

Docket: 2003-1048(GST)G

BETWEEN:

893134 ONTARIO INC. OPERATING AS
MEGA DISTRIBUTORS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on September 29 and 30 and October 2 and 3, 2008 and
February 17, 18, 19, 20, 23 and 24, 2009, at Windsor, Ontario.

Before: The Honourable Justice Réal Favreau

Appearances:

Agent for the Appellant: François Francis
Counsel for the Respondent: Gordon Bourgard and Ronald MacPhee

JUDGMENT

The appeal against the reassessment made under Part IX of the *Excise Tax Act* for the period from July 1, 1998 to November 30, 2000, the notice of which bears No. 08CP117694273 and is dated December 16, 2002, is dismissed with costs in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 30th day of June 2010.

"Réal Favreau"

Favreau J.

Citation: 2010 TCC 357
Date: 20100630
Docket: 2003-1048(GST)G

BETWEEN:

893134 ONTARIO INC. OPERATING AS
MEGA DISTRIBUTORS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Favreau J.

[1] The appellant is appealing against the reassessment made under the *Excise Tax Act*, Part IX, S.C. 1990, c. 45, as amended (the “*Act*”), for the period from July 1, 1998 to November 30, 2000, the notice of which bears No. 08CP117694273 and is dated December 16, 2002. By that reassessment, goods and services tax (“GST”) in the amount of \$768,118.15 was assessed against the Appellant as a result of its failure to collect and remit the GST on its supply of cigarettes to Zelda McNaughton/Zee’s Restaurant; penalties in the amounts of \$60,633.83 and \$181,838.63 were assessed under sections 280.1 and 285 of the *Act*, and interest in the amount of \$55,125.33 was charged under section 280 of the *Act*.

[2] The Appellant has been carrying on since 1997, under the name and style of Mega Distributors, the business of wholesaling tobacco products and other grocery and confectionery items to convenience stores, and has its principal place of business at 1285 Crawford Avenue, Windsor, Ontario. The sole director and shareholder of the Appellant is Mr. François Francis, who employs in the business a number of family members, including his brother Mr. Nayef Francis and his brother-in-law, Mr. Tony Mansour. The Appellant is registered for the purposes of the GST under the name of 893134 Ontario Limited, and its GST number is 142086545. The Appellant indicated 893134 Ontario Limited as its name in its corporate tax returns, GST returns and its notice of objection, and it cashed GST refunds sent to it in that name.

[3] The Appellant alleged that it was approached in December 1998 by Ms. Zelda Kim McNaughton (“Zelda”), a Mohawk status Indian of the Six Nations Reserve (the “Reserve”) in Ontario, who was interested in purchasing large orders of cigarettes for delivery at her business premises in Hagersville on the Reserve. Her business was operating under the name of Zee’s Restaurant and Tobacconist Warehouse (“Zee’s”). The Appellant agreed to sell and deliver large orders of cigarettes to Zelda, The sales commenced on December 16, 1998 and continued until November 29, 2000, and the amounts of the sales were as follows:

December 31, 1998	\$246,777.30
March 31, 1999	\$2,304,086.40
June 30, 1999	\$362,950.32
September 30, 1999	\$1,524,379.12
December 31, 1999	\$866,632.40
March 31, 2000	\$1,569,883.04
June 30, 2000	\$2,918,906.48
September 30, 2000	\$1,615,785.61
December 31, 2000	<u>\$670,200.91</u>
	\$12,081,601.58

The Appellant reported these sales for GST purposes on a quarterly basis until September 30, 1999. Thereafter, beginning on October 31, 1999, the Appellant reported for GST purposes on a monthly basis.

[4] During the period beginning in July 1998 and ending on December 31, 2000, the Appellant’s total sales were approximately \$25,648,000 with over \$19 millions of these being large tobacco sales, of which \$12,081,600 were tobacco sales to Zee’s.

[5] The Appellant paid GST when it purchased the cigarettes but did not collect GST on their resale to Zelda because they were delivered to a status Indian on the Reserve. Zelda was not registered for GST purposes.

[6] The Appellant recognized that the GST payable on tobacco sales to Zee’s, if these were taxable, would total \$845,712. The Appellant was reassessed for the lower amount of \$768,188.15 on the basis of an analysis by the Canada Revenue Agency (“CRA”) of all taxable sales made by the Appellant, including the sales to Zee’s less all GST remittances made by the Appellant. The difference of \$77,523.85 represents an over-remittance of GST by the Appellant.

[7] As a result of the untaxed sales of tobacco products to a Mohawk status Indian, the Appellant claimed a refund in its GST return in its first quarterly period of 1999 ending March 31, 1999. The refund claimed was in the amount of \$200,597.17. The claim was reviewed by a CRA auditor, Mr. Frank D'Agnillo, of the Windsor Tax Services Office. After a review of the documents and records of the Appellant, including the general ledgers in support of the GST claim, the invoices of the suppliers of the cigarettes purchased by the Appellant for resale and the sales receipts signed or initialled by Zelda, and after verification of Zelda's Indian status, the GST refund was approved, as claimed, and paid to the Appellant.

[8] The margins on the sales of tobacco products were thin, and the Appellant claimed that it suffered losses, which it accepted in an attempt to generate sales volume. To handle the large volume of cigarettes which had to be picked up and delivered, the Appellant entered into a 45-month lease for a GMC Topkick on February 19, 1999. The Appellant attempted to become a direct wholesaler for Imperial Tobacco and Rothmans, which would have allowed it to acquire cigarettes directly from the manufacturer at significantly lower cost. The resulting savings would have insured profitability on the low-margin sales.

[9] The Appellant was ultimately designated a direct wholesaler for Rothman's but it was never able to obtain such a designation from Imperial Tobacco.

[10] The Appellant applied for designation, and on August 1, 1999 was designated, as a collector of the tax imposed by the *Ontario Tobacco Tax Act*, R.S.O. 1990, c. T-10, as amended. To be so designated, the Appellant had to provide a \$1,000,000 surety in favour of Her Majesty the Queen in right of the Province of Ontario, which was obtained on July 12, 1999 and renewed the following year, at an annual cost of \$15,000. The Appellant alleged that this application was made in order to become a direct wholesaler.

[11] The audit of the Appellant, which began in the fall of 2000, resulted in a reassessment issued on May 2, 2001 for the period under appeal. That reassessment principally adding as payable the GST that it is alleged should have been collected on all sales to Zelda. A notice of objection to this reassessment was filed on May 28, 2001 and a notice of decision was issued on December 16, 2002 together with the new reassessment bearing the same date.

[12] The audit of the Appellant that began in December 2000 was conducted by two members of the Special Investigations branch of the CRA who had served as part

of a joint forces team that had throughout the year 2000 conducted a criminal investigation of cigarette sales in the Windsor area. The Royal Canadian Mounted Police (“RCMP”) and the Ontario Ministry of Finance, Tobacco Tax Branch also participated in this joint forces investigation.

[13] The alleged scheme investigated by the joint forces team involved cash sales of cigarettes to Windsor convenience store owners, sales which it was alleged were reported by the Appellant for GST purposes as having been made tax-free to a status Indian, Zelda McNaughton. This investigation lasted from February 15, 2000 to October 31, 2000 and involved 52 days of surveillance of the Appellant’s employees or agents (including Mohammed Nizam but not Ali Nizam, although a vehicle registered to Ali Nizam was under surveillance during the investigation). The Nizams were frequently observed by the joint forces investigation team picking up at Costco Wholesale (“Costco”) cases of cigarettes ostensibly ordered by the Appellant and delivering them to convenience stores in Windsor.

[14] Mohammed Nizam began working in the year 2000 on a part-time basis for the Appellant while his brother, Ali Nizam, owned and operated a downtown convenience store known as Tower Variety or Tower Convenience Store.

[15] The investigation of the joint forces team was abandoned in November 2000 without any criminal charges being laid against the Appellant, its employees or agents. Throughout the investigation, the CRA processed the GST returns of the Appellant and sent it refund cheques until the audit started. The monthly GST refunds for October and November 2000 were frozen upon the commencement of the audit by the Special Investigation Branch of the CRA in December 2000.

[16] The Appellant’s records reveal that over the two-year period 145 sales or more in respect of which the Appellant signed invoices were delivered to Zelda. Most of the invoices are initialled (“ZM” or “ZMcNaughton”) at the bottom while the others have the name of Michael McNaughton, Ms. McNaughton’s son, printed on them, but none of them makes mention of delivery of the goods to the Reserve.

[17] In assessing the Appellant, the Minister of National Revenue (the “Minister”) relied on, *inter alia*, the following assumptions set out in paragraphs 13(i) to 13(o) of the Further Amended Reply:

- a. The Appellant’s employment records show that the employees who allegedly made the deliveries to the reserve were not on staff at all the relevant times, or were not at work on the dates when sales were made.

- i. During the period under appeal, the first sale from the Appellant to Zee's was on December 16, 1998 and the last sale to Zee's was on November 29, 2000.
 - ii. Mr. Francis initially claimed that Mohammed Nizam ("Mohammed") made all the deliveries to the reserve.
 - iii. Mohammed worked for the Appellant from January 4, 2000 to October 6, 2000.
 - iv. The days worked by Mohammed, as recorded in the Appellant's payroll records, do not coincide with the alleged deliveries to Zee's.
 - v. Adnan Nizam ("Adnan") worked for the Appellant from May 19, 1999 to October 1999.
 - vi. The days worked by Adnan, as recorded in the Appellant's payroll records, do not coincide with the alleged deliveries to Zee's.
 - vii. Mr. Francis stated that Indians picked up cigarettes at the Appellant's place of business until the time when Adnan started.
 - viii. While Mr. Francis said his brother Nayef Francis ("Nayef") must have made the deliveries during the period between October of 1999 and January 2000, Nayef Francis was unable to provide details of or particulars about any deliveries he made.
- b. The vehicles allegedly used to deliver the cigarettes to the reserve were not large enough to hold the quantities being supplied at one time.
- i. The two employees who were alleged to have made most of the deliveries, Mohammed and Adnan, were not licensed to drive the Appellant's only large truck, a leased GMC Topkick.
 - ii. Both Mohammed and Adnan have indicated that they never used the Appellant's leased GMC Topkick to make deliveries to Zee's.
 - iii. Adnan claims to have used the Appellant's blue Chrysler mini van to make the deliveries to Zee's.
 - iv. Mohammed claims to have used his own Astro van to make deliveries to Zee's.

- v. Nayef indicated that he used mainly the Appellant's blue Chrysler mini van or his own Grand Caravan to make the deliveries. He also drove the Appellant's leased GMC Topkick a couple of times.
 - vi. The carrying capacity of the vans is approximately 30 cases or 1500 cartons of cigarettes.
 - vii. Based on the sales records available from the Appellant, of 145 orders allegedly delivered to the reserve, 121 were over 30 cases each. Some orders were as high as 174 cases and some that were under 30 cases had additional orders for the same date, which would put them over [the]30 case capacity of the vans.
 - viii. It would be physically impossible to deliver the volume of cigarettes shown on the Appellant's individual sales receipts to Zee's in the vans with the trips said to have been made.
- c. The Appellant claimed that he insisted on being paid in cash by Zelda McNaughton because he was concerned about counterfeit money and NSF cheques.
 - d. The Appellant's records show that many payments were made by "debit", which suggest payment occurred by debit card at the Appellant's premises.
 - e. Zelda McNaughton allegedly always paid for the cigarettes in cash at the time of delivery.
 - f. The individuals that the Appellant identified as drivers provided a dollar range of cash payments they claim to have collected when goods were dropped off on the reserve. The amounts are not consistent with the quantity of goods the Appellant reports as being delivered to the reserve.
 - i. When asked what was the most cash they ever had to bring back from the reserve to the Appellant, Mohammed said \$40,000, Adnan said \$40,000 to \$50,000 and Nayef said about \$30,000.
 - ii. According to the Appellant's records, the majority of the sales (79% of all orders) to Zee's were for well over \$50,000. In fact, 60% of them were over \$75,000 and 37% of them were over \$100,000.
 - g. The said cigarettes were not delivered by the Appellant or an agent of the Appellant to the purchaser at an address located on an Indian Reserve.

[18] Concerning the assumptions made in paragraph 13(i) of the Respondent's Further Amended Reply, the Appellant stated in the Answer to the Notice of Reply

that its payroll records were accurate as to the total hours worked by its employees but were not accurate as to the particular dates worked.

[19] Adnan Nizam testified at the hearing. He admitted having been on the payroll of the Appellant from May 26, 1999 to October 20, 1999, and he confirmed having made deliveries of cigarettes to the Reserve twice a week. The Appellant's payroll records show 8 hours of work per day at \$7.00 per hour paid every two weeks. He stated that he was paid cash. The trip from Windsor to the Reserve normally took him from three hours to three hours and 15 minutes.

[20] In cross-examination, he described what happened in a typical daily operation. He would receive a telephone call from François Francis or from his brother the day before a delivery had to be made to the Reserve. On the day of the delivery, he took the Appellant's blue minivan parked at the Appellant's place of business on Crawford Street, which was already loaded with cigarettes in sealed cases (the maximum capacity of the van was 23 to 25 cases of cigarettes). His destination was Zee's where he met Zelda. The van was unloaded, Zelda signed the receipt already made up, and she handed to him the receipt and the payment for the cigarettes in cash. He counted the money and put it in a bag. On his way back, he filled up the minivan with gasoline and parked the van at the Appellant's place of business. He went inside the Appellant's office and handed over the receipt from Zelda, the cash and the gasoline receipt. During his testimony, he said that he never kept the cash, that he had no access to the place where the cash was kept and that he himself never placed any orders for Zelda.

[21] He further confirmed that: (i) there was only one receipt per load; (ii) he never made more than one trip per day; (iii) he dealt only with Zelda; (iv) he never brought back the cigarettes; (v) Zelda never gave him orders for cigarettes; and (vi) he never used the minivan to make local deliveries of cigarettes. Concerning the signature of the receipts he confirmed that he never saw Zelda actually signing them and he could not remember if the receipts had duplicates and if some receipts had a different signature.

[22] Mohammed Nizam testified at the hearing. He confirmed that he worked for the Appellant in the year 2000 (from March to October) delivering cigarettes to Zee's on the Reserve. The payroll record of the Appellant shows that Mohammed Nizam did not work during the months of January and February of the year 2000. He said that he used his own vehicle, a red GM Astro van, to make the deliveries. The maximum capacity of his van was about 30 cases of cigarettes (50 cartons per case). The van was loaded at the Appellant's place of business and the receipts to be signed

were given to him. Upon delivery, the receipts were signed and payment for the cigarettes was made in cash, usually in amounts varying from \$40,000 to \$50,000. The receipts and the cash were brought back and handed over to François Francis. When confronted with the receipts that were signed during the period he made deliveries to the Reserve, he did not remember having collected the amounts of money shown on the receipts, which, with the exception of only one receipt, exceeded by far the maximum amount of money he said he had handled. Finally, he also confirmed in a rather weak way that he had made deliveries of cigarettes in the Windsor area.

[23] For the period from December 1998 to May 1, 1999 (before Adnan started working for the Appellant), there is no evidence of deliveries of cigarettes to the Reserve. At one point, François Francis said that Zelda was picking up the cigarettes at the Appellant's place of business, and, at another, he said that the deliveries were made by his brother, Nayef.

[24] Zelda McNaughton testified at the hearing. She confirmed that the receipts for the deliveries of cigarettes on the Reserve were prepared by the Appellant and given to her for signature. She recognized her signature on approximately 70% of the receipts. Other receipts were signed by her sisters, Kelly and Allison, and some by her eight-year-old son, Michael. In her testimony, she said that she was buying cigarettes for the Appellant and that the cigarettes were picked up on the Reserve. No documentary evidence supporting this assertion was however filed in court. No invoices, no orders and no proofs of payment were provided to the Court.

[25] The cigarettes delivered on the Reserve were allegedly always paid for in cash at the time of delivery. In the following extract from the examination for discovery of François Francis held on June 21, 2005, he claimed to have insisted on being paid in cash by Zelda because he was concerned about counterfeit money and NSF cheques.

609. Q. What about – What was the discussion about payment for the cigarettes? Was it cash and carry?

A. Well, once they delivered the product she will have cash for them. She will pay them for it.

610. Q. And pay them how, with a check?

A. No, usually cash.

611. Q. Usually cash or cash only?

- A. Cash only.
612. Q. Did you insist that it be cash only?
- A. Yes.
613. Q. And why was that?
- A. Well, it's too many factor. You'll be afraid from an NS (sic) check to take check from her.
614. Q. You'd be afraid of an NSF—an NSF check—
- A. Yes.
615. Q. -- if you took a check from her. So you wanted cash from her.
- A. Yes.
616. Q. That was the only—And did she ask for payment terms?
- A. Yes.
617. Q. What payment terms did you offer her?
- A. I didn't offer her any terms.
618. Q. No terms.
- A. I told her I can't afford it.
619. Q. Cash only.
- A. Yes.

[26] Contrary to what the Appellant claimed, a number of receipts signed by Zelda shows no payment made, or balance payable, or amount due, which suggests that the payment occurred by credit card at the Appellant's premises. The evidence clearly establishes that the receipts were prepared in advance by the Appellant and that the payments for the cigarettes delivered on the Reserve were not all made in cash.

[27] François Francis testified at the hearing. He stated that the cash brought back by the drivers was kept in a locked filing cabinet and that the drivers had access to

the keys to the cabinet. This was contradicted by Adnan Nizam in his testimony. There is also no evidence that the cash was deposited in a bank account.

[28] When questioned concerning the person or persons who filled the orders from Zelda, he said that everyone could fill the orders, including the drivers. No evidence of orders from Zelda was produced in court and no information was provided on how the orders from Zelda were received (by fax, by telephone or by e-mail), by whom the orders were filled or by whom the receipts were prepared. Zelda required custom-packed cigarettes and the drivers denied having prepared such orders for Zelda.

[29] In the continuation of his examination for discovery on June 22, 2005, François Francis stated that the Appellant made no deliveries of cigarettes to clients other than Zelda in 1999 and 2000. From the Appellant's client list, it is clear that the Appellant did make deliveries of cigarettes to other clients (see paragraphs 37 and 38 below).

[30] In March 2000, an agreement between the Ontario Ministry of Finance – Special Investigations Branch, the RCMP and the CRA was entered into to facilitate the cooperation of those three agencies in a specific joint forces operation (“JFO”). The objective of this JFO was to gather evidence against persons and corporations who had allegedly illegally evaded payment of the provincial retail sales tax and the federal goods and services tax, thereby allegedly committing offences contrary to the *Tobacco Tax Act*, the *Excise Tax Act* and the *Criminal Code* of Canada.

[31] Mr. Ian McGuffin, the project supervisor for the CRA on the JFO, testified at the hearing. He stated that the JFO was set up because the Ministry of Finance of Ontario had received information that cigarettes were being distributed at discounted prices to local retailers in the Essex County area without the GST being collected. At one of the first JFO meetings, it was agreed that evidence to prove that the cigarettes were delivered to local retailers was necessary in order to lay criminal charges (reference note of the JFO meeting dated February 24, 2000). According to him, the principal target was one of the Nizam brothers, but for the CRA, the principal target was the Appellant.

[32] The witness explained that a comprehensive audit of the Appellant started in the month of December 2000 and that at that time the criminal investigation was dropped. In the course of the audit, Costco agreed to provide all information concerning the purchases of cigarettes made by the Appellant. He also explained that various meetings were held with the Appellant, for example on February 21, 2001, March 31, 2001 and April 4, 2001. The reassessment was made on May 2, 2001 on

the basis of the lack of records that were adequate to prove deliveries of cigarettes on the Reserve, and the collection procedure started on May 14, 2001. Penalties were assessed under sections 280.1 and 285 of the *Act*, and interest was charged pursuant to subsection 280(1) of the *Act*. The Court notes that access to the completed audit file was denied to the Appellant until the reassessment had been issued.

[33] Mr. Bernie Campbell, the project officer for the RCMP on the JFO, testified at the hearing. He confirmed that he participated in the joint forces operation's surveillance of the pickup and delivery of cigarettes by the Appellant, which was carried out over a fifty-two day period between February 15, 2000 and October 31, 2000. He acknowledged that he was the author of an undated report which was an update of the investigation conducted with regard to François Francis and the Appellant (Exhibit A-1, Inv. 010, 011, 012 and 013). The report was obviously prepared as part of the preliminary investigation during which Mr. Michael Courtney of Courtney Wholesale and Confectionary was interviewed regarding his involvement with the Appellant. Mr. Courtney explained that he was a supplier of cigarettes to the Appellant before the Appellant started to buy them from Costco. Mr. Courtney was apparently reluctant to prepare the orders from the Appellant "custom packed" (that is, with a variety of brands in each case). The report states that two Costco employees were interviewed and that they referred to the Nizam brothers as the "Mega men". The following extracts from the report are particularly interesting:

With respect to the Nazim [*sic*] brothers the emphasis of the investigation was shifted to Tower Variety and surveillances were carried out through April and May on the Nazims (*sic*). Their activities as a result of these surveillance [*sic*] have confirmed that they are the moving force behind this crime. They appear at Costco six days per week and pick up large volumes of yellow banded cigarettes which are delivered to local retailers. Typically the local retailers have been determined to not be of the large chain variety but rather unfranchised corner stores. It has also been noted that these stores advertise cigarettes at what amounts to discounted prices.

(Exhibit A-1, Inv. 012, Lines 1 to 10).

. . . Costco sales will and have been approximately 250,000 per week since Mega began doing business with them. The same two people pick up tobacco on a daily basis and they always arrive about the noon hour. The orders are prepared on a daily basis and are based of [*sic*] faxes which are sent to Costco. These faxes are numbered by Mega and Costco custom packs them. These men (Nazim (*sic*) brothers) have advised Costco employees that their Tuesday pickup is the only one that is delivered to Mega.

(Exhibit A-1, Inv. 012, Lines 15 to 22)

This investigation has progressed in a satisfactory manner. The informant information has been varified [*sic*] through surveillance and investigation. There is little doubt at this point that Mega distributing, François Frances (*sic*), Mohamad Nazim (*sic*), Ali Nazim (*sic*) and others are committing the offence of fraud by seeking and obtaining a G.S.T. rebate on what amounts to false information.

(Exhibit A-1, Inv. 013, Lines 1 to 6)

[34] It has been established that the surveillance was conducted by Bernie Campbell*, Rich Cowell*, Mark Gillian, Steve Rose*, Michael Kanras*, Lenny Washburn, Paul Desjarlais, Cheryl Hayden, Arnie Levy, Thomas Archibald* and Lorna Kennedy, all of whom were employed with the RCMP, by John Uprichard, Jennifer Wong, Steve Irons* and Mike Martin, all of whom were employed with the Ontario Ministry of Finance, and by Gerald Hoofst* and Pamela Howick* of the CRA (* testified at the hearing). On a given day of surveillance, there were normally two teams in place. Each member of the surveillance team had a number and the numbers of the members who were present on a surveillance day had to be mentioned on the surveillance report of that day.

[35] Out of the 52 days of surveillance, there were at least 20 days on which an employee of the Appellant was observed picking up cases of cigarettes at the Costco located at 4411 Walker Road, Windsor, Ontario, and delivering them to local convenience stores. On many occasions, the number of cases of cigarettes picked up at Costco was identified and the number of cases of cigarettes delivered at each store was also observed. The time at which the deliveries took place at the stores was also noted on the daily report prepared by a member of the surveillance team.

[36] For every day of surveillance, a report had to be prepared. The report normally contained: (1) the code numbers of the individuals making up the two-person teams conducting the surveillance; (2) the place and time at which the surveillance commenced; (3) the plate number of the vehicles followed and the names of the drivers; (4) the number of cases of cigarettes loaded into the followed vehicles; (5) the places and time of the deliveries and the number of cases of cigarettes delivered at each store; and (6) the time at which the surveillance ended. The code number of the member of the surveillance team appeared beside each observation. All surveillance reports were filed in court as Exhibit A-1, Inv. 068 to Inv. 252.

[37] According to the surveillance reports, deliveries of cases of cigarettes were observed at the following stores, all located in the Windsor area:

A garage (962 Lake Trail Drive)
Ace Convenience Store (corner of Moy and Wyandotte Streets)
Ace Variety
Benson's Corner (corner of Wyandotte and Cursy Streets)
Big Bear Food Mart and Convenience (Ambassador Mall, 1660 Huron Church Road)
CK Convenience Store (Lambton Plaza on Huron Church Road)
Corner Store (3244 Walker Road)
Corner Store (3250 Walker Road)
Corner Store (6915 Wyandotte)
Corner Store (corner of Erie and Victoria Streets)
Corner Store (corner of Wyandotte and Rose Streets)
Corner Store (Sandwich Street)
Corner Store and Variety (238 Erie Street)
David's Variety (Peter Street)
David's Variety Store
Downtown Lottery and Cigar Shop Store (159 Erie Street)
Fred's Variety Spot
Fred's Variety Spot (1605 Westminster)
Glengarry Confectionary
H & V Variety (Peter Street)
Half Price Variety (1705 Malloy)
Herfy's Variety (857 University Avenue)
Herfy's Variety Store (851 University Avenue)
LaSalle Petroleum & Variety (611 Front Road)
Maple Leaf Gas Bar and Variety (3511 Wyandotte)
Midway Convenience
Mina's Variety (2919 Tecumseh Road)
Park Market Square (corner of Ottawa and Walker Streets)
Park Midway Convenience Store (corner of Wyandotte and Sawson Streets)
Royal Variety (corner of Tecumseh and Church Streets)
S & A Convenience (3750 Walker Road)
Sandwich Smoke Shop
Sunny's Gas and Variety (corner of McDougall and Howard Streets)
Sunny's Gas Bar (University Mall)
Sunrise Variety (corner of Wyandotte and Elm Streets)
Sunshine Variety (1098 Wyandotte)
Sunshine Variety and Convenience Store (corner of Pine and Ouellette Streets)

Sunshine Variety Store
Tower Convenience Store
Zom Laundry and Variety (1705 College Street)

[38] Of the above, only the following were not on the Appellant's customer list for the period from 1997-01-22 to 2001-01-22 that was prepared in the course of the audit and filed as Exhibit R-3(2), Tab 46:

Park Market Square
the garage
Maple Leaf Gas Bar

At the hearing, it was stated that the Corner Store and Variety on Erie Street was not a regular customer of the Appellant.

Costco orders

[39] Three employees of the Windsor Costco testified at the hearing: Mr. Ronald Wayne Rewakoski, warehouse manager, Mr. Dany Daguerre, cashier, and Mr. Vino Perrera, assistant warehouse manager. They explained how orders for cigarettes were received from the Appellant, how orders were filled, paid for and delivered. Mr. Rewakoski explained that his first contact with the Appellant was in response to a call from François Francis. The meeting took place at the Appellant's warehouse. On that occasion, a membership card was signed and the parties agreed on how orders of tobacco would be placed and how they would be filled and paid for. The orders had to be placed by fax the day before the delivery date, and each fax bore a number assigned in sequence according to the number of orders received during the day. The Appellant required that each order be custom-packed for its customers. Each fax was registered as a separate order with its own total. In many cases, the fax number was also written on the register receipt and on the boxes for each order so as to facilitate delivery. Payment for the tobacco purchases was made in cash, by cheque or by credit card (American Express) upon delivery. Payments in excess of \$10,000 had to be made in cash or by certified cheque.

[40] Mr. Daguerre confirmed the procedure followed: the orders were received by fax the day before delivery; the orders were numbered in sequence; the cigarettes ordered were put in cases and each case was identified by a number. Once the packing was finished, he would register the sale, prepare the invoice and call François Francis or his brother Nayef to confirm the total amount of the invoice. Deliveries of tobacco products to the Appellant were made once a day four times a

week upon payment of the invoices. The orders of tobacco products were normally picked up by Mohammed Nizam until the time he tried to pay with counterfeit money. Thereafter, François Francis or his brother Nayef took the deliveries from Costco. The witness also explained that the Mohammed Nizam's minivan could hold a maximum of 30 cases and that, upon delivery, Mohammed Nizam would give instructions as to how the cases were to be loaded into the minivan. When payment by certified cheque was required, Mohammed Nizam had to pick up the cheque at the Appellant's place of business and have it certified at the National Bank of Canada. Once the cheque was certified, delivery could take place upon handing over that certified cheque.

[41] Mr. Perrera confirmed that he called the police after he realized that Mohammed Nizam had made a \$20,000 cash payment in counterfeit money, all the bills had the same serial number.

[42] Some tobacco orders were faxed from Tower Variety, the store owned and operated by Ali Nizam. With only a few exceptions, the orders were recorded in the Appellant's books and the Appellant paid for all of them no matter where the orders had come from, and it claimed GST refunds in respect of all of them. Furthermore, the Tower Variety fax orders matched with the appellant's purchase records, as shown in Exhibit R-3(7) Tab 100.

[43] The cheques made to the order of Costco in payment of tobacco orders bear only one signature and François Francis recognized at the hearing that a majority of them were signed by him. The Appellant's cheques to Costco issued during the period beginning on December 31, 1999 and ending on December 18, 2000 were filed in court as Exhibit R-9. Statements of account from the National Bank of Canada showing the activity in the Appellant's bank account during the period from December 1, 1998 to December 31, 2000 were filed as Exhibit R-3(8), Tab 107.

[44] The following Costco documents were also filed in court, as Exhibits R-8(1) to R-8(16):

- the fax orders from the Appellant for the calendar year 2000;
- the sales records for the calendar year 2000, which identified the number of items sold, the price for each item, the total price of the order and the mode of payment; and
- monthly statements showing the daily orders.

The American Express credit card payments

[45] In addition to the documents referred to in paragraphs 43 and 44 above, Amex Bank of Canada statements for the credit cards held by the Appellant's owner, François Francis, and by the employees of the Appellant that had been used to pay for purchases from Costco made during the period from January 1, 2000 to January 31, 2001 were also filed in court, as Exhibit R-3(9) Tab 108. These statements were obtained following an application by the CRA pursuant to subsection 289.1(1) of the *Act* for an order requiring the Amex Bank of Canada to provide it with the information and documents set out in the requirement issued to the bank. The application has been granted by Frenette D.J. (see *Minister of National Revenue v. Amex Bank of Canada*, [2008] G.S.T.C. 169 (FC)).

The Audit

[46] The GST audit started on December 1, 2000 with the initial interview of François Francis conducted by Ms. Pamela Howick and Mr. Gerald Hooft. Other interviews were held with Mr. Francis on January 21 and 23 and on February 14 and 21, 2001. Mr. Francis was cooperative in providing the information requested. The most difficult part of the audit of the Appellant was the computation of the GST collected by the Appellant on its sales and the identification of the GST component of the purchases from Costco, which were recorded on thousands of tapes. The GST computations are not contested by the Appellant.

[47] While the audit was being conducted, the CRA continued to issue the GST refunds claimed by the Appellant during the year 2000. The last claim approved was for the month of November of that year. The GST refunds for the months of October and November 2000 were frozen upon the commencement of the audit by the CRA in December 2000.

[48] The assessment issued as a result of the audit was dated May 2, 2001 and the CRA initiated the collection procedure on May 14, 2001.

Admitted facts

[49] A Summary of Requests to Admit Facts and Documents was filed in court as Exhibit R-7 (the "Summary"). Having failed to respond within the prescribed time to the various requests made pursuant to section 130 of the *Tax Court of Canada Rules (General Procedure)* (the "Rules"), the Appellant is deemed, pursuant to

paragraph 131(2) of the Rules, to admit the truth of the facts and the authenticity of the documents listed in the Summary.

[50] The truth and authenticity of the following facts and documents, among others, were admitted:

1. On the dates shown in paragraph 2 of the Summary, no tobacco sales were made to the company or the persons shown in paragraph 1 of the Summary, namely:
 - a) 1256470 Ontario Ltd. O/A Windsor Tower Variety;
 - b) Ali Nizam;
 - c) Mohammed Nizam;
 - d) Fadi Nizam;
 - e) Nazim Nizam.
2. Documents in the Respondent's document production in Costco Documents Volumes 1 to 16, numbered COSTCO 0001-4277, were sent from Mega Distributors if the fax transmission line indicates the sender was Mega Distributors or Mega Food Distributors.
3. Documents in the Respondent's document production in Costco Documents Volumes 1 to 16, numbered COSTCO 0001-4277, were sent from Windsor Tower Convenience Store or Windsor Tower Variety if the fax transmission line indicates the sender was "Panasonic Fax System 4830053".

[51] The "fax lines from Costco forms faxed by Tower Convenience" were filed as Exhibit R-10.

The Appellant's position

[52] In paragraphs 13 to 18 of the amended Notice of Appeal, the Appellant states that the joint forces investigation team was unsuccessful in connecting the Appellant with the activities of the Nizam brothers and that the investigation was abandoned in November 2000 without any criminal charges being laid. The main targets were the Nizam brothers, who were frequently observed by the investigation team picking up at Costco cases of cigarettes, ostensibly ordered by the Appellant, and delivering them to convenience stores in Windsor.

[53] The Appellant claims that it was victimized by the Nizams and that Mohammed Nizam's activities in placing cigarette orders through the Appellant on the basis that they were for Zelda and then delivering those cigarettes to local convenience stores were not known to the Appellant and were not authorized by it.

[54] Save for the unauthorized activities of Mohammed Nizam, the Appellant delivered all cigarettes purchased by Zelda to her place of business on the Reserve. Over the two-year period from December 16, 1998 to November 29, 2000, the Appellant's records reveal 145 sales to Zelda in respect of all of which the Appellant obtained signed invoices acknowledging receipt.

[55] The Appellant pointed out inconsistencies in the observations made by the joint forces investigation team. For example, some deliveries were not made to clients of the Appellant. This is the case with deliveries seen made to Downtown Lottery and Variety on March 28 and April 27, 2000; the owner of that store, Mr. Charlie Sleiman, testified at the hearing and confirmed that he never purchased cigarettes from the Appellant. On some days, the surveillance team reported no activity when in fact purchases were made by the Appellant; on other days, the number of cases purchased by the appellant was smaller than the number of cases picked up, or there were returns to Costco that were not accounted for. For example, for May 1, 2000 there was an observation that one case of cigarettes was delivered at Suny's Gas Bar at University Mall while no sale was recorded in the Appellant's books.

Analysis

[56] The issues are as follows:

- a) Did the Appellant or its agents deliver the tobacco products at issue to Zelda/Zee's at an address located on a reserve?
- b) If the tobacco products were not delivered on a reserve, should the Appellant be responsible for acts of its employees?
- c) Was the Appellant grossly negligent in failing to collect and remit GST of \$768,188.15 and is it therefore liable for a penalty of \$192,047.03 pursuant to section 285 of the *Act*?

[57] Section 87 of the *Indian Act*, R.S.C. 1985, c. I-5, exempts from taxation any Indian's personal property that is situated on a reserve. Subsections 87(1) and (2) read as follows:

87. (1) Notwithstanding any other Act of Parliament or any Act of the legislature of a province, but subject to section 83, the following property is exempt from taxation, namely,

- (a) the interest of an Indian or a band in reserve lands or surrendered lands; and
- (b) the personal property of an Indian or a band situated on a reserve.

(2) No Indian or band is subject to taxation in respect of the ownership, occupation, possession or use of any property mentioned in paragraph (1)(a) or (b) or is otherwise subject to taxation in respect of any such property.

[58] As the *Act* does not deal specifically with Indians, the CRA published on November 25, 1993, Technical Information Bulletin B-039R entitled "GST Administrative Policy – Application of the GST to Indians", amended by Notice of Change in July 1996. This version of the Bulletin replaced the earlier version dated January 4, 1991.

[59] Under the administrative policy set out therein, Indians may acquire property off reserve without paying the GST, provided :

1. they have the appropriate documentation to show the vendor; and
2. the property is delivered to a reserve by the vendor or the vendor's agent.

[60] For off-reserve purchases of property delivered to a reserve, the vendor is required to maintain adequate evidence that the sale was made to an Indian registered under the *Indian Act* and proof of delivery indicating a reserve as the destination of the property.

[61] Where merchandise is delivered to a reserve in the vendor's own vehicle, the Bulletin specifies that the vendor must maintain proof that delivery was made to a reserve. This will be indicated on the invoice of the vendor and on the vendor's internal records (e.g., mileage logs, dispatch records).

[62] The reassessment was made on the basis that there were no deliveries of tobacco products on an Indian reserve and that section 87 of the *Indian Act* did not

relieve the Appellant of the obligation of collecting and remitting GST on the supply of the said tobacco products.

[63] In view of the evidence submitted by the parties, I am of the opinion that it has not been proven on a balance of probabilities that delivery of the tobacco products took place on the Reserve. In arriving at that conclusion, I considered the observations summarized by counsel for the Respondent, who divided the period covered by the reassessment into four periods, as follows:

- (a) From December 1998 to May 1999, that is, prior to the hiring of Adnan Nizam
 - As admitted by François Francis, there was no evidence of the delivery of tobacco products to an Indian Reserve. Zelda was picking up the cigarettes at the Appellant's warehouse.
- (b) From May 1999 to October 1999
 - Following a call from François Francis, Adnan Nizam was asked to make deliveries of cigarettes to Zelda.
 - François Francis told him how to get to the Reserve and how to handle the cash received after the signature of the receipts.
 - The receipts were unreliable because the van used to make the deliveries had a maximum capacity of only 23 to 25 cases of cigarettes and because Adnan never handled cash amounts as significant as the amounts shown on the receipts.
- (c) From October 1999 to January 2000
 - There was no evidence of any delivery of tobacco to the Reserve during that period.
- (d) From January 2000 to November 2000, that is, the time during which the deliveries were made by Mohammed Nizam).
 - For the months of January and February, Mohammed Nizam was not on the payroll of the Appellant, and no evidence was submitted as to who made the deliveries to the Reserve during those two months.

- The red Astro van allegedly used by Mohammed Nizam to make the deliveries of the tobacco products to the Reserve had a maximum capacity of 30 cases of cigarettes, and only one receipt came close to the kind of money that he testified he had handled.
- The receipts submitted were also not reliable because a considerable number of them were not signed by Zelda.

[64] The following inconsistencies were also taken into consideration by the Court:

- (a) Contrary to the Appellant's assertion, it has been clearly demonstrated through the surveillance that the Appellant's tobacco products were delivered to local stores by the Appellant, or its agents, or its employees.
- (b) The reference to the fact that Zee's was a customer that had to pay cash for all its purchases of tobacco products from the Appellant was also incorrect considering the entries made on the receipts.
- (c) The assertion that Mohammed Nizam acted without having been authorized to do so by the Appellant was also contradicted by what Mohammed Nizam stated in his examination for discovery, namely that he had authority to do everything, to take and prepare orders, and to handle the cash received.
- (d) Contrary to the claim made by François Francis that he had no knowledge of the preparation of the receipts for the sale of tobacco products to Zee's, the evidence reveals that he is a well-informed business person who is very knowledgeable concerning the Appellant's operations and grocery distribution in general. He arranged the purchases of custom-packed cigarettes with the Costco manager. He was the person who was called by the Costco cashier to confirm the amounts of the invoices. He alone signed most of the cheques issued in payment of the orders from Costco and he was the person to whom Costco's monthly report showing the Appellant's daily orders during the month was sent.

[65] Having determined that the tobacco products were not delivered on the Reserve, the Court must now consider whether or not the Appellant should be

responsible for the acts of the Nizam brothers and, in particular, for the acts of Mohammed Nizam, while they were employed by the Appellant.

[66] Considering the facts, I am of the opinion that the Appellant did not adduce sufficient evidence to enable me to conclude that Mohammed Nizam was placing cigarette orders through the Appellant on the basis that they were for Zelda but delivering them to local convenience stores without the knowledge and authorization of the Appellant. I cannot believe that this could have been done in the small Windsor market, particularly when almost all the deliveries were made to the Appellant's customers. In any event, the Appellant, as the employer of Adnan and Mohammed Nizam, is vicariously liable for those employees' authorized acts and for their unauthorized acts having a connection with the authorized acts. The vicarious liability principle was considered by the Supreme Court of Canada in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*, [2001] 2 S.C.R. 983, 2001 SCC 59, and in *Bazley v. Curry*, [1999] 2 S.C.R. 534.

[67] The penalty provided for in section 285 of the *Act* has been assessed against the Appellant. The section 285 penalty corresponds to that in subsection 163(2) of the *Income Tax Act*. Generally speaking, section 285 of the *Act* imposes a penalty on a person for knowingly, or under circumstances amounting to gross negligence, making or being a party to the making of a false statement or an omission in a return or other document relating to a reporting period or transaction of the person. The penalty is equal to the greater of \$250 and 25% of the total of any reductions in tax owing and any increases in refunds or rebates as a result of the false statement or omission.

[68] The notion of "gross negligence" for the purpose of applying a penalty under the *Act* or the *Income Tax Act* is defined in the following terms by Justice Strayer in *Venne v. The Queen*, 1984 DTC 6247, at page 6256:

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

[69] The burden of demonstrating that the Appellant has been grossly negligent is on the Minister of National Revenue, and the question of whether a finding that the Appellant acted knowingly or with gross negligence requires further scrutiny of the evidence.

[70] In this instance, I am of the opinion that the Respondent has met the burden of establishing by direct evidence that the Appellant was grossly negligent in failing to collect and remit GST and that it made, participated in, assented to or acquiesced in the making of a false statement in a return in respect of the supply of tobacco products to Zee's.

[71] The Appellant is a corporation carrying on a business that is owned by François Francis, who participated fully in the daily operations of the business. François Francis knew, or ought to have known, that for a sale to a status Indian to be exempt from GST he was required to deliver the goods to an Indian Reserve and to maintain proof of delivery. In paragraph 10 of the Answer filed by the Appellant's counsel on June 16, 2003, the Appellant admitted having received from its accountant on May 10, 1999 a copy of the spring 1999 edition of the GST News dealing with sales to Indians.

[72] On the facts, I find that the Appellant knowingly made false statements in its GST returns and made misrepresentations in order to make it appear that tobacco was being delivered to the Reserve when in fact it was not.

[73] The Court also holds that the Appellant is estopped by its own representations from relying on an error in the name under which it has been reassessed. The reassessment remains valid and binding despite the irregularity consisting in the misnomer with regard to the Appellant.

[74] The appeal is dismissed with costs.

Signed at Ottawa, Canada, this 30th day of June 2010.

"Réal Favreau"

Favreau J.

CITATION: 2010 TCC 357

COURT FILE NO.: 2003-1048(GST)G

STYLE OF CAUSE: 893134 Ontario Inc. Operating as Mega Distributors v. Her Majesty the Queen

PLACE OF HEARING: Windsor, Ontario

DATES OF HEARING: September 29 and 30, and October 2 and 3, 2008 and February 17, 18, 19, 20, 23 and 24, 2009

REASONS FOR JUDGMENT BY: The Honourable Justice R al Favreau

DATE OF JUDGMENT: June 30, 2010

APPEARANCES:

Agent for the Appellant: Fran ois Francis

Counsel for the Respondent: Gordon Bourgard and Ronald MacPhee

COUNSEL OF RECORD:

For the Appellant:

Name:

For the Respondent: Myles J. Kirvan
Deputy Attorney General of Canada
Ottawa, Canada