Docket: 2002-3956(IT)G

BETWEEN:

GAVRIEL WAJSFELD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeals of
2640-0614 Québec Inc. (2002-3955(IT)I) on
December 8 and 9, 2004 at Montréal, Québec

Before: The Honourable Justice Gerald J. Rip

Appearances:

Counsel for the Appellant:	Robert M. Joseph
Counsel for the Respondent:	Annick Provencher

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1998 and 1999 taxation years are allowed, without costs, and the matters are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

a) Schedules made to determine Mr. Wajsfeld's income for 1998 be adjusted as follows:

   i) his liability for 1997 re personal loan (from mother) in 1997 shall read $66,000 and in 1998, $85,000,

   ii) he had a personal loan (liability) of $5,000; and

   iii) his personal expenditures shall be reduced by $1,678;

and, accordingly, in 1998, he failed to report income of $17,199.98;

b) The penalty assessed for 1998 under subsection 163(2) of the *Act* shall be deleted;

c) Schedules made to determine Mr. Wajsfeld's income for 1999 be adjusted as follows:

i) the amount of $5,000 re loan to Mobilier Masson be deleted from his personal assets;

ii) his list of personal expenditures be reduced by the aggregate of $776 for tuition feels, $1,800 for donations and $2,716 of Visa payments, that is by $5,292;

iii) that in adjusting the increase in the appellant's net worth, there shall be deducted the amount of provincial tax refunds to Mr. and Mrs. Wajsfeld, aggregating $6,189.32;

and accordingly, in 1999 he failed to report income of $10,863.77;

d) The penalty assessed for 1999 under subsection 163(2) of the *Act* shall be deleted.

Signed at Ottawa, Canada, this 5th day of August, 2005.

"Gerald J. Rip"

Rip J.

Docket: 2002-3955(IT)I

BETWEEN:

2640-0614 QUÉBEC INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeals of
Gavriel Wajsfeld (2002-3956(IT)G) on
December 8 and 9, 2004 at Montréal, Québec

Before: The Honourable Justice Gerald J. Rip

Appearances:

Counsel for the Appellant:	Robert M. Joseph
Counsel for the Respondent:	Annick Provencher

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1998, 1999 and 2000 taxation years are allowed, without costs, and the matters are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

a) the appellant failed to report income of $2,866.73, $16,143,82 and $9,053.10 in 1998, 1999 and 2000, respectively; and

b) penalties assessed pursuant to section 163(2) of the *Act* be deleted.

Signed at Ottawa, Canada, this 5th day of August, 2005.

"Gerald J. Rip"

Rip J.

Citation: 2005TCC351
Date: 20050805
Docket: 2002-3956(IT)G

BETWEEN:

GAVRIEL WAJSFELD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2002-3955(IT)I

AND BETWEEN:

2640-0614 QUÉBEC INC.

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

[1] These are appeals by Gavriel Wajsfeld and 2640-0614 Québec Inc. ("Québec") from net worth income tax assessments against Mr. Wajsfeld for 1998 and 1999 and against Québec for its 1998, 1999 and 2000 taxation years (which ended on February 28). The assessments also include penalties imposed under subsection 163(2) of the *Income Tax Act* ("*Act*") on the basis each appellant knowingly or under circumstances amounting to gross negligence made a false statement or omission on the tax returns for the years under appeal[1].

[2] Mr. Wajsfeld is the sole shareholder of Québec, a corporation that carries on the business of selling and installing carpets under the name of "Tapis Provincial Carpet".

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[1] The assessments against Québec also imposed a late filing penalty pursuant to subsection 162(1) of the *Act*, which is not subject to an appeal.

[3] The Minister of National Revenue calculated the net worth of Mr. Wajsfeld for the years 1998 and 1999 and determined that there were discrepancies in his declarations of income of $42,878.87 for 1998 and $22,345.11 in 1999. The Minister reassessed Mr. Wajsfeld for 1998 and 1999, respectively, by adding these amounts to his income as benefits conferred upon him by Québec as appropriations of funds. The Minister reassessed Québec for 1998, 1999 and 2001 by adding business income of $7,146.48, $39,456.58 and $18,620.93, respectively. The corporate net worth assessments were based on the net worth calculations from January 1, 1998 to December 31, 1999 made for purposes of assessing Mr. Wajsfeld, which were allocated amongst Québec's three taxation years starting March 1, 1997 and ending on February 28, 2000.

[4] Mr. Steve Sahakian, the Canada Revenue Agency's ("CRA"), auditor who audited Mr. Wajsfeld's affairs, prepared net worth statements including Mr. Wajsfeld's assets and liabilities and a list of personal expenses incurred by the Wajsfeld family to determine Mr. Wajsfeld's purported income for each of 1998 and 1999 on a net worth basis. Mr. Wajsfeld's counsel prepared, or caused to be prepared, statements similar to those prepared by Mr. Sahakian that highlighted the difference between the two efforts. The parties disagree with at least four items in the Minister's net worth statements. These are as follows:

a) The aggregate amount of money Mr. Wajsfeld had borrowed from his mother-in-law, Jolan Braun, as at December 31, 1997; the Minister considered the amount borrowed was $85,000; the appellant says the amount was $66,000 at the end of 1997 and $85,000 at the end of 1999;

b) Whether, as at December 31, 1998, Mr. Wajsfeld owed the sum of $5,000, he says he did; the Minister did not include $5,000 as a debt owing by him at the end of 1998 nor did he recognize the purported repayment of the loan in 1999. Indeed, the Minister considered Mr. Wajsfeld to be a creditor of a $5,000 debt in 1999;

c) The source of funds used to repay a loan of $18,500 incurred by Mr. Wajsfeld which he, in turn, purportedly advanced to Québec;

d) Whether Mr. Wajsfeld's personal expenditures were overstated by the CRA, in particular whether the Minister "double counted" amounts by including the same amount as two different expenses, for example, medical expenses and Visa expenses.

[5] The appeals were heard on common evidence. Mr. Wajsfeld, his wife, and a friend, Abraham Reiman, testified for the appellants. Mr. Sahakian was the Crown's witness.

[6] Mrs. Wajsfeld described the family's standard of living during the years in appeal. Mr. and Mrs. Wajsfeld had six children between the ages of newborn to 12 years. Mrs. Wajsfeld had siblings living in New York City and Montréal. Her mother, Jolan Braun, who was 84 years of age at time of trial, lived across the street from the Wajsfelds; in 1998 she was diagnosed with early signs of Alzheimers.

[7] As a result of her mother's illness, Mrs. Wajsfeld did her own and her mother's banking. She prepared cheques for her mother's signature. Her mother spoke neither French nor English.

[8] During 1998 and 1999 Mrs. Wajsfeld was a student at the Université du Québec à Montréal. Her income included a student loan, bursaries, family allowance, Goods and Services tax credit, tax refunds and grants. She also received a provincial tax refund of $3,362 in 1999[2].

[9] Mrs. Wajsfeld testified that she does not purchase "too much clothing". Her sister in New York sends her used clothing. She also said that she purchases clothing in Montréal for friends in the United States and is reimbursed the approximate $2,000 she spends each year for her American friends and siblings.

[10] Mrs. Wajsfeld said that she makes and pays for all household purchases, for example, food, prescription drugs, mortgage payments, school tuition and donations. She pays by cash, cheque, bank machines, credit cards and electronic means. Mrs. Wajsfeld produced copies of bank cheque books and CIBC Visa statements. She testified she had to borrow money from her mother to help pay bills; her mother also loaned her money to purchase and renovate a house the Wajsfelds purchased in 1997. She indicated the family's financial situation was not good.

[11] Mr. Wajsfeld also testified that the family's financial situation during the years in appeal was bleak. He took no salary or dividends out of Québec. He "babysat" evenings for an elderly woman to supplement the family's income. He

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[2] See *infra* at paragraph 38.

corroborated his wife's evidence that the family purchased only "basics" and the family's clothing were "hand me downs". He had to borrow from his mother-in-law and friends. He did receive a provincial tax refund in 1999 of $2,827 which he "could've" deposited to a bank account[3].

[12] In these reasons I shall attempt to discuss the issues in the order described in paragraph [4] of these reasons.

A. Loans from Mother-in-Law

[13] Mrs. Wajsfeld's mother had two bank accounts, one at the Canadian Imperial Bank of Commerce ("CIBC") and the other at the Bank of Nova Scotia. Mrs. Wajsfeld reviewed various withdrawals from the CIBC account, starting on June 11, 1997 when a cheque in the amount of $5,000 was issued towards the purchase of the Wajsfeld house. A CIBC bank draft of $45,000, dated July 10, 1997, was issued to a notary in trust for the purchase of the Wajsfeld house. Cheques of $2,000, $4,000 and $10,000 were drawn on Mrs. Braun's account to the benefit of the Wajsfelds on December 5 and 15, 1997, respectively. Two cheques were drawn on December 15, 1997. These amounts aggregate $66,000. Additional cheques in the amounts of $8,000, $5,000 and $6,000 (aggregating an additional $19,000 in 1998) were issued by Mrs. Braun to the Wajsfelds on January 13, January 26 and February 11, 1998, respectively, to pay for renovations to the house, said Mrs. Wajsfeld. The family moved into their new home in March 1998. Mrs. Braun advanced an additional $5,000 to the Wajsfelds in 1999.

[14] Mr. Wajsfeld also recalled his mother-in-law loaned him and his wife $50,000 when he purchased the house in 1997 and later $40,000 for renovations. All in all, according to him, he borrowed $90,000 from his mother-in-law for the house.

Decision

[15] There is no evidence that Mrs. Braun advanced $85,000 to the Wajsfelds at the end of 1997; the evidence is that she had loaned her daughter and son-in-law $66,000 at the end of 1997, and advanced additional sums aggregating $19,000 in 1998 and $5,000 in 1999.

B. Mobilier Masson

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3 See *infra* at paragraph 38.

[16] Among Mr. Wajsfeld's assets in 1999, according to the Minister, was a loan of $5,000 to Mobilier Masson, a furniture and appliance store, situated next door to Tapis Provincial Carpet. Mr. Wajsfeld stated the $5,000 was withdrawn from his Power Line account, a line of credit with Canada Trust to repay a loan to Mr. Reiman, the owner of Mobilier Masson. He said he gave a blank cheque to Mr. Reiman, who wrote the name Mobilier Masson on the cheque as payee. Mr. Wajsfeld insisted the words "Mobilier Masson" as payee on the cheque are not in his handwriting. The memo "Loan Payment" on the cheque, said Mr. Wajsfeld, indicated it was to repay the loan, not to make a loan. Mr. Wajsfeld claimed that the $5,000 was a repayment of the money he borrowed from Mr. Reiman in early 1998 for renovations to the Wajsfeld home. Renovations to his new home started during the summer of 1997.

[17] Mr. Reiman corroborated Mr. Wajsfeld's testimony that Mr. Wajsfeld gave him a cheque for $5,000 as a repayment of a loan. He was "99 per cent sure" the payee's name was in blank. Mr. Reiman said he did not borrow money from Mr. Wajsfeld, Mr. Wajsfeld borrowed from him. He said that he loaned Mr. Wajsfeld the money before the renovation started on the Wajsfeld house. He agreed the loan was not documented.

[18] The Minister was originally of the view that the $5,000 represented payment by the appellant for furniture he purchased at Mobilier Masson. Later, after a meeting with Mr. Wajsfeld, Mr. Sahakian concluded from a conversation with Mr. Wajsfeld, that the appellant loaned $5,000 to Mobilier Masson and he entered the $5,000 as an asset of the appellant.

Decision

[19] Both Mr. Wajsfeld and Mr. Reiman agree that at no time was Mr. Wajsfeld a creditor of Mobilier Masson. There is no evidence that disputes this. The $5,000 was not an asset of Mr. Wajsfeld at the end of 1999. The entry on Schedule I to the CRA's net worth statement of personal assets of Mr. Wajsfeld should include no amount of a loan to Mobilier Masson[4]. However, as of the end of 1998, Mr. Wajsfeld did have a liability to Mr. Reiman of $5,000.

C. Loan to Québec

[4] Mr. Sahakian testified that since the loan of $5,000 was repaid in 1999, the $5,000 is neutral in determining any increase in net worth.

[20] Mr. Wajsfeld says that he loaned $18,500 to Québec on May 22, 1998. The source of the $18,500, he explained, came from his line of credit with Canada Trust. He said he borrowed money to lend to Québec so that Québec would be able to pay its bills. The CRA included the $18,500 as an expenditure of Mr. Wajsfeld in 1993, although a note on Schedule IV in the CRA's net worth statement states that the $18,500 "could be included as an asset".

[21] After May 1998 there are payments to the line of credit account, for example $6,000 on each of July 24 and August 25, 1998 as well as payments of $1,000 on June 23, 1998 and $600 on September 9, 1998, payments aggregating $3,363.05 in October and ongoing payments in the following months. Mr. Wajsfeld drew a cheque payable to "cash" on his Canada Trust account on what appears to be May 27, 1998 in the amount of $8,438 (cheque number 004). There are a series of Canada Trust and Banque Nationale du Canada money orders, each for $1,000, payable to Canada Trust. On July 24, 1998, Mr. Wajsfeld said, he applied six of the money orders to pay $6,000 to Canada Trust in reduction of the $18,500. Included among the payments to Canada Trust was a cheque in the amount of $1,248 made to the order of cash by a Mr. Joshua Lerner, a customer of Québec. Mr. Wajsfeld said he also paid $6,000 to Canada Trust on August 25, 1998. He recalled that it was his practice to convert cash to bank drafts in his business. The cash came from Québec's business, he said. Mr. Wajsfeld explained that Québec's accountant would walk around the neighbourhood with bank drafts and exchange them for cash. This would be reflected in the company's books of account, he insisted. Québec's accountant who, appellant's counsel advised was 89 years of age at the time of trial, did not testify. The corporation's books of account were not produced.

[22] Appellant's counsel argued that the $18,500 loan to Québec should be reduced to zero in Mr. Sahakian's net worth statements. He argued that Mr. Wajsfeld received the bank drafts from his accountant and the bank drafts were deposited. The bank drafts, he submitted, represented the cash from Québec's business so, effectively, there was a repayment of the loan that he made to Québec.

[23] Appellant's counsel referred to various bank drafts deposited as well as the cheque for $1,248 made to cash by Joshua Lerner. Counsel queries that if Mr. Sahakian is correct in assuming the loan was by a third party, why would Mr. Lerner's cheque be used to pay Québec.

Decision

[24] Mr. Wajsfeld testified that he borrowed $18,500 from his Power Line line of credit with Canada Trust and loaned the money to Québec to operate its business. The fact the loan was made is not in dispute. What is in dispute is the source of funds to repay the loan to Canada Trust. Mr. Wajsfeld says the source was Québec, the respondent disagrees. The respondent's position is based on Mr. Wajsfeld informing Mr. Sahakian during the audit that he obtained the bank drafts from an acquaintance. The CRA assumed that the acquaintance or somebody other than Mr. Wajsfeld made the loan to Québec. But, argued Mr. Wajsfeld's counsel, the acquaintance was Québec's accountant who exchanged the bank drafts for cash for repayment by Mr. Wajsfeld to Canada Trust.

[25] I agree with respondent's counsel that there is no proof, no paper trail, that Québec made payments to Canada Trust from its own sources. The particulars surrounding the loan and its repayment are unusual, if not strange. Mr. Wajsfeld's testimony concerning the $18,500 is so unusual that it may be true. It is often said that truth is stranger than fiction. However, I agree with respondent's counsel that there is no independent evidence that even suggests, let alone proves, that the money to repay the loan originated from Québec's business operations. I do not have confidence in Mr. Wajsfeld's ability to recall events of 1998 in this regard. Books of account of Québec could have been produced to corroborate Mr. Wajsfeld's testimony that the money to repay the loan was recorded in its books. Unfortunately, due to the accountant's age, the appellant did not call Québec's accountant to testify to confirm the exchange of cash for bank drafts. There is no real evidence to permit me to agree with appellant's view that Québec funded the repayment of the $18,500.

D. Personal Expenditures

[26] Mr. Wajsfeld was asked during the audit by the CRA to set out his living expenses for 1999. According to the form prepared by Mrs. Wajsfeld on July 5, 2000, for example, the family spent $2,500 for clothing and $15,000 for food. Mr. Sahakian used the amounts submitted by the Wajsfelds to prepare Mr. Wajsfeld's personal expenditures. When Mr. Sahakian prepared his first net worth calculations, Mr. Wajsfeld objected to the $15,000 for food, stating that the CRA double counted by including in food such things as newspapers, tobacco and medical expenses. Mr. Sahakian subsequently reduced food expenses to $10,000. He estimated tobacco, newspapers, medical and donation expenses at $4,000. He says he ignored expenses of less than $500.

[27] For 1998, Mr. Sahakian determined that Mr. Wajsfeld had personal expenditures aggregating $53,775.99. (This amount includes the $18,500 that he loaned to Québec.) Mr. Sahakian was able to determine that Mr. Wajsfeld withdrew $54,318.83 from his account at the Laurentian Bank during 1998 and was able to identify the expenses for which the withdrawals were made, except for withdrawals totaling $1,738.05. Apparently there were also identified expenses of $11,134 incurred by Mr. Wajsfeld that were unaccounted for which, I understand, means that the source of the funds to pay those expenses is unknown. Respondent's counsel stated the unaccounted for expenses for both 1998 and 1999 are expenses that were paid for by cash, which she said were from undeclared income.

[28] Mr. Wajsfeld's counsel suggested that in analyzing the withdrawals from the Laurentian Bank account, Mr. Sahakian did not net withdrawals against deposits to the extent that if an amount was withdrawn and subsequently a deposit was made, the deposit was ignored. For example, if Mr. Wajsfeld withdrew $500, the withdrawal of $500 was recorded by Mr. Sahakian. But if Mr. Wajsfeld did not require the $500 and deposited $100, the $100 was not considered. However, counsel did not submit any evidence regarding deposits to substantiate his theory.

[29] When he analyzed the Laurentian Bank account, Mr. Sahakian, according to appellants' counsel, apparently erred in his treatment of two deposits, one of $5,000 made on January 13, 1998 and another of $1,000 made on February 10, 1998. The $5,000 deposit was the balance of an $8,000 cheque of which $3,000 was taken in cash; the $1,000 deposit was the balance of a $6,000 cheque, of which $5,000 was taken in cash. The cash portions, aggregating $8,000 were applied to renovate the Wajsfeld's home but Mr. Sahakian did not include the $8,000 as a bank withdrawal. Counsel suggested that Mr. Sahakian "lost his freshness" for handling a file that had taken over six months and perhaps ten months and overlooked this item.

[30] Respondent's counsel disagreed with appellants' counsel's interpretation of Mr. Sahakian's treatment of the cash of $8,000. The $8,000, she stated, did not enter the Wajsfeld's bank account, it is true, but was used by the Wajsfelds to renovate their home and Mr. Sahakian included the $8,000 as a cost of renovation of $130,576 in 1998; Mr. Sahakian included the $30,575 as an identified withdrawal from the Laurentian Bank, even though only $22,576 actually came out of the account; the balance of the $8,000 was cash. Mr. Sahakian's error was to consider the $8,000 as a withdrawal from the bank account. The $8,000 was never withdrawn because it was never deposited.

[31] The unaccounted expenses for 1998 include TD Visa credit card payments made from the Laurentian Bank account. A donation of $75 was paid by TD Visa. Donations by Mr. Wajsfeld were listed at $1,750 in Mr. Sahakian's net worth schedules; the issue is whether the $75 is included in the $1,750. The primary credit card used by the Wajsfelds was a CIBC Visa card. Mr. Sahakian acknowledged that he did not review the CIBC Visa statements very closely. The Wajsfelds paid $1,098 for charges to their CIBC Visa credit card out of the Laurentian Bank account in 1998. The CIBC Visa card included $672.01 of charges paid to pharmacies. The appellant suggested that the $672.01 is included in a medical expense of $726 in Mr. Sahakian's list of expenses. It is possible that the CRA included the $672 as well as the $726 as personal expenses, that is, an amount of a medical expense was used as a CIBC Visa expense if the person used the Visa card to pay the medical expense. Respondent's counsel noted that the bulk of the purported medical expenses are payments to pharmacies; these payments may be for prescriptions but could also be for sundry items. I agree.

[32] Appellant's counsel referred to Mr. Sahakian's unidentified withdrawals from the Laurentian Bank of $1,738 in 1998. Counsel described the unaccounted for expenses of $11,134 which include costs of interest and insurance on the line of credit of $805, tobacco/alcohol of $1,200, newspapers of $500 and medical expenses of $726, which he had referred to earlier and which he considers to have been included twice and should therefore be removed as an unaccounted for expense, donations of $1,750, municipal tax of $3,928, school tax of $1,725 and TD Visa of $1,500.

[33] Appellant's counsel then suggested that since Mr. Sahakian considered that he had a $5,000 cushion with which to work, since he reduced food expenses by $5,000, he could be more stringent in considering other expenses.

[34] Appellants' counsel's view was that the unidentified withdrawals were used to pay the unaccounted for expenses. He concluded that to include the unaccounted expenses as well as the unidentified withdrawals is double counting.

[35] In 1999, the Wajsfelds paid $400 of medical expenses by cheques drawn on the Laurentian Bank account. They also incurred additional expenses of $1,041.93 for pharmacy purchases and $50 paid to a physician; the $1,091.93 was paid by CIBC Visa. Additional personal expenses of $176.43 were paid by a TD Visa card, of which $65 was paid to a physician. Appellant's counsel acknowledged that not all the $1,042 were medical expenses. In his view the $746 included as a medical

expense by Mr. Sahakian was also included in unidentified Laurentian Bank account withdrawals, TD Visa or CIBC Visa credit cards.

[36] The unaccounted for expenses for 1999 were $15,584. Again, appellant's counsel suggested the amount be reduced by $5,000 because of Mr. Sahakian's approach. He suggests that the $10,584 is close to the $11,778.16 of withdrawals Mr. Sahakian was unable to identify in 1999; again, the unidentified withdrawals were used to pay the unaccounted expenses. However, here too, counsel fails to substantiate his theory.

[37] There were other personal expenditures listed by Mr. Sahakian that Mr. Wajsfeld satisfied me were not paid by him or were "double counted". These include a City of Montreal tax of $1,678 that came from his mother-in-law in 1998. In 1999 Mrs. Wajsfeld's tuition fees of $776 and donations of $1,800 were included in other items; the $2,716 of TD Visa payments of $6,059 was paid from Mrs. Braun's account. These amounts should be deleted from the list of personal expenditures.

[38] In making adjustments to Mr. Wajsfeld's increase in net worth for 1999, Mr. Sahakian ought to have deducted provincial tax refunds to Mr. and Mrs. Wajsfeld of $2,287.37 and $3,361.95, respectively.

Penalties

[39] Both appellants have been assessed penalties pursuant to subsection 163(2) of the *Act* on the basis that each of them knowingly, or under circumstances amounting to gross negligence, made or participated in the making of a false statement or omission in their income tax returns for the years in appeal.

[40] Subsection 163(3) imposes on the Minister the burden of establishing the facts justifying the assessment of the penalties under subsection 163(2) of the *Act*.

[41] The appellants' position is that the Minister is not entitled to assess subsection 163(2) penalties against them since the Minister has not established the facts justifying the penalties.

[42] Appellants' counsel argues that the Minister did not establish that there was an understatement of income. He suggests that the net worth assessments were merely rebuttable assumptions raised by the Minister for purposes of the income tax assessments that the appellants were unable to rebut. The appellants submit

that these assumptions do not meet the burden required of the Minister under subsection 163(3).

[43] Counsel also argues that the Minister had an obligation to determine the amount of any alleged understatements or the circumstances in which they were made. He claims that the Minister never established that the books of the company were inadequate and never questioned the appellants on the books of company at any time during cross-examination and never proposed any amount as an understatement other than the net worth assessment amounts.

[44] Appellants' counsel also submits that the Minister has the obligation to establish that the understatement was made knowingly or in circumstances amounting to gross negligence. He states that the respondent has not made any proof of the appellants' knowledge in that regard. Furthermore, he said, no facts were established to support the appellants' willful blindness in the circumstances.

[45] The repondent's position is that there is no doubt, considering the amounts of unreported income after judgment, that the appellants made false statements in filing their returns. Consequently, the respondent's counsel only addresses whether the false statements were made knowingly, or under circumstances amounting to gross negligence.

[46] Respondent's counsel states that the respondent has established the indifference of the appellants as to whether the law was to be complied with or not. The amounts added to the appellants' income are significant in relation to their reported incomes. The importance of the amounts of unreported income, in particular when compared with the amounts of reported income, clearly demonstrates that the appellants knew, or should have known, if not for their willful blindness, that their income was grossly underreported. The respondent submits that such willful blindness is gross negligence and justifies the penalties assessed pursuant to subsection 163(2).

[47] In *Fortis v. M.N.R.*[5], the Court stated that

> [i]n order for a penalty to be assessed pursuant to subsection 163(2) there must be:
>
> (a) a liability for tax;

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5 86 DTC 1795 (TCC).

> (b) a false statement or omission in a return filed as required by or under the Act or a regulation;
> (c) knowledge or gross negligence by the person in the making of a false statement or omission;
> (d) an understatement of income for a year, as defined by subsection 163(2.1), that is reasonably attributable to the false statement or omission.

[48] Similarly, Bowman A.C.J. (as he then was) noted in *Urpesz v. Canada*[6], that:

> […] Under subsection 163(3) the respondent has the onus of proving all necessary constituent elements under subsection 163(2). This includes proving the amount of the understatement of income, the correctness of the amount of penalty and the fact that the understatement was made knowingly or in circumstances amounting to gross negligence.

[49] However, Décary J., writing for the Court of Appeal, in *Pompa v. Canada*[7], disagreed with the proposition that the Minister has the burden to determine with certainty the amount of income not reported by a taxpayer when a penalty was levied and subsection 163(3) applied. Décary J. referred to the decision of Martin J. in *Kerr v. M.N.R.*[8] In that case, Martin J. stated as follows:

> The proposition that the Minister should establish the precise quantum of understated income before a penalty can be imposed is supported by Fortis et al. v. Minister of National Revenue, 86 DTC 1795 [1986] 2 C.T.C. 2378 at 2386, where the Court found that because the unreported income as determined by a net worth assessment was at best an estimate no penalty could be imposed.
>
> If that is the case then it would follow that there could never be a penalty imposed where there has been a net worth assessment. In order to support a penalty under subsection 163(2) it is not necessary, in my view, to establish precisely the exact quantum of unreported income. It is sufficient that the Minister establishes that there has been gross negligence or circumstances amounting to gross negligence in making a false statement in an income tax return.

[50] In the appeals at bar the following amounts of unreported income, based on a net worth, were added to the reported incomes of Mr. Wajsfeld and Québec:

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6 [2001] 3 C.T.C. 2256.
7 [1995] 1 C.T.C. 466.
8 (1989), 27 F.T.R. 118 (F.C.T.D.).

Taxation Year	Income Reported by Mr. Wajsfeld	Unreported Income Following Judgment
1998	$4,570.00	$17,199.88
1999	$12,822.00	$10,863.77

Taxation Year	Net Income Reported by 2640-0614 Québec Inc.	Unreported Income Following Judgment
1998	($1,186)	$2,866.64
1999	$122	$16,143.82
2000	($4,965)	$9,053.10

[51] While the net worth assessments may merely be rebuttable assumptions that do not by themselves meet the burden required of the Minister under subsection 163(3), as argued by the appellants, where the contents of the net worth assessments are established, as in the present case, the Minister may use the net worth assessments to prove that there was an understatement of income for the purposes of subsection 163(2).

[52] Paragraph 163(2.1)(*a*) defines "understatement of income" for the purpose of subsection (2) with reference to the total of all amounts that were not reported. To paraphrase paragraph 163(2.1)(*a*), an "understatement of income" means the amount by which the total unreported income exceeds the total of the amounts deductible by the person and were not deducted.

[53] *Fortis*[9] considered the question of whether a court may accept without any other evidence, the income determined by the Minister in making a net worth assessment as an indication of a taxpayer's understatement of income for the year for the purposes of subsection 163(2):

> In an appeal from an assessment of a penalty under subsections 163(1) and (2), however, any fact found or assumed by the assessor or the Minister cannot be accepted as it was dealt with by those persons since as a result of the coming into force of subsection 163(3) the Minister has statutory burden of establishing the facts justifying the assessment of the penalty. The Minister now cannot rely on assumptions pleaded in his reply to the notice of appeal to establish any fact justifying the assessment of the penalty. […]

9 *Supra*, pg. 1801.

> To permit the Minister to use his own arbitrary determination of understatement of income for the year based on a net worth assessment places the onus on the taxpayer to demolish the fact on which the penalty rested: this, as already stated, is contrary to subsection 163(3) of the Act. […]

Later on in *Fortis*, it was explained that the

> […] production by the Minister of the net worth statements he prepared in making the assessments is only proof of the existence of the statements; for purposes of subsection 163(3) their contents must be established. […] [10]

[54] The respondent has established that the contents of the net worth assessments are reasonable and, as a result, I have found that there were understatements of income by the appellants.

[55] I have found that the appellants did not report their true income in the years assessed and that they made false statements in their tax returns. Therefore, the only remaining element that the respondent must show is that the false statements were made knowingly, or under circumstances amounting to gross negligence. This is the *mens rea* or gross negligence element.

[56] The respondent has not established that the appellants knowingly or under circumstances amounting to gross negligence made a false statement or omission in their relevant tax returns. Mr. and Mrs. Wajsfeld lived frugally. There is no evidence that Mr. Wajsfeld knew or could even guess how much money he required to support his family in the manner in which they lived. The respondent did attempt to prove how much money a family the size of Mr. Wajsfeld's required to live, but there was no cross-examination of either Mr. or Mrs. Wajsfeld to determine how much either of them believed, or ought to have believed, was required. The respondent has failed to meet the burden under subsection 163(3). The Minister must do more than simply rely on the failure of the taxpayer to rebut a net worth assessment and point to a high amount of unreported income to meet the burden under subsection 163(3). In *Boileau v. M.N.R.*[11], Lamarre Proulx J. dealt with a case where the appellant taxpayer was unable to contradict the net worth assessments, resulting in the calculation of a high amount of unreported income. Lamarre Proulx J. stated:

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10 *Supra*, pg. 1802.

11 89 DTC 247, at 250.

> […] However, in my view, this is not sufficient for discharging the burden of proof which lies on the Minister. To decide otherwise would be to remove any purpose to subsection 163(3) by reverting the Minister's burden of proof back onto the Appellant.
>
> There is no doubt that the *mens rea* or the gross negligence may be established by circumstantial evidence, as either can seldom be established by direct proof of the taxpayer's intention. However, that evidence should be clear and convincing, for example: the course of conduct of the taxpayer, what it is that ought to have been done that was not done, what led the Minister to assess the penalty, discussions that took place with the taxpayer in respect of the assessment of the penalties and other matters pertinent to the decision leading to the assessment of the penalty under subsection 163(2).
>
> I am of the view that in the present case, the Minister did not adequately discharge his burden of proof in that he relied almost exclusively on the fact that the Appellant was unable to reverse the net worth assessments. In effect, subsection 163(3) requires evidence of the intent or gross negligence of the contravenor. This, in my view, should be done in a structured, clear and convincing manner.

[57] On the concept of gross negligence, Strayer J. in *Venne v. Canada*[12], commented as follows:

> […] "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. […]

[58] Essentially, the Minister's argument is that the discrepancy between the amounts of income reported by the appellants and the amounts of unreported income is sufficient to demonstrate the indifference of the appellants as to whether the law is complied with or not. The Minister relies on *Thibault v. Canada*[13], and *Pal v. Canada*[14], in support of this proposition.

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12 84 DTC 6247, 6256.
13 [2002] T.C.J. No. 321 (QL).
14 [2002] T.C.J. No. 243 (QL).

[59] The facts in *Thibault* are distinguishable from the present case. As noted by Dussault J. in *Thibault*, at paragraph 46:

> The amounts added to the appellant's income were significant in relation to his reported income. The cooperation, which he said he showed during and after the audit, cannot conceal the fact that he deliberately destroyed documents that might indeed have contained personal information but also information concerning the operation of his business, which, as a result, he refused to communicate to tax authorities.

The appellants in the present case have not destroyed documents as with the appellant in *Thibault*. As a result, the respondent must do more than simply refer to the amounts added to the appellants' income.

[60] Likewise, the facts in *Pal* are distinguishable from the present case. In *Pal*, Bonner J. dealt with an appellant who earned income from the rental of a taxi cab which he owned. After the Minister had made his net worth assessments, the appellant produced amended tax returns for which he offered no explanation for the widely varying reports of income and expense except to blame his absent accountant. Bonner J. found that the amount of the discrepancies in the case of someone whose income is as easy to calculate as that of the appellant is sufficient to establish gross negligence. By contrast, in the present case, the evidence does not show that the appellants' income was as easy to calculate, nor does it show that the appellants failed to offer any explanation for the tax returns they filed.

[61] In addition, the respondent's counsel indicates that the use of the net worth method of assessment was made necessary because of the lack of internal control in Québec and because of the failure of the corporation to keep adequate books and records pursuant to subsection 230(1). This, counsel suggests, is another element demonstrating the indifference of the appellants as to whether the law is complied with or not. Although gross negligence was found in cases where there was a failure to keep adequate books and records,[15] this failure alone is not sufficient for a finding of gross negligence. As Bowman A.C.J. (as he then was) stated in *Urpesz, supra*, the failure to keep adequate books and records is not evidence of gross negligence.

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[15] See *e.g. Immeubles Equation Inc. v. R.*,[2004] 4 C.T.C. 2192 (T.C.C.) and *Hildebrandt v. R.*, [1997] 3 C.T.C.2936 (T.C.C.).

[62] Finally, counsel for the respondent asserts that the appellants should have known, if not for their willful blindness, that their income was grossly underreported: *Villeneuve v. R*,[16]. In *Villeneuve*, the taxpayer benefited from a fraud scheme set up by employees of the Canada Customs and Revenue Agency. As noted by the appellants, the present case is very different. In the appeals at bar, the respondent did not lead clear evidence that supports the conclusion that the appellants exhibited willful blindness other than referring to the amounts of unreported income, which is not sufficient for the purpose of meeting the burden under subsection 163(3).

[63] Accordingly, the subsection 163(2) penalties are to be deleted.

[64] I have also considered the representations of the parties with respect to costs.

[65] Section 147 of the *Tax Court of Canada Rules (General Procedure)* grants the Court full discretionary power over payment of costs. Subsection 147(3) states what a judge may consider in exercising his or her discretion. The judge's discretion to award costs is not an unfettered one.[17]

[66] Mr. Wajsfeld reduced the amounts of income in issue by more than 50 per cent. The assessments in issue were based on purported increases in net worth during the years in appeal. Net worth assessments were required due to Mr. Wajsfeld's failure to maintain proper records or documents and apparent omissions in the tax returns of both appellants. The appellants are not without fault. However, there was documentary evidence, such as loans from Mrs. Braun, for example, that the Crown's officials could have acted on, but did not, which would have reduced the time of the trial. In the circumstances, it would be just for the parties to absorb their own costs.

[67] No costs will be awarded in both appeals.

Signed at Ottawa, Canada, this 5th day of August, 2005.

"Gerald J. Rip"

Rip J.

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16 [2004] F.C.J. No. 134 (F.C.A.) (QL).

17 *Stiles v. Worker's Compensation Board of B.C.* (1989), 39 C.P.C. (2d) 74 (B.C.C.A.).

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