Docket: 2010-757(IT)G

BETWEEN:

LARRY GORDON SCHAFER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
Amisk Investments Limited *2010-672(IT)G* on
September 18 and 19, 2013 at Calgary, Alberta

Before: The Honourable Justice G. A. Sheridan

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Margaret McCabe

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeal from the reassessment of the 2005 taxation year made under the *Income Tax Act* is dismissed, with costs to the Respondent.

Signed at Ottawa, Canada this 2nd day of December 2013.

"G. A. Sheridan"

Sheridan J.

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REASONS FOR JUDGMENT

Sheridan J.

[1] Amisk Investments Limited and Larry G. Schafer are appealing the reassessments by the Minister of National Revenue (the "Minister") of their 2005 taxation years.

[2] In 2005, Mr. Schafer was practicing law from his home-based office in Cranbrook, British Columbia. The legal practice was incorporated as Amisk Investments Limited ("Amisk"). Mr. Schafer was the sole director of the company;

he and his spouse were equal shareholders. Mrs. Schafer looked after the administrative side of the law practice.

[3] In April 2006, Mr. John Aam, an auditor with the Canada Revenue Agency (the "Auditor") commenced an audit of Amisk's 2005 taxation year which led, ultimately, to the reassessment of both Amisk's and Mr. Schafer's 2005 taxation years. The respective details of each are set out below.

Amisk Reassessment

[4] The Minister included in Amisk's 2005 income unreported income of $214,770 assumed to have been generated from Mr. Schafer's legal practice. The $214,770 comprised $179,825 in legal fees and interest thereon of $18,627 ("$Fees & Interest") and $16,318 in unidentified deposits to Mr. Schafer's personal account ("Unidentified Deposits"). Gross negligence penalties were also imposed under subsection 163(2) of the *Act*.

[5] In its Notice of Appeal, Amisk admitted that the Fees & Interest were not reported when the company initially filed its 2005 income tax return in February 2006. As for the Unidentified Deposits, at paragraph 3 of its Notice of Appeal Amisk alleged that of that $16,318:

a) $3,596[1] was income that Amisk had inadvertently not reported;

b) $3,560 ($2,000, $560, and $1,000)[2] was income that Amisk reported; and

c) the remaining balance of $9,162 was not income to Amisk.

[6] At the hearing of its appeal, however, Mr. Schafer submitted on behalf of Amisk that the only issue before the Court was whether the imposition of gross negligence penalties was justified[3]. Briefly stated, Amisk contends that penalties are not justified because its failure to report was inadvertent and quickly remedied. Upon learning of the impending audit, Amisk immediately conducted a review of its books and records, identified its error and filed an amended return including the Fees & Interest in income and paying the tax thereon. As for the Unidentified Deposits,

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[1] Note: this amount corresponds to a dividend of $4,100 paid to Mr. Schafer and not reported in his income. Exhibit A-2.

[2] Note: these amounts correspond to some of the amounts Mr. Schafer testified at trial were paid to him as dividend income in 2005 and not reported. Exhibits A-1 and A-2.

[3] Transcript, page 142, lines 10-11 and Transcript, page 143, lines 2-6.

Amisk says gross negligence penalties ought not to apply because the failure to report was inadvertent and the amounts "nominal".

Mr. Schafer's Reassessment

[7] As a result of the Amisk reassessment, Mr. Schafer's 2005 taxation year was also reassessed to include additional income of $241,088 assumed to have been appropriated by Mr. Schafer from Amisk's business income. The Minister treated the appropriation as a shareholder benefit received by Mr. Schafer under subsection 15(1) of the *Income Tax Act*. The $241,088 consisted of:

a) $223,628 being the $214,770 Fees & Interest together with amounts equivalent to the GST and PST payable thereon ("$223,628 Payment"); and

b) $17,460 comprising the Unidentified Deposits together with GST thereon of $1,142 ("Unidentified Deposits & GST").

[8] Regarding the $223,628 Payment, Mr. Schafer contends that he received that amount from Amisk as a shareholder loan which he subsequently repaid in full in May 2006, within one year of Amisk's December 31 year end. In these circumstances, he says the $223,628 Payment was not income to him in 2005. No tax ought to have been assessed and therefore, no penalties apply.

[9] As for the $17,460 comprising the Unidentified Deposits & GST, Mr. Schafer admits[4] that individual amounts of $4,100, $2,000, $560 and $1,000 were dividend income that he had inadvertently not reported in 2005. The remaining balance was not properly included in income because $1,500 of that amount consisted of cash gifts from his father and the rest ($5,000, $1,000 and $2,300) were amounts "set aside" for his sons' university expenses from his employment income from Amisk. Mr. Schafer contends that gross negligence penalties are not justified because any failure to report was inadvertent and the amounts "nominal".

[4] Exhibit A-2. (Same document as Exhibit R-1, Tab 11.)

Analysis

[10] At the hearing, Mr. Schafer submitted on behalf of Amisk that the only issue in Amisk's appeal is whether gross negligence penalties were justified. That matter will be dealt with below along with the penalties imposed under Mr. Schafer's reassessment.

[11] In Mr. Schafer's appeal, the key question is whether, as a matter of fact, he received the $223,628 Payment from Amisk as a shareholder loan. There is also the issue of what portion, if any, of the Unidentified Deposits & GST ought to be included in Mr. Schafer's 2005 income.

[12] Mr. Schafer was the only witness to testify on the Appellants' behalf. He devoted a good portion of his testimony to his legal background and the nature of his practice. He began his legal career in Vancouver in 1980 as a litigator with a large Vancouver firm and then as in-house counsel for a large heavy industrial contractor. In 1986, he moved to London, England to pursue a Master's degree in corporate and commercial law. In 1988, he returned to Canada where he was employed as in-house counsel for a large pipeline company in Edmonton.

[13] In 1994, he decided to throw off the shackles of employment in favour of solo practice. One of his goals in making this change was to have sufficient control over his earnings to fund his plans for early retirement in Mexico. He moved his family to Cranbrook, British Columbia where he set about establishing himself in family law litigation.

[14] Because he had little understanding of the "business" of law and, in any case, preferred to devote himself to the practice of law, Mr. Schafer delegated the administrative and fiscal aspects of the practice to others: Mrs. Schafer ran the legal office and had sole responsibility for reception, office management, banking, billing and bookkeeping. The Appellants' accountant (the "Accountant") prepared their financial statements and tax returns based on the information that Mrs. Schafer provided to him at tax time. Mr. Schafer acknowledged this as a "shortcoming" for which he took full responsibility and which contributed to the Appellants' problems with the Canada Revenue Agency.

[15] Mr. Schafer then turned his focus to certain billing procedures he had devised to suit the needs of the practice's clientele. Describing Cranbrook as a "blue-collar community", Mr. Schafer went on to say that some of his clients lacked the means to pay for his services until the matter was resolved and the assets distributed. In such

circumstances, Mr. Schafer would make a special arrangement with the client whereby, upon completion of the file, an invoice would be issued but payment would be deferred pending the client's ability to pay. The client would sign an agreement to pay off the debt at some unspecified future time, together with interest on the outstanding amount, and pledging property to secure the debt. Mr. Schafer described it this way:

> … there was an understanding that this wouldn't go on indefinitely, but those issues were left on understanding as opposed to specific commitments, but that was the general understanding that it wouldn't go on forever and ever but that I wouldn't be the instigator saying, come on, let's get going, I want my money. I was getting interest, and that's – that was to be my compensation. So in that sense I really had no real idea as to when I would get paid, and it was essentially up to the client to determine the circumstances in which he was prepared to either sell his property or to finance to pay me, but the ball was in the client's court, and that was fine with me.[5]
>
> …
>
> … the bills were rendered. The security was taken. That's about the last thought I gave to the case. I just moved on to the rest of my practice, thought what I'd done was prudent and proper, and I was comfortable with it, and basically I gave that case no more thought. I just left it in my client's hands and thought, well, it'll work itself out in due course.[6]

[16] Typical of these special billing arrangements were two large amounts received in 2005, one in February for $99,882 and a second in May for $112,500, together with interest thereon. These two amounts[7] represented the lion's share of the Fees & Interest. Mr. Schafer could not say exactly when these amounts had been invoiced but said the work had been done "quite a bit earlier"[8] and billed to the clients "a long time earlier"[9], at least five years, and "quite possibly longer"[10] before payment was finally received.

[17] In any case, Mr. Schafer had given them no more thought until shortly after April 26, 2006 when Amisk received notice[11] that an audit was to be conducted of its 2005 taxation year. Mr. Schafer's reaction to this news was swift:

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[5] Transcript, page 23, lines 14-25.
[6] Transcript, page 24, lines 20-26.
[7] Exhibit R-1, Tab 7, Attached schedule.
[8] Transcript, page 20, lines 15-16.
[9] Transcript, page 21, line 1.
[10] Transcript, page 24, line 1.
[11] Exhibit R-1, Tab 4.

> [a]lmost immediately upon receiving that notice, I caused a review to be done of all my records and tax filings for the years 2004 and 2005. The purpose of that review was to confirm that all of my filings were in order and, if not, to locate any … errors apparent or otherwise. That was the goal, and upon the completion of that internal review, a number of apparent errors were, in fact, identified.[12] [Emphasis added.].

[18] Among the "apparent errors" identified was Amisk's failure to report the payments received on the two long-outstanding accounts along with some other smaller fees received over the course of 2005. He explained that at the time of filing Amisk's 2005 return, it was his understanding that the two large payments had been "… declared as income years before, taxes paid on it and, therefore, that it was not income to [Amisk]…[13]. However, his review disclosed that these amounts had, in fact, been "recorded" as bad debts:

> … That was a factual error on my part, and it was also an error on my part simply by way of … prudent business practice. I mean the amounts were significant, and I should not have relied on my memory, particularly with respect to an understanding that had gathered an awful lot of dust, but I didn't. I didn't check when [the two large payments] came in. I thought that that's what had been done, and when we reviewed the matter, it became apparent that those two amounts had, in fact, been at some point recorded as bad debts, and therefore upon receipt, they should have been declared as income, and that's what [the Accountant] attended to directly, and hence the $40,000 plus in tax that was owing as a result of those two large, albeit late, payments that were made.[14] [Emphasis added.]

[19] Thus it was on May 9, 2006, within two weeks of learning of the impending audit, Mr. Schafer wrote to the Accountant[15] instructing him to file an amended return to include the Fees & Interest in Amisk's 2005 income and to amend the company's financial statements to show a corresponding shareholder loan to him in 2005 of $223,628. Attached to that letter was a schedule Mr. Schafer had prepared setting out the dates and amounts of the shareholder loan advances, the corresponding Fees & Interest and the taxes payable thereon:

Amendments to 2005 Corporate Tax Return

	Date (2005)	**Shareholders Loan**	**Interest Income**	**Fee Income**	**PST**	**GST**

[12] Transcript, page 17, lines 25-28 to page 18, lines 1-4.
[13] Transcript, page 26, lines 27-28 to page 27, lines 1-2.
[14] Transcript, page 27, lines 2-15.
[15] Exhibit R-1, Tab 7.

1.	Jan 12	500.00		438.60	30.70	30.7
2.	Jan 18	2,000.00		1,754.40	122.80	122.80
3.	Feb 1	2,643.71		2,319.05	162.33	162.33
4.	Feb 4	5,052.00		4,431.58	310.21	310.21
5.	Feb 7	112,500.00	12,500.00	87,719.30	6,140.35	6,140.35
6.	Apr 6	250.00		219.30	15.35	15.35
7.	May 1	99,882.27	6,127.08	82,241.39	5,756.90	5,756.90
8.	July 15	800.00		701.76	49.12	49.12
	Total:	**223,627.98**	**18,627.08**	**179,825.38**	**12,587.76**	**12,587.76**

[20] When cross-examined about how he had come up with these revised numbers, Mr. Schafer had this to say:

> Q And -- and what did you look at to get to those amounts? How did you determine that those amounts had been in error included or not included in the corporate income?
>
> A I don't know. I -- I didn't physically look at the documents, at our accounting bookkeeping records. I wouldn't be able to make sense of them, but my wife did, brought matters to my attention, and then between the two of us, we went through it, and I asked questions and she gave answers, and we thought -- it appeared to us that we had a problem, so then we discussed it with [the Accountant].
>
> Q And -- and is your wife here today with you?
>
> A No.
>
> Q No? And so you've explained that in that schedule where there is an amount for interest income, that was as per an arrangement made with a particular client to pay interest because they hadn't paid their bill on time; is that correct?
>
> A They -- they hadn't paid it when rendered, and it was -- yes. Yes on both counts.
>
> Q And -- and so you say you came to find these amounts with your wife's help, correct?
>
> A Yes.
>
> Q I think in your direct testimony, you had stated that with regard especially to the bigger amounts that you recalled the clients -- you recalled the situation of the clients. Did you bring with you today the invoice that you rendered to those clients to show that amount was owing?

A You mean the -- the initial amount or the security document that would have provided for interest or both?

Q Did you bring either of those?

A No.

Q You don't have those with you today.

A No.

Q But you -- you recalled in great detail exactly who these clients were and the arrangements you made, correct?

A Yes, most certainly.

Q And am I to understand, then, that you would have looked at those records in coming to the schedule amounts that you provided in this letter to your accountant? Did you look at the invoices, the bills you rendered for these clients?

A No. No.

[21] In spite of having undertaken the review in anticipation of the audit and unearthed the records necessary to identify and correct Amisk's reporting errors, Mr. Schafer made no mention of this to the Auditor. Nor did he tell him that he had instructed the Accountant to amend the company's 2005 return and shareholder loan records. Yet this was not for lack of opportunity. On the very day Mr. Schafer sent instructions to the Accountant, he also penned a letter to the Auditor[16] seeking to postpone their first meeting scheduled for May 29, 2006 to early July 2006. When asked about this behaviour on cross-examination he offered the following explanation:

Q Well -- but surely you have to agree with me that you are now in correspondence with an auditor who's going to review the corporate tax return for … 2005. You have just communicated to your accountant to make changes to the corporate tax return for 2005. Why wouldn't you have just picked up the phone and phoned the auditor and said, oh, by the way, I've asked my accountant to look at some changes for the corporate tax return because I think I've made some errors in what was included in income? Why -- why didn't you just pick up the phone?

[16] Exhibit R-1, Tab 6.

A Because that would have served, in my view, no -- no useful purpose. He would have said presumably what errors or what are you doing, and I would have been saying you'll get it all in detail from [the Accountant] once he's got it done.

Q Did you ask [the Accountant] in the letter that you sent to him to ensure that the auditor was informed of these changes?

A I don't believe I asked him in the letter, but I certainly knew that it would be brought to his attention.

Q You knew how?

A That was the whole purpose in doing it.

Q The whole purpose in doing what, the changes to the corporate return?

A All of that would have been part of the audit, yes. He was going to come across material that was in error and that -- it was not only in error but that steps were being taken to deal with that, and he was -- all of that was going to be reviewed with him.

Q And -- and is [the Accountant] going to be giving testimony today?

A No.

[22] What the Accountant did do was follow Mr. Schafer's instructions. On May 17, 2006[17] he replied to Mr. Schafer's letter of May 9, 2006 advising that the amended return was ready for signature, suggesting the amendment and filing of GST/PST returns and showing the calculation of interest of 3% on the shareholder loan advances. Amisk's amended return was received by the Canada Revenue Agency on May 19, 2006[18]. The Canada Revenue Agency forwarded the amended return to the Auditor sometime before the meeting with Mr. Schafer scheduled for May 29, 2006.

[23] When asked why he would not have told the Auditor before that time about his efforts to get Amisk's affairs in order, Mr. Schafer explained:

[17] Exhibit R-1, Tab 9.
[18] Exhibit R-1, Tab 11.

A I don't know. I -- I understood my – my job with the auditor was to answer his questions. It wasn't to play accountant and try to tell him what was going on. That was for others. I was to answer his questions, provide his documents, and it would go from there.

Q But wasn't his questions going to be directed to you about the corporation?

A Certainly they would be.

Q And wasn't it his -- the commencement of his audit that galvanized you to review the books and records of the 2004/2005 years of the corporation?

A Certainly.

Q So isn't that relevant to the audit that's begun?

A I assume it -- I assume it would be, and I would assume that if it was relevant to him, he would ask me questions about it.

Q Well, how could he ask you questions about it if he didn't know that you had amended your return?

A He did. We've already gone over that. [The Accountant] was advising him of that.

Q He certainly didn't in May.

A I don't know when he did.

Q Not at the time you did it. We've agreed to that, right?

A I -- I didn't amend the return on May 9th. I simply sent information to [the Accountant], and [the Accountant] advised [the Auditor], … when he did so I don't know.

[24] In any case, the audit went ahead. In reviewing whatever books and records the Appellants provided, the Auditor noticed that the Fees & Interest along with the Unidentified Deposits had been deposited into Mr. Schafer's personal account rather than Amisk's and further, that that account was one he held jointly with his college-aged son. Unsatisfied with the responses to his inquiries in respect of these amounts, the Auditor ultimately recommended the reassessments currently under appeal.

[25] At the hearing, Mr. Schafer acknowledged that the Fees & Interest and some of the Unidentified Deposits ought to have gone into Amisk's account. However, he said there was a simple explanation for how they had ended up in a joint personal

account instead of Amisk's. According to Mr. Schafer, the Fees & Interest were part of a shareholder loan totalling $233,628 he received from Amisk in 2005 (already referred to herein as the "$223,628 Payment").

[26] The purpose of the shareholder loan was to help him realize his long-held objective of early retirement to a permanent residence in Mexico. The timing of the retirement move had always been "fluid", he said, but the unexpected receipt in 2005 of the two large payments comprising the bulk of the $223,628 Payment crystallized his plan. Suddenly he had the means to bridge finance the purchase of a house in Mexico pending the sale of the family home in Cranbrook. That is why "… these two payments that were received by me were treated as a shareholder's loan when they came in."[19] Apart from having used these amounts for his personal benefit, Mr. Schafer offered no details as to how he had "treated" these amounts as a shareholder loan "when they came in".

[27] Mr. Schafer then shifted his focus to why the $223,628 Payment had been deposited into an account held jointly with his son. He prefaced his remarks by posing the following question: "Why not just leave the money in the corporate account, and when you get ready to write a cheque for the house in Mexico just write the cheque and treat it as a shareholder's loan at that time?"[20] [Emphasis added.].

[28] Before turning to his answer, it is worth noting how Mr. Schafer framed the above question. By asking why not "leave" the money in the corporate account", he gives the impression that the $223,628 Payment had initially been deposited in Amisk's account which is, of course, not true. He admits it went directly into his own joint account. The reason for that, he said, was that he was fearful that he and his wife might die before they could complete the purchase of a retirement home in Mexico, thus leaving his two sons penniless while their estate "through the corporation"[21] of some $2 million was probated. By putting the $223,628 Payment directly into the joint account in 2005, he could ensure that should anything befall their parents, his sons would have access to the funds required to permit them to carry on their studies. It would have the additional benefit, Mr. Schafer said, of providing the executor of the estate (Mr. Schafer's brother) with an opportunity to assess their ability to handle large amounts of money before advancing the entire estate to them.

[19] Transcript, page 29, lines 8-10.
[20] Transcript, page 29, lines 12-15.
[21] Transcript, page 29, line 23.

[29] There ended Mr. Schafer's testimony. Portions of it have been quoted at length in these Reasons for Judgment to give a sense of the implausible nature of many of his answers, prime among them the account set out directly above. The transcripts also reveal a certain evasiveness: key questions about why or how certain things had been done went unanswered, his justification being his lack of involvement in the business side of the practice. Yet, in spite of acknowledging this "shortcoming" and having gone to some pains to inform the Court of his extensive legal background, Mr. Schafer chose not to call those to whom he had delegated these tasks. He offered no explanation as to why he had not called Mrs. Schafer or the Accountant, leaving the impression that their absence was more litigation strategy than amateur oversight. In all the circumstances, I accept the submission of counsel for the Respondent that the Court ought to draw a negative inference from the Appellants' failure to call Mrs. Schafer and/or the Accountant to answer questions that Mr. Schafer insisted he could not.

[30] Another significant weakness of Mr. Schafer's evidence was the lack of supporting documentation. In *House v. Her Majesty the Queen*[22], the Federal Court of Appeal applied the principle established in *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336 that a taxpayer's credible oral evidence does not necessarily need the support of source documents:

> [72] The [trial judge] appears to have elevated the judicial requirement that supporting documents may be required for a taxpayer to establish his or her claims and deductions to an authoritative principle that documents will always be required for a taxpayer to establish his or her case. There is, in my respectful view, no principle to the effect that oral evidence must necessarily be supported by source documents. Whether documents are required to establish a point will depend on the particular circumstances of the case. However, whether documents are required or not, a judge must nonetheless assess the oral evidence and determine whether it is credible. The requirement for documents, or not, will often turn on such an assessment.

[31] Applying this test to the present matter, given Mr. Schafer's lack of credibility and his repeated reference to the importance of his pre-audit review, corroborating documents were crucial to the success of the Appellants' appeals. They were necessary to bolster Mr. Schafer's testimony that the discoveries made during the review of Amisk's books and records provided a reasonable explanation for the reporting errors leading to the reassessments. Not only were the source documents not in evidence but also Mr. Schafer was equivocal as to exactly what documents he

[22] 2011 FCA 234, 2011 DTC 5142.

had examined. Although having emphasized the significance of the special client billing arrangements, in the same breath, he said it had not been necessary to look at the client files pertaining to the two large payments received in 2005, claiming that because of their size, he still had clear memory of the billing details when he conducted his review in May 2006. Yet, in February 2006 when he filed Amisk's return, those same sizeable amounts completely slipped his mind – even though they had just brought about the realization of his retirement dream.

[32] What is particularly troubling about the Appellants' lack of documentation is that the kinds of documents Mr. Schafer referred to – client invoices, agreements, financial statements, income tax returns - are all those which a law practice would typically maintain. Indeed, he volunteered during cross-examination that, as of the time of the hearing, they were "probably" still in his possession. He also acknowledged that any original documents provided to the Canada Revenue Agency during the audit had been returned to him. In spite of that, Mr. Schafer offered no explanation for having chosen not to bring documents with him – except to say somewhat testily on redirect that as he had provided information to the Canada Revenue Agency during the audit and documents to the Crown in the Lists of Documents and on Examination for Discovery, it was 'inappropriate" for counsel for the Respondent to invite the Court to draw a negative inference from his failure to tender supporting documents at the hearing.

[33] That reaction might be understandable coming from a self-represented taxpayer with no legal background. Coming from Mr. Schafer's mouth, it fell a little flat. In my experience, a taxpayer with documents available to justify his claims is usually eager to present them, shoebox and all. It defies belief that a man of Mr. Schafer's intelligence, education and litigation experience would not think to do so. The more likely scenario is either that corroborating documents do not exist or that whatever documents are available do not say what Mr. Schafer would have the Court believe.

[34] The great weakness of Mr. Schafer's testimony was its overall lack of credibility. His entire course of conduct upon learning of the audit cast an aura of suspicion over his true motives in revising Amisk's books and records and amending the company's 2005 return. In my view, what lay behind his actions was an attempt to retool the company's decision not to report the Fee & Interest Payments and Unidentified Deposits and to divert them directly to Mr. Schafer's account; the strategy included the recharacterization of the $223,628 Payment appropriated by Mr. Schafer as a shareholder loan.

[35] In this way, his behaviour is similar to that of the taxpayer in *Tymchuk v. R.*, 2003 TCC 699, another case of an unsuccessful attempt to reclassify amounts that the Court found were shareholder benefits. Dealing with the penalty issue in the appeal, McArthur, J. described the taxpayer's conduct at paragraph 12:

> [12] … Donald was his own bookkeeper and I believe he was a certified general accountant. He had no intention of entering the amounts as shareholder loans or anything else until they were revealed in the audit. He had the opportunity and obligation to accurately record the corporation's payments. Having been caught by the audit, he now asks that he be permitted to do some retroactive tax planning … .

[36] Similarly, Mr. Schafer, acting on his own and Amisk's behalf, was motivated to amend the records and returns to avoid the consequences that he knew an audit was bound to unleash. In his submissions, Mr. Schafer noted that in a closely held corporation it is "not uncommon" for a shareholder to take advances from the company throughout the year and to classify them as bonuses, dividends or shareholder loans "sometime into the calendar year following such advances, that being normally at the time the financial statements and ultimately the tax return are prepared for the corporation"[23]. He then went on to say that Amisk *had* classified the $223,628 Payment as a shareholder loan in 2006; in support, he pointed to the schedule attached to his letter of instruction to the Accountant dated May 9, 2006[24]. What this explanation glosses over is first, that the classification was not done in anticipation of filing Amisk's 2005 return; it occurred only after he received notice of the impending audit. It does not address why, if these amounts were treated when received as a shareholder loan 'when they came in", they were not classified as such sometime before Amisk filed its return in February 2006 when, according to Mr. Schafer, such adjustments are "normally" made. In the same vein, he did not say why he suddenly decided to repay the alleged shareholder loan in May 2006 rather than waiting until closer to Amisk's year end. This sudden flurry of activity occurred between receiving notice of the audit on April 26, 2006 and the meeting with the Auditor scheduled for May 29, 2006. These steps, along with his efforts to keep the Auditor in the dark, were taken in the hope of passing off deliberate omissions as inadvertent errors later discovered thanks to Mr. Schafer's due diligence.

[37] The upshot of Mr. Schafer's lack of credibility and failure to provide supporting documentation is that the Appellants have not demolished the assumptions underpinning the reassessments.

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[23] Transcript, page 138, lines 5-8.
[24] Exhibit R-1, Tab 7, page 2.

[38] Based on the evidence before me, I find that Mr. Schafer did not receive the $223,628 Payment as a shareholder loan in 2005; it is far more likely that that amount was received from the company as a shareholder benefit within the meaning of subsection 15(1) of the *Income Tax Act*.

[39] As for the Unidentified Deposits & GST, I am not persuaded by Mr. Schafer's testimony that these amounts were not properly included in income. Nor do I see them as "nominal", except if used as a comparator for the $223,628 Payment he also appropriated from Amisk. Given his lack of credibility, I cannot accept at face value his contention that the $1,500 was a cash gift. Nor do I understand what he meant by having "set aside" $8,300 from Amisk for his sons' education; without credible testimony or some kind of supporting documentation, it is just another term for appropriation. As for Amisk, it admitted it did not report $214,770 but in the event that some portion of the Unidentified Deposits remains in dispute, I am not satisfied that Amisk demolished the assumptions underpinning their assessment.

Penalties

[40] The only remaining issue is whether penalties ought to be imposed in respect of the Appellants' reassessments under subsection 163(2) of the *Income Tax Act*. The Minister has the onus of justifying the imposition of penalties. In *Lacroix v. Canada*, 2008 FCA 241, a net worth appeal, the Federal Court of Appeal considered how the Minister is to discharge this burden:

> 32 … There may be circumstances where the Minister would be able to show direct evidence of the taxpayer's state of mind at the time the tax return was filed. However, in the vast majority of cases, the Minister will be limited to undermining the taxpayer's credibility either by adducing evidence or cross-examining the taxpayer. Insofar as the Tax Court of Canada is satisfied that the taxpayer earned unreported income and did not provide a credible explanation for the discrepancy between his or her reported income and his or her net worth, the Minister has discharged the burden of proof on him within the meaning of … subsection 162(3) (*sic*).

[41] Here, the facts underpinning the Minister's imposition of penalties were duly pleaded in the Replies to the Notice of Appeal. In my view, it is clear from Mr. Schafer's direct testimony and his answers on cross-examination that he, both in his personal capacity and as the directing mind of Amisk, conducted himself in a manner that justifies the imposition of penalties under subsection 163(2).

[42] Mr. Schafer's own evidence was that he is a well-educated litigation lawyer with extensive experience in corporate and commercial law. Nothing in his conduct at the hearing is consistent with his portrayal of himself as a man adrift in an administrative and financial morass. Despite his stated lack of involvement in the administrative side of his practice, he was somehow able to plan for and achieve early retirement with some $2 million in assets. He admitted that two of the payments comprising the Fees & Interest were large amounts in relation to his usual billings, so significant that he could recall with clarity the details of their billing long after the fact. On cross-examination, he did not contradict the Respondent's contention that there was a material difference in the Appellants' respective reported and unreported incomes: in Amisk's case, $114,348 versus $214,770; for Mr. Schafer, $39,640 versus $241,088.

[43] Notwithstanding the above, he would have the Court believe that his failure to report or accurately record these amounts was the unintended consequence of sloppy business practices. He attributed the errors, in part, to the fact that most of the Fees & Interest was for legal services invoiced several years before. In spite of that, when initially filing Amisk's 2005 return, Mr. Schafer chose to rely on his memory rather than verify how these two large payments had been recorded and treated for tax purposes - even though at all times up to and including the hearing of these appeals the relevant client files, invoices, security agreements and tax records were available for his review. As for the smaller amounts making up the Fees & Interest received 2005, he did not provide a credible explanation for how these amounts had been inadvertently not reported.

[44] In my view, Mr. Schafer in his personal capacity and as the directing mind of Amisk was at best, indifferent to complying with the requirements of the *Income Tax Act* in failing to keep proper books and records, to report the Fees & Interest and Unidentified Deposits in the Amisk's 2005 return, and to include in income the $223,628 Payment appropriated from Amisk for his own benefit. It was only when faced with the prospect of an audit that the Appellants took steps to amend the existing documentation to conform with the more palatable version of events Mr. Schafer planned to present to the Canada Revenue Agency during the audit. This brings his conduct within the definition of "gross negligence" established in *Venne v. Canada* (1984), 84 D.T.C. 6247: "a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not". In all the circumstances, the Minister was justified in imposing penalties in respect of the reassessments of Amisk's and Mr. Schafer's 2005 taxation years.

[45] For the reasons set out above, the appeals are dismissed, with costs to the Respondent.

Signed at Ottawa, Canada this 2nd day of December 2013.

"G. A. Sheridan"

Sheridan J.

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PLACE OF HEARING:	Calgary, Alberta
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