Docket: 2012-2093(IT)G

BETWEEN:

ROBERT PAUL GALACHIUK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 26, 2014, at Calgary, Alberta.

Before: The Honourable Justice David E. Graham

Appearances:

For the Appellant:	The Appellant Himself
Counsel for the Respondent:	Margaret M. McCabe Paige MacPherson

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JUDGMENT

The Appeal is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant was not subject to a penalty under subsection 163(1) in his 2009 tax year.

The parties shall have 60 days from the date of the Judgment to make submissions on costs.

Signed at Ottawa, Canada, this 10th day of June 2014.

"David E. Graham"

Graham J.

Citation: 2014 TCC 188
Date: 20140610
Docket: 2012-2093(IT)G

BETWEEN:

ROBERT PAUL GALACHIUK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Graham J.

[1] When Robert Paul Galachiuk filed his 2008 tax return, he failed to report $683 in investment income. The Minister of National Revenue subsequently reassessed Mr. Galachiuk to include that amount in his income. Mr. Galachiuk did not dispute the reassessment. When Mr. Galachiuk filed his 2009 tax return, he failed to report $436,890 in income relating to a pension payment. The Minister reassessed Mr. Galachiuk's 2009 tax year to add the unreported income and imposed a penalty under subsection 163(1) of the *Income Tax Act* (the "*Act*"). Mr. Galachiuk does not dispute that the amount should have been included in his income but has appealed the imposition of the penalty.

[2] Subsection 163(1) is a harsh provision. It imposes a 10% penalty on the amount of the unreported income, not the amount of tax which has not been paid. When the corresponding penalty is applied under the *Alberta Personal Income Tax Act*, the result is a combined penalty equal to 20% of the amount of the unreported income. In Mr. Galachiuk's case, if the income tax that was withheld at source is treated as having already been paid, the subsection 163(1) penalty amounts to a

penalty in excess of 220% of his unpaid taxes[1]. That said, as Justice Woods stated in *Morgan v. The Queen*, 2013 TCC 232 at paragraph 27:

> Despite the harshness, it is not up to courts to rewrite the law. Parliament has seen fit to enact the penalty under subsection 163(1) and it is the duty of the courts to apply it.

Issues

[3] There are two issues in this Appeal. The first issue is whether Mr. Galachiuk can avoid the penalty if he is able to show that he exercised due diligence in preparing either his 2008 or his 2009 tax return or whether he is only able to avoid the penalty if he exercised due diligence in preparing his 2009 tax return. Depending on the outcome of the first issue, the second issue is whether Mr. Galachiuk exercised due diligence in the relevant year or years.

Witnesses

[4] Both Mr. Galachiuk and his wife, Tami Tranquada, testified. I found both of them to be credible. The Respondent did not call any witnesses.

Nature of the Test

[5] Turning first to the question of whether, to avoid the penalty, it is sufficient for Mr. Galachiuk to show that he exercised due diligence in either 2008 or 2009 or whether he must show that he exercised due diligence in 2009. Counsel for the Respondent advises me that, to date, this issue has only been considered in informal procedure cases. Clearly it is an issue on which Judges of the Court disagree.

[6] There are at least two Judges who have held that an appellant must show that he or she was duly diligent in filing his or her tax return in the year in respect of which the Minister applied the penalty: *Chendrean v. The Queen*, 2012 TCC 205

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[1] I note that the penalty imposed on Mr. Galachiuk under subsection 163(1) therefore exceeds even the maximum fine imposed for a criminal conviction for tax evasion under subsection 239(2) which is only 200% of the taxes evaded.

and *Chiasson v. The Queen*, 2014 TCC 158[2]. Justice Angers stated this position in *Chendrean* at paragraph 13 as follows:

> The defence of due diligence cannot be used to erase or eliminate either failures *per se*. It only permits a taxpayer to avoid the imposition of the penalty. In my opinion, the defence is available only after it has been established by the respondent that the taxpayer has a propensity to fail to report an amount by the existence of a first failure. The defence then becomes available on the second failure after it has been established since it is that second failure that gives use to the imposition of the penalty which is calculated on the amount of that second failure.

[7] At least three other Judges have held that an appellant need only show that he or she was duly diligent in one of the two tax years: *Franck v. The Queen*, 2011 TCC 179; *Symonds v. The Queen*, 2011 TCC 274; *Chan v. The Queen*, 2012 TCC 168; and *Norlock v. The Queen*, 2012 TCC 121[3]. Justice Webb (as he then was) stated this position in *Symonds* at paragraphs 22 and 23 as follows:

> [22] There are numerous cases that have held that a defence of due diligence, if established, may be relied upon by a taxpayer to avoid a penalty imposed under subsection 163(1) of the *Act*. The Respondent did not argue that the Appellant did not have the right to argue that such a defence was available but rather argued that the defence could only be argued in relation to the failure to include the amount in income in 2008 and not in relation to the failure to include the amount in income for 2006. However, it seems to me that since the penalty can only be imposed if a particular taxpayer fails to include an amount in income in two different years, the "prohibited act" consists of two failures - one is the failure to include an amount

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[2] In *Chiasson* Justice D'Auray stated her view that the due diligence defence could only be applied to the year in which the penalties had been assessed but, in light of the differing views on this issue among Judges on the Court and the fact that the Federal Court of Appeal had not yet had the occasion to rule on this issue, Justice D'Auray chose to give the taxpayer the benefit of the doubt and considered the taxpayer's due diligence in the earlier year as well.

[3] There are a number of cases where the Court considered the taxpayer's due diligence in more than one year but did not explicitly state that it was required to do so: *Jack v. The Queen*, 2013 TCC 1; *Paul v. The Queen*, 2008 TCC 159; *Ciobanu v. The Queen*, 2011 TCC 319; and *Tacilauskas v. The Queen*, 2012 TCC 288. The appeals were dismissed in each of these cases so I cannot draw the conclusion that the Judges in question necessarily subscribe to the view that the due diligence defence applies to either year as they would also have dismissed the appeals if they subscribed to the opposite view. It is possible that these Judges discussed the taxpayers' due diligence in the prior year merely with the goal of presenting a complete picture of the evidence. Therefore I have left these cases out of my list of cases favouring the view that due diligence may be shown in either year.

> in income in one year and the second is the failure to include an amount in income in another year that is within three years following the first failure.
>
> [23] Therefore if a taxpayer, as stated by Justice Hogan [in *Franck*], can establish that he or she (or in the case of a corporation, it) exercised due diligence in relation to either the first failure to include an amount in income or the second failure to include an amount in income, then that taxpayer will be successful in relation to the assessment of a penalty under subsection 163(1) of the *Act*. Even though the calculation of the amount of the penalty is only based on the second amount that the person failed to include in computing income, in order for the penalty to be imposed the person must have failed to include amounts in computing income in two different years and the two failures to include amounts in computing income would be part of the "prohibited act". In this case the Appellant will be successful if she can establish that she exercised due diligence in relation to either her failure to include $872 in her income for 2006 or her failure to include $28,611 in her income for 2008.

[8] With respect, I prefer the reasoning of Justice Webb over that of Justice Angers. As I stated above, subsection 163(1) is a very harsh provision. Its application all too frequently results in a penalty that bears little or no relation to the gravity of the wrong committed by the taxpayer[4]. Given the harsh and potentially disproportionate results of this penalty, if Parliament wanted to limit the circumstances in which a due diligence defence would be available, I believe that it would have expressly stated so in the subsection. Absent such an express limitation, it is my view that a due diligence defence is available to explain the omission in either year.

[9] It appears to me that the idea that the due diligence defence is only available in respect of the second failure to report is based, in part, on the belief that the first failure to report is intended to serve as a warning to the taxpayer that he or she must be particularly careful to avoid a second failure if he or she wants to avoid a penalty. I would be more open to this interpretation if there were a condition in subsection 163(1) that stated that the penalty could only be imposed if the taxpayer had first been reassessed in respect of his or her first failure to report. A precondition such as this can be found in respect of the repeat failure to file penalties in subsection 162(2). That subsection applies a larger failure to file penalty to a tax year where a taxpayer has previously failed to file a return for a

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[4] See Justice Jorré's detailed analysis of this issue in *Knight v. The Queen*, 2012 TCC 118 at paragraphs 1 to 32 in which Justice Jorré concludes that a taxpayer, such as Mr. Galachiuk, who resides in Alberta will always be punished more heavily under a combined federal and provincial subsection 163(1) omission penalty than he or she would be under a combined federal and provincial subsection 163(2) gross negligence penalty.

previous tax year on time. However, the larger subsection 162(2) penalty is only applicable if the normal subsection 162(1) failure to file penalty has already been assessed for the previous failure to file at the time the second failure to file occurs.

[10] No such precondition exists in subsection 163(1). A taxpayer could conceivably find himself or herself in a position where he or she had not yet been reassessed for the first failure to report income when he or she filed his or her return for the second year and thus was never aware of a need to be particularly careful in filing that return. The lack of such a precondition leaves me with two possible conclusions. Either Parliament omitted such a precondition because it wanted the Minister to be able to assess this harsh penalty against taxpayers who had no notice of their first failure or Parliament omitted such a precondition because it intended the due diligence defence to be available for both years. Again, given the harsh and potentially disproportionate nature of the subsection 163(1) penalty, my belief is that Parliament had the latter intention.

Due Diligence in 2008

[11] Having concluded that Mr. Galachiuk may avoid the subsection 163(1) penalty by proving that he was duly diligent in filing either his 2008 or 2009 tax return, I will now consider his level of due diligence. I will look first at Mr. Galachiuk's 2008 tax year.

[12] Mr. Galachiuk and Ms. Tranquada moved from Fort McMurray to Calgary in October 2008. Mr. Galachiuk was careful to advise his broker and his investment advisor of his move and specifically asked them to ensure that the various entities in which he had invested (the "Investment Entities") be apprised of his new address. Knowing that it was possible that some Investment Entities might fail to change his address, Mr. Galachiuk arranged with Canada Post to have his mail forwarded to his new address until April 30, 2009. He selected that date because it was one month after the March 30 deadline for issuing T3 slips. Various T-slips filed in evidence show that Mr. Galachiuk's change of address was not, in fact, processed by every Investment Entity. However, the fact that Mr. Galachiuk reported those slips on his return shows that his backup plan worked since Canada Post successfully re-directed them to him.

[13] One T3 slip somehow avoided the Canada Post re-direction and was never received by Mr. Galachiuk. Counsel for the Respondent submitted that, having received T-slips with the incorrect address on them, Mr. Galachiuk should have been alerted to the fact that his attempts to change his address with the Investment

Entities had not all worked and should have taken additional steps to ensure that he had all of his T3 slips such as contacting all of the Investment Entities personally to determine whether they had issued T-slips to him. This suggestion is premised on the idea that Mr. Galachiuk should have assumed that Canada Post would fail to forward all incorrectly addressed slips. Given that Canada Post had, in fact, forwarded a number of such incorrectly addressed slips to Mr. Galachiuk, I think that it was reasonable for him to believe that his back up system was working and that there was no need to make additional enquiries.

[14] Key to the above conclusion is Mr. Galachiuk's testimony that he was not aware that the T3 slip was missing. This was understandable in the circumstances. The missing T3 slip would have informed Mr. Galachiuk that he should have reported an additional $683 in his 2008 income. This unreported amount represented to less than 0.1% of Mr. Galachiuk's taxable income in 2008. Had the slip represented a much more significant portion of Mr. Galachiuk's income, I would have expected him both to notice its absence and to take steps to determine its whereabouts.

[15] Mr. Galachiuk and Ms. Tranquada explained how they prepared Mr. Galachiuk's tax return in 2008. Ms. Tranquada is a chartered accountant. At the time she helped Mr. Galachiuk prepare his 2008 return she was a senior tax manager at a national accounting firm. The tax return preparation process described by Mr. Galachiuk and Ms. Tranquada appeared to be thorough. Counsel for the Respondent suggested that they could have done more to ensure that no T-slips were missed. Given the amount of Mr. Galachiuk's income, the number of different investments that he was involved with, the amount of income on the missing T3 slip and the difficulty of determining from investment statements how much income has been earned in a given Investment Entity, I am not sure that even a more extensive review would have made Mr. Galachiuk aware of the missing T3 slip. I accept that the process that they followed was appropriate in the circumstances.

[16] The Respondent drew my attention to the fact that Mr. Galachiuk had also underreported his income in his 2007 tax year. Counsel for the Respondent was clear that the Respondent was not relying on the 2007 underreporting to meet the test in subsection 163(1). Rather the Respondent was relying on the 2007 tax year to show what she described as a pattern of behaviour on Mr. Galachiuk's part and to indicate that he should have been more careful in preparing his 2008 tax return.

[17] When Mr. Galachiuk filed his 2007 tax return he failed to report $517.48 in foreign non-business income. This income was contained in Box 25 of three different T3 slips that Mr. Galachiuk had received. Mr. Galachiuk reported the balance of the income from those slips in his tax return but, for some reason, the amounts from Box 25 were not picked up. Mr. Galachiuk could not explain how this had happened. His only guess was that it may have had something to do with a possible flaw with the online tax software that he used that year. I note that the unreported amount represented less than 0.02% of Mr. Galachiuk's income in 2007. I also note that the omission arose not from missing a T3 slip (as was the case in 2008) but rather from missing a box on a T3 slip that was otherwise reported. I do not draw any conclusions as to Mr. Galachiuk's due diligence in 2008 from his 2007 omission.

[18] However, the Respondent had another, more troubling submission with respect to Mr. Galachiuk's 2007 tax year. That year was reassessed to include the above $517.48 on March 19, 2008. The Notice of Reassessment stated "We have adjusted your return to include income from AGF Canadian Conservative Income Fund (T3), Fidelity Balanced Portfolio (T3), and Harmony Balanced Portfolio (T3)." The missing T3 slip in 2008 was from Harmony Balanced Portfolio. The Respondent submitted that the 2007 reassessment should have put Mr. Galachiuk on notice that he may have a T3 slip from Harmony Balanced Portfolio in 2008 and that he would thus have been careless in failing to determine whether he was missing such a T3 slip in 2008. I agree with the Respondent. However, there is an evidentiary problem with this argument. Mr. Galachiuk testified that he cannot recall when he received the 2007 reassessment nor can he recall when he filed his 2008 tax return. I accept Mr. Galachiuk's testimony on these points. Without evidence of when Mr. Galachiuk received the reassessment, I cannot conclude that he would have been aware of the reassessment when he filed his 2008 tax return. Furthermore, even if I were to conclude that Mr. Galachiuk received the reassessment within a reasonable period of time after the date on it, as I have no evidence of when Mr. Galachiuk filed his 2008 tax return, I cannot conclude that he filed it after that reasonable period of time. The copy of the 2008 tax return entered into evidence does not have a date on it. The index to the joint book of documents has a purported date that the return was filed but I am not prepared to accept a description in an index as evidence of anything. Counsel for the Respondent urged me to conclude that the notice of reassessment would have been received by the end of March before the deadline for issuing T3 slips ended and that Mr. Galachiuk would not have filed his return before that date. I am not prepared to make that leap. I find it somewhat amusing that the Respondent would

have me accept on one hand that Canada Post is regularly unreliable while on the other hand acknowledging their efficiency.

[19] The question then is whether the onus is on Mr. Galachiuk to prove that he did not receive the 2007 reassessment before he filed his 2008 return or on the Respondent to prove that he did. Clearly Mr. Galachiuk bears the onus of introducing *prima facie* proof that he was duly diligent. In my view he has done so through his description of the steps he took to ensure he received his T-slips, the steps he took to prepare his 2008 return and by demonstrating the tiny portion of his income that was unreported. It is therefore up to the Respondent to prove on a balance of probabilities that Mr. Galachiuk was not duly diligent. In doing so, it is up to the Respondent to introduce the evidence that she wants to rely upon. It is not sufficient for the Respondent to simply speculate what may have occurred and then sit back and wait for Mr. Galachiuk to prove otherwise. This is all the more true because the date on which Mr. Galachiuk net-filed his 2008 tax return is not something particularly within Mr. Galachiuk's knowledge but rather is a fact that could easily have been proven by the Minister using the Minister's own records.

[20] Had the Minister proven that Mr. Galachiuk filed his 2008 tax return after he received the 2007 notice of reassessment, I would have concluded that he was not duly diligent in filing his 2008 return. However, in the absence of that evidence, I must conclude that he was duly diligent. On that basis I would allow the Appeal.

Due Diligence in 2009

[21] Based on my conclusion that Mr. Galachiuk can avoid the subsection 163(1) penalty if he was duly diligent in filing either his 2008 or 2009 tax returns and my conclusion that he was duly diligent in filing his 2008 tax return, there is no need for me to consider whether he was duly diligent in filing his 2009 return. However, as I think that there is a reasonable chance that the Respondent may appeal my decision to the Federal Court of Appeal in order to obtain clarity on the interpretation of subsection 163(1), for the sake of completeness I will address the question of Mr. Galachiuk's due diligence in 2009.

[22] There are two ways that a taxpayer can satisfy the due diligence test. They are set out by the Federal Court of Appeal in *Les Résidences Majeau Inc. v. The Queen*, 2010 FCA 28:

> [8] According to *Corporation de l'école polytechnique v. Canada*, 2004 FCA 127, a defendant may rely on a defence of due diligence if either of the following can

> be established: that the defendant made a reasonable mistake of fact, or that the defendant took reasonable precautions to avoid the event leading to imposition of the penalty.
>
> [9] A reasonable mistake of fact requires a twofold test: subjective and objective. The subjective test is met if the defendant establishes that he or she was mistaken as to a factual situation which, if it had existed, would have made his or her act or omission innocent. In addition, for this aspect of the defence to be effective, the mistake must be reasonable, i.e. a mistake a reasonable person in the same circumstances would have made. This is the objective test.

[23] In establishing his due diligence in respect of his 2008 tax year, Mr. Galachiuk relied on the fact that he took reasonable precautions to avoid the error in question. In attempting to establish his due diligence in respect of his 2009 tax year, Mr. Galachiuk accepts that he did not take reasonable precautions to avoid the error in question but submits that he made a reasonable mistake of fact that a reasonable person would have made in the circumstances.

[24] In 2009, Mr. Galachiuk stopped working for his long time employer. Over his 27 years of working with that employer Mr. Galachiuk had enjoyed a number of benefits including a defined benefit pension, a defined benefit ancillary account, a supplemental pension plan, a personal retirement account and various stock options. When his employment ended, a great deal of money was transferred from these various plans either to Mr. Galachiuk's registered retirement savings plan, his locked-in retirement account or his personal bank account. These transfers all occurred over a period of 7 business days in October 2009. The transfers to Mr. Galachiuk's RRSP and LIRA were made on a tax deferred basis and thus he was not required to include any amounts relating to them in his income. By contrast, the transfers to his personal bank account were taxable. Income tax was deducted by his employer at source and Mr. Galachiuk was required to include the relevant amounts in his 2009 tax return. Some of the amounts in question would have been recorded on a T4 slip and the others would have been recorded on a T4A slip. Mr. Galachiuk received one T4 slip and one T4A slip from his employer for 2009. The T4 slip recorded all of the appropriate income. The T4A slip recorded only 30% of the appropriate income. The remaining 70% was recorded on a second T4A slip. Mr. Galachiuk testified that he had not received that second T4A slip when he filed his 2009 return[5] and that he believed that an employer would only issue one T4A slip to each employee and thus that the T4A slip he received must have recorded all of the appropriate income.

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[5] He admitted later finding the slip in his records when he was audited in 2011 but has no idea when or how it got there.

[25] Mr. Galachiuk submits that his mistaken belief that an employer would only issue one T4A slip for each employee and would report all relevant income that belonged on that slip satisfies the subjective component of the mistake of fact test. The Respondent concedes this point but states that a reasonable person would not have made that mistake in the circumstances. I agree with the Respondent.

[26] While a reasonable person may have believed that an employer would only issue one T4A slip per employee, I do not accept that such a person in Mr. Galachiuk's position, upon looking at the amount reported on the T4A slip that he or she received, would have believed that the slip he or she had received reported all of his or her income. The amount of income that was shown on the T4A slip that Mr. Galachiuk received represented only 30% of the income that should have been on the slip if it was intended to report all of the income in question. Mr. Galachiuk had detailed documents from his employer that listed the approximate amounts that he was to receive and the tax treatment for those amounts. He testified that he did not review those documents when preparing his return. Upon receiving a T4A slip that showed a dramatically different figure than should have been expected, a reasonable person would have reviewed the documents from his or her employer to check his or her understanding and ensure that he or she was not mistaken in his or her belief that only one slip would be issued.

[27] Mr. Galachiuk drew my attention to the fact that he had received 3 very similar amounts of money relating to the end of his employment and suggested that it was easy to be confused as to which one had to be reported. I do not accept this argument for 3 reasons. First, only 2 of the 3 amounts actually went into Mr. Galachiuk's bank account. The third amount went directly to his RRSP or LIRA so he cannot have been confused by that third amount as he would have known it was not taxable. Second, Mr. Galachiuk testified that he did not review the deposits to his bank account when he prepared his tax return. It is hard for me to accept that he would have been confused by something that he did not look at. Third, and most importantly, the T4A that Mr. Galachiuk received did not even come close to matching any of the 3 amounts in question[6].

Conclusion

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[6] The three amounts were $424,089, $413,935 and $436,890 before withholding taxes. The T4A reported $189,924 before withholding taxes. The three amounts were $424,089, $332,721 and $305,823 after withholding taxes. The T4A reported $132,947 after withholding taxes.

[28] Based on all of the foregoing, the Appeal is allowed and the matter is referred back to the Minister of National Revenue for reassessment on the basis that Mr. Galachiuk was not subject to a penalty under subsection 163(1) in his 2009 tax year.

[29] At the conclusion of the hearing, counsel for the Respondent requested the opportunity to make submissions on costs. The parties shall have 60 days from the date of the Judgment to make submissions on costs.

Signed at Ottawa, Canada, this 10th day of June 2014.

"David E. Graham"

Graham J.

CITATION:	2014 TCC 188
COURT FILE NO.:	2012-2093(IT)G
STYLE OF CAUSE:	ROBERT PAUL GALACHIUK AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Calgary, Alberta
DATE OF HEARING:	May 26, 2014
REASONS FOR JUDGMENT BY:	The Honourable Justice David E. Graham
DATE OF JUDGMENT:	June 10, 2014

APPEARANCES:

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Firm:

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