Docket: 2017-5000(IT)I

BETWEEN:

MICHEL COUTU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on May 18, 2018, at Québec, Quebec

Before: The Honourable Madam Justice Dominique Lafleur

Appearances:

For the appellant: The appellant himself

Counsel for the respondent: Stéphanie Côté

JUDGMENT

The appeal of the reassessments made pursuant to the *Income Tax Act* for the 2013 and 2014 taxation years is dismissed, without costs, in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 17th day of July 2018.

"Dominique Lafleur"

Lafleur J.

Citation: 2018 TCC 143
Date: 20180717
Docket: 2017-5000(IT)I

BETWEEN:

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Appellant,

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REASONS FOR JUDGMENT

Lafleur J.

I. BACKGROUND

[1] Mr. Michel Coutu is appealing reassessments made by the Minister of National Revenue (the Minister) pursuant to the *Income Tax Act* (R.S.C.,1985, c. 1 (5th Supp.)), as amended) (the Act) for the 2013 and 2014 taxation years. Under these reassessments, the Minister added to the calculation of Mr. Coutu's income, amounts as undeclared business income ($21,099 and $10,928, respectively, for the 2013 and 2014 taxation years), as calculated using the alternative net worth method, as well as penalties under subsection 163(2) of the Act in the amounts of $1,318 and $737, respectively, for the 2013 and 2014 taxation years with respect to unreported income.

[2] At the hearing, only two persons testified: Mr. Coutu, who represented himself alone; and Mr. Philippe Croisetière, tax auditor (the auditor).

[3] Mr. Coutu has been a businessman and entrepreneur for over 30 years. Since 1987, he has operated a business as the sole proprietor under the corporate name "Michel Coutu Déplacement de Bâtiment." The activity of this business is the moving of buildings, including lifting houses and placing them on foundations, and

excavation. Mr. Coutu also carries out snow removal activities during the winter season and, secondarily, sells miniature cars (collectively, the business).

[4] Mr. Coutu explained that, with respect to the management of his business, he performed all the tasks, including preparation of accounting entries, income statements and tax returns. He submitted that he had reported all the income from the operation of his business, except an amount of $3,000 for the 2013 taxation year.

[5] In these reasons, any reference to a statutory provision is a reference to the Act, unless indicated otherwise.

II. ISSUES

[6] This is to determine if Mr. Coutu's income was correctly determined for the 2013 and 2014 taxation years under the reassessments and if the Minister was justified in imposing penalties pursuant to subsection 163(2) for each of these taxation years.

III. POSITION OF THE PARTIES

1. *Mr. Coutu's position*

[7] Mr. Coutu challenges the method used by the Minister, emphasizing that there was only one accounting entry error for 2013 in the amount of $3,000 and that only this amount should be added to income for 2013. With respect to 2014, there was no error or omission in the calculation of business income. Also, according to Mr. Coutu, the Minister failed to take into account a depreciation expense of $14,267 in 2013 and $10,960 in 2014 in calculating the net worth, which would reduce by this much the amounts to be added to his income using the net worth method.

[8] Mr. Coutu is also of the opinion that the imposition of interest and penalties is not justified, because the only accounting entry error for 2013 was committed in good faith and involuntarily.

2. *Respondent's position*

[9] The respondent submitted that the Minister rightly had recourse to the alternative net worth assessment method, because a number of invoices were not

found, there were flaws in the internal management of the business, payments were made in cash and the numerical sequences of the invoices were not consistent.

[10] The respondent submitted that the calculation of net worth brought to light income gaps that still remain unexplained. She is of the opinion that Mr. Coutu admitted the amounts of the net worth calculation, except for the depreciation. In this regard, she submitted that the Minister indeed took into account depreciation for taxation years 2013 and 2014.

[11] Finally, with respect to penalties, the respondent claimed that she has discharged her burden of proof according to the jurisprudence *Lacroix v. The Queen*, 2008 FCA 241 [*Lacroix*], and that the imposition of penalties is justified for each of the 2013 and 2014 taxation years.

IV. DISCUSSION

1. *The net worth method and the burden of proof*

[12] Under subsection 152(7), The Minister may assess the tax payable by the taxpayer, using an alternative method, including the net worth method, since the Minister is not bound by returns or information provided by the taxpayer and "may, notwithstanding a return or information so supplied or if no return has been filed, assess the tax payable . . . ." Once an assessment is issued, it is deemed to be valid under subsection 152(8).

[13] The net worth method is defined as follows by the jurisprudence *Bigayan v. The Queen*, [1999] TCJ No. 778, at paragraph 2 [*Bigayan*]:

> 2 . . . It is based on an assumption that if one subtracts a taxpayer's net worth at the beginning of a year from that at the end, adds the taxpayer's expenditures in the year, deletes non-taxable receipts and accretions to value of existing assets, the net result, less any amount declared by the taxpayer, must be attributable to unreported income earned in the year, unless the taxpayer can demonstrate otherwise. It is at best an unsatisfactory method, arbitrary and inaccurate but sometimes it is the only means of approximating the income of a taxpayer.

[14] The burden of demonstrating the inaccuracy of the reassessments rests with Mr. Coutu, who must give credible and reliable testimony and, if possible, file evidence corroborating his testimony, to explain the apparent increase in his net worth. He can thus discharge his burden if the evidence that he presents constitutes

prima facie evidence demolishing the accuracy of the assumptions of fact on which the reassessments are based. Thus, he could refer, on a balance of probabilities, to new facts that would not have been considered by the Minister showing that he did not earn the alleged income, or else, present evidence that the assumptions of fact on which the Minister based herself to issue the reassessments are erroneous. If such evidence is presented and accepted by the Court, then the burden shifts to the Minister, who must then present evidence of the existence of facts justifying the issuance of reassessments based on a balance of probabilities.

[15] The process was explained by the Supreme Court of Canada in *Hickman Motors Ltd v. Canada*, [1997] 2 SCR 336, [1997] SCJ No. 62, at paragraphs 92 to 94:

> 92 It is trite law that in taxation the standard of proof is the civil balance of probabilities . . . The Minister, in making assessments, proceeds on assumptions (*Bayridge Estates Ltd. v. M.N.R.*, 59 D.T.C. 1098 (Ex. Ct.), at p. 1101) and the initial onus is on the taxpayer to "demolish" the Minister's assumptions in the assessment . . . The initial burden is only to "demolish" the exact assumptions made by the Minister but no more . . .
>
> 93 This initial onus of "demolishing" the Minister's exact assumptions is met where the appellant makes out at least a *prima facie* case . . . The law is settled that unchallenged and uncontradicted evidence "demolishes" the Minister's assumptions . . .
>
> 94 Where the Minister's assumptions have been "demolished" by the appellant, "the onus . . . shifts to the Minister to rebut the *prima facie* case" made out by the appellant and to prove the assumptions . . .

[16] In *Amiante Spec Inc. v. The Queen*, 2009 FCA 139, [2009] GSTC 71, the Federal Court of Appeal specified what a *prima facie* case is:

> 23 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. It may be contrasted with conclusive evidence which excludes the possibility of the truth of any other conclusion than the one established by that evidence" (*Stewart v. Canada*, [2000] T.C.J. No. 53, paragraph 23).
>
> 24 Although it is not conclusive evidence, "the burden of proof put on the taxpayer is not to be lightly, capriciously or casually shifted", considering that "[i]t is the taxpayer's business" (*Orly Automobiles Inc. v. Canada*, 2005 FCA 425, paragraph 20). This Court stated that the taxpayer "knows how and why it is run in a particular fashion rather than in some other ways. He [or

> she] knows and possesses information that the Minister does not. He [or she] has information within his [or her] reach and under his [or her] control" (*ibid*.).

[17] As the Federal Court of Appeal explained in *Lacroix*, *supra* paragraph 20, these principles also apply to assessments using the net worth method:

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

[18] Apart from filing evidence demolishing the presumptions of fact on which the Minister based herself to issue reassessments, another method of challenging an assessment using the net worth method was explained as follows, in *Bigayan*, *supra* (paragraphs 3 and 4):

> 3 The best method of challenging a net worth assessment is to put forth evidence of what the taxpayer's income actually is. A means that is less satisfactory, but nonetheless acceptable, is described by Justice Cameron in *Chernenkoff v. Minister of National Revenue*, 49 D.T.C. 680, at page 683:
>
> > [TRANSLATION]
> >
> > In the absence of records, the alternative course open to the appellant was to prove that, even on a proper and complete "net worth" basis, the assessments were wrong.
>
> 4 This method of challenging a net worth assessment is accepted, but even after the adjustments have been completed, one is left with the uneasy feeling that the truth has not been fully uncovered. Tinkering with an inherently flawed and imperfect vehicle is not likely to perfect it. . . .
>
> [Emphasis added]

[19] In *Garage Pierre Allard Inc v. Québec (Deputy Minister of Revenue)*, [1995] RDFQ 36, 1995 CanLII 5523, the Court of Appeal of Québec ruled on the quality that the evidence of the Minister and the taxpayer must have when an alternative audit method is used:

> [TRANSLATION] In terms of evidence, the question is not to determine if one way of proceeding is preferable to another. It is essentially a question of **reliability** and **sufficiency**. . . . In either case, regardless of which method is used, as long as

> it is legal and **reliable**, the evidence must be sufficient to attain the quality required.
>
> In this case, because of the statutory presumption of validity attached to the respondent's assessment, it was up to the appellant to show that the method used to establish it was not reliable or, if it was reliable in itself, that the conditions required for its reliability were not observed.
>
> [Emphasis added]

[20] Thus, Mr. Coutu's credibility, as well as the sufficiency and reliability of the evidence on the subject of net worth calculations, will be determinative of the outcome of the appeal (*Landry v. The Queen*, 2009 TCC 399, 2009 DTC 1265 at paragraph 47). However, our Court will also be able to take into consideration the reasonableness of the assessment using the net worth method.

[21] Although the preceding observations state that, in general, Mr. Coutu has the burden of demonstrating that the presumptions of fact on which the Minister based herself to issue the reassessments were erroneous, the Minister will have the burden of proving the facts justifying the imposition of penalties under subsection 163(2), on a balance of probabilities.

2. *The reassessments using the net worth method*

i) Business income:

[22] According to the reassessments, amounts totalling $21,099 and $10,928 for the taxation years 2013 and 2014, respectively, must be added to Mr. Coutu's business income. However, according to him, only an amount of $3,000 was not entered in the general ledger of the business, the lack of an entry for this contract in the books (Exhibit A-21) being due to a bookkeeping error, since a contract for the same amount had been concluded in October and only one of the two contracts was entered.

[23] Mr. Coutu submitted as evidence copies of his accounting records and his tax returns: the general ledger of the business for 2013 (Exhibit A-3) and for 2014 (Exhibit A-5), the specific ledger for snow removal for 2013 (Exhibit A-13) and for 2014 (Exhibit A-14), the record of vehicle use for 2013 (Exhibit A-15) and for 2014 (Exhibit A-16) and parts of his T1 tax return for 2013 (Exhibit A-4) and 2014 (Exhibit A-6). Mr. Coutu also filed as evidence copies of building moving contracts for 2013 (Exhibit A-9) and for 2014 (Exhibit A-12), as well as

snow removal contracts for 2013 (Exhibit A-8) and for 2014 (Exhibit A-11). According to him, the accounting records and tax returns show that his gross business income was $237,999 for 2013 and $178,615 for 2014, that his net income before depreciation was $32,147 for 2013 and $29,368 for 2014, and that his net income after the capital cost allowance was $17,879 for 2013 and $18,407 for 2014.

[24] Mr. Coutu also explained that the majority of the business transactions were done by cheque and that he had no bank account or line of credit dedicated to his business. He thus filed as evidence bank statements, including the statements of an account held at Manulife Bank for 2013 (Exhibit A-7) and for 2014 (Exhibit A-10) and statements from the National Bank of Canada showing the balance for his personal line of credit at the end of 2013 (Exhibit A-19) and 2014 (Exhibit A-20).

[25] Following the examination of all the evidence, the Court concludes that the business's accounting records filed by Mr. Coutu are not reliable. Indeed, numbered invoices are missing from the invoices filed under Exhibit A-8 (snow removal contracts for 2013); although certain missing invoices are found among the invoices filed for 2014 under Exhibit A-12 (moving contracts for 2014), at least six invoices are missing from the numerical sequence of the invoices filed under Exhibit A-8. What is more, the documents filed under exhibits A-9 and A-12 (moving contracts for 2013 and 2014, respectively), include different types of documents: numbered sales forms bearing preprinted numbers without a consistent numerical sequence, numbered invoices without a consistent numerical sequence, as well as numbered contracts. The two numbered contracts found under Exhibit A-9 (moving contracts for 2013) are numbered 0114 and 0111; the contract numbered 0113 (A-21), representing the contract that had been omitted in the calculation of business income for 2013, must also be added; however, contract number 0112 is missing. During the audit, the auditor did not receive any explanation from Mr. Coutu as to this problem of numerical sequence. At the hearing, Mr. Coutu testified that he purchased invoice booklets and that his invoices were filed by date, not by number, and that it was therefore normal that the invoices did not follow a perfect chronological order. This explanation could not be accepted by our Court, for the simple reason that there are invoices missing. Mr. Coutu provided no credible explanation as to this problem of numerical sequence or to the absence of invoices. Finally, during his conversation with Mr. Coutu, the auditor was informed that certain business expenses were paid in cash. Also, $3,000 in petty cash was kept in the business.

[26] Thus, the Court concluded that the accounting records filed as evidence did not constitute reliable and sufficient evidence of Mr. Coutu's business income for the 2013 and 2014 taxation years.

ii) Calculations using the net worth method:

[27] Mr. Coutu submits that the calculations of net worth are erroneous in that the Minister should have taken into account expenses claimed as capital cost allowance during the 2013 and 2014 taxation years (an amount of $14,267 for 2013 and $10,960 for 2014), which she did not do, according to him, and which would reduce the amounts to be added to his business income by these amounts. He did not mention other errors in the net worth calculation.

[28] Mr. Coutu did not file with the Court evidence of the receipt of non-taxable amounts by either him or his spouse that could explain the increase in his net worth during the years 2013 and 2014. Moreover, Mr. Coutu did not challenge the amounts established as personal expenses.

[29] The auditor explained that he drew up Mr. Coutu's financial statement at December 31 of each year based on information gathered during an interview with him, banking statements, the Canada Revenue Agency system (RRSP), and Mr. Coutu's accounting records. The auditor revised the value of the assets downwards over the years, taking into account the claimed tax depreciation expenses. He testified that since he took into account depreciation at the stage when he calculated the difference in net worth, no amount was deducted to take into account depreciation at the stage of adjustments to net worth. Concerning Mr. Coutu's automobile and residence, the auditor used constant values each year to avoid influencing the increase in the net value.

[30] During the audit process, Mr. Coutu and his spouse completed a form entitled "Personal and Family Expenses" (Exhibit I-1) containing all the household's personal expenses for taxation years 2012, 2013 and 2014. These amounts were added to the net worth calculation. Payments, rebates and tax credits were also added to or subtracted from the calculation.

[31] As for depreciation expenses, the Court is of the opinion that the auditor took these expenses into account in calculating the net worth and that, therefore, the argument raised by Mr. Coutu cannot be accepted. Whether the depreciation expenses were taken into consideration during the net worth calculation step or at the net worth adjustment stage, it does not change the final net worth calculations in this case.

[32] Given that Mr. Coutu filed no evidence of receipt of non-taxable amounts explaining the increase in his net worth during 2013 and 2014, and given that the Court is also of the opinion that the calculations performed with respect to net worth seem to be reasonable, in that the method employed by the auditor is reliable, the Court concluded that amounts totalling $21,099 and $10,928, respectively, must be added to Mr. Coutu's business income for the 2013 and 2014 taxation years.

3. *Penalties under subsection 163(2)*

[33] Subsection 163(2) imposes a penalty on every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return filed or made in respect of a taxation year. The relevant part of this section reads as follows:

163(2) False statements or omissions — Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of $100 and 50% of the total of . . .	**163(2) Faux énoncés ou omissions** — Toute personne qui, sciemment ou dans des circonstances équivalant à faute lourde, fait un faux énoncé ou une omission dans une déclaration, un formulaire, un certificat, un état ou une réponse (appelé « déclaration » au présent article) rempli, produit ou présenté, selon le cas, pour une année d'imposition pour l'application de la présente loi, ou y participe, y consent ou y acquiesce est passible d'une pénalité égale, sans être inférieure à 100 $, à 50 % du total des montants suivants : […]

[34] The burden of establishing the facts justifying the assessment of a penalty is on the Minister, not the taxpayer. Subsection 163(3) stipulates the following:

163(3) Burden of proof in respect of penalties — Where, in an appeal under this Act, a penalty assessed by the Minister under this section or section 163.2 is in issue, the burden of establishing the facts justifying the assessment of the penalty is on the	**163(3) Charge de la preuve relativement aux pénalités** — Dans tout appel interjeté, en vertu de la présente loi, au sujet d'une pénalité imposée par le ministre en vertu du présent article ou de l'article 163.2, le ministre a la charge d'établir les faits qui justifient l'imposition de la

Minister. pénalité.

[35] According to the wording of subsection 163(2), two elements must come together for a penalty under section 163(2) to apply: (1) a mental element ("knowingly, or under circumstances amounting to gross negligence"); and (2) a material element ("makes . . . a false statement or omission").

[36] It has been established that Mr. Coutu filed his income tax returns for the 2013 and 2014 taxation years; thus, the material element is present in this case (*D'Andrea v. The Queen*, 2011 TCC 298, [2011] TCJ No. 243 at paragraph 35). But what about the mental element? Did Mr. Coutu knowingly make a false statement or omission or has he made a false statement or omission in circumstances amounting to gross negligence?

[37] The Honourable Mr. Justice Strayer defined the concept of "gross negligence" in *Venne v. The Queen*, [1984] F.C.J. No. 314 (F.C.T.D.):

> . . . "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. . . .

[38] In *DeCosta v. The Queen*, 2005 TCC 545, [2005] TCJ No. 396 (informal procedure), the Honourable Chief Justice Bowman stated the following:

> 11 In drawing the line between "ordinary" negligence or neglect and "gross" negligence, a number of factors have to be considered. One of course is the magnitude of the omission in relation to the income declared. Another is the opportunity the taxpayer had to detect the error. Another is the taxpayer's education and apparent intelligence. No single factor predominates. Each must be assigned its proper weight in the context of the overall picture that emerges from the evidence.

[39] In the present case, the Court is of the opinion that Mr. Coutu knowingly made a false statement or omission, or made a false statement or omission in circumstances amounting to gross negligence. Thus, the penalties provided for in subsection 163(2) are justified in the circumstances.

[40] Having concluded that the explanation provided by Mr. Coutu regarding the problem of the numerical sequence of the invoices was not credible, the only reasonable conclusion to draw is that Mr. Coutu knowingly omitted certain income from the calculation of his business income, or made a false statement or omission

in circumstances amounting to gross negligence (*Lacroix*, *supra* paragraphs 29 and 30).

[41] In fact, the evidence showed that, as part of his business, Mr. Coutu performed all the tasks, including preparation of accounting entries and of income and other tax returns. Thus, he had the ability to discover errors and oversights; he also had a number of years of experience in running a business.

V. CONCLUSION

[42] The appeal of the reassessments issued pursuant to the Act for the 2013 and 2014 taxation years is dismissed, without costs.

Signed at Ottawa, Canada, this 17th day of July 2018.

"Dominique Lafleur"

Lafleur J.

CITATION:	2018 TCC 143
COURT FILE NO.:	2017-5000(IT)I
STYLE OF CAUSE:	MICHEL COUTU AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Québec, Quebec
DATE OF HEARING:	May 18, 2018
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APPEARANCES:

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