and 640. According to Raymond Légaré, the pub was patronized by businessmen from the neighbouring municipalities, as well as labourers, and students from Cégep Lionel-Groulx, which was nearby.

[44] At the time of the purchase, beer sales were high, and the pub had roughly ten employees assigned to beer sales, and ten to fifteen other employees assigned to meal sales. Raymond Légaré explained that he had the experience needed to manage beer sales, but that, as to the two pubs he had previously purchased he had had problems and even losses involving food sales, so it was agreed that his son Michel would look after the management of that part of the business.

[45] According to Raymond Légaré, pub customers want fast and courteous service, good food and moderate prices, and he was able to offer this with competitive pricing thanks to the many promotions offered by his son Michel — promotions that attracted more customers and boosted alcoholic beverage sales. Mr. Légaré explained that in light of this, he did not expect profits on food sales, but simply asked that there be no losses on such sales. In his view, the 200% markup on food purchases which Ms. Morand used was not an option, because he had to keep his pricing competitive in view of the numerous restaurants that were opening in the area.

[46] Mr. Légaré said that as part of his management of the business, he tracked sales of the various alcoholic beverages using detailed reports submitted by the employees. He explained that he compiled the sales recorded on these reports on a daily sheet on which he also entered the expenses paid in cash, and that he submitted this compilation to Mr. Richard, the accountant. Mr. Légaré said that since all the sales were entered and accounted for, and the revenues were deposited, there was no way that the Department's allegation that some \$3.5 million worth of sales<sup>1</sup> went unreported could be correct; in this regard, he noted that his numbers definitely were not used for such calculations. He said that even the amounts that he earned from the video poker machines installed in the pub were deposited as business income. Although he initially asserted that all the expenses were paid for by cheque, he later admitted that some purchases from the SAQ were made partly in cash, especially in the beginning, because he was not authorized to pay more than a certain amount by cheque. Thus, the remainder had to be paid in cash. This authorization limit imposed by the SAQ on cheques that it accepted was supposedly increased each year and eventually disappeared completely.

[47] Raymond Légaré also admitted that certain employees, such as students who worked when additional staff was needed — on Thursdays, for example — were

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<sup>1</sup> The witnesses and counsel sometimes cited \$3.5 million worth, and sometimes \$3.3 million worth, of unreported sales.

also paid in cash. Mr. Légaré said that these cash payments were also entered as expenses.

[48] Counsel for the Appellant questioned Mr. Légaré about his assets and lifestyle. Counsel's reasoning behind these questions was that since the Appellant had been assessed for \$3.5 million in unreported sales, some trace of these millions would have to be found somewhere. Mr. Légaré said that, apart from the pub, which actually had a \$1 million liability secured by a hypothec, he had no other assets in Quebec or abroad. His family residence, which was purchased for \$190,000, belonged to his spouse. Mr. Légaré said that he owns only one car, a 2002 Cadillac purchased with financing from the Royal Bank. As for travel, he testified that he normally takes a vacation in February, when he stays with his sister-in-law in Florida. He mentioned only one other trip, a promotional trip to Texas paid for by Molson.

[49] Counsel for the Appellant also questioned Raymond Légaré briefly about the Squirrel software which his son Michel brought into the pub in May 1996 to do accounting in relation to meal sales. Raymond Légaré simply said that each food item sold at the pub was recorded in the computer system.

[50] Counsel for the Appellant also dealt with the question of the search and seizure that occurred on April 12, 2000, the day after the assessment in issue. Mr. Légaré said that he was not on the premises at the time of the search, but that he was told that there were 15-20 police officers there; they seized everything in the filing cabinet and the Squirrel system, and the Appellant was suspected of "zapping" (erasing data).

[51] On cross-examination, Mr. Légaré, who had said that he was at the pub 15-16 hours a day, corrected his statements and said that this was the case in the beginning, but that, from 1994 to 1999, he arrived around noon every day, and stayed much less time than he had done in the beginning.

[52] Mr. Légaré explained again the system that was implemented to track sales of alcoholic beverages: the number of beer bottles in the refrigerator allocated to each employee who sold alcoholic beverages was counted, and each such employee used special meters for draft beer, wine on tap, and spirits, and had to submit a detailed sales report at the end of his shift or whenever the price changed in the course of his shift. The report stated the quantities of each item sold, the price, the total, and the cash remitted in an envelope. The report took any promotions into account.



[53] Mr. Légaré explained that, after checking the employee reports, he entered the totals of each item sold in a daily sheet that was later remitted to Mr. Richard, the accountant. He said that the employee reports were simply destroyed after being used.

[54] Raymond Légaré then explained the mechanism for tracking food sales. First of all, the employees assigned to food service only looked after food sales, since other employees were assigned solely to the sale of alcoholic beverages. Each employee assigned to food sales had to remit an envelope bearing the total sold and the cash payments, with a copy of each numbered bill that contained the customer's order and was given to the kitchen. My understanding is that this was a duplicate of the bill handed to the customer. Mr. Légaré said that it was these bills that enabled him to track food sales, and that he did the daily compilations of all sales. He explained that he had kept all these bills in boxes and remitted them to the auditor, Ms. Morand. According to Mr. Légaré, this was the control system in place until the Squirrel computer system, which he was not involved with, was introduced. In fact, the computer system was introduced in May 1996. Mr. Légaré said that he had actually stopped looking after the tracking of food sales shortly before that.

[55] Raymond Légaré's testimony on his involvement in the management of the pub during the period covered by the audit is rather confusing. Given his frequently imprecise or even contradictory statements, it is very difficult to know exactly to what extent he was involved, what controls he did, and what documents he filled out in relation to the tasks carried out by his son Michel in this regard.

[56] Raymond Légaré offered no meal bills, employee reports, or daily or weekly meal compilations in evidence. He offered only two drink compilations, which turned out to be weekly, not daily ones (Exhibits A-3 and A-4). These documents were also offered in evidence by the Respondent, and I have already referred to them at paragraph 17 of these Reasons for Judgment. (Both documents are shown as part of Exhibits I-25 to I-28). Although these documents cover two different one-week periods, that is to say, May 19 to May 25, 1996, and May 26 to June 1, 1996, it can be seen, as I have noted earlier, that the amounts entered for five different line items are exactly identical for both weeks. The details are as follows:

Draft sales	\$19,618.75
Bottle sales	\$5,688.50

Liquor sales	\$1,342.00
Wine sales	\$297.25
Wine sales	\$2,911.25

[57] Since the amounts for the other line items are different, it is rather difficult to believe that this was a mistake. In addition, these documents contain no compilation concerning meal sales. Mr. Légaré explained that this is probably because the Squirrel system was already in place at that time.

[58] With respect to cover charges, Raymond Légaré simply stated that there were none in the beginning and that his son Michel introduced them and looked after that aspect of the business.

[59] Robert Richard is a chartered accountant. He did the Appellant's bookkeeping and prepared its financial statements from 1980 to 2000. He had no auditing mandate. The Appellant's financial statements for the fiscal years that ended on April 30, 1995, 1996, 1997 and 1998, were offered in evidence (Exhibits A-6 to A-9). Mr. Richard also prepared Raymond and Michel Légaré's income tax returns.

[60] Mr. Richard explained that he would receive two separate compilations to account for the Appellant's receipts: one concerning alcohol sales, and the other concerning meal sales. He said that the meal sales compilations were primarily weekly summaries of the total daily sales (Exhibit A-5). From 1996 onward, they were computer printouts. With respect to alcohol sales, Mr. Richard said that the compilation that he was given corresponded to the documents that have just been mentioned, and that were offered in evidence by Raymond Légaré (Exhibits A-3 and A-4). Mr. Richard acknowledged that there were discrepancies between the taxes reported quarterly and the taxes payable according to the financial statements. He said that he knew about the discrepancies, which were actually entered in the books, and that he would have given Ms. Morand all the explanations that she would have needed if she had raised this question at the beginning of her audit, which she did not.

[61] According to Mr. Richard, the Appellant simply cannot have failed to report \$3.5 million in sales during the period covered by the audit because there was no trace of this money among the assets of the directors or elsewhere. His comment was [TRANSLATION] "This is beyond reason."



[62] Noting that he had been the business's accountant for 20 years, he placed particular emphasis on the fact that a 200% markup on the food purchases was completely unreasonable for a pub in which Raymond Légaré always tried to maintain the lowest prices possible by means of numerous promotions and without really being concerned about controlling costs. He said that although the pub was profitable from the moment it was purchased and became more profitable thanks to expansions, advertising and promotions, its gross profit was in the 48-50% range. He said that he has never seen a pub make a gross profit of 70% or 75%.

[63] In addition, Mr. Richard acknowledged that some cash purchases might not have been accounted for, but he said that the sales were accounted for, which meant that the only impact was on the ITCs. He also discussed errors in attributing lottery earnings and "complimentary items" amounts to line items in the general ledger, and said that he made adjusting entries each year in order to prepare the financial statements, in particular because all the revenues, except food, were lumped together and were only broken down at the end of the year by Raymond Légaré, who was primarily responsible for the financial aspects of the business. Another problem stemmed from the fact that the bank deposit totals exceeded the sales amounts entered in the books, thereby necessitating year-end adjusting entries.

[64] With regard to Ms. Morand's audit, Mr. Richard said that he tried, despite some confusion, to comply with all her requests for documents, which he passed along to Michel Légaré. He said that the requests were primarily for computerized documents from the Squirrel system and that Ms. Morand did not ask for bills issued prior to the installation of that system in the pub.

[65] On cross-examination, Mr. Richard admitted that despite the adjusting entries in the accounting books and the notes in the financial statements, a significant amount of unreported and unremitted taxes accumulated year after year during the period covered by the audit. As to the GST alone, \$79,604.44, the amount of has already been noted, and the Appellant admits to it. This amount is included in the total assessment of \$314,832.51.

[66] Mr. Richard said that he discussed this issue of unreported and unremitted taxes that accumulated year after year with Raymond Légaré, but that Mr. Légaré did not issue cheques in payment. However, Mr. Richard acknowledged that he should have personally corrected the situation involving the tax returns and notified the Department of the situation.

[67] Mr. Richard specified that the reports that Ms. Morand requested were reports generated by the Squirrel system for a sampling period, and that they were provided. He explained that he was somewhat confused because he did not really know or understand what she was looking for, because she simply told him that she was doing a [TRANSLATION] "statutory audit."

[68] On cross-examination, Mr. Richard stated that the only things he had at his disposal to account for drink sales and then prepare the financial statements were the weekly reports prepared by Raymond Légaré (Exhibits A-3 and A-4) and certain "complimentary" item slips that Raymond Légaré would give him. He was unable to specify how the year-end reconciliation was done. He admitted that he had never verified the employees' daily reports, which Mr. Légaré purportedly used to prepare his weekly reports. He added that he only worked with the documents that he was given. Although the weekly reports offered in evidence as Exhibits A-3 and A-4 also show certain expenses paid in cash for which receipts were supposedly attached, Mr. Richard acknowledged that the cash purchases from the SAQ were not entered up in them, and that he received no document evidencing those purchases. For food sales, he said that he used a report prepared by an employee (Exhibit A-5) and documents generated by the Squirrel system, but he did not specify exactly which ones.

[69] Annie Latreille is an auditor with the Ministère du Revenu du Québec.

[70] On April 7, 2000, on the basis of a report by Claude Hébert, an investigator with the Ministère du Revenu du Québec, a warrant of search and seizure was issued against the Appellant covering all documents related to his business (Exhibit A-13). The warrant was executed on April 12, 2000, and 36 boxes of documents and other items, such as computer monitors and software, were seized (Exhibit A-12). I should note that the notice of assessment in issue is dated April 11, 2000 (Exhibit A-1). Mr. Hébert initiated the audit to determine whether the Appellant was guilty of tax offences, and, in particular, the offences set out in paragraph 327(1)(a) of the Act. Ms. Latreille apparently took over the matter from Mr. Hébert in 2001, roughly one year after the search and seizure, although her testimony on the subject was somewhat vague. Lastly, the Appellant and Michel Légaré were accused of failing to report, and attempting to evade the payment of, \$61,946.59 in GST, an amount equal to the difference between the tax reported and the tax owed according to the books and financial statements for the years 1995 to 1998 inclusive. A motion for non-suit was brought by the Appellant and Michel Légaré; it was granted, and the proceedings ended in an acquittal on

April 27, 2004, notably because of a lack of evidence of culpable intent (Exhibit A-11).

[71] Ms. Latreille's testimony was rather vague and confused and did not contribute much to the Court's understanding. However, counsel for the Appellant considered it very important to emphasize the enormous difference between the amount of the criminal prosecution, namely \$61,946.59, and the \$314,832.51 adjustment to the net tax in the assessment in issue (Exhibit A-1).

[72] Mario Gratton has been the Appellant's accountant since 2000. Although he is not a chartered accountant, he claims to have 22 years of experience in accounting. He explained that he recovered the Fortune 1000 accounting software diskettes used by his predecessor, Mr. Richard, for the years 1995 to 1998, in order to conduct various analyses so that he could determine, among other things, the gross margin, and whether profits were consistent.

[73] Mr. Gratton determined the gross margins on a category-by-category basis, specifically "food service", "beer and draft" and "wine and liquor", for the years 1995 to 2004, by comparing the percentages resulting from Ms. Morand's calculation of the reconstructed sales; those established by Marc Bélanger, a partner with the firm of Dallaire Forest Kirouac, which the Appellant retained as an expert; and, lastly, those established in accordance with the Appellant's accounting records (Exhibit A-14). I would simply point out that Ms. Morand's calculations were obviously limited to the period from May 1, 1994, to January 31, 1999.

[74] According to Mr. Gratton, the major variations from one category to another category, which can be seen by examining the Appellant's books, particularly in 1995, 1996 and 1997, occurred because sales were charged incorrectly. For example, some sales in the "food service" category should have been entered in the "beer and draft" or "liquor/wine" category, or vice-versa. However, Mr. Gratton says that there is a certain degree of stability in the gross profit margins for all the categories from 1998 to 2004. In addition, according to the Appellant's books, the Appellant's gross profit margins for the "food service" category varied from 28% to 37%, the margins for the "beer and draft" category varied from 45% to 70%, and the margins for the "liquor/wine" category varied from 41% to 57% during those years. No reference was made to the cover charges.

[75] Mr. Gratton explained that his own accounting was much sounder, and that work was done every month, using, among other things, the sales journal, supplier invoices and deposit books, to ensure that the appropriate amounts were posted to the correct line items. In his determination, these new control measures reduced the variations from 2001 to 2004.

[76] With respect to the cost of the goods sold, Mr. Gratton said that Ms. Morand's calculations placed them at 36% for 1995, 34% for 1996, 37% for 1997 and 34% for 1998, whereas the Appellant's financial statements place them at 47%, 52%, 51% and 51% for each of those respective years (Exhibit A-15). Based on these calculations, he asserts that the percentages resulting from the figures arrived at by Ms. Morand were [TRANSLATION] "outlandish" because restaurant cost prices vary from 47% to 52%, which puts them in the 50% range.

[77] Mr. Gratton then proceeded to determine the Appellant's general gross profit margin, in percentage terms, for the years 1995 to 2003, on the basis of the financial statements. That margin varies from 48% to 53% depending on the year (Exhibit A-15). Therefore, at the end of the day, he concluded that the general gross profit percentage was constant throughout a nine-year period.

[78] When the Appellant's counsel asked Mr. Gratton a question about the possible effect of adding \$3.5 million in sales during the period covered by the audit, Mr. Gratton answered that, first of all, this was outlandish and impossible because the pub did not have enough space to serve the additional customers that this amount would represent, and secondly, that the gross profit percentage was not constant, and varied significantly from 1998 to 2004. However, Mr. Gratton acknowledged that something must have happened in 1995, 1996 and 1997, [TRANSLATION] "perhaps with respect to charging," but that he could not answer in the place of the accountant who preceded him.

[79] On examination in chief, Mr. Gratton explained that, in 2000, when he began looking after the Appellant's accounting, the Appellant had hired a manager responsible for organizing the internal controls, and that he, Mr. Gratton, had implemented tighter and more efficient control mechanisms. For example, although he acknowledged that the report forms that employees began having to fill out for drink and food sales after his arrival (Exhibits A-19 and A-20) were similar to the forms that had been used beforehand (Exhibits A-3, A-4 and A-5), he explained that he met with the employees responsible for filling them out in order to ensure that they did so properly.

[80] However, with respect to the earlier numbers that he recovered thanks to Mr. Richard's Fortune 1000 diskettes, he said that all the numbers were there, that all the sales had been recorded and that the problem was mostly with the data entry by Mr. Richard's office, which resulted in sales being charged incorrectly.

[81] Michel Légaré is a shareholder and director of the Appellant. He says that the pub's clientele includes many students, but that businesspeople and families also patronize the establishment. Due in part to the large student customer base, he says that he emphasized low prices and promotions, especially on Thursday evenings. He says that his father managed the business and that he focussed more on welcoming customers to the pub, customer contact, promotions and shows.

[82] In his testimony, Michel Légaré also explained the metering system for alcoholic beverage sales, and spoke about the inventory or control reports that employees filled out daily. He said that a daily or weekly compilation of these reports was submitted to the accountant every month. If I understand Mr. Légaré's initial explanations, after the Squirrel system was installed in May 1996, the compilations that stated the totals for each category of alcoholic beverage were entered in the Squirrel system. As far as food was concerned, the orders were entered through the Squirrel software's touch screens, which generated an individual bill. At the end of their work shift, each of the employees obtained their food totals from the system, broken down by general category, and submitted an envelope containing the cash that they had received. In addition, a monthly summary of everything that had been entered into the computer, broken down by general category (such as the number and total amount of breakfasts, *tables d'hôte*, pizzas, and so forth) could be obtained. The summary also stated the totals for beer, wine and other alcoholic beverages. According to Michel Légaré, these monthly summaries were available during Ms. Morand's audit and were among the documents seized (Exhibit A-21). However, according to Mr. Légaré, Ms. Morand wanted to check the individual bills for food sales, bills which the system could not generate after the day ended because it [TRANSLATION] "shut itself down". He said that he himself did not know how to produce the individual bills after a day ended, and that he then referred Ms. Morand to a certain Mr. Goulet, who had sold him the Squirrel system. According to Mr. Légaré, Ms. Morand did not seem to be satisfied with the Squirrel system's reports and the Ministère du Revenu du Québec was insinuating that some "zapping" had taken place. However, after keeping the seized computers and documents for three years, the Ministère gave them back to the Appellant — in poor condition — without being able to point to anything at all that was irregular. From that point onward, the Appellant has no longer been using the computer, and has kept all the individual handwritten bills.



[83] With the help of three documents, entitled "*Évènements thématiques*" [themed events] (Exhibit A-22), "*Activités de la semaine*" [activities of the week] (Exhibit A-23) and a menu for May and June 1997 (Exhibit A-24), Michel Légaré discussed the many price reductions, both for alcohol and for food, which were offered each day throughout the year to attract customers. With respect to the alcoholic beverages, he emphasized, among other things, Thursday or Friday promotions during student parties or evenings, at which time draft beer, liquor and "shooters" were sold for \$0.99, "beat the clock" parties on Saturdays at which the prices began at \$0.25 and increased by \$0.25 every half-hour until they hit \$2.00, as well as reduced (two-for-one) pricing from 4 p.m. to 7 p.m., "toonie" nights (\$2 cover, \$2 beer and \$2 liquor), reduced pricing for baseball or hockey league players, or during evenings with singers or DJs or during themed events, and so forth. Price reductions on food were just as numerous: in addition to five "specials" each day that included dessert and coffee and were offered at \$3.50 to \$7.00, there were two hot dogs for a quarter on Mondays, \$1.99 pizza on Tuesdays, \$1.50 spaghetti on Wednesdays, all-you-can-eat *fondue chinoise* for \$9.95 on weekends, and so forth. According to Michel Légaré, several of these discounted food items were "loss leaders". If the pub lost money on food, it attracted customers, increased the crowds, and, obviously, sold more alcoholic beverages.

[84] Michel Légaré also discussed the birthday party, which was held under a big top in the parking lot and featured guest artists. They sold as many as 20,000 glasses of beer in a single day at \$0.75 per glass at that event. Mr. Légaré compared this price with the price of \$2.11 per glass that Ms. Morand had calculated. He also referred to other parties or festivals, such as the lobster festival, where he sold some 2,000 pounds of lobster per week and did not even make a dollar in profit per plate, and this was when he did not lose money outright.

[85] Mr. Légaré also discussed the thefts of food and drink and the money that employees swiped from the cash that was used to feed the video poker machines. Although he provided a few examples of theft, he did not volunteer how much money was lost annually or during the period covered by the audit.

[86] Michel Légaré explained that in view of the numerous special events and parties of all kinds, no two weeks in any year were the same, and one simply could not take a sample from a short period, as Ms. Morand did, to determine the pub's alcoholic beverage sales. With respect to the 200% markup that Ms. Morand applied to purchases in order to determine the dollar amount of food sales,

Mr. Légaré said that he would have loved for his business to have made that much profit, but that it didn't.

[87] Michel Légaré also explained that there were four or five other people with Ms. Morand at the meeting at which she gave him and Mr. Richard the draft assessment. Mr. Légaré said that since he considered the government's numbers completely unrealistic to say the least, he even offered the officials the keys to the business, telling them that they would undoubtedly run his business better than he could, because he had never seen amounts of that kind.

[88] Since the officials reacted by asking him to show that the amounts that Ms. Morand arrived at were inaccurate, Mr. Légaré therefore contacted Alberto Pizzi, a gentleman to whom an acquaintance had referred him. Although Mr. Pizzi claimed to know people at the Ministère du Revenu du Québec, and had promised to sort things out with them, he did not actually undertake any efforts in that regard, and he agreed to write a letter acknowledging this, without, however, reimbursing the fees that he had obtained from the Appellant (Exhibit A-25).

[89] Michel Légaré said that he cooperated with Ms. Morand throughout her audit, that he was available to answer questions, that all the documents were available, and that the government had, in fact, seized 36 boxes in the course of the search and seizure of April 12, 2000.

[90] Michel Légaré also explained that gross profit margins remained constant throughout the years covered by the audit and for some time thereafter, but that everything was better controlled now, meal bills were more detailed, deposits were better documented and expenses paid in cash were correctly entered. He also stated that the Appellant no longer used a computer system and that all bills were filled out manually.

[91] As for the cash purchases from the SAQ during the years covered by the audit, Michel Légaré essentially repeated the explanations provided by his father Raymond Légaré regarding the obligation to pay cash for part of the purchases, especially during the first years, due to the limits that the SAQ imposed on payments made by cheque.

[92] Michel Légaré also testified about his lifestyle from 1994 to 1999. He said that he acquired a residence in Rosemère for \$165,000, which was financed with a \$150,000 hypothec. He said that he owned a Pontiac Firebird, which he sold in 1998, and that he leased a Porsche Boxster for \$800 a month after that.

[93] On cross-examination, Michel Légaré once again explained the method for controlling alcoholic beverage sales, the use of the meters and the reports that employees had to fill out, and he offered a sample of such a report (Exhibit A-26).

[94] He explained that food orders were sent to the kitchen through the Squirrel system. The menu information was entered in the computer; each member of the wait staff had an access card and ordered the dishes by entering the appropriate codes. The computer generated an individual bill for each customer throughout the day, and, at the end of their shift, each of the waiters could obtain the total that they had sold. However, according to Mr. Légaré, the computer shut itself down automatically every 24 hours during the night. After that point, it was impossible to obtain the previous day's individual bills, and only summaries were available. Mr. Légaré claimed that the Squirrel system was purchased for \$34,000, and that the seller, one Mr. Goulet, said that the system was government-approved. When Ms. Morand asked him for individual meal bills, Mr. Légaré contacted Mr. Goulet and he confirmed that it was not possible to obtain a copy of the individual bills for a day that was finished. After that, Mr. Légaré supposedly asked Mr. Goulet to contact Ms. Morand in order to explain the situation to her.

[95] According to Michel Légaré, the computer was also used once a week to enter the compilations of alcoholic beverages, by category, sold during the week, compilations that he or his father did on a daily basis using the reports submitted by the employees. These daily compilations were entered in a book, and an employee was responsible for entering the data in the computer once a week.

[96] Mr. Légaré was cross-examined about the thefts by employees, to which he referred in his testimony. He specified that those thefts occurred a few years ago, not during the period covered by the audit.

[97] As far as his lifestyle is concerned, Mr. Légaré said that his annual salary was roughly \$27,000 from 1994 to 1999, and that it increased during the last year. He also said that he has won lottery prizes twice, but did not specify the amounts. After selling the Pontiac Firebird, he supposedly advanced \$17,000 to the Appellant. He then rented a Cadillac STS for \$800 per month in 1997 and 1998, and then leased the Porsche Boxster for the same amount in 1998. He specified that he took dividends of \$800 per month to pay for the lease of that car. As one can see, this version is somewhat different from the account that he gave during his testimony-in-chief. Lastly, he said that he had a credit card under the Appellant's



name for his gas purchases. As for his grocery purchases, he said that they were low, because he was always at the pub and ate his meals there.

[98] The Appellant called Marc Bélanger as an expert witness. Mr. Bélanger has been a Quebec chartered accountant since 1983. He has been a partner with the firm of Dallaire Forest Kirouac since 1992. In 2004, he obtained a graduate diploma in forensic accounting from Montréal's École des hautes études commerciales (Exhibit A-27).

[99] Although Mr. Bélanger has served as an expert before courts in various types of matters, including breaches of contract, he has never been an expert in an excise tax case. However, he said that he has relevant experience in the restaurant industry because he has had some restaurants and bars in the Québec area as clients and has represented them in tax investigations or audits. In fact, Mr. Bélanger said that his expertise was developed in relation to the operations of these types of establishments and what he called their "cultural" characteristics.

[100] Mr. Bélanger's report, dated December 12, 2003, was offered in evidence (Exhibit A-28). Mr. Bélanger did an initial analysis of the situation involving the assessment in issue, a Québec sales tax assessment, and some income tax assessments. Other assessments had been made in respect of appropriations of funds by Raymond and Michel Légaré, the two shareholders.

[101] I must note from the outset that the calculations that Mr. Bélanger made throughout his report cover only four full fiscal years, that is to say, from May 1, 1994, to April 30, 1998, while the period covered by Ms. Morand's audit also encompasses the nine-month period from May 1, 1998, to January 31, 1999.

[102] For the purposes of his analysis, Mr. Bélanger consulted, among other things, the documents seized in April 2000 and the report prepared by Ms. Morand. The first thing that he observed was an accounting "delinquency" problem, because the deposits exceeded the reported sales during the various periods, and this resulted in the taxes accumulating period after period. Although adjusting entries were made at the end of each year and the amounts of taxes due appeared on the financial statements prepared by the accountant Mr. Richard, the fact does remain that the problem was never rectified. The total GST due amounted to \$79,000 for the entire period covered by the audit, an amount which, as stated above (Exhibit A-28, at page 7), the Appellant has admitted to.

[103] In addition to a problem with accounting entries of source documents, Mr. Bélanger identified what he called a [TRANSLATION] "lack of rigour" with respect to the creation of source documents themselves. For example, there were identical alcoholic beverage sales reports for two different days. In addition, \$130,840 in purchases from the SAQ were made in cash, and these purchases were never entered in the books (Exhibit A-28, at page 2). These problems were, in fact, noted by Ms. Morand early on in her audit.

[104] Mr. Bélanger also found that certain entries, such as lottery earnings by Raymond Légaré, were treated as though they had been reinvested in the business, when they actually consisted of \$149,563 in sales that were not entered in the books and were therefore not reported. The objection officer determined, in respect of the assessment for appropriation of funds, that the amount of these sales was \$151,975. Given the small difference, Mr. Bélanger at the end of the day accepted the latter number in his report (Exhibit A-28, at pages 3 and 4).

[105] In his initial analysis of Michel Légaré's lifestyle, Mr. Bélanger determined that the sum of \$240,000 was appropriated in the course of the years 1995 through 1998 (\$60,000 x 4). Mr. Bélanger's report states, without going into any detail, that since Mr. Gratton, the Appellant's new accountant, had done a more thorough analysis of this question, he was reducing this amount to only \$24,599 in view of the fact, among other things, that Michel Légaré ate all his meals at the pub. According to Mr. Bélanger, this reduction also corrected an initial error that he had made when he determined that Michel Légaré had paid for the lease of his vehicle personally, when, in fact, it was the Appellant that had paid for the lease (Exhibit A-28, at page 4). I must say that these explanations, which are quite cursory given the circumstances, leave me puzzled because there is no analysis substantiating the amounts determined. Moreover, Mr. Bélanger's finding regarding the automobile lease contradicts Michel Légaré's testimony.

[106] According to Mr. Bélanger, in businesses such as the Appellant's, certain employees [TRANSLATION] "insist on being paid in cash". Among others, doormen and other people assigned to security fall under this category. Mr. Bélanger found that the Appellant's books made no reference to payments to such employees. While he initially determined that these payments amounted to \$1,000 a week and actually came from undeposited and unreported sales, he later reduced this amount to \$300 per week based on Mr. Légaré and Mr. Gratton's assertion that the \$1,000 per week received by these people came primarily from the sharing of tips received by the wait staff (Exhibit A-28, at pages 4 and 5). Thus, Mr. Bélanger estimated that \$62,400 (\$300 x 52 weeks x

4 years) worth of wages were paid in cash. Once again, Mr. Bélanger's estimates omit the nine-month period from May 1, 1998 to January 31, 1999.

[107] Lastly, Mr. Bélanger showed that the weighted gross profit from the Appellant's operations during the period covered by the audit was 50-51%. At pages 5 and 6 of his report, he explains how he reached this result:

[TRANSLATION]

**Assumptions regarding the percentage of gross profit**

Lastly, the assumption regarding the percentage of gross profit is the key to this entire matter.

In our initial report, we used the following weighted gross profit percentages:

	Financial statements	DFK	Revenu Québec
	%	%	%
1995	52.9	55.9	64.1
1996	47.7	52.6	66.5
1997	48.9	53.4	62.9
1998	49.5	53.9	65.7

The Revenu Québec representatives assumed that the unreported sales for the period covered by the audit amounted to \$3,006,967. This finding was incomplete because Revenu Québec never determined how these funds were used.

In the absence of reliable numbers, considering that Revenu Québec's detailed analysis yields improbable and unreasonable results, we made another analysis applying an average gross profit percentage to the only audited figure that the parties agree upon: the total amount of purchases.

Total purchases are as follows:

	Revenu Québec reference	Purchases reported in the books \$	SAQ discrepancy \$	Total \$
1995	(ref. 6,40)	693,374	61,979	755,353
1996	(ref. 6,35)	776,319	63,873	840,192
1997	(ref. 6,28)	841,336	712	842,048
1998	(ref. 6,21)	891,783	4,276	896,059
		3,202,812	130,840	3,333,652

The breakdown of sales entered in the books is as follows:

	\$
1995	1,470,336
1996	1,483,339
1997	1,644,974
1998	1,767,163
	6,365,812

Subsequently, from 2000 to 2002, the company's gross profits were 47.6 % in 1999, 50.7% in 2000, 49.4% in 2001 and 52% in 2002. During this period, we believe that the presence of a new manager, the introduction of appropriate controls and the supervision of accounting entries by Mario Gratton improved the company's performance.

Based on this information, we believe that the weighted gross profit margin for the period covered by the audit is in the 49–51% range. Thus, the use of the funds from unreported sales would be reconciled as follows:

	49%	50%	51%
Sales, extrapolated from total purchases of \$3,333,652	\$6,536,573	\$6,667,304	\$6,803,371
Sales as reported in the books	\$6,365,812	\$6,365,812	\$6,365,812
Unreported sales	\$170,761	\$301,492	\$437,559
Use of funds			
Advances to directors		\$151,975	
SAQ cash purchases		\$130,840	
GST – QST on cash purchases		\$19,659	
Withdrawals by Michel Légaré		\$24,599	
Expenses paid in cash		\$62,400	
		\$389,473	

Since the use of funds points to \$389,473 in unreported sales, the weighted gross profit ranges from 50 to 51%, an average equal to the results obtained for the years 2000 to 2002.

[108] Mr. Bélanger emphasized that his findings on the percentage of gross profit were only a few percentage points apart from those of the accountant Mario Gratton (Exhibit A-14). According to Mr. Bélanger, the unreported sales amounted to \$389,473, not \$3.3 million as the Ministère du Revenu du Québec was alleging. Thus, since the assets and personal expenses of the two shareholders

showed no trace of these \$3.3 million in supposedly unreported sales, no such sales beyond the amount of \$389,473 were made.

[109] Mr. Bélanger acknowledged that there is a [TRANSLATION] "mathematical rigour" to Ms. Morand's method for determining the dollar amount of alcoholic beverage sales. However, he said that it was difficult for him to determine whether the few weeks sampled were representative of the entire period covered by the audit, but that, at the end of the day, one had to [TRANSLATION] "close the loop", i.e. find a trace of the supposedly unreported amounts, which Ms. Morand neglected to do.

[110] Since Mr. Bélanger's expert report did not explicitly bear on Ms. Morand's sampling, her use or non-use of the Squirrel system data, or the reliability of those data, I had to limit the questioning by counsel for the Appellant on these points.

[111] Mr. Bélanger also referred to a decision made by an objections officer named Mr. Fontaine, a decision which he called [TRANSLATION] "ambivalent". After Mr. Bélanger submitted his representations, Mr. Fontaine reduced the appropriations of funds by the directors from \$2,910,021 to \$391,975, but maintained the initial assessments for consumption taxes on unreported sales of more than \$3 million as well as the income tax assessments on this additional income imputed to the Appellant.

[112] Mr. Bélanger explained that the distinguishing characteristic of this matter was precisely that the Ministère du Revenu du Québec found no trace of the amounts in question, which made this situation the opposite of the usual scenario, where observations regarding a person's assets and lifestyle lead to the conclusion that the additional funds could only have come from the business's unreported sales. Mr. Bélanger said that regardless of the method followed in the case at bar, one had to find a trace of the amounts that one claims to be unreported sales, and that Ms. Morand's findings on the subject were not sufficiently substantiated and therefore remain somewhat "exotic".

The Appellant's submissions

[113] Counsel for the Appellant began by emphasizing that the Appellant's business is located close to a college in a Montréal suburb. It is a pub, which is not a high-end restaurant, but rather, a high-volume business that uses many promotions to attract customers. Hence, counsel submits that the general standards of the industry cannot be applied to determine the dollar amounts of its sales.

[114] Counsel for the Appellant noted that the only offence for which the Appellant was charged following the seizure of dozens of boxes of documents, and the retention thereof for more than two and a half years, pertained to GST in the amount of \$61,946.59 that was already entered in the books but was not reported. In fact, this charge was dropped due to a lack of evidence of dishonest intent.

[115] With respect to the information in the Squirrel system, counsel for the Appellant submitted that all the daily reports in the nature of Exhibit I-19 were available to Ms. Morand, but that she rejected them on the pretext that they did not provide information about the individual transactions but simply stated the totals by general category. He said that it was never proven that the general data from the system were wrong, even though the Ministère du Revenu du Québec had suspicions about them, suspicions that Ms. Morand has always refused to admit to. Thus, if the general data from the system are valid, counsel for the Appellant submits that they cannot be rejected on the pretext that Ms. Morand could not be given the data concerning the individual transactions.

[116] Counsel for the Appellant also noted that the Appellant's gross profit margins after correction of the erroneous accounting entries were constant during the period covered by the audit, and remained stable in the 49-52% range over the subsequent years, whereas Ms. Morand's calculations suggested that the gross profit margin was even as high as 67%, a difference of 16 or 17%. In his view, such results are totally illogical and are due, among other things, to a 200% markup on food purchases that is not supported by any technical document.

[117] On the basis of the findings of the expert Marc Bélanger, the Appellant's counsel submitted that even though Ms. Morand calculated that there had been \$3.3 million in unreported sales, she was never able to show where that money went, and she even said that she was under no obligation to do so, even though the amounts considered to have been appropriated by the two shareholders had been reduced from \$2.9 million to \$391,975 at the objection stage.

[118] Counsel for the Appellant submitted that the Squirrel system was used for both alcoholic beverage sales and food sales, that all the transactions were entered in the system, and that although the individual bills were not kept, the printouts from that system were sent to the accountant. He therefore cast doubt on the work done by Ms. Morand, who used a sample consisting of 14 days over a four-year period to establish the sales of alcoholic beverages. He said that these results are open to challenge as well, because Mr. Légaré told him that he sold beer for \$0.99 for days on end, whereas Ms. Morand determined that beer was always sold for \$1.89 plus tax, which comes out to approximately \$2.25 or \$2.30 including tax. According to the Appellant's counsel, it has been proven that one-half the volume of the beer was sold for \$1 per glass (bock). As for the food, he submitted that the Appellant clearly did not make money off the "top sellers" such as chicken wings, pizza, spaghetti or hot dogs and that a 200% markup on the purchases of such foods makes no sense.

[119] Counsel for the Appellant submits that the financial statements reflected its true position. He discussed the admissions regarding the amounts of GST payable, and argued that they were the result of a certain amount of negligence or bungling by the accountant. However, he said that the allegation that \$3.3 million in sales were not reported [TRANSLATION] "is totally beyond reason."

[120] Counsel for the Appellant submits that the Appellant, through the testimony of Marc Bélanger and computer printouts, has adduced *prima facie* evidence refuting the Minister's assumptions. Thus, in his submission, the onus was on the Minister to prove his assumptions. Since no expert was called forward to establish that a 14-day sample was valid for alcoholic beverage sales and that a 200% markup on food purchases was appropriate, he argued that the Respondent's position cannot succeed.

[121] Counsel for the Appellant also emphasized that there was no proof that the documents generated by the Squirrel system were inaccurate or tampered with, or that any "zapping" took place. He also argued that while the courts have recognized that an audit by survey or sampling can be valid in and of itself, one must first show that the surveying and sampling was reliable and sufficient. Now, a sample of 14 days over four years, and a 200% markup on purchases for the entire period even though the Appellant's business experiences seasonal fluctuations, were not sufficient in his view, especially since the total sales amounts recorded in the Squirrel system were available. Counsel also emphasized that while the accounting system was far from perfect insofar as the charging of amounts to



different items or headings was concerned, the total sales numbers were consistent, and this could have been confirmed by the data from subsequent years.

[122] Counsel for the Appellant therefore submitted that Ms. Morand's findings were based solely on conjecture, estimates and very subjective choices. Marc Bélanger, Mario Gratton and even Robert Richard said that the Appellant cannot possibly have failed to report \$3.3 million in sales during the period covered by the audit.

[123] Counsel for the Appellant referred to the decisions in the following cases in support of his arguments:

- *Gestion Cheers Inc. v. Canada*, [2001] T.C.J. No. 179 (QL);
- *Garage Pierre Allard Inc. c. Québec (Sous-ministre du Revenu)*, [1995] R.D.F.Q. 36 (C.A.);
- *Huyen v. R.*, [1997] G.S.T.C. 37, at page 37-4 (T.C.C.);
- *Giannoukakis c. Québec (Sous-ministre du Revenu)*, [1995] R.D.F.Q. 34;
- *Restaurant Brossard Inc. c. Québec (Sous-ministre du Revenu)*, [1993] R.D.F.Q. 137 (C.Q.).

#### The Respondent's position

[124] First of all, counsel for the Respondent noted that the Appellant did not keep the relevant documents in respect of food sales, that is to say, the invoices themselves. He emphasized that, despite her requests, Ms. Morand was only able to obtain daily summaries for 26 days in August 1996 (Exhibit I-19) and that if such documents existed for other periods, they were not submitted, or, at any rate, the Appellant did not prove that they were submitted because no document of the kind was adduced in evidence. According to counsel for the Respondent, the 26 days' worth of summaries were not, in any event, the ones being sought by Ms. Morand, who was trying to ascertain the selling price of the various food items in order to determine the average gross profit margin. Now, the summaries did not specify the items sold, the quantity of each item sold, and the price for which it was sold. For example, the invoices would have made it possible to determine the exact price of a spaghetti dish, and whether the price varied according to the time of day and the day of the week. In addition, and quite unlike the summaries, the invoices would have made it possible to ascertain how many spaghetti dishes were sold for each of the different prices.



[125] According to counsel for the Respondent, the Appellant most certainly voiced its disagreement with the 200% markup that Ms. Morand used to determine the dollar value of the food sales. In addition, Michel Légaré spoke at length about the numerous promotions and discounts, alleging that he did not make much of a profit, that he even lost money on certain items based on the discounted prices printed on the menu place mat, and that he also lost money on the activities of the week or the themed events (Exhibits A-22, A-23 and A-24). However, counsel submits that no evidence was adduced and no document was offered to establish the cost price of the various items offered at discounted prices, or the quantities sold at those prices. Thus, to come back to the example of a spaghetti dish, he submitted that if the Appellant actually did sell the dish for \$1, only the invoices would have made it possible to determine how many spaghetti dishes the Appellant sold for that price, as well as the difference between that price and the normal price, and only evidence as to cost price would have made it possible to determine the gross profit margin on the dish. However, in the submission of counsel for the Respondent, there is absolutely no documentary evidence on the basis of which the average selling prices or the cost prices of the dishes sold at a discount can be determined. Furthermore, it is impossible, in the absence of details regarding the sales, to determine the ratio of reduced-price sales to regular-price sales. In other words, he submits that it is impossible to determine the volume of the sales of what Michel Légaré called "top sellers", such as pizza, spaghetti, chicken wings, hot dogs and so forth, in relation to the other sales.

[126] With respect to alcoholic beverage sales, counsel for the Respondent noted that all the employees' daily reports, which Ms. Morand first asked Mr. Légaré to keep in October 1998, were destroyed. Despite Ms. Morand's request, Raymond Légaré continued to destroy them. Thus, at the end of the day Ms. Morand was only able to obtain these reports for the period from November 7, 1998, to January 31, 1999, which is just short of three months in duration. In this regard, and given the volume of the audit work involved, Ms. Morand compiled all the data from the daily reports for 14 days spread out over that period, making sure to use the same day of the week twice in order to account for promotions, discounts, themed events, etc. Indeed, this enabled her to determine the average selling prices for beer (for example, beer by the bottle, by the glass or bock, by the pitcher and by the half-pitcher), the percentage of sales that each category accounted for, and the average markup percentages on wine and liquor sales. The results of this compilation were then applied to the actual purchases for each year in order to reconstruct the sales. Counsel for the Respondent emphasized that the Appellant did not contest Ms. Morand's sampling and that even its expert witness, Marc Bélanger, found that there was a

[TRANSLATION] "mathematical rigour" to the method that Ms. Morand used, though he challenged the results. Thus, counsel for the Respondent submits that no evidence has been adduced to suggest that the sampling was inadequate or unreliable.

[127] According to counsel for the Respondent, Ms. Morand had to do an audit in which the Appellant had no meal bills, its employees' daily reports on alcoholic beverage sales were systematically destroyed or thrown out, and its accounting was patently deficient, notably because purchases from the SAQ were not entered in the books; thus, Ms. Morand had to use indirect audit methods.

[128] Counsel for the Respondent submitted that the onus was on the Appellant to show that the assessment was erroneous and provide positive evidence that the assumptions on which the assessment was based were inaccurate, because the assessment is presumed valid and this presumption of validity includes a presumption that all the assumptions on which the Minister based the assessment are valid.

[129] Counsel for the Respondent did not see the relevance of the questions concerning the penal prosecution and the assessments concerning the appropriations of money by the two shareholders. He also rejected the principle of "communicating vessels" pleaded by Marc Bélanger and adopted by counsel for the Appellant. Essentially, as far as counsel for the Respondent is concerned, the only issue is to determine the amount of the Appellant's taxable sales and the amount of applicable GST. In this regard, he argued that it was not Ms. Morand's obligation find out where the money went or to determine how much the shareholders personally appropriated.

[130] Counsel for the Respondent acknowledged that the assessment did not necessarily reflect reality, but he said that there was no way to ascertain the true picture because the Appellant's situation forced the tax authorities to use indirect assessment methods the results of which must be accepted since nothing better is available. As far as those results are concerned, counsel for the Respondent said that the Appellant was the author of its own misfortune. In particular, he noted that the 200% markup, less 5% for losses, applied by Ms. Morand to determine the dollar value of food sales, yielded results that were close to the amount that the Appellant reported for the last period, that is to say, from May 1, 1998, to January 31, 1999, since the difference was only approximately \$18,000. Thus, in his submission, if the method employed yielded valid results for this period, the results for the other periods should be valid as well.

[131] Counsel for the Respondent emphasized that, in addition to the fact that the Appellant's accounting was negligent, the documents prepared by Raymond Légaré yielded evidence of gross negligence. For example, Exhibits A-3 and A-4 are weekly reports that stated exactly the same amounts for the sales of several categories of drinks for two different periods; this clearly does not reflect reality, as Marc Bélanger, the Appellant's expert, even acknowledges. Other reports (Exhibit I-28, at pages 35 to 38) stated identical \$2,000 cover charge revenues for several one-week periods, while other documents indicate cover charge revenues of \$2,880 and \$2,790 for certain days (Exhibit I-11, at pages 7.162 and 7.164). For certain weeks, the weekly reports filled out by Raymond Légaré indicate no cover charge revenue (Exhibit I-28, at pages 31 to 34). All of this shows that the reports did not reflect reality and that some income was intentionally not reported.

[132] Counsel for the Respondent submits that the fact that the daily reports from employees assigned to the sale of alcoholic beverages were not kept, even during a one-month period following a request for such retention in October 1998, is also a factor to consider in evaluating the Appellant's liability.

[133] Furthermore, counsel for the Respondent noted that the GST amounts reported and remitted were always lower than the amounts due, that they grew with every passing year and that nothing was done to correct the situation despite that fact that the accountant, Mr. Richard, had notified Raymond Légaré of this. Not all the purchases made in cash at the SAQ were entered up in the books either, and the result was that the accounting documents did not reflect reality.

[134] With respect to the Squirrel system food sales reports, counsel for the Respondent noted that the bills were not kept even though they were printed out throughout the day. Since the only thing that could be produced after a day ended was a summary, he submits that the Appellant did not comply with section 286 of the Act, that provides for the keeping of appropriate records.

[135] The Respondent referred to the following cases, among others, in support of his submissions:

- *Garage Pierre Allard Inc. c. Sous-ministre du Revenu du Québec*, [1995] R.D.F.Q. 36 (C.A.);
- *9001-9159 Québec Inc. v. Canada*, [2002] T.C.J. No. 49 (QL), [2002] G.S.T.C. 14;

- *Ouaknine v. Canada (Attorney General)*, [2001] T.C.J. No. 720 (QL), [2001] G.S.T.C. 130;
- *Ouaknine v. Canada (Attorney General)*, [2003] F.C.J. No. 535 (QL), [2003] G.S.T.C. 65 (C.A.);
- 2868-2656 *Québec Inc v. Canada*, [2003] T.C.J. No. 291 (QL); [2003] G.S.T.C. 98;
- 2868-2656 *Québec Inc v. Canada*, [2004] F.C.J. No. 1979 (QL), [2005] G.S.T.C. 156;
- 9036-9695 *Québec Inc v. Canada*, [2004] T.C.J. No. 252 (QL), [2004] G.S.T.C. 66;
- *Bordeleau v. Canada*, [2003] T.C.J. No. 208 (QL), [2003] G.S.T.C. 73;
- *Old Western Pizza Inc. v. Her Majesty the Queen*, 2004 TCC 452; [2004] T.C.J. No. 326 (QL), [2004] G.S.T.C. 83;
- *Entrepreneur Peintre J.L. Inc. v. Canada*, [1999] T.C.J. No. 253 (QL), [1999] G.S.T.C. 60, at page 60-5;
- 9028-7103 *Québec inc. c. Sous-ministre du Revenu du Québec*, [2004] Q.J. No. 463 (QL) (C.Q.);
- *Sous-ministre du Revenu du Québec c. Dupuis*, [1996] R.D.F.Q. 70 (C.A.);
- *St-Martin c. Québec (Sous-ministre du Revenu)*, [2003] R.D.F.Q. 123, [2002] Q.J. No. 9325 (QL) (C.Q.);
- *Pétroles Irving inc. c. Sous-ministre du Revenu du Québec*, [2003] R.D.F.Q. 151; [2003] Q.J. No. 154 (QL) (C.Q.);
- *Pétroles Irving inc. c. Sous-ministre du Revenu du Québec*, [2004] Q.J. No. 6726 (QL) (C.A.);
- *Daw c. Québec (Sous-ministre du Revenu)*, [2005] R.D.F.Q. 352; [2004] Q.J. No. 12885 (QL) (C.Q.).

### Analysis

[136] I would begin by pointing out that the Appellant acknowledged that an amount of \$79,604.44 in net tax was collected but not remitted during the period

from May 1, 1994, to January 31, 1999. This amount consists of GST that was collected according to the Appellant's accounting records and financial statements, but was neither reported to the government nor remitted during that period, less the additional ITCs that were allowed during the audit in respect of purchases from the SAQ that were paid for in cash and were not entered in the accounting records.

[137] This first point reveals two things. The Appellant's admission and the testimony of the accountant Mr. Richard show that although the accountant notified Raymond Légaré that the tax that was collected was not being reported and remitted in full and that the discrepancy was getting larger every year, nothing was done to correct the situation. Moreover, the purchases from the SAQ that were paid for in cash were never entered in the books, and this was only discovered by the auditor, Ms. Morand. If one wishes to ascribe blame for "errors" or "bungling" to an accountant, one has at least to act on his notifications and give him all the necessary figures, along with the relevant documents, so that he can perform his task correctly; this was not done in the instant case. I will come back to the documents submitted to Mr. Richard in connection with the Appellant's sales.

[138] The Appellant's expert Marc Bélanger admitted that, apart from the unreported and unremitted GST, the Appellant owed an additional \$14,542 in GST on unreported sales that he estimated at \$389,473 (Exhibit A-28, at pages 6 and 7). This amount of \$14,542 consists of net tax, that is to say, tax minus certain ITCs.

[139] According to Mr. Bélanger's expert report and testimony, the Appellant's taxable sales were not fully entered in its books. This contradicts the testimony of the accountants Mr. Richard and Mr. Gratton, who said that all the sales had been accounted for and that, ultimately, the problem involved [TRANSLATION] "incorrect charging" to various headings and line items. In fact, Mr. Bélanger was very much correct when he noted that the sales summaries filled out by Raymond Légaré and submitted to Mr. Richard indicated the same numbers for several categories of alcoholic beverage sold during different periods, which clearly did not reflect reality.

[140] At the request of counsel for the Appellant company, Raymond Légaré himself, perhaps inadvertently, perhaps not, offered Exhibits A-3 and A-4, which he had filled out, and which purport to be weekly alcoholic beverage sales summaries. A reading of these documents clearly discloses that there is no way that they could reflect the true picture. Yet Mr. Richard said that this was the type of document that he was given for the purpose of recording sales of alcoholic beverages.

[141] Mr. Bélanger also acknowledged that certain expenses, including the wages of doormen or security employees, were paid in cash and were not entered in the Appellant's books. Although he initially estimated these payments at \$1,000 per week, he later reduced them to \$300 per week because, according to Raymond Légaré and the accountant Mr. Gratton, the cash payments to these employees came primarily from the sharing of tips received by the other employees. However, no evidence was adduced in this regard, and neither Mr. Légaré nor Mr. Gratton even addressed this question.

[142] In addition, in Marc Bélanger's expert opinion, Raymond Légaré's lottery earnings, which were entered in the Appellant's books as though they had been reinvested in the business, were actually \$149,563 in sales that were not entered in the books and were therefore not reported. Having accepted the tax authorities' calculations in this regard, he determined that the total was \$151,975.

[143] Mr. Bélanger's initial analysis determined that Michel Légaré appropriated \$240,000 from 1995 to 1998. Mr. Bélanger did not take the period from May 1, 1998, to January 31, 1999, into account. This large amount was reduced to only \$24,599 by Mr. Bélanger for the purposes of the instant case. In order to explain this major change, Mr. Bélanger cited an error concerning the payment of Michel Légaré's personal automobile lease, which was supposedly entered into by the Appellant, not by Mr. Légaré himself, and the fact that Mr. Légaré ate all his meals at the pub because he was always there. First of all, the explanations about the payment of the lease expenses contradict the testimony given by Michel Légaré, who said that he personally paid the \$800 monthly lease expense using dividends that the Appellant paid him. Secondly, not even a minimal analysis of Michel Légaré's lifestyle was adduced in evidence by Mr. Bélanger or anyone else.

[144] The point of all this is that while Mr. Bélanger estimated that the Appellant's additional unreported sales amounted to \$389,473, his explanations regarding the way in which he arrived at this amount are not supported by any serious analysis or by any document or any testimony. In my opinion, Mr. Bélanger's expert report and his testimony served only to establish two things: firstly, and contrary to what the accountants Mr. Richard and Mr. Gratton, and Raymond and Michel Légaré said, not all taxable sales were entered in the books; and secondly, the true problem did not consist of erroneous accounting charges, but, rather, the falsification of documents submitted to the accountant. Given these findings, all the gross profit margin calculations that were done by the accountant Mr. Gratton based on entries made by the accountant Mr. Richard and by Mr. Bélanger himself, and that yielded margins characterized as reasonable,



normal and constant, lose much of their meaning, in my opinion. I find that the exercise was an attempt to achieve results favourable to the Appellant using numbers that were partially false to begin with. Even the accountant Mr. Richard said that the bank deposits exceeded the sales entered up in the books and that he had to make year-end adjusting entries in order to account for the discrepancies.

[145] This brings me to the documents offered by the Appellant, the documents that it kept, the documents used for its accounting and the documents discovered by Ms. Morand during her audit.

[146] It has been determined that no bills were drawn up with respect to alcoholic beverage sales. The employees tracked sales by manually counting the bottled beer sales and by reading special meters for draft beer, wine on tap, and spirits. The employees assigned to beverage sales had to submit one or more reports at the end of each work shift or when the prices changed. The person who primarily tracked these reports was Raymond Légaré, who also compiled them. Once this operation was complete, the employees' reports were destroyed or thrown out. Although Raymond Légaré stated that a daily compilation was made and then submitted to the accountant once a month, the documents offered in evidence are weekly summaries (Exhibits A-3 and A-4, and Exhibit I-28, at pages 31 to 38). Mr. Richard said that Exhibits A-3 and A-4 are representative of the type of document that he was given in order to do his accounting work. In addition, Michel Légaré said that the daily compilations of alcoholic beverage sales were entered in a book and that an employee then entered the data into the Squirrel system once a week. However, it can be seen that the 26 daily Squirrel reports offered in evidence during Ms. Morand's testimony give a summary of alcoholic beverage sales by general category (Exhibit I-19). In view of these multiple versions, it is difficult to ascertain what documents were actually used for accounting purposes.

[147] During her audit, Ms. Morand found that the weekly compilations made by Raymond Légaré (e.g. Exhibits A-3 and A-4) were patently false. While Exhibits A-3 and A-4 state identical sales totals over two different one-week periods for several categories of alcoholic beverage, other documents report sales totals in round numbers (\$1,500, \$2,000, \$2,500 and \$3,500), which makes them hardly plausible (Exhibit I-28, at pages 35 to 38).

[148] Ms. Morand discovered more documents that refer to cash payments, including in respect of wages, which had clearly not been accounted for, or for which the entry in the Appellant's books could not be verified (Exhibits I-11 and

I-13). This fact was actually noted by Marc Bélanger, the Appellant's expert, who made his own estimate of these payments, an estimate that was not based on a single document, but rather, on the assertions allegedly made by Raymond Légaré, and by the accountant Mr. Gratton, who, it should be added, was not the Appellant's accountant at the relevant time. Neither of these two people testified on this point, and no evidence was offered with respect to it.

[149] As far as cover charges are concerned, we know that the weekly alcoholic beverage summaries prepared by Raymond Légaré occasionally refer to them, in which case they always state identical amounts of \$2,000 per week, whereas others make no reference to cover charges at all (Exhibit I-28, at pages 31 to 38). Ms. Morand discovered documents stating that cover charge revenues amounted to \$2,880 and \$2,790 on certain days (Exhibit I-11, at pages 7.162 and 7.164). Despite the claims by counsel for the Appellant that the daily Squirrel summaries included all revenues, there is no reference to cover charges on the 26 daily summaries from August 1996 that Ms. Morand managed to obtain (Exhibit I-19).

[150] As far as food sales are concerned, the Appellant did not keep any bills, and none were offered in evidence. Despite her requests for Squirrel system printouts providing the details of all transactions for two ten-day periods chosen at random from two different fiscal years, Ms. Morand claims that she only obtained the summaries referred to above for a period of 26 days in August 1996 (Exhibit I-19). Raymond and Michel Légaré testified that documents of this nature existed and had been submitted to Ms. Morand in boxes of documents that were brought to her during the audit that she commenced on Mr. Richard's premises in November 1998. No other such summary was offered in evidence. Of course, there was the search and seizure of April 12, 2000, the day after the assessment under appeal. However, the seized documents were given back at some point, and Marc Bélanger, the Appellant's expert, claims to have consulted them while they were still under seizure. Nothing in his report or his testimony addresses this, however.

[151] In view of the total absence of documents through which the details of the Appellant's sales could be verified, and after issuing two warnings and a requirement letter, Ms. Morand managed to obtain the employees' daily reports concerning the sales of alcoholic beverages. Having extended her audit period from October 31, 1998 to January 31, 1999, she finally obtained these reports for a period just shorter than three months in duration, namely from November 7, 1998, to January 31, 1999. She selected 14 days from this entire period, ensuring that she took a different day for each week, and the same day of the week twice. Thus, she



compiled data from some 146 employee reports in respect of the 14 days in order to determine exactly what was sold and at what price. She also calculated the percentages that draft beer, that is to say, beer by the glass (bock), pitcher and half-pitcher, accounted for. The same exercise was done for wine and spirits in order to determine an average selling price, and thus, an average markup, for each product and each form of that product sold, so that the different prices for a given product or form of product could be taken into account on the basis of the many promotions offered by the Appellant. All in all, this was work of exemplary rigour and attention to detail. In the next step, with a view to reconstructing the alcoholic beverage sales for the entire period covered by the audit (that is to say, from May 1, 1994, to January 31, 1999) Ms. Morand transposed the data thereby obtained to the purchases for each year or part thereof within the period covered by the audit (the purchase data having first been corrected), adjusting the numbers from each year to account for inflation.

[152] Naturally, the Appellant is challenging the results because the sample consists of only 14 days within a three-month period. However, no precise and concrete evidence has been adduced that would justify these results to be discarded or even altered. Beyond the general protestations and assertions, no minimally serious evidence, supported by documents, has been adduced that would enable the Appellant's alcoholic beverage sales to be determined in some other way, and there is a reason for this: all the employee reports setting out the details of the sales were destroyed shortly after being created, and the evidence has shown that the summaries were falsified. The sampling work done by Ms. Morand covered 14 days within a period of close to three months because she had nothing else to work with, and, in my opinion, the sample is sufficiently representative of the products sold and the different selling prices in the course of that period. The average prices or average markup percentages, based on the Appellant's own numbers, were then applied to the unchallenged purchase amounts for each year or part thereof. Even inflation was taken into account. Ms. Morand's work followed from the Appellant's methods. It is above reproach, and the results must be accepted in the absence of persuasive evidence to the contrary. I certainly admit that sampling can only yield approximate results that do not necessarily reflect fully the true picture; this is true of any alternative or indirect method that the tax authorities use when a taxpayer's affairs, or a taxpayer's documents or lack thereof, require the authorities to use such a method.

[153] Ms. Morand's reconstruction of the meal or food sales raises another kind of problem. First of all, she obtained no bills of sale and no detailed daily sales reports from the Squirrel system for specific days, even though she had requested

these documents (Exhibits I-14, I-15, I-17, and I-18). She testified that she obtained only 26 daily reports for the period of August 6 to August 31, 1996, and those reports only set out the dollar value of sales by general category, as explained above (Exhibit I-19). The Appellant's witnesses alleged that all of the daily Squirrel reports were submitted to Ms. Morand and were in boxes of documents that Michel Légaré brought to Mr. Richard's accounting firm. Although these documents were seized on April 12, 2000, and returned to the Appellant after two and a half years, no additional report was offered in evidence. As I have explained, these Squirrel system reports do not provide any details regarding the transactions; they merely provide a summary of the sales broken down by general category. Since she was unable to determine what was sold and for what price, as she had done in relation to the alcoholic beverages thanks to the daily employee reports that she managed to obtain for the period from November 7, 1998, to January 31, 1999, Ms. Morand decided that in order to reconstruct the food sales, she would apply a 200% markup to purchases, minus 5% for losses. She testified that this was the minimum markup that she and her team of auditors, as well as other teams of auditors specializing in the restaurant industry, applied when a taxpayer had deficient accounting or did not keep all the documents that would make a direct audit possible, as opposed to an alternative or indirect method.

[154] No evidence was adduced on behalf of the Respondent that the markup percentage applied by Ms. Morand constitutes a recognized standard that is reasonably applicable to a restaurant business of the same kind as the Appellant's, namely a high-volume pub that relies on low food prices to attract customers.

[155] It is true that Ms. Morand verified some easily determinable item prices in order to ensure that the markup that was used did not penalize the Appellant. However, in doing so, she used only the one menu that she obtained upon her first visit to the pub, a menu that states only the normal or regular prices (Exhibit I-10). While Mr. Michel Légaré's testimony did not provide clarifications or concrete numbers concerning his gross profit margin in light of the many food price reductions and promotions that he referred to (Exhibits A-23 and A-24), the fact remains that one cannot totally disregard this aspect of the business, which Ms. Morand says that she was not told about. It seems clear that Ms. Morand's main objective was to obtain documents, and not to get information about the special aspects of the business's operations. There is no denying that she focussed her efforts on documents that were obtained without speaking with Raymond and Michel Légaré, who could have told her more about certain aspects of the operations of the business from a commercial standpoint. Indeed, she said that she did not meet with Michel Légaré, and that she met with Raymond Légaré a single

time after starting her auditing work at Mr. Richard's office. Based on the evidence as a whole, I find that the testimony of Ms. Morand and Michel Légaré, and Exhibits A-23 and A-24, were the most serious indicators that the overall position of the business was not fully taken into account.

[156] Ms. Morand also said that the numbers obtained by applying a 200% markup less 5% for losses were close to the numbers that the Appellant entered for the period from May 1, 1998, to January 31, 1999. It is true that the difference for this period is only \$18,000. However, the difference is so enormous for the four previous years that one would have to conclude that the Appellant reported less than 40% of its food sales for the years that ended April 30, 1995, and April 30, 1996. Such results seem hardly plausible.

[157] The extrapolation of the total food sales based on the 26 daily Squirrel system statements from August 1996 to determine the total sales for the year is another exercise that I do not think is so conclusive that it must be accepted from the outset because the extrapolation led to a higher number (Exhibits I-19 and I-20). It does not show that the 200% markup, less 5% for losses, was an objective and reasonable standard that takes account of the overall position of the Appellant's business for the entire period covered by the assessment. Indeed, the extrapolation is very different from the method that Ms. Morand used to determine the alcoholic beverage sales, and, in any event, the results of the extrapolation were not used.

[158] It goes without saying that the gross profit margins in the restaurant industry, and the pub sector in particular, fall outside the scope of judicial notice. If the tax authorities believe that the only way to determine the sales of a taxpayer whose accounting is deficient and who does not have the appropriate documents is to mark up its sales by a certain percentage, they must still show, by means of evidence regarding industry standards or otherwise, and, if not by an expert, then with statistics, that the markup being applied is a recognized, reasonable and appropriate standard for the taxpayer's business. I cannot accept the submission by counsel for the Respondent that the presumption of an assessment's validity automatically carries with it a presumption that all the assumptions on which the Minister relied to make the assessment are valid and that no evidence of any kind need ever be offered. The 200% markup that Ms. Morand used may well constitute a recognized, reliable and reasonably applicable standard in this case, though I doubt it under the circumstances. It is also possible that the appropriate markup was 175%, 150% or even less. In short, when a taxpayer can raise a serious doubt, it must be shown that the markup used is not a purely subjective standard, but, rather, a standard that is objective, reliable and acceptable under the circumstances.

One cannot hide behind the presumption of an assessment's validity in order to avoid having to offer such evidence. To claim otherwise is to open the door to arbitrariness by allowing the tax authorities to propound any theory with the assurance that it would be deemed valid. Just because a taxpayer has failed to meet its obligations, has deficient accounting, does not have the appropriate documents, or has destroyed those documents, does not mean that all assumptions are warranted and that those assumptions will be deemed valid under all circumstances. In income tax cases where a taxpayer is assessed by means of the indirect net worth method, and, for lack of anything better, his personal expenses are determined by means of assumptions, this is done by using minimum objective standards drawn from official statistics published by Statistics Canada with respect to the cost of living for individuals and households in different parts of the country, not by relying on numbers that stem from the auditor's impressions. In my opinion, this approach is also applicable to GST cases. In summary, the assertion that "my team and I apply a markup of at least 200%, less 5% for losses" is not sufficient to shift to the taxpayer the full burden of rebutting this assumption where there are serious doubts about it. A minimum amount of evidence is required in order to determine that such a markup is recognized, reliable and reasonably applicable under the circumstances.

[159] In *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336, L'Heureux-Dubé J. of the Supreme Court of Canada addressed the burden of proof in tax cases in the following terms, at paragraphs 92 and 93 of her decision:

- 92 It is trite law that in taxation the standard of proof is the civil balance of probabilities: *Dobieco Ltd. v. Minister of National Revenue*, [1966] S.C.R. 95, and that within balance of probabilities, there can be varying degrees of proof required in order to discharge the onus, depending on the subject matter: *Continental Insurance Co. v. Dalton Cartage Co.*, [1982] 1 S.C.R. 164; *Pallan v. M.N.R.*, 90 D.T.C. 1102 (T.C.C.), at p. 1106. The Minister, in making assessments, proceeds on assumptions (*Bayridge Estates Ltd. v. M.N.R.*, 59 D.T.C. 1098 (Ex. Ct.), at p. 1101) and the initial onus is on the taxpayer to "demolish" the Minister's assumptions in the assessment (*Johnston v. Minister of National Revenue*, [1948] S.C.R. 486; *Kennedy v. M.N.R.*, 73 D.T.C. 5359 (F.C.A.), at p. 5361). The initial burden is only to "demolish" the exact assumptions made by the Minister but no more: *First Fund Genesis Corp. v. The Queen*, 90 D.T.C. 6337 (F.C.T.D.), at p. 6340.
- 93 This initial onus of "demolishing" the Minister's exact assumptions is met where the appellant makes out at least a prima facie case:

*Kamin v. M.N.R.*, 93 D.T.C. 62 (T.C.C.); *Goodwin v. M.N.R.*, 82 D.T.C. 1679 (T.R.B.). . . .

[160] At paragraph 96 of the decision, L'Heureux-Dubé J. cited with approval the following comment made by Brulé J. of the Tax Court of Canada in *Kamin v. M.N.R.*, 93 DTC 62, at page 64:

The Minister does not have a *carte blanche* in terms of setting out any assumption which suits his convenience. On being challenged by evidence in chief he must be expected to present something more concrete than a simple assumption.

[Emphasis in the decision.]

[161] In my opinion, the Appellant has adduced *prima facie* evidence that the 200% markup applied to the overall food purchases cannot adequately have reflected the total dollar amount of sales for the entire period covered by the assessment. In my opinion, the elements referred to in paragraph 155 of these reasons are sufficient in this regard. Under the circumstances, the Respondent needed to make a more convincing case that the assumption utilized was, on a balance of probabilities, the standard that most adequately reflected the dollar amount of the Appellant's meal sales during the period in issue, and this was not done.

[162] Thus, as far as the meal sales are concerned, it is my opinion that the assessment must be limited to the sales set out in the Appellant's financial statements for the fiscal years from May 1, 1994, to April 30, 1998, and in the general ledger for the period from May 1, 1998, to January 31, 1999.

[163] The evidence has revealed that not all the cover charges imposed by the Appellant were reported. Examples of this can be found in the weekly reports completed by Raymond Légaré (Exhibit I-28, at pages 31 to 38). Although the Appellant collected cover charges on a regular basis commencing with the fiscal year that began on May 1, 1995, there are no cover charges in some of the weekly summaries offered in evidence, and in other such summaries, an identical amount of \$2,000 is stated for several weeks. Other documents show that the cover charges amounted to \$2,880 and \$2,790 for two specific days (Exhibit I-11, at pages 7.162 and 7.164). Ms. Morand reconstructed the cover charges by determining the ratio of the reconstructed alcoholic beverage and meal sales to the amounts reported in the Appellant's financial statements or books for these two items and by determining the share that the cover charges represented in relation to these other two elements (Exhibit I-25, at page 29, Exhibit I-26, at page 30, Exhibit I-27, at



page 29, and Exhibit I-28, at page 30). The Appellant did not expressly challenge this method for increasing the cover charges. However, the method was contested implicitly as part of the Appellant's challenge against the reconstructed alcoholic beverage and meal sales. Since the amount of meal sales was limited to the amount reported in the Appellant's financial statements or general ledger, the reconstructed cover charges must be reduced using the same formula that was used to make the assessment in issue.

[164] In addition to the penalty and interest under subsection 280(1) of the Act, the assessment in issue includes a penalty under section 285 of the Act. Section 285 is similar to subsection 163(2) of the *Income Tax Act* and applies to false statements or omissions made knowingly or under circumstances amounting to gross negligence. The Courts have frequently addressed the level of negligence that triggers these provisions. The remarks by Marceau J. (as he then was) in *Cloutier v. The Queen*, 78 DTC 6485 are among the most frequently cited ones. At page 6487, he stated:

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.

[165] In *Venne v. Canada*, [1984] F.C.J. No. 314 (QL), 84 DTC 6247, at page 6256, Strayer J. dealt with the concept of gross negligence in the following terms:

. . . "Gross negligence" must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.

[166] Mistakes, bungling, and incorrect accounting charges were cited frequently in the case at bar. However, the evidence reveals something else. First of all, the Appellant's GST returns do not report all the tax collected. The ever-growing gap between the tax reported and remitted, and the tax entered in the books or financial statements, was acknowledged by the accountant Mr. Richard, who said that he had discussed it with Raymond Légaré. Yet nothing was done to correct the situation, which lasted throughout the period covered by the audit, and resulted in an aggregate GST discrepancy of \$84,524.02. Thus, the Appellant failed to report and remit GST in respect of \$1,207,486 in sales on time for more than five and a half years. The repeated omissions each quarter, and the false statements in the



returns that the Appellant was required to submit, were made knowingly, or, at the very least, under circumstances amounting to gross negligence, and that is exactly what section 285 is intended to penalize.

[167] Another form of conduct for which the Appellant and Raymond Légaré can certainly be criticized is the systematic destruction of the employees' daily reports concerning the sales of alcoholic beverages. Since these were the only documents with which sales could be directly verified, it seems obvious that they should have been kept. However, it was only after a second request by Ms. Morand that they started to be kept. This is why Ms. Morand was able to obtain such reports only for a period slightly shorter than three months, and she used those reports as the basis of her sampling and analysis.

[168] This issue brings me to the summaries which Raymond Légaré filled out and which Mr. Richard used to do the Appellant's accounting. I am referring to documents such as Exhibits A-3 and A-4, on which identical sales amounts are entered up for five categories of alcoholic beverage. Ms. Morand offered other examples of similar documents (Exhibit I-28, at pages 31 to 38). Some contain round numbers such as \$1,500, \$2,000, \$2,500 and \$3,500 for the sales of several categories of alcoholic beverage. Moreover, some of the weekly reports state \$2,000 in cover charges. Others state no amount. The only conclusion that can be drawn from an examination of these summaries or weekly reports is that the Appellant's income was clearly not reported in full, that these documents are false, and, above all, that they are the product of deliberate acts that could only result in false statements. Marc Bélanger, the Appellant's expert, himself acknowledged that one cannot have identical reports for two different periods.

[169] The expenses paid in cash, including the SAQ purchases identified by Ms. Morand, are another consideration tied to unreported sales. Furthermore, the evidence reveals that some employees' wages were paid out of income that was not on the books, and points to other expenses paid for in cash (Exhibits I-11 and I-12).

[170] According to the estimate made by the Appellant's expert, an estimate that I find very cursory, the Appellant failed to report \$389,473 in sales for the years 1995 to 1998 (Exhibit A-28, at page 6). First of all, as I have said earlier, this estimate does not take into account the nine-month period from May 1, 1998, to January 31, 1999. In addition, the expert's estimate of the expenses paid for in cash, other than the purchases from the SAQ, is not supported by analysis or evidence of any kind whatsoever. The same thing can be said about his estimate of Michel Légaré's withdrawals during the years 1995 to 1998, which were reduced

from \$240,000 in his initial assessment, to only \$24,599, without any detailed analysis that could account for such a major change.

[171] In my opinion, the evidence adduced by the Respondent is sufficient to enable me to uphold not only the penalty set out in paragraph 280(1)(a), but also the penalty set out in section 285 of the Act. However, the penalties and interest must be adjusted in accordance with the reduction of the Appellant's sales for the period covered by the assessment, that is to say, from May 1, 1994, to January 31, 1999.

[172] In light of the foregoing, the appeal is allowed, without costs, and the assessment is referred back to the Minister for reconsideration and reassessment on the basis that

- (1) the Appellant's meal sales amounts must be limited to the amounts entered in the financial statements for the fiscal years from May 1, 1994, to April 30, 1998, and in the general ledger for the period from May 1, 1998, to January 31, 1999;
- (2) the cover charge amounts must be reduced as per the reduction of the meal sales amounts using the same formula that was used to make the assessment under appeal; and
- (3) the penalties and interest must be adjusted as per the reduction of the meal sales and cover charge amounts.

Signed at Ottawa, Canada, this 19th day of October 2006.

"P.R. Dussault"

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Dussault J.

Translation certified true  
on this 19th day of February 2008.

François Brunet, Revisor

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Her Majesty the Queen

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