Docket: 2000-4466(IT)I

BETWEEN:

VICTORIEN ROUSSEL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on August 23, 2002, at Matane, Quebec

Before: The Honourable Judge François Angers

Appearances

For the Appellant: The Appellant himself

Counsel for the Respondent: Stéphanie Côté

AMENDED JUDGMENT

The appeals from the assessments made under the *Income Tax Act* are allowed and the assessments are referred back to the Minister of National Revenue for rectification by including in the appellant's income for his 1995 taxation year the amount of $**30,595;** for his 1996 taxation year, the amount of $8,715; and for his 1997 taxation year, the amount of $139. The penalties will have to be recalculated on the basis of the unreported business income for each of the taxation years at issue.

Signed at Ottawa, Canada, this **9th day of June 2003**.

"François Angers"

J.T.C.C.

Translation certified true
on this 12th day of May 2004.

Sophie Debbané, Revisor

Citation: 2003TCC153
Date: 20030609
Docket: 2000-4466(IT)I

BETWEEN:

VICTORIEN ROUSSEL,

Appellant,

and

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Respondent.

[OFFICIAL ENGLISH TRANSLATION]

AMENDED REASONS FOR JUDGMENT

Angers, J.T.C.C.

[1] By Notices of Assessment dated July 5, 1999, the appeals in the case at bar concern the 1995, 1996 and 1997 taxation years. The Minister of National Revenue (the "Minister") increased the appellant's net business income by $46,435, $8,715 and $2,865 respectively. He also assessed a penalty under subsection 163(2) of the *Income Tax Act* (the "*Act*") on the unreported business income for the years at issue. On July 21, 2000, a reassessment for the 1995 taxation year reduced the appellant's net business income by $15,840, which automatically resulted in a reduction of the penalty. The net amount of unreported income for 1995 is accordingly $30,595. The assessments for the 1996 and 1997 taxation years are unchanged.

[2] The Minister based the reassessments on the following facts, which were admitted or denied by the appellant as is indicated:

[TRANSLATION]

(a) during the years at issue, the appellant rented rooms located in the basement of his residence and operated a business known by the name of "Variétés Nord-Sud", located at 1484 Jacques-Cartier in Mont-Joli; (admitted)

(b) the business included a tobacco shop and a video centre, and the appellant was its sole proprietor during the years at issue; (admitted)

(c) at all material times, the appellant kept his own books and records for his business and recorded his rental income himself; (admitted)

(d) during the years at issue, the appellant worked more than 80 hours a week in his business and kept track of nearly all of the cash receipts and disbursements; (admitted)

(e) the appellant recorded his income in a sales register and prepared the compilation of deposits himself; in short, he kept track of every aspect of his business; (admitted)

(f) a third person prepared his tax returns on the basis of the information and documents that the appellant provided him with; (admitted)

(g) for the years at issue, the appellant reported the following income:

DESCRIPTION	**1995**	**1996**	**1997**
Investment income	$1,752	$7,017	$10,986
Net rental income	$999	($320)	$729
Net business income	$1,742	$1,113	($2,287)
Total income	$4,493	$7,810	$9,427
less:			
RRSP contributions		$4,000	$4,000
Net income	$4,493	$3,810	$5,427

(admitted)

(h) the appellant's gross business income for the years at issue was:

30/09/1995	$277,038
31/12/1995	$67,682
31/12/1996	$252,884
31/12/1997	$229,393

(admitted)

(i) in view of the non-existent internal controls, the lack of a fact-based audit trail and the basic records and background documents that were unavailable or incomprehensible, the audit of the appellant's tax returns for the years at issue was made according to the "net worth" method; (denied)

(j) initially, the additional income for each year at issue, established according to the "net worth" method, was itemized as follows:

30/09/1995 (12 months)	$30,968
31/12/95 (3 months)	$15,467
31/12/1996 (12 months)	$8,715
31/12/1997 (12 months)	$2,865

(denied)

(an analysis of the change using the "net worth" method is found under the heading entitled "Schedule")

(k) at the objections stage, the additional income calculated by the "net worth" method for the period ending on 30/09/1995 was reduced to $15,128; therefore, an adjustment of $15,840 to the inventory balance of 01/10/1994 was reflected; (admitted)

(l) the inventory balance of 01/10/1994, overstated by the appellant by an amount estimated at $15,840, was adjusted twice at the time of the audit; the error was therefore corrected at the objections stage; (admitted)

(m) as a result of the adjustment, the additional income calculated according to the "net worth" method for the 1995 taxation year is therefore $30,595, that is, $15,128 for the period ending on 30/09/1995 and $15,467 for the period ending on 31/12/1995; (admitted)

(n) for the 1995 taxation year, the penalty was calculated on $14,755 instead of $30,595 since a portion of the difference, namely $15,840, can be attributed to the overstatement of the inventory as at 01/10/1994; (admitted)

(o) this is not the appellant's first "net worth" audit since the 1991, 1992 and 1993 years were audited according to that method; (admitted)
the appellant did not, however, improve his accounting system or his bookkeeping; (denied)

(p) the appellant knowingly, or under circumstances amounting to gross negligence, made or participated in, assented to or acquiesced in the making of, a false statement or omission in the returns filed for the taxation years at issue, with the result that the tax that he would have had to pay according to the information provided in the income tax returns filed for those years was $1,777.50 less than the amount of tax payable for the 1995 taxation year; $841 less for the 1996 taxation year; and $261.64 less for the 1997 taxation year; (denied)

(q) consequently, on the Notice of Reassessment dated July 5, 1999, for the 1996 and 1997 taxation years, and dated July 21, 2000, for the 1995 taxation year, the Minister assessed the appellant a penalty under subsection 163(2) of the Act of $888.79 for 1995, $420.50 for 1996, and $100 for 1997; (denied)

(r) in addition, having received the appellant's tax return for the 1997 taxation year on June 19, 1998, the Minister assessed him a penalty of $13.08 for late filing under subsection 162(1) of the Act. (admitted)

[3] It is not necessary to reproduce the Schedule attached to the Reply to the Notice of Appeal or the amended version of the Schedule, which was adduced at

the hearing. It will suffice for me to refer to it, if necessary, in order to illustrate the evidence presented. The appeals were heard in two stages and it was when the hearing resumed that the respondent filed in evidence a corrected version of the Schedule attached to his Reply to the Notice of Appeal, which version reflected and considered some information adduced by the appellant in the first stage of the trial.

[4] The facts set out in the Reply to the Notice of Appeal that the appellant admitted provide a good summary of the appellant's business operations and there is no need to revisit them. Annie Primard, a tax auditor with the respondent, was put in charge of auditing the appellant's tax returns. She contacted the appellant on April 21, 1998, and, because of the appellant's special circumstances at the time, she postponed the audit to October 1998 and finally to December 1998.

[5] Ms. Primard testified that the accounting records in the case at bar seemed to be adequate, but there was no internal control of the deposits and withdrawals. She noted that the appellant's net income was very low compared to his gross business income from his activities and that, despite this, there was investment income. She therefore decided to conduct the audit by the "net worth" method. She testified that she had a great deal of difficulty obtaining the appellant's cooperation. A request for a bank authorization dated December 14, 1998, was sent to the appellant, but the authorization was not provided until April 7, 1999. The appellant refused to talk to Ms. Primard on the telephone and, when he did talk to her, what he said was not always favourable. Ms. Primard tried to meet with him on a number of occasions to talk to him about some adjustments because the appellant was in the best position to explain things to her. The appellant was never available. Ms. Primard accordingly had to spend about seventy-five additional hours on the appellant's audit because of his lack of cooperation.

[6] She testified that, in the light of the information provided by the appellant in his testimony at the first stage of the hearing, she made adjustments to the calculations found in the Schedule attached to the Reply to the Notice of Appeal. For instance, for the financial year ending on September 30, 1994, she increased the amount indicated as the appellant's investment in Les Mutuellistes by $15,000, which favoured the appellant. Later in my Reasons, I will return to the other evidence adduced by the appellant.

[7] The principles that apply in cases involving assessments based on "net worth" were summarized by Judge Bowman in *Bigayan* v. *The Queen*, [1999] T.C.J. 778; 2000 DTC 1619, where he says at paragraphs 2 to 4:

> [2] The net worth method, as observed in *Ramey* v. *The Queen*, 93 DTC 791, is a last resort to be used when all else fails. Frequently it is used when a taxpayer has failed to file income tax returns or has kept no records. It is a blunt instrument, accurate within a range of indeterminate magnitude. It is based on an assumption that if one subtracts a taxpayer's net worth at the beginning of a year from that at the end, adds the taxpayer's expenditures in the year, deletes non-taxable receipts and accretions to value of existing assets, the net result, less any amount declared by the taxpayer, must be attributable to unreported income earned in the year, unless the taxpayer can demonstrate otherwise. It is at best an unsatisfactory method, arbitrary and inaccurate but sometimes it is the only means of approximating the income of a taxpayer.
>
> [3] The best method of challenging a net worth assessment is to put forth evidence of what the taxpayer's income actually is. A less satisfactory, but nonetheless acceptable method is described by Cameron J. in *Chernenkoff* v. *Minister of National Revenue*, 49 DTC 680 at page 683:
>
> > In the absence of records, the alternative course open to the appellant was to prove that even on a proper and complete "net worth" basis the assessments were wrong.
>
> [4] This method of challenging a net worth assessment is accepted, but even after the adjustments have been completed one is left with the uneasy feeling that the truth has not been fully uncovered. Tinkering with an inherently flawed and imperfect vehicle is not likely to perfect it.…

Judge Bowman also said in *Martin* v. *Canada*, [1999] T.C.J. No. 781 (Q.L.), at paragraph 3:

> It is not necessary for me to repeat what has been said about net worth assessments in other cases. The statutory basis is found in subsections 152(4) and 152(7) of the Income Tax Act. The effect of subsection 152(7) has been articulated in Dezura v. Minister of National Revenue, [1948] Ex. C.R. 10; Morrow v. The Queen, 92 D.T.C. 6380; Kerr v. The Queen, 89 D.T.C. 5348; Chernenkoff v. Minister of National Revenue, 49 D.T.C. 680 and Ramey v. The Queen, 93 D.T.C. 791. The means of determining a taxpayer's income by the net worth method is necessarily somewhat arbitrary and imprecise and it is used only as a last resort.

[8] In the case at bar, the calculations of net worth were made according to the information that the auditor obtained in the context of the investigation that she undoubtedly conducted and that was necessary given that the appellant's bookkeeping was inadequate and he did not want to cooperate with the auditor or explain things to her.

[9] In his testimony, the appellant contented himself with indicating some errors that he had found in the auditor's calculations. In support of his position, he filed a number of vouchers, some and even many of which were accepted by the auditor. Examination of the evidence filed by the appellant, moreover, allowed the auditor to adjust her calculations and file them when the hearing resumed. The appellant did not prove, however, that his real income was what he had reported in his returns.

[10] Based on the net worth calculations and the evidence provided by the appellant, Exhibit I-1 became the basis on which the government increased the appellant's net worth. In her testimony, the auditor was careful to review each of the points advanced by the appellant and supported by vouchers, and she made changes that were favourable to the appellant.

[11] Some of the points raised by the appellant could not be considered by reason of the principles applicable to the calculations used in determining net worth, which is essentially a comparison of a situation existing on two given dates. This explains the difference between the value of the inventory at September 30 and at October 1, 1994. At September 30, 1994, the value of the appellant's inventory was $10,000 according to his tax returns, and the purchases of videos for his business were made the following day. However, the value of the inventory at the beginning of a financial year should be the same as at the end of the preceding financial year.

[12] According to the appellant, the bank accounts referred to in the auditor's calculations included his RRSPs. The auditor based her calculations on an examination of the Caisse Populaire's microfiches and, since the appellant made withdrawals from his accounts without receiving T4RSPs and did not report the withdrawals in his income, the auditor concluded that the bank accounts in question did not include any investments in RRSPs.

[13] The auditor, furthermore, analysed the supporting evidence relating to the appellant's accounts payable. In her amended calculations she grossed up the

accounts payable on the basis of the evidence the appellant had adduced at the hearing. She explained that during the audit, the appellant had never provided her with his list of accounts payable. She had made her initial calculations on the basis of invoices that she had found by searching through the boxes the appellant had given her. However, according to the auditor's calculations, some other points raised by the appellant were correct. This was the case, *inter alia*, for the figures concerning the amounts of GST and QST owing.

[14] Under the circumstances and having regard to the auditor's testimony, I am satisfied that she did everything in her power to ensure that the net worth calculation was reasonable. As Judge Bowman emphasized, it is at best an unsatisfactory method, arbitrary and inaccurate, but sometimes it is the only means of approximating the income of a taxpayer. Taking into account in her adjusted calculations the evidence adduced by the appellant, the auditor gave him what could be given, despite the difficulties that she had and the lack of information available to her.

[15] The appellant is the one who was in the best position to establish the amount of his income. It fell to him to prove on a balance of probabilities that the income reported for the three years at issue was accurate. The necessary evidence was not given, except with regard to the adjustments made in calculating the appellant's income according to the net worth method and, in this case, it involved evidence that was largely reflected in the adjusted calculations.

[16] Concerning the penalties assessed under subsection 163(2) of the *Act*, I shall refer to the decision in *Venne* v. *The Queen*, [1984] F.C.J. No. 314; 84 DTC 6247, at page 6256, where Judge Strayer analysed gross negligence in the following terms:

> … "Gross negligence" must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.…

[17] Former Chief Justice Couture of this Court stated in *Morin* v. *M.N.R.*, 88 DTC 1592, at page 1597:

> To escape the penalties provided in subsection 163(2) of the Act, it is necessary, in my opinion, that the taxpayer's attitude and general behaviour be such that no doubt can seriously be entertained as to his

> good faith and credibility throughout the entire period covered by the assessment, ….

[18] Analysis both of the appellant's behaviour during the audit and of the evidence, particularly the evidence relating to the impossibility of keeping track of the deposits and withdrawals from the business and adequately auditing the accounting records, reveals an attitude that reflects a certain indifference on the appellant's part with respect to his fiscal obligations. As Judge Bowman noted in *Ramey* v. *The Queen*, [1993] T.C.J. No. 142; 93 DTC 791, at page 793:

> … A taxpayer whose business records and method of reporting income are in such a state of disarray that a net worth assessment is required is frequently the author of his or her own misfortunes.…

[19] I am satisfied that, on a balance of probabilities, the respondent was justified in assessing penalties for the years at issue in the case at bar.

[20] For these reasons, the appeals are allowed and the assessments are referred back to the Minister for rectification by including in the appellant's income for his 1995 taxation year the amount of $**30,595**; for his 1996 year, the amount of $8,715; and for his 1997 year, the amount of $139. The penalties will have to be recalculated on the basis of the unreported business income for each of the taxation years at issue.

Signed at Ottawa, Canada, this **9th day of June 2003**.

"François Angers"
J.T.C.C.

Translation certified true
on this 12th day of May 2004.

Sophie Debbané, Revisor