

1964
 Sept. 28-30
 Oct. 1, 2
 Nov. 27

BETWEEN :

THE MINISTER OF NATIONAL
 REVENUE) APPELLANT :

AND

OLVA DIANA ELDRIDGE RESPONDENT.

Revenue—Income—Income tax—Taxability of earnings from illegal operation or illicit business—Business expenses—Deductibility of expense laid out for purpose of gaining income—Deductibility of expense of account of employee incurred as result of terms of employment—Arbitrary assessment—Onus of proof when arbitrary assessment has been made—Income Tax Act, R.S.C. 1952, c. 148, ss. 12(1)(a), 44, 46 and 56.

The respondent operated a call girl business in Vancouver, British Columbia, for several years until she and her nine employees were arrested in November 1960, charged with conspiring to live on the avails of prostitution, and, after pleading guilty, were sentenced to varying terms of imprisonment. After the arrest of the respondent, police seized a voluminous amount of documents at her home, all of which were turned over to the Taxation Division of the Department of National Revenue in answer to a requirement dated March 20, 1961.

The respondent had filed net worth returns for the years 1958 and 1959 and an incomplete net worth return for 1960, accepted by the Taxation Division in the belief that she had no records of her business operations. After reviewing the documents turned over to them by the Vancouver police, the officers of the Taxation Division delivered Notices of Assessment for the years 1959 and 1960 which indicated revised taxable incomes for the two years of \$22,046.75 and \$19,103.77 respectively. The respondent did not object to the gross revenues calculated by the Taxation Division but objected to the assessments on the ground that substantial operating expenses were not allowed. Her appeal to the Tax Appeal Board was allowed in part and the appellant appeals from that decision.

The main expenses in issue are for rent for various premises in which to carry on her business, legal fees in connection with the charges against her and her employees and fees for bail bonds, telephone inspection

fees to ensure against wire tapping, payments for assistance to her employees in the performance of their duties, protection fees, cost of liquor and the cost of buying up an entire issue of Flash newspaper.

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE

Held: That it is abundantly clear from the decided cases that earnings from illegal operations or illicit businesses are subject to tax.

2. That all the items of expenses in issue, with the possible exception of the legal fees, the cost of the purchase of Flash newspaper and the fees paid for bail bonds, are of such a nature that, if proven to have been disbursed, would be proper deductions.
3. That it must be assumed that the law enforcement officers are conscientious in the exercise of their duties and are incorruptible and such assumption can be rebutted only by convincing evidence to the contrary.
4. That the legal fees paid by the respondent for the defence of one of the call girls charged under the Criminal Code in 1959 is properly deductible for the twofold reason that it was laid out for the purpose of gaining income, the girl upon her acquittal returned to work, which she could not have done if sentenced to imprisonment, and it was part of the girl's arrangement with the respondent that in the event of criminal prosecution as a result of the activities, the respondent would assume the cost of the girl's defence.
5. That although the fee paid to counsel for one of the girls arrested with the respondent in November 1960 cannot be justified as a legal expense laid out for the purpose of gaining income from the business since the business had been brought to an end by the wholesale arrests, it is properly deductible because it was a term of the call girl's engagement with the respondent that the respondent would assume responsibility for legal expenses as part of the girl's remuneration.
6. That the commission paid for procuring bail bonds for the respondent's employees was a responsibility assumed by the respondent as a term of the engagement of the call girls and the cost thereof is therefore properly deductible, but not the commission paid for procuring the bail bond for the respondent.
7. That the Minister of National Revenue is not bound by a return or information supplied by or on behalf of a taxpayer and may make what has been termed an "arbitrary" assessment under s. 46 of the *Income Tax Act*. In that event, the onus is on the taxpayer to show that the amount determined by the Minister is erroneous.
8. That the appeal is allowed.

APPEAL from a decision of the Tax Appeal Board.

The appeal was heard by the Honourable Mr. Justice Cattanach at Victoria.

R. M. Hayman and *F. D. Jones* for appellant.

N. Mussallem and *M. G. Kemp* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

CATTANACH J. now (November 27, 1964) delivered the following judgment:

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 ———
 Cattanach J.
 ———

This is an appeal from a decision of the Tax Appeal Board dated November 21, 1962 in respect of income tax assessments of the respondent for her 1959 and 1960 taxation years.

The respondent had been carrying on a call girl operation in the City of Vancouver, British Columbia during the taxation years under review and had been so engaged since 1953. She filed her first income tax return for the year 1957 and also filed returns for the three preceding years, 1954, 1955 and 1956, following a discussion in 1957 between the respondent and her tax consultant and officers of the Taxation Division of the Department of National Revenue. The respondent had not filed income tax returns and the purpose of the discussion in 1957 was to review the respondent's affairs generally. Because of the nature of the respondent's business, she alleged that she kept no books of account or similar records. At that time the officers of the Taxation Division pointed out the advantages and necessity of maintaining complete records for income tax purposes. However, since such records were apparently lacking, the officers of the Taxation Division obtained net worth statements for the taxation years 1953 to 1957 inclusive.

The respondent filed a net worth return for the years 1958 and 1959 and an incomplete return for the 1960 taxation year, also on a net worth basis.

In the latter part of 1960 the respondent's activities came under the surveillance of dedicated and efficient members of the morality squad of the Vancouver police who, after secret and careful preparation, arrested the respondent at her home on the evening of November 10, 1960 and seized a voluminous amount of documents. On the same night, or very shortly thereafter, the seven call girls who worked exclusively with the respondent, were also arrested, together with two girls who attended the telephones in the respondent's operations. The ten girls, including the respondent, were confined in jail, but all ten were, within the next few days, released on bail.

The respondent, her two telephone operators and the seven call girls who worked with the respondent, were all charged with conspiring to live from the avails of prostitution. The material seized by the police, conclusively

established the guilt of the accused persons each of whom pleaded guilty to the charges laid against them and they were sentenced to varying terms of imprisonment.

1964
 }
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 —
 Cattanach J.
 —

By requirement dated March 20, 1961, all records seized by the police were obtained by the officers of the Taxation Division who thereupon undertook an exhaustive and painstaking reconstruction of the respondent's affairs for the 1959 and 1960 taxation years.

This reconstruction formed the basis of Notices of Assessment for the respondent's taxation years 1959 and 1960 and disclosed the following revenues and expenditures:

	1959	1960
Gross Revenue	\$ 77,661.50	\$ 80,749.00
Expenses:—		
Associates share of gross revenues	38,830.75	40,374.10
Dispatchers Wages (telephone operators) ..	6,504.20	7,862.25
Commissions	2,996.03	5,735.75
Telephone	276.13	409.67
Room rentals	1,583.50	1,783.50
Refreshments	1,120.94	862.56
Taxis	101.00	61.50
Bad debts	990.00	1,334.50
Miscellaneous	612.20	621.00
	<hr/>	<hr/>
Net income	\$ 53,014.75	\$ 59,045.23
	<hr/>	<hr/>
Net income	\$ 24,646.75	\$ 21,703.77

In making the assessment for the respondent's 1959 taxation year the Minister recomputed the respondent's income as follows:

Net income previously assessed	\$ 3,718.09
Add—unreported income	20,928.66
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Revised net income	24,646.75
Deduct—Personal exemptions \$2,500	
Standard deduction 100	2,600.00
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Revised taxable income	22,046.75

Upon the revised taxable income the Minister assessed tax amounting to \$9,275.75 and levied a penalty amounting to \$2,150.00

In making the reassessment for the respondent's 1960 taxation year the Minister recomputed the respondent's income in the following manner:

Net income reported	\$ nil
Add unreported income	21,703.77
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1964	Revised net income	21,703.77
MINISTER OF NATIONAL REVENUE	Deduct—Personal exemption \$2,500	
	Standard Deduction 100	2,600.00
	Revised taxable income	19,103.77

v.
ELDRIDGE
Cattanach J.

The respondent objected to both such assessments. She admitted that gross revenues in the amounts of \$77,661.50 in 1959 and \$80,749.00 in 1960 were received by her. In fact I think the gross revenues received in the years in question were in excess of these amounts because in the year 1959 there were 71 days for which the daily recordings (which came into the hands of the taxation officials) were missing and 34 days in 1960. In addition there was gross income in the amount of \$2,118.75 and expenses of \$1,389.25 leaving a net income of \$729.50 (see Exhibit A-48) which, because of the absence of dates, could not be allocated to the appropriate year and accordingly were omitted from the compilation. However, she complains that the expenses of \$53,014.75 for the year 1959 and \$59,045.23 for the year 1960 are not conclusive of the operating expenses incurred by her during the taxation years in that they do not include further items of expense, which will be considered in detail later.

The Minister, having reconsidered the assessments and having considered the facts and reasons set out in the respondent's notices of objections, by notification dated March 1, 1962 confirmed the assessments,

... on the ground that subsection (6) of section 46 of the Act provides that the Minister shall not be bound by any return or information supplied by or on behalf of a taxpayer and notwithstanding such return or information the Minister may assess the amount of tax payable by any person; that in the absence of proper proof and accounting records and upon investigation and in view of all the facts the Minister has under the said subsection (6) of section 46 assessed the tax payable by the taxpayer for the taxation years 1959 and 1960; that additional expenses claimed as deductions from income have not been shown to have been outlays or expenses incurred by the taxpayer for the purpose of gaining or producing income within the meaning of paragraph (a) of subsection (1) of section 12 of the Act; that a penalty has been levied in the 1959 taxation year in accordance with the provisions of section 56 of the Act.

The respondent appealed the assessments to the Tax Appeal Board. By a judgment dated November 21, 1962 the Tax Appeal Board allowed the respondent's appeal in part, directing that the sum of \$11,860.00 be deducted from the respondent's assessed income for the year 1959 and the sum of \$9,700 from her assessed income for 1960, and that the

penalty imposed be duly reduced. In the aforesaid judgment the Tax Appeal Board stated that "due credit had not been given by the respondent (i.e. the Minister) to the appellant (the respondent herein) for certain expenses necessarily incurred by her for the gaining or producing of income during 1959 and 1960". However, the judgment does not indicate the details of the expenses which comprise the respective total sums of \$11,860.00 and \$9,700.00

1964
 }
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 —
 Cattanach J
 —

It is from this judgment that the present appeal to this Court is taken.

The basic record of the respondent may be described as daily call sheets. The respondent's business was arranged exclusively by telephone. An apartment was maintained in the west end of Vancouver where the telephones were located. There was a normal staff of two girls, which was sometimes increased to three, who worked in shifts from 11:00 a.m. to 7:00 a.m. These girls received telephone calls from prospective customers. After checking the authenticity of the caller they would then arrange an assignation, the details of which were carefully recorded on a sheet of paper from a stenographer's notebook indicating the name of the caller, a code number for the girl assigned to the call and the place of assignation which was indicated by means of a certain sequence of the digits in the telephone number at the place. The time of the commencement of the girl's visit was also recorded and the time of its termination. The girl would report her arrival and departure by telephone so that the whereabouts of the girl was known at all times. If the girl did not so report, checks were made by calling the telephone number at the place of assignation and if difficulty was thereby apparent assistance was sent to the girl. Those circumstances were recorded on the daily sheet. In any event the daily sheets do record the duration of each visit and the fee therefore which was at the rate of \$25 per hour. A great number of assignations were made in motel or hotel rooms engaged by the caller, but in many instances, where such was not feasible, the meetings were arranged in suites or rooms rented by the respondent. The girl who took the assignment would receive the payment from the customer and subsequently deliver the respondent's 50 percent share to the telephone operator, which amount was also recorded in the daily sheet by her.

1964
 }
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 ———
 Cattanach J.

Unquestionably these daily sheets did comprise a complete record of the revenues received and were obviously necessary to ensure the accurate division thereof between the respondent and the girls.

Further, the arrangement whereby 50 percent of the fees received were delivered to the respondent was satisfactory to the call girls. It obviated the necessity for them to solicit in the streets thereby avoiding police surveillance, they were assured of assistance in the event of trouble with a customer, the way for them to enter and leave hotels and motels was smoothed by payments by the respondent to desk clerks and like employees and when calls were not made at hotels or motels a place of assignation was provided. Further the respondent also provided a centrally located apartment to which the girls could resort while awaiting calls rather than return to their own residences. This had the additional advantage to the respondent that she did not have to pay taxicab fares over greater distances.

If cheques were accepted in payment for services, the respondent bore the loss if the cheques were dishonoured.

The respondent undertook the responsibility for all legal expenses in the event of the girls who had an exclusive arrangement with her being arrested (including the provision of bail and counsel to conduct her defence).

The respondent testified that during the years she conducted this operation she had entered into such an arrangement with hundreds of girls. It often occurred that girls who did not have this exclusive arrangement with her were engaged, in which case the respondent's share of the fees earned was 30 percent. However, the respondent did not assume responsibility for any possible legal expenses of the girls so engaged who were considered by her to be casual employees.

The daily sheet was begun by the telephone operator, also referred to as a dispatcher, when she began the shift at 11:00 a.m. and was continued by her succeeding dispatcher and was concluded at the end of the shifts at 7:00 a.m. the following morning.

From the money on hand in the telephone rooms certain expenses were paid, such as the dispatchers wages, commission paid to desk clerks, bellhops, taxicab drivers and like persons for the referral of customers to the respondent,

telephone bills, rent, groceries, taxicab fares, bad debts and miscellaneous expenses. These payments were also entered on the daily sheets. When these payments out were deducted from the revenues received from the girls, the cash on hand represented the respondent's income for the particular day. The dispatcher going off duty at 7:00 a.m. would then mail the daily sheet to the respondent at her home address.

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 Cattanach J.

From these sheets, for the years 1959 and 1960 which were found and seized by the police when the respondent was arrested at her home on the evening of November 10, 1961 and which were obtained from the police by the officials of the Taxation Division, those officers compiled summaries of the respondent's income and expenses for the years 1959 and 1960 for each month which were received in evidence as Schedules 2 and 3 to Exhibit A.46. The respondent admitted that the summaries so prepared are accurate summaries of the income and expense of the respondent from her operation during the years 1959 and 1960 so far as disclosed by the daily sheets which were received in evidence as Exhibit A.6, A.16, A.18 and A.24.

However, the respondent and two of her dispatchers testified that there were further expenses paid which were not included on the daily sheets. The total remaining for each daily sheet at the conclusion of the working day at 7:00 a.m. was transferred to "Bank". By being transferred to "Bank" was meant that the cash and cheques on hand were placed in a white envelope which was secreted in the telephone rooms behind a mirror in the bathroom. Expenses were sometimes paid after completion of the daily call sheet for the preceding day and before the beginning of the succeeding day's sheet by the dispatchers (who were trusted employees) from the cash in the envelope and noted by them on the envelope. These envelopes were picked up by the respondent or her agent at intermittent intervals. From the daily sheets which had been mailed to her and the notations of money paid out thereon and on the envelopes, the respondent could balance the cash in the envelopes against such notations and so ascertain the correctness of the amount of cash received by her. She testified that the envelopes with their notations

1964
 MINISTER OF NATIONAL REVENUE
 v.
 ELDRIDGE
 Cattanach J.

were effectively destroyed by her forthwith after they had served this purpose.

While the daily sheets were the basis of the summary of income and expenses of the respondent for the taxation years in question and which in turn form the basis of the assessments presently under appeal, nevertheless, the officers of the Taxation Division meticulously checked other sources of information available to them, such as the bank accounts of the respondent with deposits and withdrawals.

In my view the summaries of revenue are accurate and if any error occurs therein, that error is in favour of the respondent.

The respondent freely admits that she was engaged in an illegal and illicit business, nor does she dispute the computation of the gross income received by her. The substance of her objection to the assessments is that further expenses were incurred by her in the operation of her business which should be taken into account and her taxable income reduced to the extent of those expenses.

At this point I would mention it is abundantly clear from the decided cases that earnings from illegal operations or illicit businesses are subject to tax. The respondent, during her testimony, remarked that she expressed the view to the officers of the Taxation Division that it was incongruous that the government should seek to live on the avails of prostitution. However, the complete answer to such suggestion is to be found in the judgment of Rowlatt, J. in *Mann v. Nash*¹ where he said at p. 530:

It is said again: "Is the State coming forward to take a share of unlawful gains?" It is mere rhetoric. The State is doing nothing of the kind; they are taxing the individual with reference to certain facts. They are not partners; they are not principals in the illegality, or sharers in the illegality; they are merely taxing a man in respect of those resources. I think it is only rhetoric to say that they are sharing in his profits, and a piece of rhetoric which is perfectly useless for the solution of the question which I have to decide.

The respondent puts forward as further expenses items in the total amount of \$20,255.40, which she claims should have been deducted in the year 1959 to arrive at her taxable income which if allowed, would reduce her taxable income for the year 1959 to \$4,391.35.

¹ (1929-1932) 16 T.C. 523.

With respect to the taxation year 1960, the respondent claims additional expenses to the total amount of \$22,140 which, if allowed would result in a loss of \$336.33 for the 1960 taxation year.

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 ———
 Cattanach J.
 ———

The items put forward by the respondent as operating expenses of her business for the 1959 taxation year, not taken into account in making the assessment on that year, are as follows:

	<i>Cheques</i>	<i>Cash</i>	<i>Total</i>
(1) Rent paid to Kamlo Motel ...	\$ 475.40	\$ 500.00	\$ 975.40
(2) Rent for apartment at 1095 Bute St.	180 00	1,155.00	1,335 00
(3) Rent paid to Shirley Milne for apt. occupied by her		2,100 00	2,100.00
(4) Rent paid for additional suites		1,170.00	1,170.00
(5) Legal fees	425.00	500.00	925.00
(6) Telephone inspection		1,000 00	1,000.00
(7) Payments for assistance to girls	100.00	900 00	1,000.00
(8) Payments to casual employees ..	150.00		150.00
(9) Protection fees		9,000.00	9,000.00
(10) Liquor Payment fees		2,600.00	2,600 00
	—————	—————	—————
Totals for 1959 taxation year ..	\$1,330.40	\$ 18,925.00	\$ 20,255.40
	—————	—————	—————

Items put forward by the respondent as operating expenses of her business during her 1960 taxation year which were not taken into account in making the assessment for that year, are as follows:

	<i>Cheques</i>	<i>Cash</i>	<i>Total</i>
(1) Rent paid to Shirley Milne for suite occupied by her for 11 months		\$ 1,925.00	\$ 1,925.00
(2) Legal fees		1,000.00	1,000 00
(3) Telephone inspection		1,000.00	1,000.00
(4) Purchase of entire issue of Flash newspaper		500.00	500.00
(5) Rent paid for additional suites ..		1,300.00	1,300.00
(6) Rent paid for suites at 1107 Howe St. (Vincent Lodge)		515 00	515.00
(7) Protection fees		7,500.00	7,500 00
(8) Fees paid for bail bonds		6,400.00	6,400.00
(9) Liquor payment fees		2,000 00	2,000.00
		—————	—————
Total .. .		22,140.00	22,140.00
		—————	—————

All such items, with the possible exception of the items for legal fees, the purchase of Flash newspaper and fees

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 ———
 Cattanach J.

paid for bail bonds, are of such a nature that, if proven to have been disbursed, would be proper deductions. With respect to such items as are deductible, if proven, counsel for the Minister contends that the onus, which is on the respondent, that she did so expend such sums, has not been discharged by the production of acceptable evidence. With respect to the payments of legal fees, for Flash newspaper and fees for bail bonds, he contends that even if payment of those fees is proved, they were not outlays or expenses made or incurred by the respondent for the purpose of gaining income from her business and accordingly the deduction thereof in computing income is precluded by s. 12(1)(a) of the *Income Tax Act*.

With such considerations in mind I propose to deal with each individual item advanced by the respondent. It will be observed that the items respecting (1) rent paid to Shirley Milne; (2) rent for additional suites; (3) telephone inspection (4) protection fees and (5) liquor payments, are common to both taxation years under review, for which reason I shall deal with those items first particularly since the circumstances and considerations applicable thereto are the same in each year.

The claim with respect of the premises at 1095 Bute Street, occupied by Shirley Milne is in the total amount of \$4,025 being \$2,100 for twelve months in the year 1959 and \$1,925 for eleven months in the year 1960 which is at the rate of \$175 per month. These premises were occupied by Shirley Milne as her personal living accommodation. Mrs. Milne was apparently an intimate and trusted friend of the respondent having previously lived with the respondent in her home. Shirley Milne occasionally acted as a call girl and sometimes acted as a telephone operator. However, in addition to being personally occupied by Shirley Milne as her living accommodation, the premises were used as a central location to which the call girls could resort to (and did so resort) between calls so as to be readily available and to avoid the necessity of travelling greater distances to places of assignation with a corresponding increase in taxicab fares. Further, the premises were used as a place of assignation when other such places were not available. Therefore, there is no doubt that these

premises were used in the conduct of the respondent's business.

Mrs. Milne testified that the respondent paid the monthly rent of the premises and the cost of further expenses in connection with the maintenance of the premises to her in cash while she in turn paid the rent to the landlord and paid the bills for expenses. She further testified that the monthly rental was \$105 and that the expenses usually amounted to \$75 per month. She also added that the respondent paid for utility services such as electricity and telephone for which the respondent seeks to claim \$370 or \$185 for each year which amount was not previously claimed in the respondent's expenses as before outlined herein. This money was paid directly to Mrs. Milne by the respondent which undoubtedly accounts for the fact that entries of these expenditures were not made in the daily sheets by the telephone operators, nor was it contended by the Minister that any such payments could be attributed to the expenses outlined in Schedules 2 and 3 to Exhibit A.46 under the heading "Room Rentals" which were allowed by him in making the assessments. While I am satisfied that a monthly rental of \$105 was paid for these premises and that the premises were used in the respondent's business, the evidence with respect to the additional expenses is extremely vague. With respect to the further monthly amount of \$75, this was put forth as an estimate for expenses which were not particularized other than by mention in the evidence of the respondent and Mrs. Milne of maid service and groceries and a yearly amount of \$185 for utilities, such as electricity and telephone, which was added as an afterthought. The relationship between Mrs. Milne and the respondent was not explained with any degree of exactitude, that is, whether she was the resident manager of the respondent for the operation of these premises and if so the nature of the arrangement for her compensation. I am certain that a portion of the expenses incurred were personal living expenses of Mrs. Milne. Further the additional expense put forward is admittedly an estimate unsupported by vouchers, receipts and no proper records or accounts were kept to support the statements. While I am satisfied that the monthly rental of \$105 was paid, I have

1964

MINISTER OF
NATIONAL
REVENUE
v.
ELDRIDGE
Cattanach J.

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 Cattanach J.

not been satisfied by adequate evidence which is the responsibility of the respondent to produce, as to the additional expenses claimed. Therefore, I would allow as a deduction as a business expense incurred by the respondent for these premises the sum of \$1,260 for the year 1959 and the sum of \$1,155 for the year 1960.

The second item applicable to the 1959 and 1960 taxation years is a claim, the rent of for "at least" one other suite leased at all times from April 1959 at an "average" rental of \$130 per month. The amounts claimed by the respondent in this regard are \$1,170 for the 1959 taxation year and \$1,300. No satisfactory evidence was adduced to confirm the respondent's statement that such amounts were paid, nor as to the amounts alleged to have been paid. This amount is an obvious estimate because the respondent states it was an "average" rental, nor is it certain how many suites were rented, or the precise dates when they were rented. I have not been presented with evidence which would enable me to determine if any such amounts were paid and, even if any such amounts were paid, precisely how much was so paid. The appellant, by reason of her failure to keep proper records, has been unable to show to my satisfaction that the Minister erred in not crediting these amounts as an expense in her business.

The third item common to the 1959 and 1960 taxation years is an amount of \$1,000 in each year for telephone inspections. The respondent, by reason of the nature of her business, suspected that a listening device might be surreptitiously attached to the telephones in her telephone room by the law enforcement authorities to secure information which might lead to the respondent's criminal prosecution and conviction and so hamper or terminate her business. To guard against such possibility she testified that she engaged an employee of the telephone company to ascertain if her telephones had been so tapped. Admittedly, the telephone company employee was prohibited by his employer from conducting such an inspection. The respondent claims that a fee was charged for each such inspection but that no receipt was given to the respondent. The respondent admits that she did not keep records of the number of such inspections or of the total cost thereof. The amount of \$1,000 for each year is admittedly only a very

rough estimate. Again, such vague generalities as were introduced in evidence are not adequate to discharge the onus on the respondent. That onus can only be discharged by precise and definite evidence. The respondent has not satisfied me by adequate evidence that any such amount was expended and, if so, of the amount so expended.

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 Cattnach J.

The fourth item common to the 1959 and 1960 taxation years is the amount claimed for protection fees, being \$9,000 in 1959 and \$7,500 in 1960. The respondent maintained that she could not conduct her business without the payment of protection to the law enforcement authorities. She alleges that she paid \$750 per month for this purpose based on \$100 for each call girl in her employ and \$50 for the messenger who collected the money which she testified was paid in cash, placed in a white envelope and invariably collected the first of each month by a person who identified himself as Mr. Jones of Seattle. In exchange for such payment the respondent was advised of certain hotels to be avoided by her girls when these hotels were under police surveillance and like information. She also attributed the fact that her business was operated without molestation until November 10, 1960 to these protection payments being made. While the respondent hinted that she knew the recipients of these payments, she refused to identify such persons because, as she stated, she feared for the safety of the lives of her children and her own life if she made such disclosures. I must assume that the law enforcement officers are conscientious in the exercise of their duties and are incorruptible and such assumption can only be rebutted by convincing evidence to the contrary. The evidence which I received was not of this nature and accordingly I have not been satisfied that payments for protection were made.

The concluding item common to the years 1959 and 1960 is for liquor payment fees, being one case of liquor per week purported to have been given to officials of the civic administration amounting to \$2600 for the year 1959 and \$2,000 for the year 1960. These amounts are admittedly only an estimate. The respondent, at one stage of his testimony, said she caused to be delivered a case of high quality whiskey once a week, but during her examination for discovery she stated deliveries were made once a month. I have not been convinced that these gifts were, in fact,

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 Cattanach J.

made and even if they were made, no evidence has been adduced from which I could ascertain the number of such gifts and so compute their value.

I now proceed to a consideration of the items put forward as operating expenses incurred by her exclusively in the 1959 taxation year.

The first such item is in the total amount of \$975.40 alleged to have been paid for rooms in the Kamlo Motel used in the respondent's business daily from January 1, 1959 until March 31, 1959 at the rate of \$12 per day plus telephone calls. The respondent rented these rooms in fictitious names of man and wife whom the call girl purported to visit, but there is no doubt whatsoever that the respondent paid the cost of engaging the rooms. Two payments were made by the respondent's cheques, one dated February 24, 1959 for \$229.75 and the other dated April 15, 1959 for \$245.65, being a total of \$475.40 which are conceded by the Minister as not having been included in the computation of the respondent's taxable income. In my view an amount of \$475.40 is a deductible business expense of the respondent's and of which cognizance should be taken in computing her taxable income for 1959. However, the respondent also claims an approximate amount of \$500 as paid in cash for room rentals in the Kamlo Motel. This claim is admittedly a mere approximation and is not substantiated by such acceptable evidence as convinces me that such payments were made and if made the precise amount thereof.

The next item is a claim for rent paid to Mrs. W. deSantis for premises at 1095 Bute Street. Mrs. deSantis leased unfurnished premises from the landlord. She installed tastefully selected furniture and sublet the furnished premises to the respondent at an increased monthly rental of \$180 per month. These premises were used by the respondent for her business during the months of April, May, June, July, August and part of September 1959, the rent paid for September being \$65. The payments of \$180 for July and August and \$65 for September were entered on the daily call sheets and were credited to the respondent by the Minister in making the assessment for 1959. Therefore, the claim by the respondent in respect of this item must be reduced to \$360 being the rent for April, May

and June. The rent for May was paid by the respondent by cheque dated May 4, 1959. I am satisfied that the rent of \$180 was also paid by the respondent in each of the months of April and June of that year. The inference is almost irrebuttable that, since the months following June were entered in the daily call sheets and allowed by the Minister as an expense, and the rent for May was paid by cheque, that the rent was also paid for the months of April and June. Therefore, the respondent is entitled to a deduction of \$360 as a business expense in respect of this item.

The next item is a claim for \$925 paid by the respondent to Mr. N. Mussallem in August 1959 for his services in defending one of the call girls engaged by the respondent on a charge under the Criminal Code. I might mention that Mr. Mussallem is counsel for the respondent in the present appeal and that the accused call girl was acquitted. In my opinion the amount of \$925 paid by the respondent for legal expenses is properly deductible for the twofold reason (1) that it was laid out for the purpose of gaining income, the girl upon her acquittal of the charge returned to work which she could not have done if sentenced to imprisonment and (2) it was part of the girl's arrangement with the respondent that in the event of criminal prosecution as a result of the activities, the respondent would assume the cost of the girl's defence. Compare *The Minister of National Revenue v. Goldsmith Bros. Smelting and Refining Company Limited*¹.

The concluding item for the year 1959 is a claim for \$1,000 as having been paid for assistance to the girls. It frequently happened that a girl sent on an assignment would encounter difficulty with the customer. In these events the respondent had an arrangement with certain men possessed of physical strength and some guile, which they exercised when set to extricate a girl from difficulty, for which services these men were paid. By cheque dated July 2, 1959 the respondent paid P. Graham \$100 for these services performed by him, which, in my opinion, is properly deductible as a business expense. However, the respondent estimates that she paid a further \$900 in cash during 1959 for like services for which there is no confirmation

1964

MINISTER OF
NATIONAL
REVENUE
v.
ELDRIDGE
Cattanach J.

¹ [1954] S.C.R. 55.

1964
 MINISTER OF
 NATIONAL
 REVENUE

v.
 ELDRIDGE
 Cattanach J.

by means of any record. Therefore, the further amount of \$900 has not been substantiated to my satisfaction and is not allowed.

There now remains for consideration the items put forward by the respondent for business expenses incurred by her in the 1960 taxation year with which she was not credited by the Minister in making the assessment for that year, but excluding these items which I have already considered as applicable in both taxation years under review.

The first item is a claim for legal fees in the amount of \$1,000 paid by the respondent to R. Myers for his services in defending one of the call girls when the respondent and her girls were arrested on November 10, 1960 and charged with conspiring to live from the avails of prostitution. This particular girl wished to be defended by counsel of her own choice. This payment of \$1,000 cannot be justified as a legal expense laid out for the purpose of gaining income from the business since the respondent's business had been brought to an end by the wholesale arrests. However, it was a term of the call girl's engagement with the respondent that the respondent would assume responsibility for legal expenses as a part of the girl's remuneration. As such, I am of the opinion that this amount is properly deductible and should be allowed.

The second item is the payment of \$6,400 for commission on procuring bail bonds for the respondent and the girls who were arrested and confined to jail on November 10, 1960, or immediately thereafter. The respondent testified that she paid the foregoing amount for this purpose and in this she was supported by a witness who termed himself a bonding agent and who testified under the protection of the *Canada Evidence Act* that he received \$6,400 from the respondent as a commission for arranging the furnishing of bail of which he retained \$1,400 for himself. One bondsman also testified under similar protection that he received \$600 from the bonding agent for furnishing bail for one of the accused girls. I am, therefore, satisfied that the respondent did expend the amount of \$6,400. This responsibility, like the responsibility for legal fees, was assumed by the respondent as a term of the engagement of the girls and the cost thereof in respect of the girls is therefore, in my opinion, properly deductible. However, \$1,000 of

the \$6,400 so paid by the respondent was for the commission on bail for herself and accordingly the amount to be allowed should be reduced to \$5,400.

1964
 }
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 —
 Cattanach J.
 —

The next item claimed as a business expense by the respondent is an amount of \$500 paid for the entire issue of a newspaper called Flash, which was to be distributed on the British Columbia mainland. This newspaper, which specializes in the publication of scandalous stories, contained a story concerning the respondent which she considered scurrilous and detrimental to her business. The entire issue was, therefore, purchased by her to suppress this article. A copy of the newspaper was not produced but upon asking I was informed that the article had described the respondent as a Czarina of the particular underworld trade in which she was engaged who wished to obtain control of all prostitutes in the area and that the independents had risen against her, kidnapped her and subjected her to loathsome physical indignities which latter statements the respondent testified were completely false. From the brief description of the substance of the article which I received, I am unable to conclude that the respondent could have been of the opinion that the circulation of this newspaper would have been detrimental to her business. I must, therefore, conclude that this expenditure was not laid out for the purpose of earning income and that it must be disallowed.

The concluding item for the 1960 taxation year is a claim by the respondent for rent paid by her for five one room suites at various times in Vincent Lodge at 1107 Howe Street in the total amount of \$515. A witness, who described himself as a property manager, produced receipts totalling that amount made out to fictitious persons. However, he did testify that the rent was paid by the respondent who was well known to him. That the respondent was well known to him has been confirmed to my satisfaction because I have observed that this witness made numerous bank deposits to the credit of the respondent's accounts as her agent. While I would not normally consider this witness to be particularly credible, nevertheless, he would be obligated to make an accurate report of the rents received to the landlord for whom he acted, although he may have been allowed considerable latitude as to the

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 Cattanach J.

desirability of the tenants. I am, therefore, satisfied that the amount of \$515 was expended by the respondent for these premises which was an operating expense and therefore properly deductible.

There is one further item common to both taxation years and that is a claim by the respondent for the payment of \$1,837.50 to casual employees which arose as a result of evidence which occurred during the trial when the respondent's memory was assisted by an examination of cancelled cheques which had been seized by the police. By cheque dated July 21, 1959 an amount of \$150 was paid by the respondent to a casual employee. The Minister concedes that this amount is properly deductible and such amount is, therefore, allowed with respect to the assessment for 1959. In 1960 there were payments to casual employees in the respective amounts of \$937.50, \$512.50 and \$237.50. These payments were to the girls for their share of the proceeds from a payment to the respondent by a cheque for \$3,500. If this were the proceeds of what was identified as the "yachting party" when a customer engaged the entire company of girls for the entertainment of his guests on a weekend cruise, then the Minister has credited these amounts as expenses of the respondent and her share thereof has been taken into account as revenue when making the assessment for 1960. If, however, as the respondent believes, this cheque for \$3,500 was the proceeds from what has been identified as the "Penthouse party" when similar arrangements were made as for the yachting party, the respondent's share was not taken into account as revenue and it follows that the failure to credit the expense would be counterbalanced by the omission of the revenue in making the assessment. Therefore, if either was the case, the amount of \$1,687.50 can be disregarded.

To summarize, it has been proven to my satisfaction that the respondent is entitled to deduct from her 1959 assessment a total amount of \$3,270.40 as expenses incurred in the operation of her business, such total being made up as follows:

- (1) Rent paid for suite occupied by Shirley Milne \$ 1,260.00
- (2) Rent paid to Kamlo Motel 475.40
- (3) Rent paid to Mrs. W. deSantis 360.00
- (4) Legal fees 925.00

(5) Paid for assistance for girls	100.00
(6) Paid to casual employee	150.00
	3,270.40
Total	\$ 3,270.40

1964
)
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE

For the year 1960 the respondent is entitled to deduct as business expenses a total amount of \$8,070 for the reasons outlined above, such total being made up as follows:

(1) Rent paid for suite occupied by Shirley Milne	\$ 1,155.00
(2) Legal fees	1,000.00
(3) Commission on bail bonds	5,400.00
(4) Rent paid for Vincent Lodge ..	515.00
	8,070.00
Total	\$ 8,070.00

CATTANACH J.

It was contended on behalf of the respondent that since she had filed tax returns on a net worth basis, which had been accepted by the Minister for the 1954, 1955, 1956 and 1957 taxation years, that there was no justification for the Minister in making arbitrary assessments under s. 46(6) of the Act, nor for imposing a penalty for evasion of tax under s. 56 of the Act.

I cannot accept either such contention. S. 46 is explicit that the Minister is not bound by a return or information supplied by or on behalf of a taxpayer and may make what has been termed an "arbitrary" assessment. If the Minister elects to do so then the onus is on the taxpayer to show that the amount determined by the Minister is erroneous. This, except to the extent above indicated, the respondent has failed to do. Further, s. 44 of the Act requires that a return of income for each taxation year shall be filed with the Minister by an individual without notice or demand in the form prescribed and containing information prescribed by him. This the respondent did not do, despite the fact that she was advised of the necessity of maintaining accurate records at her meeting with the Taxation officials in 1957. At no time was she informed or led to believe that a return not in the prescribed form and containing the prescribed information would be acceptable. On the other hand the respondent did maintain records from which an accurate tax return could have been prepared by her or on her behalf. Her suppression of those records and her destruction of some for the obvious reason that their seizure by the police would result in her criminal prosecution, as eventually happened, was a choice she made voluntarily and dictated by her choice of the means of

1964
 MINISTER OF
 NATIONAL
 REVENUE
 v.
 ELDRIDGE
 Cattanach J.

earning her livelihood. She has no one to blame but herself. She, therefore, acted in a wilful manner as a result of which she attempted to evade payment of tax payable under Part I of the *Income Tax Act* for the 1959 taxation year or part thereof. Therefore, I can find no reason for interfering with the exercise of the Minister's discretion in imposing a penalty under s. 56 other than to direct that the amount of the penalty should be reduced corresponding to the amount by which the assessment should be reduced for that year.

The appeal is therefore allowed with costs and the assessment is referred back to the Minister for reassessment with the direction that an amount of \$3,270.40 be deducted from the respondent's assessed income for the year 1959 and an amount of \$8,070 from her assessed income for the year 1960 and that the penalty imposed for the year 1959 be correspondingly reduced, the whole in accordance with the foregoing reasons for judgment.

Judgment accordingly.