Docket: 2009-1756(IT)G

BETWEEN:

DONNA MCMILLAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on July 4, 2011 at Toronto, Ontario

Before: The Honourable Justice Wyman W. Webb

Appearances:

Counsel for the Appellant:	James N. Aitchison
Counsel for the Respondent:	Amit Ummat

JUDGMENT

The Appellant's appeals in relation to the reassessments of her 2002 and 2003 taxation years are dismissed, without costs. The Appellant's appeals in relation to the reassessments of her 2004 and 2005 taxation years are allowed, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the loss incurred by the Appellant in carrying on her business in 2004 was $2,881 and the loss incurred by the Appellant in carrying on her business in 2005 was $8,492.

Signed at Vancouver, British Columbia, this 24th day of August 2011.

"Wyman W. Webb"

Webb, J.

Citation: 2011TCC393
Date: 20110824
Docket: 2009-1756(IT)G

BETWEEN:

DONNA MCMILLAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Webb, J.

[1] The Appellant was carrying on business in the Dominican Republic in 2002, 2003, 2004, and 2005. She filed tax returns in Canada for those years and in each year claimed a loss from her business. The Canada Revenue Agency (the "CRA") reduced the loss that was incurred for 2002 and denied the losses that were incurred for each of the other three years. The Canada Revenue Agency was initially taking the position that the Appellant was not carrying on a business. Prior to the commencement of the hearing the Respondent acknowledged that the Appellant was carrying on a business and therefore this was no longer an issue in this appeal.

[2] Counsel for the Appellant, at the commencement of the hearing, acknowledged that the reassessment for 2002 arose as a result of a clerical error that had been made by the Appellant or the Appellant's accountant and that the Appellant was no longer pursuing the appeal of the 2002 taxation year. Therefore the only reassessments that were addressed during the hearing were the reassessments of the Appellant's tax liability for 2003, 2004, and 2005 and the only issues in this appeal were whether the amounts that were claimed as "expenses" were incurred by the Appellant and if so, whether they were incurred for the purpose of earning income.

[3] The assumptions that were made by the Minister in reassessing the Appellant are set out in paragraph 9 of the Reply and these are as follows:

In so assessing the Appellant, the Minister made, *inter alia*, the following assumptions:

a) For the 2002, 2003, 2004 and 2005 taxation years, the reported gross income, net income, expenses and losses are set out in *Schedule "A"* attached hereto;

b) During the relevant period, the Appellant did not carry on a business in the Dominican Republic;

c) For the 2002, 2003, 2004 and 2005 taxation years, the Appellant did not incur business losses of $2,727, $14,171, $30,711 and $12,206 respectively;

d) The Appellant did not incur any amounts as expenses in connection with the carrying on of a business;

e) If any amounts were incurred by the Appellant, they were not incurred to earn or produce income from a business; and

f) The disallowed amounts were not reasonable in the circumstances.

[4] Since the Respondent has acknowledged that the Appellant was carrying on a business, the assumption as set out in paragraph b) is no longer applicable. Schedule "A" to the Reply sets out the following amounts for 2003, 2004 and 2005[1]:

	2003	**2004**	**2005**
Gross Income	$6,675	$13,351	$4,103
Net Income	$1,112	($2,881)	($8,492)
Expenses	$15,283	$27,830	$3,715
Loss	($14,171)	($30,711)	($12,206[2])

[5] The amount identified as "Net Income" is the gross profit determined by deducting the cost of goods sold from the Gross Income. This is not explained or discussed in the Reply but is evident based on the Statements of Business Activities that were filed during the hearing. The issues as described in the Reply are as follows:

The issue is whether the Appellant made or incurred expenses in connection with a business, and if so, whether the Appellant incurred those expenses for the purpose of gaining or producing income from a business.

[1] The table also includes the amounts for 2002 but since the 2002 taxation year is no longer in issue, the amounts for 2002 have not been included.

[2] The amounts in the table are the amounts as set out in Schedule "A" to the Reply. Each amount was rounded to the nearest dollar amount. The loss as reported on the tax return was $12,206.27.

[6] It seems to me that the only issues raised in the Reply relate to the items identified as "Expenses" in Schedule "A". It does not seem to me that the Respondent raised any issue in relation to the cost of goods sold. The only statement that might suggest that the Respondent was challenging the amounts claimed for cost of goods sold for 2003, 2004 or 2005 is the reference in paragraph 9 c) of the Reply to the assumption that the Appellant did not incur business losses of $14,171, $30,711 and $12,206 in 2003, 2004 and 2005 respectively. For 2003 the loss of $14,171 only arises after the additional expenses of $15,283 are deducted from the net income of $1,112. The Respondent must therefore have allowed the full amount of the cost of goods sold and a portion of the additional expenses in denying the loss of $14,171 for 2003. For 2004 and 2005 the cost of goods sold resulted in a loss before the additional expenses are taken into account. However if the cost of goods sold is not allowed as a deduction, the Appellant would not have incurred a loss but would have realized a profit from her business.

[7] If the Respondent wanted to challenge the amount of the cost of goods sold then this should have been clearly addressed in the Reply. To simply make the assumption in paragraph 9 c) of the Reply that the Appellant did not incur the losses does not satisfy this requirement since the Respondent had also made the assumption that the Appellant was not carrying on a business. If the Appellant had not been carrying on a business, then there would not have been any losses that would have been deductible.

[8] Paragraph 9 d) of the Reply states that "[t]he Appellant did not incur any amounts as *expenses*[3] …". The only other references to "expenses" in any of the assumptions are in paragraph 9 a) (which simply states that the reported "expenses" are set out in Schedule "A" and in Schedule "A" (which is incorporated by reference). The only amounts identified as "expenses" are the additional expenses referred to in Schedule "A" which were deducted from the gross profit in the Statements of Business Activities. It is clear from the Statements of Business Activities that the "expenses" of $15,283 for 2003 do not include the cost of goods sold for 2003, the "expenses" of $27,830 for 2004 do not include the cost of goods sold for 2004 and the "expenses" of $3,715 for 2005 do not include the cost of goods sold for 2005. There is no reference to the cost of goods sold in Schedule "A" or in any other part of the Reply. The cost of goods sold is the undisclosed amount that reduces the "Gross Income" stated in Schedule "A" to the "Net Income" stated in Schedule "A". It seems clear to me that the only items that the Respondent was

[3] Emphasis added.

contesting were the additional expenses as set out in Schedule "A" and not the cost of goods sold.

[9] Justice Rothstein (as he then was) writing on behalf of the Federal Court of Appeal in *The Queen* v. *Anchor Pointe Energy Ltd.*, 2003 DTC 5512 stated that:

> [23] The pleading of assumptions gives the Crown the powerful tool of shifting the onus to the taxpayer to demolish the Minister's assumptions. The facts pleaded as assumptions must be precise and accurate so that the taxpayer knows exactly the case it has to meet.

[10] The Reply is not precise and accurate with respect to any issue related to the cost of goods sold. By not precisely and accurately indicating that the Respondent was challenging the cost of goods sold, the Respondent cannot do so at the hearing. Procedural fairness would require that the Respondent would have to amend the Reply if the cost of goods sold were to be challenged.

[11] The income (loss) incurred by the Appellant if only the cost of goods sold is deducted from the gross income would be as follows:

	2003	**2004**	**2005**
Gross Income	$6,675	$13,351	$4,103
Cost of Goods Sold	$5,563	$16,232	$12,594
Income (Loss)	$1,112	($2,881)	($8,492)[4]

[12] Because the Respondent did not raise any issue in relation to the cost of goods sold in the Reply, the losses that are determined for 2004 and 2005 by deducting the Cost of Goods Sold from the Gross Income are allowed.

[13] As noted above, by denying the loss that was claimed for 2003 (and therefore concluding that the net income for 2003 was nil), the Respondent is allowing additional expenses of $1,112 for 2003. The issue in this appeal is therefore whether the Appellant is entitled to claim as a deduction in computing her income from her businesses all or any portion of the following amounts which were identified as expenses in the Statements of Business Activities and which were disallowed by the CRA:

[4] The difference between $4,103 and $12,594 is $8,491 not $8,492. However both $4,103 and $12,594 have been rounded to the nearest dollar and when the amounts from the Statement of Business Activities (which were not rounded to the nearest dollar amount) are used, the result is a loss of $8,491.53, which rounded to the nearest dollar amount would be $8,492.

	2003	2004	2005
Advertising			$134
Maintenance and repairs	$831	$831	
Motor vehicle expenses	$1,793	$2,455	
Office expenses		$9,105	
Supplies	$9,119	$9,119	
Legal, accounting and other professional fees	$3,044	$3,044	$119
Rent			$710
Telephone and Utilities	$496	$498	
Capital Cost Allowance		$2,778	$2,752
Total Expenses	$15,283	$27,830	$3,715
Amount Allowed by the CRA	($1,112)		
Amount Disallowed by the CRA	$14,171	$27,830	$3,715

[14] There was very little evidence presented at the hearing of this appeal in relation to the amounts that were claimed as expenses (including the amounts that were claimed for capital cost allowance). Although the matter was scheduled for two days the only witness who testified during the hearing was the Appellant. The Appellant's testimony was brief and consisted of a general description of the businesses that she was carrying on in the Dominican Republic and a general statement that the amounts that she had claimed were correct. Although the Appellant described her activities as different businesses, only one Statement of Business Activities was filed with her tax return for each year. All of the revenue and the amounts claimed as expenses for a particular year were consolidated in the one Statement of Business Activities prepared for that year.

[15] The Appellant decided to move to the Dominican Republic in 2001 and she started her first business there in September 2001. Because she was not a resident of the Dominican Republic at that time she had to register the business in the name of her boyfriend. Over the course of the next few years the Appellant rented beach chairs, cars and scooters and she sold drinks (soft drinks and alcoholic beverages), cigarettes, T-shirts and towels. The Appellant indicated that the individuals who would work for her and who would set up the chairs that were rented to customers were paid $0.50 per chair and this amount was paid in cash. The chairs were rented for $2.

[16] The Appellant indicated that most of the transactions that were done in the Dominican Republic were completed in cash. She also indicated that many of the office supplies and the materials to repair the chairs were purchased in Canada. She would take these items to the Dominican Republic when she returned there. The Appellant indicated that she did have receipts for the items purchased in Canada, but none of these receipts were introduced at the hearing.

[17] When the Appellant returned to the Dominican Republic from one particular trip that she took to Canada she found that one of her businesses had been sold by her former boyfriend. She then commenced legal proceedings against her former boyfriend. This matter took a number of years to be resolved. One of the issues that she raised in the court proceedings was related to the sale of this business by her former boyfriend. She indicated the court confirmed that her former boyfriend did not have the right to sell all of this business without her consent and therefore the Court ordered that the business or part of the business be returned to her.

[18] The accountant for the Appellant was examined out of court pursuant to section 119 of the *Tax Court of Canada Rules* (*General Procedure*) (the "*Rules*"). The transcript of his examination for discovery was introduced during the hearing. His examination by counsel for the Appellant consisted of general questions related to the preparation of the Statements of Business Activities and whether the amounts shown were correct. Neither the Appellant nor the accountant for the Appellant provided any explanation with respect to any of the items that comprised the expenses claimed. None of the receipts for any of the amounts claimed were introduced at the hearing.

[19] In *Wiens* v. *The Queen*, 2011 TCC 152, I reviewed the decision of Justice L'Heureux-Dubé of the Supreme Court of Canada in *Hickman Motors Ltd.* v. *Her Majesty the Queen*, [1997] S.C.J. No. 62, and the subsequent decision of the British Columbia Court of Appeal in *Northland Properties Corp.* v. *British Columbia*, 2010 BCCA 177, 319 D.L.R. (4th) 334. As I had stated in *Wiens*, it seems to me that the conclusion to be drawn is simply that the Appellant has the initial onus of proving on a balance of probabilities (i.e. that it is more likely than not), that any of the assumptions that were made by the Minister in assessing (or reassessing) the Appellant with which the Appellant does not agree, are not correct.

[20] In this case, two of the assumptions that were made were that:

> d) The Appellant did not incur any amounts as expenses in connection with the carrying on of a business; [and]

> e) If any amounts were incurred by the Appellant, they were not incurred to earn or produce income from a business;…

[21] Since the Respondent had assumed that the Appellant did not incur any amounts as expenses in connection with the carrying on of a business, the Appellant had the onus of proving, on a balance of probabilities, that she did incur the amounts that she was claiming as expenses. If the Appellant is able to establish that the amounts were incurred, the Appellant would also have to establish that the expenditures were incurred for the purpose of earning income. Even if I did accept, based only on the statements that all amounts were correct and were supported by receipts (that were not produced at the hearing), that the Appellant spent amounts equal to or greater than the amounts claimed as expenses, this does not address the issue of what goods or services were acquired. Without knowing what goods or services were acquired it is not possible to determine whether the expenditures were incurred for the purpose of earning income.

[22] The cross-examination of the Appellant included the following exchange between counsel for the Respondent and the Appellant in relation to the amount claimed for supplies for 2003:

> Q. Ms McMillan, let's go to supplies; it is line 8811. You have a supplies expense of over $9,000. What does this relate to?
>
> A. It would be an accumulation of receipts. It is the total of all of the receipts that relate to supplies.
>
> Q. Like what?
>
> A. In 2003? It would have been T-shirts, towels, lawn chairs. It could have been something as small as ... the beer, the soft drinks. I mean, it could be ... I am going off the top of my head, now, and I would have to take a look at them. So it could be any number of things.

[23] Presumably the amounts expended for T-shirts, towels, beer and soft drinks would have been included in the cost of goods sold. The amount expended for lawn chairs would presumably have been included in determining the undepreciated capital cost of the applicable class of assets (presumably Class 8).

[24] The cross-examination of the Appellant included the following exchange between counsel for the Respondent and the Appellant in relation to the amount claimed for office expenses and supplies for 2004:

Q. Ms. McMillan, let’s move on to your 2004 income tax returns, at tab 2. This is your tax return?

A. Yes, it is.

Q. I will take you to the Statement of Business Activities, please. Like I said, I don't want to go through each expense, but I do want to go through some of the larger ones. For example, you have office expenses of more than $9,100; that is at line 8810, Ms McMillan.

A. Yes.

Q. Can you tell me what that relates to?

A. Not specifically.

…

Q. What exactly are you saying then, Ms. McMillan?

A. What I am saying is that I have no idea what the $9,000 is because it is an accumulation of a whole bunch of ... it could have been software, it could have been any kind of thing. But I am not saying that capital is included in there.

Q. But you don't know, definitively, right?

A. I don't know exactly what is in there.

Q. Yes, you don't know what it’s for. What about supplies? It would be the same, probably, for the previous year, your inventory type thing?

A. No, not inventory. I had no inventory. I told you, I had no inventory. There is no inventory.

Q. What were the supplies, then?

A. This? I don't know.

[25] To simply state at the hearing that she did not know what comprised any of the categories is not sufficient to prove that the amounts were incurred for the purpose of earning income. The testimony of the accountant provided at the examination out of court did not provide any further assistance or clarification with respect to what goods or services were acquired (the cost of which was claimed as an expense) or how such goods or services were related to the business.

[26] There was simply no evidence presented by the Appellant at the hearing with respect to what supplies were purchased for $9,119 in 2003 and for the same amount in 2004. There is also no indication in the testimony of the accountant of what supplies were purchased. There was no indication of how the motor vehicles were used in carrying on the business or how the claims for motor vehicle expenses were determined. There was no explanation for why rent was only claimed in one year (2005) or what was rented for just this one year. There was no indication of what was included in the office expenses of $9,105 claimed for 2004 or why an amount was claimed for office expenses in only one year. There was no explanation of why a business that had total sales of $13,351 in 2004 would spend $9,105 on office expenses and $9,119 on supplies in that year. There simply was little or no explanation for the different amounts.

[27] The Appellant indicated that she paid her workers $0.50 per chair for each chair that was rented. However there is no obvious claim for this expense in her Statements of Business Activities. She also stated that she paid dues to various associations but again it is impossible to determine where this amount would have been included in her expenses.

[28] It seems to me that the Appellant would have incurred some expenses in carrying on her business. However the only evidence that was introduced by the Appellant was her general statements that the Statements of Business Activities accurately reflected the amounts that were incurred. The statements of the accountant do not provide any more details with respect to the goods and services that were acquired.

[29] The Appellant did not introduce any receipts for the expenditures that she made. She clearly stated that she had the receipts but no receipts were introduced at the hearing. Each counsel noted the absence of receipts. Counsel for the Respondent repeatedly referred to the Appellant's onus of proof and counsel for the Appellant repeatedly stated that it was a hearing not an audit. While it is correct that it is a hearing and not an audit, the Appellant, as noted above, did have the onus of proving that she incurred the expenditures as claimed and that the expenditures were incurred for the purpose of earning income.

[30] In *Bernardi (c.o.b. Bruno's Pizzeria & Main Street Billiards)* v. *Guardian Royal Exchange Assurance Co.*, [1979] O.J. No. 553, Justice Blair, writing on behalf of the Ontario Supreme Court – Court of Appeal, stated that:

> 28 … Where a party has an evidentiary burden of establishing an issue, his failure, in certain circumstances, to call necessary evidence to support his case justifies a court in drawing the inference that the evidence of the witness who might have been called would have been unfavourable to him. The broad principle on which the rule is based is stated in Wigmore on Evidence, (3rd ed.) Vol. II, p. 162, as follows:
>
> > The failure to bring before the tribunal some circumstance, document, or witness, when either the party himself or his opponent claims that the facts would thereby be elucidated, serves to indicate, as the most natural inference, that the party fears to do so, and this fear is some evidence that the circumstance or document or witness, if brought, would have exposed facts unfavourable to the party. These inferences, to be sure, cannot fairly be made except upon certain conditions; and they are also open always to explanation by circumstances which make some other hypothesis a more natural one than the party's fear of exposure. But the propriety of such an inference in general is not doubted.

[31] The above passage from an earlier edition of *Wigmore on Evidence* was cited with approval by Justice Rothstein (as he then was) in *Milliken & Co.* v. *Interface Flooring Systems (Canada) Inc.*, 251 N.R. 358, [2000] F.C.J. No. 129 (FCA).

[32] In *Chrabalowski* v. *The Queen*, 2004 TCC 644, [2005] 1 C.T.C. 2054, then Associate Chief Justice Bowman stated that:

> 9 The appellant came into court with a large box of receipts. They were grouped in bundles with adding machine tapes attached. Contrary to the allegations that the revenue authorities ignored his evidence or treated him unfairly, I find that Ms. Lo, the appeals assessor who dealt with his objection, made a serious and conscientious attempt to reconcile his claims with the receipts and she gave him ample opportunity to organize the receipts in an orderly and comprehensible way. She cited a number of instances in which she attempted to reconcile the amounts claimed under specific headings with the receipts, but was unable to do so.
>
> 10 As this court has said on a number of occasions there is no requirement that vouchers or receipts be provided for all expenditures claimed as deductions provided that the expenditures are proved by other credible evidence. I do not however think the appellant has passed even the very modest threshold of proving his case that I consider appropriate. It is worthwhile repeating what was said in Merchant v. R. (1998), 98 D.T.C. 1734 (T.C.C.) :
>
> > [7] Where a large number of documents, such as invoices, have to be proved it is a waste of the court's time to put them in evidence seriatim. The approach set out in Wigmore on Evidence (3rd Ed.) Vol IV, at s. 1230 commends itself:

> s.1230(11): ... Where a fact could be ascertained only by the inspection of a large number of documents made up of very numerous detailed statements - as, the net balance resulting from a year's vouchers of a treasurer or a year's accounts in a bank-ledger - it is obvious that it would often be practically out of the question to apply the present principle by requiring the production of the entire mass of documents and entries to be perused by the jury or read aloud to them. The convenience of trials demands that other evidence be allowed to be offered, in the shape of the testimony of a competent witness who has perused the entire mass and will state summarily the net result. Such a practice is well-established to be proper.
>
> [8] This passage was cited with approval by Wakeling, J.A. in *Sunnyside Nursing Home* v. *Builders Contract Management Ltd. et al.*, (1990) 75 S.R. 1 at p. 24 (Sask. C.A.) and by MacPherson, J. in *R.* v. *Fichter, Kaufmann et al.*, 37 S.R. 128 (Sask. Q.B.) at p. 129. I am in respectful agreement.

Some form of the method approved by Wigmore would have been appropriate here.

[33] The Appellant did not need to introduce every single receipt but the Appellant would have had to prove that she incurred the expenditures and the expenditures were incurred for the purpose of earning income by some other credible means. The general statements made by the Appellant and her accountant are not sufficient since there is no indication of what goods and services were acquired. Even if some of the receipts were introduced it might have helped to identify what goods or services were acquired in relation to the various expense amounts that were claimed. It seems to me that an adverse inference can be drawn from the failure of the Appellant to introduce any receipts and this inference is that the receipts would not support the amounts that she had claimed or that the goods or services that were acquired were not acquired for the purpose of earning income.

[34] No amount was claimed for capital cost allowance in 2003. Amounts were claimed for capital cost allowance in 2004 and 2005. No capital assets are listed in the schedule of capital assets that was included with the Statement of Business Activities for 2003. In the schedule of capital assets for 2004 an amount is shown as an opening balance of undepreciated capital cost for class 8, class 10, and class 13 assets. No explanation was provided to explain why no capital assets were listed for 2003 but an opening balance was shown for assets of three classes in 2004. While capital cost allowance is a discretionary deduction, if there are depreciable properties, these should be listed on the schedule of capital assets even if no capital cost allowance is claimed for the year. The Appellant did not provide any information to support the amounts shown as the opening balance of undepreciated

capital cost of her depreciable property as of the beginning of 2004. It also seems to me that an adverse inference can be drawn from the failure of the Appellant to introduce any documents or receipts to establish the undepreciated capital cost amounts of the depreciable property. The Appellant has not satisfied the onus that was on her to establish on a balance of probabilities that the amounts as shown in the schedules of depreciable property prepared for 2004 and 2005 are correct.

[35] Also, with respect to the amounts claimed for legal fees in 2003 and 2004, the Appellant did not produce sufficient evidence to justify the deduction for the amounts claimed. In any event, to the extent that these amounts relate to the claim by the Appellant for a return of the assets of the business that were sold by her former boyfriend, these payments would be on account of capital as they would be related to the reacquisition of a capital asset i.e. her interest in the business or in the assets of the business. As a result these fees would not be deductible as a result of the provisions of paragraph 18(1)(*b*) of the *Income Tax Act*.

[36] As a result the Appellant's appeals in relation to the reassessments of her 2002 and 2003 taxation years are dismissed, without costs. The Appellant's appeals in relation to the reassessments of her 2004 and 2005 taxation years are allowed, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the loss sustained by the Appellant in carrying on her business in 2004 was $2,881 and the loss sustained by the Appellant in carrying on her business in 2005 was $8,492.

Signed at Vancouver, British Columbia this 24th day of August 2011.

"Wyman W. Webb"

Webb, J.

CITATION:	2011TCC393
COURT FILE NO.:	2009-1756(IT)G
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APPEARANCES:

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