

Docket: 2008-4125(IT)I

BETWEEN:

GARAGE GILLES GINGRAS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on common evidence with the appeals of
Gilles Gingras (2008-4127(IT)I),
on October 5, 2009, at Sherbrooke, Quebec.

Before: The Honourable Justice Alain Tardif

Appearances:

Counsel for the Appellant: Richard Généreux

Counsel for the Respondent: Anne Poirier

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 2003, 2004 and 2005 taxation years are allowed in part, to the extent that the changes to be made in Gilles Gingras' personal file, number 2008-4127(IT)I, should be taken into account. The penalties are confirmed, subject to the various changes.

Signed at Ottawa, Canada, this 2nd day of July 2010.

“Alain Tardif”

Tardif J.

Translation certified true
on this 31st day of August 2010.
Tu-Quynh Trinh, Translator

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Appellant,

and

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Appeals heard on common evidence with the appeals of
Garage Gilles Gingras, (2008-4125(IT)I)
on October 5, 2009, at Sherbrooke, Quebec.

Before: The Honourable Justice Alain Tardif

Appearances:

Counsel for the Appellant: Richard Généreux

Counsel for the Respondent: Anne Poirier

[OFFICIAL ENGLISH TRANSLATION]

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 2003, 2004 and 2005 taxation years are allowed in part, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessments on the basis of the following:

- the appellant Gilles Gingras received \$200 per month from his spouse as reimbursement for an undivided share of the trailer, for the years 2003, 2004 and 2005;
- Mr. Gingras inherited \$4,500, which was paid in cash, thus inflating his assets by the same amount; and,

- lastly, \$1,000 should be subtracted from Mr. Gingras' cost of living for the taxation years at issue.

The penalties are confirmed, subject to the changes to be made, all according to the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 2nd day of July 2010.

“Alain Tardif”

Tardif J.

Translation certified true
on this 31st day of August 2010.
Tu-Quynh Trinh, Translator

Citation: 2010 TCC 343
Date: 20100702
Dockets: 2008-4125(IT)I
2008-4127(IT)I

BETWEEN:

GARAGE GILLES GINGRAS,
GILLES GINGRAS,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Tardif J.

[1] These are two appeals in which the parties have agreed to proceed on common evidence on the basis that the appellant Gilles Gingras owned all of the shares of the appellant Garage Gilles Gingras. In Mr. Gingras' file, number 2008-4127(IT)I, the issues are as follows:

[TRANSLATION]

- a) For the 2003, 2004 and 2005 taxation years, the Minister was justified in adding \$22,836, \$14,667 and \$1,072, respectively, to Mr. Gingras' income as taxable benefits conferred on him by the Company;
- b) For the 2004 and 2005 taxation years, the Minister was justified in adding \$2,760 and \$2,619, respectively, to Mr. Gingras' income as taxable benefits conferred on him by the Company;
- c) For the 2003, 2004 and 2005 taxation years, the Minister was justified in adding \$1,545, \$1,956 and \$1,892, respectively, to Mr. Gingras' income as taxable benefits for the use of the Company's cars; and,

- d) For the 2003, 2004 and 2005 taxation years, the Minister was justified in assessing penalties against Mr. Gingras under subsection 163(2) of the Act.

[2] In making the reassessments, the respondent relied on the following assumptions of fact listed in Mr. Gingras' file, 2007-4127(IT)I:

[TRANSLATION]

- a) During the taxation years at issue, the appellant Gilles Gingras was the sole shareholder and director of the company "Garage Gilles Gingras" (hereafter, the "Company");
- b) During the taxation years at issue, Mr. Gingras was also employed by the Company;
- c) The Company's fiscal year ended August 31 of each year;
- d) According to the Minister's records, during the taxation years at issue, the Company carried on a general car repair business;
- e) During the taxation years at issue, the Company operated under the "Autopro" banner;
- f) Most of the Company's customers were private individuals;
- g) The Minister's auditor (hereafter, the "auditor") conducted an audit of Mr. Gingras and the Company for the taxation years at issue;
- h) The auditor carried out the following:
 - i) A general audit of the Company's file;
 - ii) An audit of purchase invoices and cheque returns;
 - iii) A sample audit of sales invoices;
 - iv) An analysis of bank deposits in the Company's accounts;
 - v) An analysis of bank deposits in Mr. Gingras' personal bank account;
 - vi) An estimate of Mr. Gingras' net worth;
- i) Regarding the internal audit of the Company's business, during her audit of the taxation years at issue, the auditor noted the following:
 - i) Mr. Gingras' sister kept the Company's books and records;

- ii) Mr. Gingras prepared certain sales invoices whenever his sister was not working;
 - iii) At the end of the year, Mr. Gingras turned over the books and records to his accountant to prepare the Company's financial statements and T2 income tax returns;
 - iv) Mr. Gingras approved the Company's financial statements and T2 income tax returns;
- j) During her audit of the taxation years at issue, the auditor also noted the following:
- i) The reported income was higher than the amounts deposited;
 - ii) The deposits were never explained;
 - iii) Mr. Gingras bought and sold used cars;
 - iv) No books were kept regarding the purchase and sale of used cars;
 - v) No income from that activity was reported by either the Company or Mr. Gingras;
 - vi) The transactions noted at paragraph 18. j) iii) were made in cash, no income was deposited in the bank accounts, and no amount was withdrawn from the bank accounts to purchase the cars;
 - vii) The estimate of the net worth indicated discrepancies;
- k) In light of the foregoing, the auditor used the indirect "net worth" method to audit the Company's and Mr. Gingras' files for the taxation years at issue;
- l) The auditor determined Mr. Gingras' cost of living for the taxation years at issue on the basis of his bank account withdrawals;
- m) Using the indirect "net worth" method, the auditor determined that there was \$22,836, \$14,667 and \$1,072, respectively, in unreported income for Mr. Gingras' 2003, 2004 and 2005 taxation years (see Schedules I and II for details);
- n) Since Mr. Gingras' sole "active" source of income during the taxation years at issue was the Company, the auditor deemed that the unreported income determined using the indirect "net worth" auditing method was the Company's unreported income;
- o) Further to her audit, the auditor made the following changes to Mr. Gingras' income for the taxation years at issue:

<u>Description</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
ADDITION/(DEDUCTION)			
Taxable benefit - cars	\$1,545	\$1,956	\$1,892
Benefit to the shareholder	\$0	\$2,760	\$2,619
Benefit to the shareholder	\$22,836	\$14,667	\$1,072
TOTAL	<u>\$24,381</u>	<u>\$19,383</u>	<u>\$5,583</u>

[3] In the file of the appellant Garage Gilles Gingras, number 2008-4125(IT)I, the issues are as follows:

[TRANSLATION]

- a) For the 2003 taxation year, the Minister was authorized to make a reassessment after the normal reassessment period;
- b) For the 2003, 2004 and 2005 taxation years, the Minister was justified in adding \$15,203, \$17,398 and \$5,616, respectively, to Garage Gilles Gingras' net business income;
- c) For the 2004 and 2005 taxation years, the Minister was justified in disallowing the amounts of \$2,760 and \$2,619, respectively, claimed by Garage Gilles Gingras as business expenses;
- d) For the 2003, 2004 and 2005 taxation years, the Minister was justified in assessing penalties against Garage Gilles Gingras under subsection 163(2) of the Act.

[4] In making the reassessments, the respondent relied on the following assumptions of fact listed in Garage Gilles Gingras' file, 2008-4125(IT)I:

[TRANSLATION]

- a) During the taxation years at issue, Mr. Gingras was the sole shareholder (hereafter, the "shareholder") and director of the appellant Garage Gilles Gingras;

- b) During the taxation years at issue, the shareholder was also employed by Garage Gilles Gingras;
- c) Garage Gilles Gingras' fiscal year ended August 31 of each year;
- d) According to the Minister's records, during the taxation years at issue, Garage Gilles Gingras carried on a general car repair business;
- e) During the taxation years at issue, Garage Gilles Gingras operated under the "Autopro" banner;
- f) Most of Garage Gilles Gingras' customers were private individuals;
- g) The Minister's auditor (hereafter, the "auditor") conducted an audit of Garage Gilles Gingras and the shareholder for the taxation years at issue;
- h) The auditor carried out the following:
 - i) A general audit of Garage Gilles Gingras' file;
 - ii) An audit of purchase invoices and cheque returns;
 - vii) A sample audit of sales invoices;
 - viii) An analysis of bank deposits in Garage Gilles Gingras' accounts;
 - ix) An analysis of bank deposits in the shareholder's personal bank account;
 - x) An estimate of the shareholder's net worth;
- i) Regarding the internal audit of Garage Gilles Gingras' business, during her audit of the taxation years at issue, the auditor noted the following:
 - i) The shareholder's sister kept Garage Gilles Gingras' books and records;
 - ii) The shareholder prepared certain sales invoices whenever his sister was not working;
 - v) At the end of the year, the shareholder turned over the books and records to his accountant to prepare Garage Gilles Gingras' financial statements and T2 income tax returns;
 - vi) The shareholder approved Garage Gilles Gingras' financial statements and T2 income tax returns;
- j) During her audit of the taxation years at issue, the auditor also noted the following:
 - i) The reported income was higher than the amounts deposited;

- ii) The deposits were never explained;
 - iii) The shareholder bought and sold used cars;
 - iv) No books were kept regarding the purchase and sale of used cars;
 - v) No income from that activity was reported by either Garage Gilles Gingras or the shareholder;
 - vi) The transactions noted at paragraph 19. j) iii) were made in cash, no income was deposited in the bank accounts, and no amount was withdrawn from the bank accounts to purchase the cars;
 - vii) The estimate of the net worth indicated discrepancies;
- k) In light of the foregoing, the auditor used the indirect “net worth” method to audit Garage Gilles Gingras’ and the shareholder’s files for the taxation years at issue;
- l) The auditor determined the shareholder’s cost of living for the taxation years at issue on the basis of his bank account withdrawals;
- m) Using the indirect “net worth” method, the auditor determined that there was \$22,836, \$14,667 and \$1,072, respectively, in unreported income for the shareholder’s 2003, 2004 and 2005 taxation years (see Schedules I and II for details);
- n) Since the shareholder’s sole “active” source of income during the taxation years at issue was Garage Gilles Gingras, the auditor deemed that the unreported income determined using the indirect “net worth” method was Garage Gilles Gingras’ unreported income;
- o) The auditor allocated the “net worth difference” obtained for each of the shareholder’s taxation years, taking into account Garage Gilles Gingras’ fiscal years (see Schedule III for details);
- p) Further to her audit, the auditor made the following changes to Garage Gilles Gingras’ net business income for the taxation years at issue:

<u>Description</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
ADDITION/(DEDUCTION)			
Undeclared business income	\$15,203	\$17,398	\$5,616
Travel expenses disallowed	\$0	\$2,760	\$2,619
TOTAL	<u>\$15,203</u>	<u>\$20,158</u>	<u>\$8,235</u>

[5] The respondent submitted that the facts collected during the audit, namely, several acts of negligence and signs of indifference regarding the obligation to comply with the *Income Tax Act* (“**Act**”), justified the reassessment after the normal reassessment period.

[6] The main basis for imposing penalties is that the discrepancies between the amounts reported and what they should have been were significant.

[7] The appellants’ evidence was mainly in the form of grievances against the respondent regarding the method and means of making the assessments under appeal.

[8] The appellants submitted that the use of the net worth method was unjustified, for the following reasons. Firstly, the Agency made that choice even before conducting the analysis and on-site audit, on the pretext that Mr. Gingras had paid cash for a recreational vehicle and that the amount was particularly substantial, given the modest income that he had reported for that year.

[9] Secondly, the appellants stated that the Agency had jumped to the wrong conclusion that Mr. Gingras had personally carried on a business buying and selling used cars. On this point, Mr. Gingras submitted that he had never operated a business for the purposes of purchasing and selling several exclusively family-oriented cars.

[10] Lastly, the appellants stated that the company’s accounting and management was totally beyond reproach. As for Mr. Gingras personally, he stated that he was under no obligation to keep records or do any kind of accounting, as he was not operating and had not operated any business. In other words, Mr. Gingras argued that nothing in the *Income Tax Act* required him to keep personal accounting records.

[11] First, the auditor was questioned at length by counsel for the appellants. She had to explain in detail the work that she had done leading to the assessments under appeal.

[12] She stated, among other things, that she had been puzzled by the fact that there had been many cash transactions, including one especially large transaction for the purchase of a trailer.

[13] She also stated that the decision to use the net worth method had been made prior to the start of the audit, when she had noted that cash transactions had been made to purchase goods, including the trailer.

[14] During her testimony on the file of the appellant Garage Gilles Gingras, the auditor acknowledged that the books had been properly kept and that she had noticed no irregularities save for the fact that the reported income was greater than the amounts deposited and that there were unexplained deposits.

[15] Mr. Gingras stated that, on August 12, 2005, he had received an inheritance on his mother's death and was paid his part of the succession, \$4,500, in cash. A written document signed by his sister, dated August 25, 2005, confirmed this statement. He also claimed to have been reimbursed \$3,850 for the cost of repairs to his car following an accident in which his daughter had been the driver. This amount is of no consequence, given that it was paid for repairs costing no doubt the same amount.

[16] The car was registered to Mr. Gingras because his daughter benefited from lower insurance premiums.

[17] Consequently, the cheque reimbursing the cost of the repairs was made out to Mr. Gingras. The issue of the ownership of certain cars that were registered to Mr. Gingras but of which the purchase and operating costs were paid by others, either his spouse or his daughters, was not questioned or challenged.

[18] He also explained the type of transactions that he would make and for which he would pay cash.

[19] For Mr. Gingras, it was a normal, common and useful practice, given the nature of his activities, and it was a feature of his personality and family culture. He explained that he had gotten into the habit of keeping large sums in cash for reasons of practicality and efficiency.

[20] Mr. Gingras also stated that his spouse gave him most of the cheques that she received but that, in return, he had to pay the household expenses. He also stated that the trailer purchased in June 2003 for \$26,900 had been acquired jointly with his spouse, in accordance with the handwritten note on the purchase contract, in exchange for a new trailer. There was no evidence regarding the ownership of the new trailer given in exchange, valued at \$15,000.

[21] He emphatically denied having told the auditor that he did not usually have more than a few hundred dollars on hand, given that he always had more substantial liquid assets in his possession. In addition, he implied that he also kept large sums of cash elsewhere.

[22] Regarding the significance of his cash transactions, which was one of the determinative factors relied on by the tax authorities to justify using the net worth method, Mr. Gingras submitted that, in his opinion, this justification was not valid: he spent little and would therefore rapidly accumulate as much as several thousands of dollars, which he usually kept in ready cash. He thus concluded that he had reported all of his income.

[23] He also stated that he had never operated any businesses, although he admitted to having bought and sold several cars during the three years covered by the appeal.

[24] He explained that he would buy and sell the cars used by his daughters and spouse. He and his spouse drove a convertible, which they would put in storage for the winter, during which time they would use [TRANSLATION] “clunkers” for their personal needs and to accommodate certain clients.

[25] Given the number of people involved, namely, his daughters, his spouse and himself, they needed several cars, in particular because of his habit of putting his convertible in storage each winter. As the cars were cheap, he would often replace them. Consequently, he would buy and sell many cars.

[26] Even though his spouse and two daughters were concerned in this matter, they did not testify. It would have been extremely interesting to have certain clarifications and information on their part, as they were often involved in Mr. Gingras' explanations. A number of times, he claimed, among other things, that his spouse would give him almost all of the cheques that she received.

[27] As regards the company's file, Mr. Gingras, its sole shareholder, claimed that the company's management and accounting were adequate and irreproachable. On this point, he explained that, as he lacked the necessary knowledge, he employed two people to handle the company's accounting and ensure compliance with all tax obligations. The two people in question testified on the nature of their work.

[28] Mr. Gingras' cross-examination revealed to the Court that he was thoroughly familiar with both his and the company's files. At times, he would act arrogant so as to avoid answering a question or create a diversion whenever the issue became particularly sensitive.

[29] Mr. Gingras admitted that the sales figures of the company, of which he was the sole shareholder, remained essentially the same throughout the years: \$415,000, \$422,000, \$411,000, \$423,000, \$400,000 and \$397,000, respectively.

[30] However, the net income for the same years, namely, 2003, 2004, 2005, 2006, 2007 and 2008, increased significantly: \$33,000, \$30,000, \$25,000, \$70,692, \$69,671 and \$54,397, respectively. The substantial increases in net income starting in 2007 were unexplained.

[31] As for whether Mr. Gingras had actually carried on a business buying and selling cars, the evidence showed that he had purchased and sold a number of cars, not for commercial purposes but, rather, for personal or family purposes. He would buy cars for his two daughters, his spouse and himself.

[32] These were usually used cars, worn out by several years of frequent use, which is why they were continually replaced. Mr. Gingras and his spouse also had a passion for convertibles, which they would put in storage for the winter, requiring them to find a replacement car and thus explaining the large number of cars in their possession.

[33] After having heard Mr. Gingras' explanations and seen in particular the table that he had prepared, the auditor, Chantal Boisvert, admitted that she probably would not have concluded that it was a business if, at the time of the audit, she had heard the explanations that were given at the hearing.

[34] Regarding the existence of a business, the auditor's about-face is rather peculiar, for the evidence revealed nothing new, except that Mr. Gingras had prepared a table for quickly and efficiently viewing the number and nature of the car transactions.

[35] During the audit, the auditor was obviously uncomfortable with her conclusion that Mr. Gingras had personally operated a business for buying and selling cars, since, at that point, she treated the profit generated by one of the transactions involving the sale of a car as a capital gain, thus validating Mr. Gingras' theory that the purchase and sale of cars did not constitute a business.

[36] I note that the evidence revealed nothing new, aside from presenting an edited version of the information available. Thus, the determination that Mr. Gingras had carried on a business is inconsistent with the conclusion that the profit made through one of the transactions had been treated as a capital gain.

[37] In answer to the criticism made against her, the auditor stated that the debate was pointless, since her initial interpretation had had no bearing on the assessment: she had accepted the explanations that the price paid for the cars usually corresponded to the price at which they had been sold, meaning that these transactions generated no profit.

[38] The auditor accepted Mr. Gingras' explanations on the absence of any profit or benefit in the various transactions involving cars. In other words, she concluded that the various transactions had no effect on Mr. Gingras' asset base, except in one case, where it was determined that the most profitable transaction constituted a capital gain.

[39] She accepted Mr. Gingras' explanations on this subject but did not take into consideration the note on the co-ownership of the trailer because it was a handwritten addition that she did not find to be credible.

[40] Mr. Gingras claimed to have little or no knowledge in accounting, which is why he relied on two people to ensure compliance with his tax obligations. In their testimony, these two people, his sister, Rita Bergeron, who generally worked three days a week, and Benoit Rochette, who was in charge of reviewing and preparing the results used for the annual returns, confirmed Mr. Gingras' testimony regarding the nature of their jobs.

[41] Mr. Gingras denied having told the auditor that he usually had only a few hundred dollars on hand. Instead, he claimed that he had said that he always kept significantly greater amounts on him.

[42] Even though Mr. Gingras maintained that he lacked knowledge in tax matters, he insisted on the importance of balancing the accounts and seemed confident, quite savvy and comfortable. It seemed obvious that he would answer only those questions that bore out his theory, avoiding the ones he did not want to answer or giving general and somewhat confused answers whenever he thought that they would not support his argument.

[43] Mr. Gingras gave no specific explanations; with his ability to avoid certain questions, his tremendous confidence and, lastly, his arrogance, he revealed only what he actually wanted to reveal.

[44] Mr. Gingras is a person who states and claims only what he really wants to state and claim. He has clearly understood that using cash generally leaves fewer traces, and this practice allows him some latitude, in particular the possibility of giving any number of explanations regarding both the source and use of the money, so as to render the various facts compatible with the theory of the increase in assets.

[45] Mr. Gingras submitted that he was penalized by the respondent's method of calculating the difference on which the assessments are based, since, as a result of this method, certain additions were accounted for twice: once in the calculation of the cost of living and again in the assets in terms of an increase in assets.

[46] The topic of the trailer raised several questions, including with respect to the ownership of the unit given in exchange and valued at \$15,000.

[47] Mr. Gingras claimed that he acquired the trailer in 2003. When asked about the ownership of the trailer in question, he gave no specific explanations, aside from the fact that his spouse gives him \$200 per month. The start date of the payments was not established, but the handwritten note on the contract suggests that they began at that point.

[48] Regarding the question of ownership, the auditor stated that she had assumed that Mr. Gingras was the sole owner of the trailer, on the basis of the registered title. She therefore implied that the spouse's name had been added after the fact, as the name did not appear on the registration certificate.

[49] Was Mr. Gingras' spouse the co-owner of the trailer given in exchange and valued at \$15,000, that is, \$7,500 for her undivided share? Despite its significance, this question was not answered, except for the general explanation that she paid \$200 per month for the duration of the periods covered by the assessments.

[50] The first grievance noted was that the net worth method was unjustified and inappropriate, if not abusive. According to the appellants, this one allegation alone was enough to lead to the conclusion that the assessments should be vacated and the penalties cancelled. In other words, the appellants submitted that using the net worth method to reassess without reason or justification should be sanctioned by the outright vacation of the resulting assessments.

[51] Relying on case law, including a decision of the former Chief Justice of this Court, the Honourable Donald Bowman, the appellants vigorously argued that the use of the net worth method to reassess was a special, if not exceptional, method to

be used solely in cases where a business was being carried on and where it was absolutely impossible to determine the income otherwise.

[52] In this regard, Mr. Gingras stated that he has never carried on a business for buying and selling cars and was therefore under no obligation to keep records pursuant to section 230 of the Act.

[53] Proceeding on the basis that Mr. Gingras had indeed operated such a business, the respondent faulted him for the lack of reliable and credible information regarding that business.

[54] However, the evidence shows that, even before verifying whether there were records and adequate accounting, the Agency had already decided how it would conduct the audit, which started with the company.

[55] The appellants' strategy mainly consisted in complaining about, criticizing and vehemently challenging the Agency's approach. Put another way, the appellants claimed that there was no reason or ground for using the net worth method to audit either Mr. Gingras' or Garage Gilles Gingras' files.

[56] According to the appellants, the net worth method was unjustified in the company's case, as the evidence revealed that the management was adequate, a point that was also confirmed by the auditor. In Mr. Gingras' case, as there was no business, he did not need to keep any accounting records or other documentation to prove the accuracy of his income. Again according to Mr. Gingras, the Act in no way requires an individual who does not carry on a business to keep accounting records.

[57] The appellants would like the Court in a way to draw on the penal and criminal approach, where the sanction for an irregularity in an investigation, such as in obtaining or executing a warrant, is often the acquittal or release of the accused.

[58] The procedure is not that strict in tax matters. The State has a wide range of means at its disposal, including the net worth method, to verify whether people have properly fulfilled their tax obligations.

[59] The jurisdiction of the Tax Court of Canada is limited to deciding whether the assessment is correct or not. It is true that audits should follow standard accounting practices. It is true that audits call for professionalism and transparency. Needless to say, any breach of these key principles is regrettable.

[60] However, I do not think that breaches, even significant ones, are sanctioned or remedied by vacating the assessment. An assessment cannot be vacated, or even reduced, if the only grounds of attack are the auditor's conduct and method of evaluation. In other words, an assessment must be based solely on the Act, not the conduct—even if it was improper—of the auditor or auditors.

[61] The Tax Court of Canada lacks the jurisdiction to sanction improper conduct, except of course where the abuse or abuses distorted, changed or even falsified the calculation of the assessment or one of its bases.

[62] As for the authority to use the net worth method, I have compiled a number of decisions, beginning with those not involving businesses.

Hsu v. Canada 2001 FCA 240

[63] A taxpayer who had immigrated to Canada in 1992 had reported owning property and shares with a value of \$3 million. However, in his income tax returns for the years 1993 and 1994, he had reported \$1,207 and \$636, respectively. The Minister asked the taxpayer to provide documentation justifying his income. He refused to do so, and the Minister therefore made an assessment using the net worth method, estimating the taxpayer's income to be 10 per cent of \$3 million. The relevant paragraphs of that decision are as follows:

[29] Net worth assessments are a method of last resort, commonly utilized in cases where the taxpayer refuses to file a tax return, has filed a return which is grossly inaccurate or refuses to furnish documentation which would enable Revenue Canada to verify the return (*V. Krishna, The Fundamentals of Canadian Income Tax Law*, 5th ed. (Toronto: Carswell, 1995) at 1089). The net worth method is premised on the assumption that an appreciation of a taxpayer's wealth over a period of time can be imputed as income for that period unless the taxpayer demonstrates otherwise (*Bigayan*, supra, at 1619). Its purpose is to relieve the Minister of his ordinary burden of proving a taxable source of income. The Minister is only required to show that the taxpayer's net worth has increased between two points in time. In other words, a net worth assessment is not concerned with identifying the source or nature of the taxpayer's appreciation in wealth. Once an increase is demonstrated, the onus lay entirely with the taxpayer to separate his or her taxable income from gains resulting from non-taxable sources (*Gentile v. The Queen*, [1988] 1 C.T.C. 253 at 256 (F.C.T.D.)).

[30] By its very nature, a net worth assessment is an arbitrary and imprecise approximation of a taxpayer's income. Any perceived unfairness relating to this type of assessment is resolved by recognizing that the taxpayer is in the best position to know his or her own taxable income. Where the factual basis of the Minister's

estimation is inaccurate, it should be a simple matter for the taxpayer to correct the Minister's error to the satisfaction of the Court.

...

[33] I would add that it was open to the Tax Court judge to conclude that the Minister's method for determining the appellant's income was reasonable and logical in the circumstances of this case. Although the Minister's reassessments were clearly arbitrary, it cannot be forgotten that this approach was the direct result of the appellant's refusal to disclose any financial information or documentation. In *Dezura*, supra at 1103-1104, the President of the Exchequer Court of Canada explained:

The object of an assessment is the ascertainment of the amount of the taxpayer's taxable income and the fixation of his liability in accordance with the provisions of the Act. If the taxpayer makes no return or gives incorrect information either in his return or otherwise he can have no just cause for complaint on the ground that the Minister has determined the amount of tax he ought to pay provided he has a right of appeal therefrom and is given an opportunity of showing that the amount determined by the Minister is incorrect in fact. Nor need the taxpayer who has made a true return have any fear of the Minister's power if he has a right of appeal. The interests of the revenue are thus protected with the rights of the taxpayers being fully maintained. Ordinarily, the taxpayer knows better than any one else the amount of his taxable income and should be able to prove it to the satisfaction of the Court. If he does so and it is less than the amount determined by the Minister, then such amount must be reduced in accordance with the finding of the Court. If, on the other hand, he fails to show that the amount determined by the Minister is erroneous, he cannot justly complain if the amount stands. If his failure to satisfy the Court is due to his own fault or neglect such as his failure to keep proper account or records with which to support his own statements, he has no one to blame but himself.

[34] As the Tax Court judge observed, the appellant has done nothing to ensure a full, complete and correct audit. The appellant has consistently failed to provide any evidence which would prove his actual income during the period in question. Accordingly, he cannot complain that the Minister has proceeded on the basis of speculative assumptions.

[35] Given that the burden of disproving the reassessments lay squarely with the appellant, it is necessary to consider whether the appellant successfully discharged that onus. In *M.N.R. v. Pillsbury Holdings Ltd.* ((1964), 64 D.T.C. 5184, at 5188 (Ex.Ct.)), the Court explained that an appellant can satisfy this burden in three ways:

- a) challenging the Minister's allegation that he did assume those facts;
- b) assuming the onus of showing that one or more of the assumptions were wrong; and
- c) contending that, even if the assumptions were justified, they do not of themselves support the assessment.

[36] The appellant did not attempt to demonstrate that the Minister's assumptions were wrong in fact. Further, for the reasons set out above, I have rejected the appellant's contention that the Minister proceeded other than by way of a net worth assessment. Therefore, the only issue is whether the assumptions, as pleaded, operate to support the Minister's reassessments.

(Emphasis added)

[64] That case illustrates the fact that the net worth method is commonly used as a last resort whenever taxpayers refuse to cooperate and provide documentation justifying their expenses and income. Taxpayers then have the burden of disproving the Minister's estimate, in particular by producing appropriate documentation to support their allegations. Thus, even individuals not carrying on a business must keep some accounting records.

Landry v. The Queen 2009 TCC 399

[65] In that case, a former erotic dancer had received several gifts from someone who had once been a client. The tax authorities assessed her using the net worth method. In his decision, Justice Hogan explained that this method is used as a last resort in situations where the taxpayer provides no documentation:

[42] The net worth method is arbitrary, unsatisfactory and imprecise. It is a blunt instrument of which the Minister must avail himself as a last resort, for instance where the taxpayer's accounting makes it impossible to adequately assess his or her income and expenses for a given period. Judge Bowman (as he then was) had this to say about the net worth method at paragraph 6 of *Ramey v. Canada*:

[6] . . . A net worth assessment involves a comparison of a taxpayer's net worth, i.e. the cost of his assets less his liabilities, at the beginning of a year, with his net worth at the end of the year. To the difference so determined there are added his expenditures in the year. The resulting figure is assumed to be his income unless the taxpayer establishes the contrary. Such assessments may be inaccurate within a range of indeterminate magnitude but unless they are shown to be wrong they stand

[66] The passage above shows the relevance and validity of an assessment using the net worth method whenever an individual fails to keep proper accounting records, even if the individual is not carrying on a business. Paragraphs 46 to 50 are equally relevant:

[46] With regard to the burden of proof, it is up to the appellant to rebut the assumptions of fact on which the Minister based himself in making the assessments for the 2000 and 2001 taxation years. The standard of evidence that the appellant must meet in order to rebut the Minister's assumptions is proof on the balance of probabilities. Essentially, the onus of proving the inaccuracy of the assessments in this case is on the appellant, who must provide *prima facie* evidence to show that the amounts thus arrived at do not represent, from a tax standpoint, the true state of her income. It is up to the appellant to identify the source and establish the non-taxable nature of her income. The Federal Court of Appeal stated that onus in *Lacroix*:

[19] The Supreme Court has endorsed this approach on a number of occasions, including in *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336, to name just one example. In that case, the Court stated the following at paragraphs 92-93:

92. . . . 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.). . . . The law is settled that unchallenged and uncontradicted evidence “demolishes” the Minister’s assumptions: see for example *MacIsaac v. M.N.R.*, 74 D.T.C. 6380 (F.C.A.), at p. 6381; *Zink v. M.N.R.*, 87 D.T.C. 652 (T.C.C.) . . .

[20] Applying the net worth method changes nothing in this method of proof. Where the Minister presumes that the income detected using the net worth method is taxable income, the onus is on the taxpayer to demolish this presumption. If the taxpayer presents credible evidence that the amount in question is not income, the Minister must then go beyond these assumptions of fact and file evidence proving the existence of this income.

[47] The credibility of the appellant and the sufficiency of the evidence against the net worth calculations play a crucial role. The fate of the appeal will depend entirely on those two factors.

[48] Judge Bowman (as he then was) stated the best method of challenging such assessments in *Bigayan*:

[3] The best method of challenging a net worth assessment is to put forth evidence of what the taxpayer's income actually is. A less satisfactory, but nonetheless acceptable method is described by Cameron J. in *Chernenkoff v. Minister of National Revenue*, 49 DTC 680 at page 683:

In the absence of records, the alternative course open to the appellant was to prove that even on a proper and complete "net worth" basis the assessments were wrong.

[4] This method of challenging a net worth assessment is accepted, but even after the adjustments have been completed one is left with the uneasy feeling that the truth has not been fully uncovered. Tinkering with an inherently flawed and imperfect vehicle is not likely to perfect it. The appellant chose to use the second method.

[49] In *Saikely v. Canada*, Judge Hamlyn had this to say concerning net worth assessments:

[36] The taxpayer may attack the assessments in various ways. A taxpayer may prove that some of his increase arose from non-taxable receipts, such as inheritances or gambling; that his net worth at the beginning of the period was undervalued or that his assets at the end were overvalued; that liabilities existing at the end were omitted or undervalued; that the money had been borrowed or that income losses were greater than assessed. Whatever is alleged by the taxpayer must be proved by him; a mere statement is not enough. Moreover, cogent evidence is required to disprove a net worth assessment.

[Emphasis added.]

[50] In addition, in *Morneau v. Canada*, the Federal Court of Appeal noted that net worth assessments are frequently vacated when *viva voce* or documentary evidence succeeds in discharging the burden on the taxpayer challenging those assessments.

[67] All of these excerpts show that documentation plays an extremely important role in challenges to assessments made using the net worth method. In *Landry*, the appellant testified convincingly and provided certain documents that, having satisfied the Court, enabled her to discharge her burden of proof.

[68] The other decisions involve businesses, and I will simply list a few citations:

Baker v. The Queen, [2001] TCC 98-2652(IT)I (informal procedure);

Sidhu v. M.N.R., 93 D.T.C. 5453;

Ramey v. The Queen, [1993] 2 C.T.C. 2119;

Watts v. The Queen, [2006] 1 C.T.C. 2106 (informal procedure);

Deschênes v. The Queen, [2009] D.T.C. 62;

Vigeant v. The Queen, 2009 TCC 143;

Chernenkoff v. Minister of National Revenue, [1949] C.T.C. 369;

Tremblay v. The Queen, 2009 TCC 313.

[69] Mr. Gingras also contended that, in managing both his personal and business affairs, he frequently made cash transactions and that this was legitimate, legal and common. He stated that he has always done so, just like certain members of his family.

[70] Using the net worth method to calculate a person's income is usually justified in the absence of information, documentation or records allowing tax authorities to audit income using the traditional method.

[71] Absolutely nothing in the *Income Tax Act* imposes any specific conditions on the use of this method. Generally, the method is used as a last resort whenever taxpayers' records are inexistent or incomplete.

[72] This method is not ideal. It is very often criticized for being inaccurate, flawed and, occasionally, arbitrary. It is therefore an easy target for taxpayers facing assessments made using this method.

[73] I have also often noticed and pointed out that those who challenge an assessment made using this method devote much, if not all, of their efforts and arguments describing the flaws of the method rather than those of the assessment itself.

[74] Using cash is legal and legitimate, but it does frankly raise scepticism, being a common practice in work under the table, tax avoidance, etc. Cash leaves no or so few traces that a plausible explanation can always be given depending on the context.

[75] Cash-basis accounting is not illegal and does not necessarily indicate tax avoidance. There may be several reasons for engaging in this practice, including practicality, efficiency and advantages such as discounts, given that cash transactions do not entail transaction fees, unlike credit card or cheque transactions, which often call for delays or fees.

[76] Nevertheless, it may be a means of avoiding tax obligations, be it income or sales tax.

[77] During a tax audit, this practice may raise certain questions requiring the taxpayer concerned to provide explanations that are clear, precise, consistent and credible, failing which these explanations may be rejected or omitted from the analysis. Moreover, answers that are unsupported by documentary evidence may be deemed to be less reliable, if not questionable.

[78] In other words, it would require a prodigious memory and explanations that are not only clear and consistent but also reasonable and credible. The passage of time and its effects on one's memory cannot be relied on as a valid excuse. On this point, counsel for the appellants also stated the following:

[TRANSLATION]

It is an unidentified cheque. He did not review everything. He is not an accountant, and it would have taken an insane amount of time. It would have taken an accountant working full time three months to review the work as thoroughly as she

did, but I understand that she cannot do everything, and any unidentified cheques were included in the cost of living. It does not matter if it is money that was not spent or that was cashed. It is indicated, and the \$3,000, well, that's that. So if the unidentified cheques are disregarded, given the evidence, there is no longer a discrepancy.

[Emphasis added.]

[79] In light of this reality, any taxpayer who routinely makes cash transactions should be cautious and careful.

[80] Conducting an audit or asking questions is neither abuse nor harassment. It is an indisputable and fundamental right of the State, and taxpayers must in turn explain the nature of their income and expenses. These are not traps. It is essentially an incontestable right of the State to verify whether people have properly fulfilled their tax obligations under the *Income Tax Act*.

[81] Ultimately, there is no magic formula for obtaining foolproof answers to certain questions on income and expenses. The Court's only option is to draw a conclusion on the basis of the evidence, on a balance of probabilities, and the evidence is always assessed with some subjectivity. The risk that the Court's conclusion may not be what was expected is very real.

[82] To begin with, Mr. Gingras submits that he was not carrying on a business, that all of the transactions involving cars were of a personal nature and that he had not made a profit overall. He also submits that, as it was his habit, he often had in his possession very substantial sums of money.

[83] Such a practice is possible, even reasonable. It is certainly legitimate and legal.

[84] Furthermore, Mr. Gingras submits that it is impossible for him to remember exactly what he might have done with his cash in the past. Again, this is a reasonable argument.

[85] However, in a dispute before the Tax Court of Canada, the appellant bears the burden of proving the basis of the assessment. The Minister's statements must be presumed to be true.

[86] Under tax legislation, everyone must report all income. It is not a request; it is an unavoidable obligation.

[87] It is an absolute obligation that has nothing to do with reasonableness. No income tax return is a matter of common sense and reasonableness, where the information may depend on the taxpayer's memory, the context or the particular facts. It is a mathematical and accounting exercise that leaves little room for confusion, oversight or ambiguity. In the absence of adequate and reliable evidence, the correctness of an assessment, even one established arbitrarily, will very likely be confirmed by the court hearing the case.

[88] On this point, Mr. Gingras stated the following:

[TRANSLATION]

For businesses, every penny is accounted for, and they hire professionals for that. For individuals, in Canada, there is nothing to prevent, in legislation, unless the contrary is shown, in Canada, there is nothing to prevent an individual from not keeping records required by section 230. We cannot remember, Your Honour, you and I, what we did six years ago with a withdrawal, cash purchases. We have to . . . we're forced to go back, take out the accounting records, the bank records, and even when we do that, if we use cash, we wouldn't be able to remember, because the . . . we can't see a withdrawal or a cheque, what was used to pay for what asset or what item. So, automatically, when the net worth method is used for an individual who functions that way, essentially, like Justice Bowman said, that individual "will be nailed and hit hard for no reason".

[Emphasis added.]

[89] Mr. Gingras may claim that no specific section required him to keep elaborate and sophisticated accounting records in the management of his personal affairs. However, he was required to report all of his income and be able to reliably show the accuracy of the information. This is not an exercise undertaken to the best of one's knowledge or recollection. Memory is flawed and has limitations, and one's imagination becomes a way of filling the gaps, often at the expense of reliability. Assessing and calculating someone's assets is a mathematical exercise in which memory is, again, a somewhat imperfect tool, especially if the assessment of the assets covers a prior three- or four-year period.

[90] Here, the appellants chose to rely mainly on memory. It is therefore not surprising that they put such emphasis on the auditor's conduct and very little on what the correct assessments should have been.

[91] A person being assessed arbitrarily must, using decisive evidence, not only show how and why the assumptions of fact should be excluded from the analysis but also, and most importantly, establish the facts that should have been considered to support the conclusion that the disputed assessment should be varied or even vacated. To do so using nothing but one's memory is a tall order.

[92] Using the net worth method to establish someone's income is an appropriate choice if the person concerned lacks reliable accounting records or has records that are incomplete, confused, ambiguous or falsified. Using the net worth method may also be justified in situations where accounting or records are not required but where the asset is inconsistent with the reported income. Using this method, described by some as being arbitrary, may also be warranted in situations where the existing accounting records adhere perfectly to standard practice, if there are indications that certain facts regarding the income or expenses have been deliberately or inadvertently distorted or omitted.

[93] All persons and corporations must respect all provisions of the law with respect to the accuracy of income and expenses. Any breach of this obligation justifies the use of an arbitrary method by the tax authorities. The alleged breach or breaches may have been the result of perception or misinterpretation, in which case the persons or corporations could easily show that the mistake was not theirs but, rather, the auditor's, if the appropriate records and documentation are available.

[94] Here, I am of the opinion that Mr. Gingras is not quite the person he described, that is, someone with little or no knowledge of management and administrative matters, someone with very limited education and for whom the use of cash is a practice consistent with his specific personality.

[95] It is my view that Mr. Gingras has understood that cash leaves few or no traces and allows him to provide all sorts of explanations or verbal justifications that are difficult to refute, particularly since they are subject to the credibility test.

[96] Written documents leave traces and enable tax authorities to determine a taxpayer's income using analyses that are more reliable than the net worth method. Discharging the burden of proof without documentation such as records is therefore a difficult and often insurmountable challenge.

[97] In this case, Mr. Gingras tried to discharge the onus of proof by relying mainly on his testimony. Even though he often mentioned his daughters and spouse, they did not testify on an important element of his evidence.

[98] He was very vague and contradicted the auditor, claiming that she had lied about, among other things, the money he kept on hand and the audit process.

[99] Mr. Gingras spent more energy attacking the Minister's decision to choose the net worth method to make the assessment than he did showing why and how the assessments were incorrect.

[100] Mr. Gingras submitted and maintained that he was under no obligation to keep records. Asking questions or putting forth hypotheses may help to raise doubts in the Court's mind, but it will not lead the Court to draw a conclusive and determinative finding.

[101] The appellants' evidence is unreliable, a point that they themselves conceded. First, a significant portion of the evidence at the hearing consisted in showing that Mr. Gingras had not personally carried on a business for the purposes of buying and selling cars.

[102] Second, the hearing was spent discrediting the relevance of the net worth method. The appellants submitted and maintained that it amounted to abuses that had to be sanctioned by the outright vacation of the assessments and cancellation of the resulting penalties.

[103] I find it helpful to reproduce the following excerpt from the transcript:

[TRANSLATION]

And in 2005, Your Honour, I won't waste any more breath on this. The penalties, for example, in 2005, were \$700. Look, the amounts at issue, I refer you to my Notice of Appeal. In 2003, for the company, in taxes, the amount of the assessment was \$3,700; in 2004, \$4,500; in 2005, \$1,560, which included the penalties, interest. This doesn't seem to be the case of the century.

[104] The Court cannot act as an accountant. It does not have the resources for the work that the appellants refer to in this excerpt. However, I note that it would have been easy to draw conclusions on the basis of basic facts that any prudent and wise person should have in his or her possession.

[105] It is not necessary to have any knowledge of accounting or keep highly sophisticated records. Essentially, it requires acting as a reasonable person would with respect to his or her tax obligations. To do so often simply requires having

notes, to be able to present credible and coherent evidence supporting one's arguments.

[106] The jurisdiction of this Court is essentially to decide whether a disputed assessment complies with the Act.

[107] The appellants allege that the auditor's work contains inconsistencies, even contradictions. Relying on these shortcomings, errors or inconsistencies, they request that these assessments be reduced, if not vacated.

[108] The Agency does not bear the burden of proof. I was rather surprised to hear that a taxpayer could no longer recall what had happened a few years ago but expected the auditor to be able to reconstruct the facts of the case without any documentation or records.

[109] A good example of this ambiguity that is difficult for a third party to resolve is the issue of the trailer. Mr. Gingras buys a trailer, his spouse's name is added by hand to the contract, and, as payment, Mr. Gingras gives another trailer in exchange and pays off the balance in cash. He states that his spouse's undivided part stems from a \$200 monthly payment. Does the payment in question apply to both trailers or merely the new one in his name?

[110] He states that the asset is actually held jointly with his spouse. The payment methods are very confusing, and there is no evidence on the ownership of the trailer given in exchange. A sum of \$200 is involved. His spouse, who paid this amount, did not testify.

[111] Another example of ambiguity was the issue of the cars bought and sold by Mr. Gingras. Some were used for customer service, others by Mr. Gingras, others by his spouse, and yet others by one or other of his two daughters. On this issue, the auditor would have had to shed light on the use, ownership, period of use, purchase price, selling price, etc.

[112] The Silverado truck was not often used, allegedly because Mr. Gingras wanted to keep it in mint condition, but it belonged to the company. Mr. Gingras and his spouse are camping enthusiasts, and they have a trailer. This context favours the theory that the truck was actually used for personal purposes.

[113] It is important to remember that, whenever an assessment is made using the net worth method, the difference noted is usually the object of an informal draft

assessment, and the taxpayer concerned is given the chance to submit explanations or documents before the formal assessment is made, in order for it to be varied or vacated.

[114] I must rule on the appeals on the basis of the evidence. However, the evidence, on a balance of probabilities, largely consisted in describing and challenging the use of the net worth method to make the assessments. As for the correctness of the assessments, the evidence revealed a number of factors affecting the assessments in both cases.

[115] The respondent assumed that Mr. Gingras' unreported income came from the company, of which he was the sole shareholder. At subparagraph n) of the Reply to the Notice of Appeal, the respondent alleged as follows:

[TRANSLATION]

n) Since Mr. Gingras' sole "active" source of income during the taxation years at issue was the Company, the auditor deemed that the unreported income determined using the indirect "net worth" auditing method was the Company's unreported income;

[116] The evidence showed that Mr. Gingras had inherited \$4,500, which had not been taken into account. The respondent rejected the explanation that Mr. Gingras' spouse was the co-owner of the trailer, despite the note in the contract.

[117] However, the auditor herself admitted that Mr. Gingras did not own some of the cars, even though the registration certificates show otherwise; I refer to his daughters' cars.

[118] By the same logic, I accept Mr. Gingras' claims that his spouse co-owned the trailer and contributed \$200 per month for the duration of the period covered by the assessments, that is, 2003, 2004 and 2005.

[119] The next point is the validity of the penalties and of the period covered by an assessment after the period provided for in the Act. The Court confirms the validity of both the penalties and the relevance of an assessment after the prescribed time limits, for the following reasons. Firstly, the amounts involved were substantial. Secondly, and most importantly, Mr. Gingras, the company's sole shareholder, clearly had full control over the company's practices for keeping proper and accurate records, but these records did not correspond to the actual income and expenses.

[120] Mr. Gingras has always been in total control of the management of both the company he ran and his personal affairs. The auditor's various findings regarding the income and expenses were obviously correct, and therefore the discrepancies resulted from Mr. Gingras' evident complicity, justifying the imposition of the penalties and the assessment for the year that was theoretically statute-barred.

[121] Mr. Gingras' argument that his obligation to ensure that accounting was done by specific, competent people applied only to the company's affairs, not his personal ones, was correct and acceptable, as long as everything was coherent, reliable and credible.

[122] The evidence actually showed that, in reality, he alone was in charge of accounting for both the company and his personal affairs. Moreover, the evidence did not shed any light on this accounting because, once again, Mr. Gingras controlled the situation.

[123] However, on a balance of probabilities, the evidence indicates that the results obtained using the much disparaged and disputed approach are clearly more faithful to reality than those submitted by Mr. Gingras. Consequently, the discrepancies noted were essentially the result of Mr. Gingras' voluntary, if not planned, decision. The penalties were therefore valid, and the respondent was justified in making the assessment after the prescribed time limit.

[124] For all of these reasons, the appeals are allowed in part, and the two files should be referred back to the Agency for reassessments in both cases, given their close connection (see paragraph 115).

[125] The files will be referred back to the Agency for reassessments on the basis of the following:

- Mr. Gingras' spouse contributed to his enrichment in the amount of \$200 per month for the years 2003, 2004 and 2005;
- Mr. Gingras inherited \$4,500 in cash; and,
- lastly, \$1,000 should be subtracted from Mr. Gingras' cost of living for the taxation years at issue.

The penalties imposed are confirmed, subject to the changes to be made.

Signed at Ottawa, Canada, this 2nd day of July 2010.

“Alain Tardif”

Tardif J.

Translation certified true
on this 31st day of August 2010.
Tu-Quynh Trinh, Translator

CITATION: 2010 TCC 343

COURT FILE NOS.: 2008-4125(IT)I and 2008-4127(IT)I

STYLES OF CAUSE: Gilles Gingras and Her Majesty the Queen
Garage Gilles Gingras and Her Majesty the Queen

PLACE OF HEARING: Sherbrooke, Quebec

DATE OF HEARING: October 5, 2009

REASONS FOR JUDGMENTS BY: The Honourable Justice Alain Tardif

DATE OF JUDGMENTS: July 2, 2010

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