Docket: 2008-1769(IT)I

BETWEEN:

LARISSA MIKHAILOVA,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on January 28, 2009, at Toronto, Ontario

Before: The Honourable Justice Wyman W. Webb

Appearances:

Agent for the Appellant:	Ken Gratton
Counsel for the Respondent:	Jenny P. Mboutsiadis
Student at Law:	Stella Luk

JUDGMENT

The appeal from the reassessment of the Appellant's liability under the *Income Tax Act* (the "*Act*") for 2003 is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the additional income of the Appellant for 2003 should be $35,000 and not $50,000.

The appeal from the reassessment of the Appellant's liability under the *Act* for 2004 is allowed, with costs, and this reassessment is vacated.

It is further ordered that the filing fee of $100 be refunded to the Appellant.

Signed at Toronto, Ontario, this 26th day of February 2009.

"Wyman W. Webb"

Webb J.

Citation: 2009TCC120
Date: 20090226
Docket: 2008-1769(IT)I

BETWEEN:

LARISSA MIKHAILOVA,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Webb J.

[1] The Appellant was reassessed to include an additional amount of $50,000 in her income in 2003 and the same amount in her income for 2004. The issue in this appeal is whether these amounts should be included in her income in these years.

[2] The Appellant was the sole shareholder of a numbered company (the "Corporation") that was carrying on business under the name Back to Work Rehabilitation Center in Hamilton, Ontario. The Corporation operated a physiotherapy clinic. Prior to forming a corporation, the business had been operated as a partnership.

[3] A trust examiner with the Canada Revenue Agency testified during the hearing. He indicated that the Canada Revenue Agency had received a complaint from a person who was working at the clinic while it was being operated as a partnership. The person complained that no source deductions had been taken from their paycheck. The trust examiner indicated that he had difficulty in obtaining the payroll records for the partnership.

[4] Following the transfer of the business to the Corporation, the Corporation was selected for a review of its payroll account. The reason that the examination was done was that no remittances were being made in relation to the payroll account of the Corporation. The examination was referred to the same trust examiner who had dealt with the complaint while the business was operated as a partnership. He made several calls to the clinic and left messages, but his phone calls were not returned. The trust examiner reviewed the tax returns for the Corporation. For the fiscal year ending July 31, 2003 the Corporation had claimed management and administration fees of $50,000 and for the fiscal year ending July 31, 2004 the Corporation had claimed management salaries of $45,000.

[5] Since the trust examiner was not receiving any response from the Corporation with respect to his enquiries about the payroll account, he decided to raise an arbitrary assessment and to issue T4 slips for 2003 and 2004 each in the amount of $50,000 and each in the name of the Appellant. It is the Appellant’s position that she did not receive these amounts.

[6] At the commencement of the hearing the Respondent brought a motion to amend the Reply to include an assumption that the Appellant had received $50,000 from the Corporation in 2003 and $50,000 in 2004. The agent for the Appellant did not oppose the Motion. Since the Respondent had issued the T4 slips and since employees would only be required to report income on amounts received (which would be reflected in a T4 slip) it seems obvious that the Respondent must have assumed that the Appellant received these amounts in these years and the omission of this assumption was simply an oversight. As a result the Reply was amended to include this assumption.

[7] In *Hickman Motors Ltd. v. Her Majesty the Queen*, [1997] S.C.J. No. 62, Justice L’Heureux-Dubé of the Supreme Court of Canada made the following comments in relation to an Appellant's onus of “demolishing” the Minister’s assumptions:

> 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 (S.C.C.), 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 Ltd.*, [1982] 1 S.C.R. 164 (S.C.C.); *Pallan* v. *Minister of National Revenue* (1989), 90 D.T.C. 1102 (T.C.C.) at p. 1106. The Minister, in making assessments, proceeds on assumptions (*Bayridge Estates Ltd.* v. *Minister of National Revenue* (1959), 59 D.T.C. 1098 (Can. 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 (S.C.C.); *Kennedy* v. *Minister of National Revenue* (1973), 73 D.T.C. 5359 (Fed. 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. *R.* (1990), 90 D.T.C. 6337 (Fed. 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. *Minister of National Revenue* (1992), 93 D.T.C. 62 (T.C.C.); *Goodwin* v. *Minister of National Revenue* (1982), 82 D.T.C. 1679 (T.R.B.). In the case at bar, the Appellant adduced evidence which met not only a prima facie standard, but also, in my view, even a higher one. In my view, the Appellant “demolished” the following assumptions as follows: (a) the assumption of “two businesses”, by adducing clear evidence of only one business; (b) the assumption of “no income”, by adducing clear evidence of income. The law is settled that unchallenged and uncontradicted evidence “demolishes” the Minister's assumptions: see for example *MacIsaac* v. *Minister of National Revenue* (1974), 74 D.T.C. 6380 (Fed. C.A.), at p. 6381; *Zink* v. *Minister of National Revenue* (1987), 87 D.T.C. 652 (T.C.C.). As stated above, all of the Appellant's evidence in the case at bar remained unchallenged and uncontradicted. Accordingly, in my view, the assumptions of “two businesses” and “no income” have been “demolished” by the Appellant.

94 Where the Minister's assumptions have been “demolished” by the Appellant, “the onus shifts to the Minister to rebut the prima facie case” made out by the Appellant and to prove the assumptions: *Magilb Development Corp.* v. *Minister of National Revenue* (1986), 87 D.T.C. 5012 (Fed. T.D.), at p. 5018. Hence, in the case at bar, the onus has shifted to the Minister to prove its assumptions that there are “two businesses” and “no income”.

95 Where the burden has shifted to the Minister, and the Minister adduces no evidence whatsoever, the taxpayer is entitled to succeed: see for example *MacIsaac*, supra, where the Federal Court of Appeal set aside the judgment of the Trial Division, on the grounds that (at pp. 6381-2) the “evidence was not challenged or contradicted and no objection of any kind was taken thereto”. See also *Waxstein* v. *Minister of National Revenue* (1980), 80 D.T.C. 1348 (T.R.B.); *Roselawn Investments Ltd.* v. *Minister of National Revenue* (1980), 80 D.T.C. 1271 (T.R.B.). Refer also to *Zink* v. *Minister of National Revenue*, supra, at p. 653, where, even if the evidence contained “gaps in logic, chronology and substance”, the taxpayer's appeal was allowed as the Minster failed to present any evidence as to the source of income. I note that, in the case at bar, the evidence contains no such “gaps”. Therefore, in the case at bar, since the Minister adduced no evidence whatsoever, and no question of credibility was ever raised by anyone, the Appellant is entitled to succeed.

96 In the present case, without any evidence, both the Trial Division and the Court of Appeal purported to transform the Minister's unsubstantiated and unproven

> assumptions into "factual findings", thus making errors of law on the onus of proof. My colleague Iacobucci J. defers to these so-called "concurrent findings" of the courts below, but, while I fully agree in general with the principle of deference, in this case two wrongs cannot make a right. Even with "concurrent findings", unchallenged and uncontradicted evidence positively rebuts the Minister's assumptions: *MacIsaac*, *supra*. As Rip T.C.J., stated in *Gelber* v. *Minister of National Revenue* (1991), 91 D.T.C. 1030 (T.C.C.), at p. 1033, "[the Minister] is not the arbiter of what is right or wrong in tax law". As Brulé T.C.J., stated in *Kamin*, supra, at p. 64:
>
> > the Minister should be able to rebut such [prima facie] evidence and bring forth some foundation for his assumptions.
> >
> > …
> >
> > 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 added by Justice L'Heureux Dubé]

[8] Two accountants testified for the Appellant. Edward Hiutin CGA, prepared the financial statements for the Corporation for the year ended July 31, 2003 and Rita Zelikman CA, prepared the financial statements for the Corporation for the years ended July 31, 2004 and July 31, 2005.

[9] Edward Hiutin stated that an entry was made as of the year-end July 31, 2003 to show management fees payable of $50,000 for that year. This was deducted in computing the income of the Corporation for that year and credited to the shareholders loan account.

[10] Edward Hiutin had made a hand written note indicating that his instructions from the Appellant were that $29,975 of this amount was to be allocated to the Appellant and the balance was to be allocated between two other individuals, Alexander Mikhailova and Ivan Terziev. However the amount to be allocated to each of these two other individuals was not specified. Alexander Mikhailova is the Appellant's son. Ivan Terziev was an individual with whom the Appellant worked.

[11] Edward Hiutin clearly stated that he prepared the Appellant's tax return for 2003, and that he reported the $29,975 in her income for that year. He stated as follows in relation to the $50,000 claimed by the Corporation as management fees for its fiscal year ending July 31, 2003:

A:… That was management fees, basically elimination of corporate profits and paying of management fees to be allocated, okay? -- to people who were involved in the management activities. At that time, as per instruction of Larissa Mikhailova, I allocated $29,975 in management fees to her to be claimed on her 2003 T1 which I prepared also and I gave it to her to be submitted to Revenue Canada at the time.

The two other -- and the balance she said she was going to allocate because I didn't do the other people's income taxes. She said they want to allocate it, and whatever.

So all I can say is the $29,975 was included in her personal 2003 T1, her personal income tax, and which I prepared. The balance, I don't know how it was reported or allocated.

…

Q. Did you prepare the personal tax return of Ivan?

A. No. No, no, no. I said before, I just said it two minutes ago, that I prepared Larissa Mikhailova's T1 which I gave it to her to be signed and to remit it to Canada Revenue. The other two, she said that they are going to -- you know, she going to let them know and they going to report it, whatever. I don't know what happened with the balance.

Q. You don't really know how the $50,000 has been reported?

A. I don't. I didn't prepare the T3s, no. And I don't know who reported them.

[12] A copy of the Appellant's 2003 tax return was introduced as an exhibit. The only amounts included in her income for 2003 were, however, $15,878.41 of other employment income and $19.90 of net rental income. The T4A slips attached to the Appellant's 2003 tax return show that $878.41 was not income from the Corporation which would only leave $15,000 as the amount that could be income from the Corporation. The Appellant stated that the $15,000 balance was the income that she was reporting from the Corporation. The Appellant's only explanation of this discrepancy between the amount that Edward Hiutin indicated was reported in her 2003 tax return and the $15,000 that she actually reported was as follows:

Q. Mr. Hiutin indicated that he had allocated $29,975 to you, but you only report $15,000.

A. Yes, because we were equally, the three of us was equally involved in the business and we divide to -- to split it in three of us.

> Q. I see. So if we add up the income reported by Larissa, Alex and Ivan, it will come to $50,000?
>
> A. I guess so.

[13] If the $50,000 would have been divided equally among the Appellant, Alexander Mikhailova and Ivan Terziev, then each would have had income of $16,667 not $15,000. This does not explain why the Appellant only reported $15,000 in 2003. Her response of “I guess so” to the direct question of whether the total amount reported by the Appellant, Alexander Mikhailova and Ivan Terziev would add up to $50,000, leaves room for doubt about the amounts reported by Alexander Mikhailova and Ivan Terziev.

[14] Rita Zelikman is the accountant who prepared the financial statements for the Corporation for the years ending July 31, 2004 and July 31, 2005. She also prepared a shareholders loan account statement for the Corporation showing the debits and credits made to that account for the period from August 1, 2003 to July 31, 2004. The statement shows an opening balance of $0. The shareholders loan statement prepared by Edward Hiutin shows a balance as of July 31, 2003 of -$83,457.74 (which would indicate that the Corporation owed the Appellant this amount as of July 31, 2003). No explanation was provided to explain this discrepancy between the closing balance of -$83,457.74 as determined by Edward Hiutin as of July 31, 2003 and the opening balance of $0 as determined by Rita Zelikman as of August 1, 2003.

[15] The shareholder loan statement prepared by Rita Zelikman shows that the balance as of July 31, 2004 was -$5,438.87. However the financial statements prepared by her indicate that the Advances from shareholders as of July 31, 2004 were $50,128. No explanation was provided to explain this discrepancy between the shareholders loan account ledger (showing a balance of -$5,438.87 as of July 31, 2004) and the balance sheet (showing Advances from shareholders of $50,128 as of July 31, 2004).

[16] In *VanNieuwkerk v. The Queen*, 2003 TCC 670, [2004] 1 C.T.C. 2577, Associate Chief Justice Bowman (as he then was) stated that:

> 6 Part of the confusion stems from the accounting records which show either no transfer, or a transfer on December 31, 1998 or January 1, 1998 depending on which version you look at. It has been said on many occasions in this Court that accounting entries do not create reality. They simply reflect reality. There must be an underlying reality that exists independently of the accounting entries. I accept Mr. Goeres'

> explanation that adjusting entries, such as entries reflecting the transaction involved here or capital cost allowance, are all shown in the general ledger on December 31. That may well be so, but it does underline how unreliable accounting records are in determining when a transaction has taken place.

[17] The significant discrepancies in the accounting records make it very difficult to determine the underlying realty in this case.

[18] While copies of the 2004 tax returns for Alexander Mikhailova and Ivan Terziev were introduced as exhibits, copies of their 2003 tax returns were not introduced. Rita Zelikman had not prepared the tax returns for Alexander Mikhailova and Ivan Terziev for 2003 and neither had Edward Hiutin. Therefore neither accountant could comment on what Alexander Mikhailova and Ivan Terziev had reported in their 2003 tax returns. Neither Alexander Mikhailova nor Ivan Terziev testified during the hearing and no explanation was provided to explain why neither individual testified or why copies of the 2003 tax returns for these individuals were not available but copies of their 2004 tax returns were available. It raises question about what was or was not included in their 2003 tax returns.

[19] In the *Law of Evidence in Canada*, second edition, by Sopinka, Lederman and Bryant, it is stated at p. 297 that:

> In civil cases, an unfavourable inference can be drawn when, in the absence of an explanation, a party litigant does not testify, or fails to provide affidavit evidence on an application, or fails to call a witness who would have knowledge of the facts and would be assumed to be willing to assist that party.

[20] Since Alexander Mikhailova is the Appellant’s son and since Ivan Terziev is a person who was working with the Appellant and who lived at the Appellant’s house for a period of time, it seems that it could be assumed that these individuals would be willing to assist the Appellant if they could. As well Rita Zelikman stated that Ivan Terziev had contacted her to request a copy of his 2004 tax return (which was the copy that was introduced during the hearing) so he certainly was willing to assist with respect to the amounts paid in 2004.

[21] Since it was the Appellant’s position from the beginning that $50,000 for 2003 (and $45,000 for 2004) had been paid to herself, Alexander Mikhailova and Ivan Terziev and since the Appellant introduced Alexander Mikhailova’s and Ivan Terziev’s 2004 income tax returns to show that each of them had reported their share of the 2004 amounts, it seems to me that an unfavourable inference should be drawn

from the fact that neither Alexander Mikhailova nor Ivan Terziev testified and that the Appellant did not otherwise try to introduce their 2003 tax returns.

[22] There are also other factors that are relevant in relation to the amount for 2003. Whenever the Appellant was questioned with respect to any amounts that the Corporation had paid to her or to the other individuals she consistently stated that she did not understand the numbers and any questions with respect to the amounts that had been paid should be referred to her accountant. Her accountant, Rita Zelikman, prepared the shareholders loan account statement for the period from August 1, 2003 to July 31, 2004. There are two entries that are notable. There is a debit entry dated August 19, 2003 which indicates that the Appellant was paid $30,000 and there is an additional debit entry dated September 24, 2003 indicating that the Appellant received $20,000. These two debits indicate that payments totaling $50,000 were made to the Appellant shortly after the year ending July 31, 2003 and still in the calendar year 2003. As well the $30,000 amount is only $25 more than the $29,975 amount (and is this amount rounded to the nearest $100) that Edward Hiutin had indicated was to be allocated to the Appellant.

[23] Since there was no evidence with respect to the amounts that Alexander Mikhailova or Ivan Terziev had reported in their 2003 tax returns, since Edward Hiutin clearly stated that the amount to be allocated to the Appellant from the $50,000 management fees for 2003 was $29,975 and that this amount had been included in her tax return for 2003, since the Appellant provided contradictory statements that the $50,000 was to allocated equally among the three individuals (which would mean $16,667 each) but she only reported $15,000 in her tax return, and since the shareholders loan account ledger indicates that $30,000 was paid to the Appellant in August of 2003 and $20,000 was paid to the Appellant in September of 2003, I find that the Appellant has not demolished the assumptions made by the Respondent that the Appellant received $50,000 in 2003. However since the Appellant did report $15,000 in her 2003 income tax return, the amount by which her income should be increased for 2003 should be $35,000.

[24] Rita Zelikman testified that the $45,000 that was claimed by the Corporation as management salaries in its fiscal year ending July 31, 2004 was allocated equally among the Appellant, her son Alexander Mikhailova and Ivan Terziev. The 2004 income tax returns for each of the Appellant, Alexander Mikhailova and Ivan Terziev were introduced as exhibits. Rita Zelikman had prepared these returns. For each of Alexander Mikhailova and Ivan Terziev the $15,000 that was allocated to them was reported as gross business income. The amount allocated to the Appellant was also included in her tax return as part of her gross business income.

[25] I accept the testimony of Rita Zelikman and I find, on a balance of probabilities, that the $45,000 of management salaries claimed by the Corporation for 2004, was included in the income of the Appellant, Alexander Mikhailova and Ivan Terziev for 2004 ($15,000 each) and therefore no additional amount should have been included in the income of the Appellant for 2004. In this case, there was no contradictory evidence introduced by the Respondent and the assumption that $50,000 was paid to the Appellant in 2004 was just that - an assumption. It was based on a deduction of $45,000 claimed by the Corporation and therefore the amount that was assumed to be paid was $5,000 more than the deduction claimed.

[26] The agent for the Appellant had argued that the amounts had not been paid to the Appellant because the amounts were simply entered in the shareholders loan account as a credit. His argument was that because the Corporation was indebted to the Appellant in the amount of $50,128 as of July 31, 2004 and $89,980 as of July 31, 2005, that simply adding more amounts to this debt did not mean that she was paid. The Corporation has ceased operations and presumably has no means to repay the Appellant.

[27] However in this case that argument has no merit. As noted above, the appeal is allowed for 2004 without even considering this argument. Therefore the only relevance of this argument, if any, is in relation to 2003. The opening balance as of August 1, 2003 as shown on the shareholders loan account ledger that was prepared by Rita Zelikman was zero. If the balance of -$83,457.74 as of July 31, 2003 as shown on the shareholders loan account schedule prepared by Edward Hiutin is carried forward to this account, the account is still in a debit balance by December 31, 2003 as the balance in this account as of December 31, 2003 (as determined by Rita Zelikman who started with a zero balance as of August 1, 2003) was $132,157.32. This would mean that the $50,000 that was credited to the account by Edward Hiutin as of July 31, 2003 was paid out by December 31, 2003. The $50,000 did not simply increase the debt of the Corporation to the Appellant - it was actually paid out.

[28] The income that the Appellant received from the Corporation was reported as gross business income in 2004 (and as other employment income in 2003). The issue before me is whether the additional amounts should be included in her income. The appeal is from a reassessment which is an assessment of the tax liability of the Appellant under the *Act*. Since the tax rate applicable to income from employment would be the same rate applicable to income from a business, the distinction between whether the income is from employment or a business is not material in this case. If

the dispute would have been related to the amounts claimed as expenses, then the distinction would have been important as employees are restricted to the types of expenses that they can claim pursuant to section 8 of the *Act* and subsection 8(2) of the *Act* provides that no deduction may be claimed by an employee unless the deduction is permitted by section 8. It does, however, seem to me that when an individual is providing services to his or her own company that such individual is providing these services as an employee and not as an independent contractor.[1]

[29] As a result, the appeal from the reassessment of the Appellant's liability under the *Act* for 2003 is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the additional income of the Appellant for 2003 should be $35,000 and not $50,000. The appeal from the reassessment of the Appellant's liability under the *Act* for 2004 is allowed, with costs, and this reassessment is vacated.

Signed at Toronto, Ontario, this 26th day of February 2009.

"Wyman W. Webb"

Webb J.

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[1] There is also the question of whether the Appellant or her accountant turned their mind to the application of GST. In 2004 the Appellant reported gross business income of $34,390 which, **if** this was business income, would have meant that the Appellant would have ceased to have been a small supplier for the purposes of the *Excise Tax Act.*

It should also be noted that subsection 248(1) of the *Income Tax Act* provides that an employee will include an officer and therefore if the Appellant was an officer of the Corporation she was an employee for the purposes of the *Income Tax Act.*

As well, **if** the Appellant would have been an independent contractor, the issue would have been whether the amount was payable to her and not whether it was paid to her since as an independent contractor she would report her income on an accrual basis.

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APPEARANCES:

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