

Docket: 2007-3557(GST)G

BETWEEN:

9116-0762 QUÉBEC INC. (BELLE-OR),

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on March 31, April 1 and June 29, 2009,
at Montréal, Quebec

Before: The Honourable Justice Paul Bédard

Appearances:

Counsel for the appellant: Daniel Bourgeois
Counsel for the respondent: Benoît Denis

JUDGMENT

The appeal from the reassessment made under Part IX of the *Excise Tax Act*, the notice of which bears the number 03110101003 and is dated October 7, 2005, is dismissed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 11th day of March 2010.

"Paul Bédard "

Bédard J.

Translation certified true
on this 1st day of June 2010.

François Brunet, Revisor

Citation: 2010 TCC 116
Date: 20100311
Docket: 2007-3557(GST)G

BETWEEN

9116-0762 QUÉBEC INC. (BELLE-OR),

Appellant,

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HER MAJESTY THE QUEEN,

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REASONS FOR JUDGMENT

Bédard J.

[1] This is an appeal from an assessment of \$949,548.21 made under Part IX of the *Excise Tax Act* (the Act) for the period of May 13, 2002, to October 31, 2004 (the relevant period).

[2] The \$949,548.21 in question can be broken down as follows:

Adjustment to net tax calculation	\$679,904.57
Penalties	\$240,239.00
Interest	\$29,404.64
Total	\$949,548.21

[3] The above-noted adjustment to the appellant's net tax calculation of \$679,904.57 can be broken down as follows:

Goods and services tax ("GST") collected and non-remitted	\$5,001.79
Input tax credit ("ITC") not claimed and granted after audit	(\$5,165.88)
Over-claimed ITC (Bijouterie Massis)	\$8,175.09
Calculation error (Celi Kar)	(\$8.06)
ITC disallowed for lack of supplies	\$671,901.62
Total	\$679,904.57

[4] It should immediately be noted that this appeal is not about the disallowed ITC of \$671,901.62. The Minister of Revenue of Québec (the Minister) essentially disallowed the ITC claimed by the appellant on the ground that the tax for which the ITC was claimed was paid to sub-contractors who had produced invoices characterized as invoices of convenience and on the ground that the documentary evidence submitted by the appellant did not meet the documentary requirements prescribed by the Act and the *Input tax Credit Information Regulations* (the Regulations).

Background

[5] During the relevant period, the appellant operated a business selling bulk jewellery under the name Bel Or. I will immediately note that Viken Gebenlian, the appellant's president, testified that the appellant operated another business during the same period, as a gold dealer. It is of note that the appellant did not disclose this activity in its notice of objection, in its notice of appeal or during negotiations with the tax authorities, even though this other activity represented 52% (see Exhibit I-1, volume 2, page 124) of the appellant's sales in 2003 and 44% (see Exhibit I-1, volume 2, page 125) of the appellant's sales in 2004. During the relevant period, the appellant did business with several suppliers. The Minister is challenging the invoices from seven of these suppliers (the "problem suppliers"). These seven problem suppliers are:

- (i) 9111-6566 Québec Inc. The appellant is claiming ITC of \$39,386.17 in regard to goods it allegedly acquired from this supplier;
- (ii) Créations Ziza Inc. ("Ziza"). The appellant is claiming ITC of \$3,139.64 in regard to goods it allegedly acquired from this supplier;

- (iii) Bijouterie A.S.N. ("ASN"). The appellant is claiming ITC of \$40,001.71 in regard to goods it allegedly acquired from this supplier;
- (iv) Bijouterie Massis (1988) Inc. ("Massis"). The appellant is claiming ITC of \$89, 937.15 in regard to goods it allegedly acquired from this supplier;
- (v) 9106-4816 Québec Inc. operated a business under the name Créations Molto-Bella ("Molto-Bella"). The appellant is claiming ITC of \$202,547.28 in regard to goods it allegedly acquired from this supplier;
- (vi) 9140-1133 Québec Inc. operated a business under the name Khristor Inc. ("Khristor"). The appellant is claiming ITC of \$91,262.57 in regard to goods it allegedly acquired from this supplier;
- (vii) 9114-4733 Québec Inc. operated a business under the name Bijouterie Trésor ("Trésor"). The appellant is claiming ITC of \$5,627.09 in regard to goods it allegedly acquired from this supplier.

[6] The Minister acknowledged the legal existence of the problem suppliers. The Minister acknowledged these suppliers had a registration number for GST and source-deduction purposes. The Minister also acknowledged that the problem invoices existed and that the appellant had written cheques in payment of these invoices. However, on the basis of the profile of these suppliers, the Minister presumed that the documentary evidence the appellant submitted were invoices of convenience that created an impression that a regular supply had been made while in reality, no supply of goods had been made by the suppliers named in these documents. In regard to the problem suppliers, the Minister presumed that:

- (i) they did not have the employees, equipment, offices or capacity required to make the supplies the appellant claims to have acquired;
- (ii) the addresses of the suppliers' place of business usually correspond to a residential building or a commercial office with no relationship to the fabrication or distribution of jewellery;
- (iii) these suppliers generally had done no bookkeeping and did not file any net tax returns;

- (iv) these suppliers are part of a network that produces invoices of convenience for the purpose of allowing registrants such as the appellant to obtain disallowed ITC.

[7] It must also be noted that in his Reply to the Notice of Appeal, the Minister claimed to have noted in the audit calculation that:

[TRANSLATION]

- (i) the appellant's net tax reports are generally in credit, which is incompatible with the type of business that the appellant operates, where supplies are only made in Canada;
- (ii) the appellant has an unusually high number of transactions, which only generate minimal benefits or losses;
- (iii) the appellant claims to have paid certain invoices in gold whereas its inventory did not allow for such payments to be made;
- (iv) the appellant claims to have made an unusually high number of gold waste supplies.

Issues

[8] The first issue to address is whether the appellant has the right to claim the ITC of \$671,901.61 in the calculation of its net tax for the relevant period. As an underlying issue, the Court must determine whether:

- (i) the appellant truly acquired the supplies for which it claimed the ITC of \$671,901.61 in the calculation of its net tax;
- (ii) the invoices allegedly prepared by the appellant's suppliers meet the requirements set out in the Regulations.

The second issue to address is whether the Minister was entitled to impose a penalty on the appellant as provided under section 285 of the Act.

Analysis and conclusion

[9] *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336 is to the effect that the Minister uses assumptions to make assessments and the taxpayer has the initial

burden of demolishing the Minister's assumptions. This is met where the taxpayer makes out at least a *prima facie* case that demolishes the Minister's assumptions. Then, after the taxpayer has met the initial burden, the onus shifts to the Minister to rebut the *prima facie* case made out by the taxpayer and to prove the assumptions. As a general rule, a *prima facie* case is defined as one with evidence that establishes a fact until the contrary is proved. In *Stewart v. M.N.R.*, [2000] T.C.J. No. 53, Cain J. states that "[A] *prima facie* case is one supported by evidence which raises such a degree of probability in its favour that it must be accepted if believed by the Court unless it is rebutted or the contrary is proved. Moreover, in *Orly Inc. v. Canada*, 2005 FCA 425, at paragraph 20, the Federal Court of Appeal stated that "the burden of proof put on the taxpayer is not to be lightly, capriciously or casually shifted..." considering "[i]t is the taxpayer's business." The Federal Court of Appeal also stated in the same decision that it is the taxpayer who "knows how and why it is run in a particular fashion rather than in some other ways... He has information within his reach and under his control." As a result, the appellant in this case had to show, with a *prima facie* case, that it genuinely purchased the gold supplies from the problem suppliers. On this matter, the appellant submits it has demolished the Minister's assumptions that it had not acquired any gold supply from the problem suppliers by submitting to evidence the credible and uncontradicted testimony of its president and the directors of the suppliers in question.

[10] In this case, Haroutian Dakessian (director of Trésor), Yessai Kratchenian (director of 9111-6566 Québec Inc.), Hrikor Tufenkjian (director of Tiza), Avedis Karadjian (director of ASN), Vatche Hititian (director of Molto-Bella and Khristor) and Viken Gebenlian testified in support of the appellant's position.

[11] Immediately, I will note that I give no probative value to the testimony of these directors, in particular because the companies they were running were, with no exception, serious tax offenders. The propensity of these companies to avoid their tax obligations was, to say the least, appalling.

[12] In regard to the company Molto-Bella, the evidence shows that:

- (i) for the period of June 1, 2003, to May 17, 2004 (date of its bankruptcy), it did not make or file any net tax report even though it had made taxable supplies of \$28,606,716 during that same period;
- (ii) it had not done any bookkeeping. Marina Raposo, the auditor who audited the company Molto-Bella for the relevant period, testified that she had to reconstruct the sales of Molto-Bella using invoices she had

found at the offices of the company's clients who were also being audited. Moreover, Ms. Raposo explained that she had found only a few purchase invoices;

(iii) the net tax assessed and unpaid for this period is \$17,741,026.

[13] In regard to the company Khristor, the evidence shows that:

- (i) it began its activities on March 23, 2004, a few days before the company Molto-Bella (whose director was also Mr. Hititian) became bankrupt;
- (ii) it became bankrupt on May 31, 2006;
- (iii) it made taxable supplies of \$24,299,807 during its fiscal year ending February 28, 2005;
- (iv) it made taxable supplies of \$24,034,408 during its fiscal year ending February 28, 2006;
- (v) it made taxable supplies of \$591,609 for the period of March 1, 2006, to May 31, 2006;
- (vi) it had never made or filed net tax reports;
- (vii) it never paid the GST collected;
- (viii) many documents (purchase invoices, deposit slips and cheque stubs) had not been given to Ms. Raposo.

[14] In regard to the company Trésor, the evidence shows that:

- (i) for the period of April 2003 to March 31, 2004, it neglected to pay substantial amounts of GST collected. For the company Trésor, the Minister made an assessment of \$658,620.26 (amount of net tax) that had not been paid;
- (ii) since March 31, 2004, it had not filed a net tax report although it had made taxable supplies of \$33,683,721 including \$21,335,328 to the company Khristor;

- (iii) it had not done any bookkeeping;
- (iv) its purchase invoices were missing;
- (v) most of the bank statements were missing;
- (vi) the amount of net tax assessed and unpaid for the period of April 2004, to February 4, 2005, is \$2,499,000;
- (vii) from April 2004 to May 17, 2004, the company Trésor had purchased gold supplies for \$4,753,705 from the company Molto-Bella, whose director was Mr. Hititian. During this same period, the company Trésor had sold gold supplies for \$871,000 to the company Khristor, whose director was also Mr. Hititian.

[15] In regard to the company Massis, the evidence shows that:

- (i) from January 1, 2003, to May 8, 2004, it did not file a net tax report and had not done any bookkeeping, although it had made taxable supplies of \$25,603,078 during that period;
- (ii) all the purchase invoices, all the deposit slips and all the cheque stubs were missing;
- (iii) it became bankrupt on May 7, 2004;
- (iv) taxes collected but not reported for the period of January 1, 2003, to May 8, 2004, were \$1,792,742. I note that this amount remains unpaid;
- (v) the company 9141 7220 Québec Inc. (whose president is the same as that of the company Massis), also a jewellery wholesaler, began operating its business one week before the company Massis declared bankruptcy.

[16] In regard to the company ASN, the evidence shows that:

- (i) from April 2004 to May 2005, it did not file a net tax report although it had made taxable supplies of \$9,250,485 during that period. It must be noted that this sales figure was established by Ms. Raposo based on

invoices found at ASN's clients (who were also subject to an audit) since she was unable to obtain the sales invoices for that period from ASN;

- (ii) the net tax amount assessed and unpaid for the period of May 1, 2001, to December 31, 2005, is \$1,977,178;
- (iii) the company 9141-2882 (whose president is the same as that for the company ASN) was in operation as of June 1, 2004, and never filed a net tax report.

[17] In regard to the company Ziza, the evidence shows that:

- (i) Anthony Starnino (the Agency's auditor who conducted the audit of the company Ziza) was unable to obtain any documents from Ziza related to its activities for the period of February 13, 2002, to March 31, 2003, despite having served a letter of requirement to produce them;
- (ii) Mr. Starnino established the sales figures based on invoices found at Ziza's clients who were also being audited by the Minister. Mr. Starnino established that Ziza had made taxable supplies for \$4,423,000 during this period;
- (iii) the amount of the net tax assessed (and still unpaid by Ziza for this period) was \$823,239.

[18] In regard to the company 9111-6566 Québec Inc., the evidence shows that:

- (i) during the period of January 1, 2002, to February 28, 2003, it did not produce a quarterly statement;
- (ii) it never filed an income tax report;
- (iii) it had not done any bookkeeping;
- (iv) Mr. Starnino was only able to obtain the purchase and sales invoices from 9111-6566 Québec Inc. for the period of February 1, 2002, to November 30, 2002;

- (v) the amount of net tax assessed and still unpaid for this period is \$166,545.

[19] I would add that the answers given by these five directors were generally vague, inaccurate and ambiguous, and often incomprehensible. Not only were their answers usually vague and inaccurate, they were also occasionally contradictory. The vast majority of these directors testified that their companies had filed net tax reports, but that testimony was contradicted by the very credible testimony of Ms. Raposo and Mr. Starnino. Several of these directors stated that their companies had gone bankrupt because the Minister disallowed the ITC they had claimed. These explanations are simply not valid considering these same companies had not even filed any net tax returns. Some of the directors did not even remember the name of the suppliers of the companies they directed and their sales figures. Mr. Tufenkjian claimed that the sales figure for the company Ziza was somewhere around \$500,000 and \$600,000 in 2002 (see transcript of April 1, 2009, pages 115 et. seq.). On this, the evidence shows that the company's sales figure was closer to \$4 or \$6 million. Moreover, Mr. Hititian (the director of Khristor and Molto-Bella) claimed that the sales figure for the company Khristor, for the fiscal year ending June 28, 2005, was around \$10 million (see transcript of April 1, 2009, pages 179 and 180). On this, the evidence shows that the sales figure was closer to \$24 million. Lastly, Mr. Dakessian stated that the sales figure for the company Trésor was around \$2 or \$5 million for 2004 (see transcript of April 1, 2009, pages 52 to 54). The evidence shows that the sales figure was around \$33 million. Of course, the fact these events occurred many years earlier may explain some of the directors' inaccuracies or memory blanks; that being said, such errors regarding the sales figures of the companies they directed are inconceivable. For all these reasons, I grant very little probative value to the testimony of these directors.

[20] In my opinion, it is also very difficult to give any probative value to the testimony of Mr. Gebenlian, in particular for the following reasons:

- (i) first, during his testimony, Mr. Gebenlian did his best to explain that a large portion of the jewellery purchased was sold as scrap gold. In other words, Mr. Gebenlian explained that one of the appellant's main activities consisted in speculating on the price of gold. The evidence in this matter (see Exhibit I-1, volume 1, pages 124 and 125) shows that 48% and 56% of the jewellery purchased by the appellant had been sold as custom jewellery to retail jewellery stores in 2003 and 2004, respectively; the balance of the jewellery purchased was sold as scrap gold at a price usually equal to the weight of the jewellery in ounces

multiplied by the prevailing market price for an ounce of gold on the day of the sale. However, Mr. Gebenlian told Ms. Raposo from the start of the audit that in regard to the appellant's activities, [TRANSLATION] "sometimes the jewellery ordered did not all get sold, so they sold it as scrap, even at a loss" (see Exhibit I-1, volume 1, page 7, from the audit report). Moreover, did the appellant not indicate in its own notice of appeal that it [TRANSLATION] "operated a jewellery shop whose activities were the distribution of bulk jewellery, namely creating custom jewellery"?

- (ii) Mr. Gebenlian claimed many times during his testimony that the stock of jewellery the appellant purchased during the period in question were sold the same day or at the latest two days after they were acquired. The following statements by Mr. Gebenlian are worth citing:

[TRANSLATION]

[758] Q. An invoice like that, you purchased for a good \$30,000...

A. Yes.

[759] Q. ... a little more than \$30,000 taxes included...

A. \$33,000.

[760] Q. ... all that jewellery, how long does it take to get rid of it, to sell it all?

A. As I told you this morning, maybe the same day, maybe two days, but I cannot say. It happens sometimes, half that jewellery I can sell with another five kilos, that might stay for one or two days.

[761] Q. Could you be stuck with that in stock for a month?

A. That is impossible, one month, because I would go bankrupt, because I need to sell. That is also a reason, I cannot wait, I do not have the capacity to wait more than two, three, four days, whatever.

[762] Q. So, basically, jewellery purchased on a Monday, a lot of jewellery purchased...

THE COURT: On average, is sold four days later.

A. On average, a few days later...

[763] Q. ... on Friday there is none left?

A. It must be sold, yes.

[764] Q. Either to other jewellers, other bulk vendors or as scrap gold?

A. Exactly.

I must note that most of the directors of the problem suppliers also confirmed this *modus operandi* during their testimony, that, as the appellant, they sold the lots of jewellery purchased almost immediately. However, the appellant's financial statements (see Exhibit I-1, volume 1, pages 149 to 152) indicate that it could not have disposed of this stock of jewellery purchased in such a short time. In fact, these financial statements indicate that the turnover rate of the appellant's stock (the *Dictionnaire de la comptabilité et de la gestion financière* [Accounting and Financial Management Dictionary], 2nd edition, produced by Louis Ménard, FCA et al., defines the turnover rate as: [TRANSLATION] Ratio of activity indicating the average number of times the inventory is renewed during a period and which allows for an assessment of the level of stock in relation to the stock going out, being consumed or sold, and the efficiency with which the directors manage and dispose of their stock. The turnover rate corresponds to the quotient that results from dividing the disposition, consumption or sale of an article, family of articles or all of an article, by the corresponding average physical inventory. The two terms of this ratio must be expressed on the same basis, either in quantity or in purchase value, the latter generally used more often. Frequently, the average physical inventory is replaced with the inventory at a given time (end of the month, end of the fiscal; year, etc.), when there is no better option; in this case, it is better to use the term specific turnover rate.) was 28.83 for its 2003 fiscal year (the figure obtained by dividing the cost of sales, in this case \$1,926,976, by the average inventory of \$77,606) and 16.50 for its 2004 fiscal year (the figure obtained by dividing the cost of sales, in this case \$3,791,059, by the average inventory of \$229,657). Since the appellant likely operated its business for around 260 days per fiscal year, it would have taken an average of 9.01 business days in 2003 to sell its stock (figure obtained by dividing the number of business days, in this case 260, by the turnover rate for the period in question, 28.83) and 15.75 business days in 2004. Moreover, it can also be stated that if it took the appellant one to three days to sell its stock, as Mr. Gebenlian claimed, the appellant's average inventory in 2003 would have been around \$7,411 and

\$22,233 rather than \$77,606 according to the financial statements and its average inventory in 2004 would have been around \$43,742 rather than \$229,657 according to its financial statements. I note that Mr. Gebenlian was unable to explain these significant discrepancies in the time required to sell the stock stock between his claims and the appellant's financial statements. It is certainly not by providing contradictory evidence on such a fundamental point that the appellant might hope to convince me that it presented a *prima facie* case that demolished the accuracy of the Minister's assumptions.

[21] I would add that the Ms. Raposo's analysis and conclusion (see Exhibit I-1, volume 1, page 10 of her audit report) that indicate it was highly likely that during the period of May 2004 to October 2004, the company Khristor could not have sold gold stock for \$3,262,524 to the appellant, only added to my doubts as to the reality of appellant's acquisition of supplies for which it claimed an ITC of \$671,901.61 in its net tax calculation. Two invoices were issued by the company Trésor (see Exhibit 1-1, volume 3, pages 657 and 660) on September 17, 2004, and November 17, 2004. I noted that these two invoices are identical (same description, same payment terms and same sale price) except they were issued one month apart. What is the likelihood that the price of gold would be the same on September 17, 2004, and November 17, 2004? The submission of these two invoices to evidence only adds to my doubts as to the appellant's real acquisition of supplies for which it claimed an ITC of \$671,901.61 in its net tax calculation. Moreover, it seems unlikely to me that the appellant was actually involved in activities related to gold speculation considering it could not easily make a profit by purchasing jewellery stock at a price that included the cost of labour to make it and then selling it almost immediately after purchase at a price established solely based on the market value of gold on the date of sale.

[22] In my view, the appellant has not met its initial burden of proof, to present at least a *prima facie* case demolishing the Minister's assumptions. The evidence adduced by the appellant consisted essentially in the testimonies of Mr. Gebenlian and the five directors of the problem suppliers; these testimonies were simply not credible in my opinion. Considering my conclusions, it seems useless to address the second issue and determine whether the invoices prepared by the problem suppliers meet the requirements set out in the Regulations.

[23] It is now relevant to answer the following question: did the Minister meet his burden under section 285 of the Act? Since I am persuaded that the appellant did not genuinely acquire the supplies for which it claimed ITC of \$761,901.61 in its net tax

calculation, the Minister has met his burden of proof as set out in section 285 of the Act.

[24] For all these reasons, the appeal is dismissed with costs.

Signed at Ottawa, Canada, this 11th day of March 2010.

"Paul Bédard"

Bédard J.

Translation certified true
on this 1st day of June 2010.

François Brunet, Revisor

CITATION: 2010 TCC 116

COURT FILE NO.: 2007-3557(GST)G

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PLACE OF HEARING: Montréal, Quebec

DATE OF HEARING: March 31, April 1, and June 29, 2009

REASONS FOR JUDGMENT BY: The Honourable Justice Paul Bédard

DATE OF JUDGMENT: March 11, 2010

APPEARANCES:

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 Counsel for the respondent: Benoît Denis

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