Udell (*Appellant*) *v.* **Minister of National Revenue** (*Respondent*)

Cattanach J.—Saskatoon, October 28; Ottawa, December 19, 1969.

Income Tax—Penalty for understating income—Gross negligence of professional accountant employed by taxpayer—Not attributable to taxpayer—Construction of penal enactment—Income Tax Act, s. 56(2).

A professional accountant employed to prepare a farmer's income tax returns, through his gross negligence made omissions and errors, of which the farmer was unaware, with the result that the farmer's tax return for 1962 substantially overstated his loss for that year and his tax return for 1965 understated his profit. The farmer's 1962 loss was applied against his income for 1961 and 1963. The farmer was assessed to penalties under s.56(2) of the *Income Tax Act* for 1961, 1963 and 1965.

Sec. 56(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 statement or omission in a return . . ." which would result in an under-assessment.

Held, the farmer was not liable to penalties under s. 56(2). The accountant's gross negligence was not attributable to his principal, the farmer. If there is a reasonable interpretation of a penal enactment that will avoid the penalty, the court must adopt that construction. It is a reasonable interpretation of s. 56(2) that it connotes knowledge and concurrence of the principal in his agent's act or omission. *Tuck & Sons v. Priester* (1887) 19 Q.B.D. 629, applied.

Held also, the Minister was entitled to assess a penalty under s. 56(2) for the farmer's 1961 and 1963 years which resulted from the excessive loss claimed in his 1962 return.

INCOME tax appeal.

H. M. L. Robertson for appellant.

D. G. H. Bowman and *G. I. Rip* for respondent.

CATTANACH J.—These are appeals from the Minister's assessments to income tax for the appellant's 1961, 1963 and 1965 taxation years.

The appellant is a farmer and lives at Viscount, Saskatchewan, where he operates a farm consisting of five and three-quarter sections. On this farm he grows grain and, in addition, engages in livestock transactions on the "contract system". As I understand this arrangement it is that the appellant agrees to feed a stated number of cattle which are purchased exclusively from Weiller & Williams Ltd. The proceeds from the sale of all or a portion of the cattle are applied to reduce the appellant's indebtedness under a conditional sales contract. It follows, in effect, that Weiller & Williams Ltd. is financing the appellant's cattle transactions and he is, in effect, operating a feed lot. The appellant maintained his accounts on a cash basis from which it follows that the total contract price of cattle purchased by him should not be claimed by him as an expense in the year but the expense arises only when payments are made on the contract.

The appellant recorded all his transactions in a pre-printed account book, published and distributed by "The Western Producer" a well known newspaper devoted to the interests of western farmers. This account book was designed for the use of farm operators in Western Canada but is designed more for cost purposes than for income tax purposes.

I found the appellant to be an intelligent man and, had he applied his mind to it, I am certain that he could have prepared accurate income tax returns. However he did not consider himself qualified to do so. From the inception of his farming operations he employed an accountant to perform this service for him. During the taxation years here under review, he employed MacKinnon, Repski & Co., a firm of certified public accountants at Saskatoon, Saskatchewan. The preparation of the appellant's income tax return was undertaken personally by Mr. MacKinnon of that firm, who for eight years prior to beginning practice as a certified public accountant in 1955 had been an assessor in the Department of National Revenue.

At the close of each of the appellant's taxation years he would take his farm account book, together with all supporting vouchers and cancelled cheques to Mr. MacKinnon. Because the farm account book was designed for cost purposes, it was necessary for the accountant to prepare his own work sheets from the information contained in the farm account book in order to reflect a more detailed distribution of income and expense items for income tax purposes.

In so transposing the information contained in the appellant's farm account book for 1962 to his work sheet for the preparation of the appellant's income tax return for that year, the accountant made a number of inexplicable errors in substantial amounts and this despite the fact that the requisite information on all transactions had been scrupulously and accurately entered by the appellant in his farm account book before it was made available to the accountant.

The accountant failed to transpose to his working sheet and to list in the appellant's 1962 tax return, cattle sales to the amount of $25,577.25 although he placed a check mark opposite this item in the appellant's farm account book to indicate that it had been so transposed.

In partial self-exculpation the accountant proferred the explanation that the appellant's income tax return was being prepared by him immediately before April 22, 1963, the date of the return, (the deadline for filing the return was April 30, 1963) that it was at the height of his busy season when he was constantly being interrupted and that, accordingly, he failed to make the mechanical transposition from the farm account book to his work sheet, although he had marked the item as transposed.

In addition, in the 1962 return, the accountant transferred from the farm account book an expense item of $20,000, being a payment on the purchase of cattle, to his working papers as $2,000. He left off one cipher making a difference of $18,000.

As a result of first the omission of income in the amount of $25,577.25 from cattle sales by the accountant and second, the incorrect entry by the accountant of an expense item of $2,000 rather than $20,000, the appellant reported a loss of $12,701.02 when his real loss was $5,143.77. The excess of $7,577.25 represents the difference between the sums of $25,577.25 and $18,000. As a result of this and other variations in the 1962 return made by the Minister, which are not in dispute, the Minister re-assessed the appellant with respect to his 1961 taxation year by reducing the loss carried back to his 1961 taxation year from his 1962 taxation year and revised the appellant's taxable income for his 1961 taxation year accordingly.

In addition the Minister imposed a penalty upon the appellant for his 1961 taxation year in the amount of $240.16 pursuant to section 56(2) of the *Income Tax Act.*

In the year 1963 the appellant followed the same procedure as he had done in the previous years. He delivered his farm account book with supporting vouchers and cancelled cheques to Mr. MacKinnon in order that Mr. MacKinnon could prepare his 1963 income tax return. Again Mr. MacKinnon transferred that information to his own working papers.

Mr. MacKinnon included in the appellant's 1963 return three entries of livestock purchases by the appellant from Weiller & Williams Ltd. made by him in his farm account book for that year in the total amount of $30,306.51, but against which three items the appellant had noted "not deductible—on contract". Mr. MacKinnon was dubious that such items should be included as part of the appellant's expenses for the 1963 year but he did include them in the appellant's 1963 income tax return without any notation or explanation by way of covering letter or otherwise because once again the April 30 deadline was close upon him. Further, the accountant did not include four payments on cattle purchases made by the appellant in the total amount of $10,718.51.

Mr. MacKinnon followed this course because he was anxious to avoid a penalty for late filing and because he wanted an explanation from the appellant with respect to these particular items.

He testified that he telephoned the appellant sometime in May 1964 asking him to drop into his office at some convenient time to discuss the matter.

The accountant wrote a letter dated June 29, 1964 to the Director of Taxation, London Building, Saskatoon, Saskatchewan, in which he pointed out the error he had made in the appellant's 1962 return in that the cattle purchases should have been $20,000 rather than $2,000. He did not mention that he had omitted cattle sales in that year in the amount of $25,577.25 because he was unaware of his omission at that time. This omission was discovered later when the officers of the Department made an exhaustive review of the appellant's records. He did make specific mention of the fact that the amount of $30,306.51 should be deducted from the appellant's 1963 purchases of cattle and that, in fact, payments had been made by the appellant in the amount of $10,718.51 which should have been included but was not.

These errors amounted to an overstatement of the appellant's expenses by an amount of $19,588. However upon being informed of these errors in the appellant's 1963 tax return, the Department made the necessary corrections, re-assessed the appellant accordingly, but did not impose a penalty under section 56(2) of the *Income Tax Act* with respect thereto.

As with the appellant's 1961 assessment the Minister did not allow the loss of $12,701.02 reported in the appellant's 1962 tax return to be treated in full as available for deduction in computing the appellant's taxable income for 1963 under section 27(1)(e) but, as previously intimated, reduced the 1962 loss available by reason of the omissions above recited.

The Minister imposed penalties in the amounts of $1,645.86 and $456.08 with respect to the appellant's 1963 income tax under section 56(2) of the Act.

The appellant did precisely the same thing with respect to his 1965 return as he had done with his returns for 1961, 1962 and 1963. He delivered his account book to his accountant Mr. MacKinnon with instructions to prepare his income tax return. Again the accountant failed to transpose a wheat sale in the amount of $2,814.04 from the appellant's farm account book. In addition there was claimed a capital cost allowance in excess of the amount allowable by the sum of $1,368.66. As a consequence of the omission of the wheat sale receipt and the excessive claim for capital cost allowance, the net income reported on behalf of the appellant was $4,182.70 less than should have been reported. Accordingly the Minister assessed the appellant on this revised amount and in addition the Minister assessed penalties in the amounts of $212.84 and $47.82 pursuant to section 56(2) of the *Income Tax Act* with respect to the appellant's 1965 taxation year.

The appellant's income tax returns for the years 1961 and 1963 were signed by Mr. MacKinnon as follows "C. C. Udell, per J. C. MacKinnon". The returns for 1962 and 1965 were signed by the appellant personally. In signing the 1961 and 1963 returns as he did, Mr. MacKinnon did so without prior authorization from his client, the appellant. He did this, in each instance, to avoid late filing. I attach no significance to the accountant's failure to obtain the appellant's approval to him signing the returns on his client's behalf because the appellant by his subsequent actions and conduct ratified the accountant's action.

Immediately following the filing of the returns for 1961 and 1963, copies thereof were sent by the accountant to the appellant for his perusal, examination and retention. The returns for 1962 and 1965 had been examined and signed personally by the appellant prior to filing, and copies thereof were supplied to him.

With respect to the appeals respecting the assessments for the appellant's 1961 and 1963 taxation years, he pleaded that Mr. MacKinnon did not advise him that he had written the letter dated June 29, 1964 to the Director of Taxation in Saskatoon, Saskatchewan wherein the accountant advised of the errors made by him in the 1962 and 1963 returns.

This allegation was not established by the evidence but in my view the contrary was the case.

The appellant's memory of the incident was quite hazy and naturally he could not and did not testify with certainty. On the other hand, Mr. MacKinnon testified that between May and June of 1964 he telephoned the appellant requesting him to attend at his office to discuss and explain the entries in his farm account book respecting the livestock purchases in 1963 in the total sum of $30,306.51. It is logical to assume that the appellant did attend at his accountant's office during that interval of time and that the requisite explanations were forthcoming. At that time the error of $18,000 in the 1962 return was also discussed which had resulted from the accountant transposing the figure of $20,000 as $2,000, but the omission of cattle sales in the 1962 year in the amount of $25,577.25 was not discussed. It is equally logical to assume, as Mr. MacKinnon testified, that the appellant instructed him to take the necessary steps to rectify the then known errors in the 1962 and 1963 returns by advising the Director of Taxation in Saskatoon. While the appellant did not see the accountant's letter of June 24, 1964, nevertheless, he would have been aware that such a letter would be written and of its content.

The appellant does not dispute the Minister's assessments which increased his taxable income as a consequence of the errors and omissions which occurred in his 1962, 1963 and 1965 tax returns. It is not disputed that such errors were made, nor that the amounts of the errors and the increase in taxable income were correctly determined by the Minister. Neither is it disputed that the amounts of the penalties assessed by the Minister are correctly computed.

The sole issue is whether, on the facts as above recited, the Minister properly assessed the penalties for the years in question in accordance with the provisions of section 56(2) of the *Income Tax Act* which reads as follows:

> 56. . . .
>
> (2) Every person who, knowingly, or under circumstances amounting to gross negligence in the carrying out of any duty or obligation imposed by or under this Act, has made, or has participated in, assented to or acquiesced in the making of, a statement or omission in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation, as a result of which the tax that would have been payable by him for a taxation year if the tax had been assessed on the basis of the information provided in the return, certificate, statement or answer is less than the tax payable by him for the year, is liable to a penalty of 25% of the amount by which the tax that would so have been payable is less than the tax payable by him for the year.

The Minister, in assessing the penalties as he did, did so on the assumption that the errors and omissions referred to above and under those circumstances amounted to gross negligence made or acquiesced in by the appellant with the result that the tax that would have been payable by the appellant in the years 1961, 1963 and 1965 (if the tax had been assessed on the basis of the information provided in those returns) was less than the tax in fact payable by him for those years.

Counsel for the appellant submitted that the errors which gave rise to the excessive loss claimed by the appellant in his 1962 taxation year, occurred in the income tax return for that year and that accordingly penalties should not have been assessed by the Minister under section 56(2) with respect to the appellant's 1961 and 1963 taxation years for the simple reason that the error did not occur in the tax returns for those years.

I do not agree that such submission is warranted by the language of section 56(2).

Under section 27(1)(*e*) a taxpayer, in computing his taxable income for a taxation year, may deduct from the income of that year, subject to limitations prescribed, business losses sustained in the five taxation years immediately preceding and the taxation year immediately following the taxation year.

By reason of the errors in his 1962 tax return, a loss was claimed which was in excess of the loss actually incurred by the appellant in that year. By virtue of section 27(1)(*e*) the appellant sought to deduct the full amount of that reported loss in computing his taxable income for his 1961 and 1963 taxation years. The Minister did not permit the appellant to do this but in assessing the appellant for the 1961 and 1963 taxation years reduced the loss reported in the appellant's 1962 return to the loss actually incurred by him in that year and treated that lesser amount as available for deduction in the appellant's 1961 and 1963 taxation years.

Section 56(2) provides in part that if "a statement" in "a return" filed results in the tax payable by the taxpayer "for a taxation year" if assessed on the basis of the information provided in "the return" is less than the tax payable by him for the year, the taxpayer is then liable to a penalty if the other conditions provided for in this section are present.

The careful use of the indefinite article in the first three instances quoted in the preceding paragraph leads to the conclusion that the incorrect statement should not be restricted to a particular taxation year.

For these reasons I cannot accept the submission of counsel for the appellant that because the errors and omissions occurred in the appellant's 1962 tax return, the penalties assessed by the Minister are not properly applicable to the appellant's 1961 and 1963 taxation years.

The argument stressed by counsel for the appellant as to why the penalties assessed by the Minister are not properly assessable under section 56(2) was, as I understood it, that the circumstances under which the errors and omissions were made in the appellant's tax returns, do not amount to "gross negligence" on the part of the appellant. He pointed out specifically that all of the appellant's farm transactions were carefully and scrupulously recorded in his farm account book. No attempt was made at any time to deny or hide any of such transactions. The complete and accurate record of the appellant's transactions were placed by him in the hands of a qualified professional

accountant with instructions to prepare his income tax returns. The appellant considered that he did not possess the qualifications and knowledge to reconcile the figures in his farm account book with those required to be included in the income tax returns. He considered that to be the job of an accountant, not a farmer. He, therefore, employed an accountant for that purpose. This very action by the appellant, it was argued, negatived any implication of gross negligence on his part.

It was conceded by counsel for both parties that the errors and omissions in the appellant's tax returns were made by the accountant and that the accountant was grossly negligent in doing so. I readily agree with this concession.

Counsel for the Minister did not suggest that the appellant "knowingly" made, participated in, assented to or acquiesced in the making of the errors and omissions in his tax returns. He did suggest, however, that the appellant was personally guilty of gross negligence in that he was alerted to the likelihood of an error having occurred by reason of the large loss claimed in his 1962 return and accordingly the circumstances were such that he ought to have known that there was every likelihood of an error having been made and that he should have been put upon his enquiry and made enquiries.

The appellant's explanation was that he had implicit faith in the accountant and had placed complete reliance upon him. He knew that 1962 had not been a successful year for him and that he had suffered a loss which he estimated from the state of his bank account and his cash flow to have been in the neighbourhood of $4,000 to $5,000. He assumed that the reported loss of approximately $12,000 in his 1962 return was attributable to capital cost allowances. He further testified that his review of his income tax returns in all years when submitted to him for approval by his accountant was casual. He said that if the profit or loss reported in his returns coincided approximately with his own estimate of his profit or loss, then he accepted the return and did not closely scrutinize the computations by which the result was arrived at in his tax return as prepared by his accountant.

As I have intimated before, from my observation of the appellant as he testified, I found him to be an intelligent man, that he made every effort to be truthful and I found that his explanation of his failure to question the magnitude of the loss reported in his 1962 tax return to have been a reasonable one. I, therefore, have no hesitation in accepting his explanation in this respect.

However the question remains as to whether the gross negligence of the appellant's accountant, which his actions constituted, can be attributed to the appellant in the circumstances of these appeals.

The submission of the appellant is that it cannot because the language of section 56(2) contemplates that the gross negligence must be that of the appellant personally or that he was privy to it. This is cardinal to his argument. He says that the section applies only to the acts of the appellant himself and cannot possibly apply on the facts of the present case where the appellant was completely innocent of any negligence but that the errors and omissions were committed by his accountant and had not been authorized by him, nor subsequently ratified by him because he was not aware of them, nor did he have reason to suspect them.

In considering the question so posed, I do so on the acceptance of three premises:

(1) that the relationship between the appellant and his accountant was that of principal and agent;

(2) that the omission and errors of the accountant in preparing the appellant's tax returns constituted gross negligence on the part of the accountant; and

(3) that the appellant did not know of these omissions and errors on the part of the accountant.

In general, a person is not personally responsible for infractions of a penal nature committed by another in the position of an agent, but this rule is not absolute. A principal may be involved in penal responsibility for the act or omission of his agent by the effect of the statutory enactment.

Whether the appellant has been properly assessed to penalties is, therefore, dependent upon the interpretation of section 56(2). Does that section contemplate that a taxpayer shall be personally responsible for the gross negligence of his agent in the making of a statement or omission in a return? The language of the section is clear that the penalty is to be imposed, if the circumstances contemplated by the section are present, on the taxpayer and not upon a person who made the statement or omission on the taxpayer's behalf. The person, who is liable to penalty, is the person by whom the tax is payable. Therefore, in the present case, the person who may be liable to penalty is the appellant, not his agent, the accountant. It is conceivable that the appellant might have a cause of action against the accountant for any loss arising out of the preparation of the returns, but that matter does not concern me in the present action.

There is no doubt that section 56(2) is a penal section. In construing a penal section there is the unimpeachable authority of Lord Esher in *Tuck & Sons v. Priester*[1] to the effect that if the words of a penal section are capable of an interpretation that would, and one that would not, inflict the penalty, the latter must prevail. He said at page 638:

> We must be very careful in construing that section, because it imposes a penalty. If there is a reasonable interpretation which will avoid the penalty in any particular case we must adopt that construction.

At this point it is convenient to reproduce the relevant language of section 56(2). It is that "every person" (which means the taxpayer) "who knowingly" (I have found that the appellant did not have knowledge of the errors and omissions made by his accountant) "or under circumstances amounting to gross negligence . . has made or has participated in, assented to or acquiesced in the making of a statement or omission . . . is liable to a penalty . . .".

The circumstances of this case, as I have found them to be, do not constitute personal gross negligence on the part of the appellant for the reasons I have previously outlined.

[1] (1887) 19 Q.B.D. 629.

Accordingly there remains the question of whether or not section 56(2) contemplates that the gross negligence of the appellant's agent, the professional accountant, can be attributed to the appellant. Each of the verbs in the language "participated in, assented to or acquiesced in" connotes an element of knowledge on the part of the principal and that there must be concurrence of the principal's will to the act or omission of his agent, or a tacit and silent concurrence therein. The other verb used in section 56(2) is "has made". The question, therefore, is whether the ordinary principles of agency would apply, that is, that what one does by an agent, one does by himself, and the principal is liable for the actions of his agent purporting to act in the scope of his authority even though no express command or privity of the principal be proved.

In my view the use of the verb "made" in the context in which it is used also involves a deliberate and intentional consciousness on the part of the principal to the act done which on the facts of this case was lacking in the appellant. He was not privy to the gross negligence of his accountant. This is most certainly a reasonable interpretation.

I take it to be a clear rule of construction that in the imposition of a tax or a duty, and still more of a penalty if there be any fair and reasonable doubt the statute is to be construed so as to give the party sought to be charged the benefit of the doubt.

Accordingly the appeals are allowed with costs.