

BETWEEN:

RESHAD OMER O/A KABUL AUTO SELL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeals heard on common evidence with the appeal of *Reshad Omer*  
(2008-2735(GST)I) on February 27, 2009 at Toronto, Ontario.

Before: The Honourable Justice Wyman W. Webb

Appearances:

Agent for the Appellant:

Narine Persaud

Counsel for the Respondent:

Nikki Kumar

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**JUDGMENT**

The appeals from the reassessments made under the *Income Tax Act* (the "Act") for the 2004 and 2005 taxation years are allowed in part, with costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

- (a) the net business income of the Appellant for each of these years was as follows:

	<b><u>2004</u></b>	<b><u>2005</u></b>
Net Business Income as reported on the Appellant's tax returns	\$ 1,341	\$ 3,488
Amount Reassessed as Unreported Business Income	\$19,962	\$15,694
Adjustments to be made pursuant to this Judgment	(\$11,194)	(\$ 8,934)
Revised Net Business Income:	\$10,109	\$10,248

(b) The penalties imposed under subsection 163 (2) of the *Act* are deleted.

The filing fee of \$100 is to be refunded to the Appellant.

Signed at Halifax, Nova Scotia, this 23<sup>rd</sup> day of March 2009.

“Wyman W. Webb”

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Webb J.

Docket: 2008-2735(GST)I

BETWEEN:

RESHAD OMER O/A KABUL AUTO SELL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on common evidence with the appeals of *Reshad Omer*  
(2008-2734(IT)I) on February 27, 2009 at Toronto, Ontario

Before: The Honourable Justice Wyman W. Webb

Appearances:

Agent for the Appellant:

Narine Persaud

Counsel for the Respondent:

Nikki Kumar

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**JUDGMENT**

The appeal from the reassessments made under the *Excise Tax Act* (the "*ETA*") for the period from January 1, 2004 and to December 31, 2005 (the "Period") is allowed in part, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

- (a) the net tax payable by the Appellant for the Period is reduced by the amount of \$1,409;
- (b) The penalties imposed under section 285 of the *ETA* are deleted; and

- (c) The penalties imposed under section 280 of the *ETA* are reduced to reflect the revised net tax payable for the Period but are otherwise confirmed.

The filing fee of \$100 is to be refunded to the Appellant.

Signed at Halifax, Nova Scotia this 23<sup>rd</sup> day of March 2009.

“Wyman W. Webb”

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Webb J.

Citation: 2009TCC158  
Date: 20090323  
Dockets: 2008-2734(IT)I  
2008-2735(GST)I

BETWEEN:

RESHAD OMER O/A KABUL AUTO SELL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

### **REASONS FOR JUDGMENT**

Webb J.

[1] The Appellant carries on a used car dealership business as a sole proprietorship in Toronto. For his 2004 and 2005 taxation years, the Appellant was reassessed to include additional income from this business in his income as determined for the purposes of the *Income Tax Act* (the “Act”) based on a net worth analysis that was completed for his family. This also resulted in a reassessment for additional net tax under the *Excise Tax Act* (the “ETA”) for the period from January 1, 2004 to December 31, 2005 (the “Period”). Also included in the reassessment issued under the *ETA* was a denial of input tax credits that had been claimed in the amount of \$1,743 in 2004 and \$8,994 in 2005 (\$10,737 in total). Prior to the commencement of the hearing the parties met to review the receipts that the Appellant and his Agent had brought to the hearing. Following this meeting, the Agent for the Appellant stated that the Appellant was no longer appealing the denial of the input tax credits of \$10,737.

[2] As a result, the only issue in this case is whether the Appellant had the amount of unreported income as determined by the Respondent based on the net worth analysis. The only issue raised by the Appellant in relation to the net worth analysis is related to the amounts determined for the personal expenditures. The analysis of the assets and liabilities had only disclosed an increase in the net worth of the Appellant of \$3,052.59 for 2004 and \$10,763.27 for 2005. The amount of personal

expenditures that had been determined by the Respondent was \$39,770 for 2004 and \$38,293 for 2005.

[3] In the Appellant's tax return for 2004 and 2005, the following amounts were reported as his gross income and net income from his used car dealership business:

<u>Taxation Year</u>	<u>Gross Income</u>	<u>Net Income</u>
2004	\$ 55,550	\$1,341
2005	\$171,710	\$3,488

[4] The Canada Revenue Agency (the "CRA") reassessed the Appellant based on a net worth analysis and included the following amounts in his income as unreported income and assessed the following penalties pursuant to subsection 163 (2) of the *Act*:

<u>Taxation Year</u>	<u>Amount Added as Unreported Income</u>	<u>Penalties</u>
2004	\$19,962	\$1,962
2005	\$15,694	\$2,156

[5] In addition to the amounts included in the Appellant's income for the purposes of the *Act*, the Appellant was also reassessed under the *ETA* to increase his net tax payable for the Period by \$2,496 based on the above unreported income amounts and assessed penalties under section 285 of the *ETA* of \$624 on this additional net tax. A penalty was also assessed under section 280 of the *ETA*.

[6] Justice Bowman (as he then was) made the following comments on the net worth method of determining a taxpayer's income in *Bigayan v. The Queen*, [2000] 1 C.T.C. 2229, 2000 DTC 1619:

2 The net worth method, as observed in *Ramey v. R.* (1993), 93 D.T.C. 791 (T.C.C.), 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* (1949), 4 D.T.C. 680 (Can. Ex. Ct.) at 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.

[7] During the hearing the parties agreed that certain adjustments should be made to some of the amounts included as personal expenditures. The following adjustments were agreed upon by the parties:

**2004**

<u>Item:</u>	<u>Amount included in the Reassessment</u>	<u>Amount Agreed Upon</u>	<u>Deduction re Net Worth Analysis</u>
Water, fuel & electricity	\$1,945	\$ 0	\$1,945
Recreational vehicles & boats	\$ 527	\$ 0	\$ 527
Home entertainment (radio, TV, VCR etc.)	\$ 766	\$406	\$ 360
Total:			\$2,832

**2005**

<b><u>Item:</u></b>	<b><u>Amount included in the Reassessment</u></b>	<b><u>Amount Agreed Upon</u></b>	<b><u>Deduction re Net Worth Analysis</u></b>
Recreational vehicles & boats	\$527	\$ 0	\$527
Home entertainment (radio, TV, VCR etc.)	\$766	\$406	\$360
Total:			\$887

[8] The amounts used by the CRA for personal expenditures were taken from reports from Statistics Canada on personal expenditures for a family of three, unless the amount proposed by the Appellant was accepted. In this case the Appellant lived with his wife and their first child who was born in March 2004. The Appellant's wife was working in a dental office for parts of 2004 and 2005 and her income for these years was included in the net worth analysis. There were some amounts for personal expenditures that were not contested by the Appellant. The following is a list of the amounts included for personal expenditures that were contested by the Appellant with the amount used to determine the Appellant's unreported income and the amount proposed by the Appellant:

**2004**

<b><u>Item</u></b>	<b><u>Amount included in the Reassessment</u></b>	<b><u>Amount Proposed by the Appellant</u></b>
Food from restaurants	\$1,969.60	\$0
Shelter – other quarters – traveller accommodation	\$ 228.26	\$0
Telephone	\$ 914.20	\$396
Child care	\$ 851.85	\$360
Cleaning supplies	\$ 340.03	\$120
Paper, plastic & foil supplies	\$ 365.92	\$180
Clothing – women's wear	\$1,347.19	\$180
Men's wear	\$ 896.56	\$240
Clothing material, notions, laundry	\$ 234.14	\$100
Automotive fuels	\$1,737.81	\$960
Maintenance & repair	\$ 580.05	\$120

<u>Item</u>	<u>Amount included in the Reassessment</u>	<u>Amount Proposed by the Appellant</u>
Medical & pharmaceutical	\$ 267.08	\$0
Eye care goods & services	\$ 162.37	\$0
Dental care	\$ 217.67	\$0
Private & public health insurance	\$ 329.44	\$0
Personal care supplies & equipment	\$ 810.66	\$100
Hair cutting, washing, styling	\$ 378.86	\$120
Sporting & athletic equipment	\$ 180.02	\$0
Toys, games, computer, hobby equipment, etc.	\$ 694.18	\$0
Photographic goods & services	\$ 189.43	\$0
Recreation services (spectator entertainment, recreation & sport facilities, package tour, etc.)	\$ 1,043.63	\$0
Reading material	\$ 307.09	\$0
Education	\$ 585.94	\$0
Money gifts & contributions	\$ 811.84	\$0
Gifts - Other (flowers, toys etc.)	\$ 536.52	\$0
Gifts & Contributions - Religious organizations	\$ 171.78	\$120
Gifts & Contributions - Other charitable organizations	\$ 131.78	\$0
Government pool & lottery tickets	\$ 194.14	\$0
	\$16,478.04	\$2,996.00

**2005**

<u>Item</u>	<u>Amount included in the Reassessment</u>	<u>Amount Proposed by the Appellant</u>
Food from restaurants	\$1,969.60	\$0
Shelter – other quarters – traveller accommodation	\$ 228.26	\$0
Telephone	\$ 914.20	\$396
Child care	\$ 851.85	\$480
Cleaning supplies	\$ 340.03	\$120
Paper, plastic & foil supplies	\$ 365.92	\$180

<b><u>Item</u></b>	<b><u>Amount included in the Reassessment</u></b>	<b><u>Amount Proposed by the Appellant</u></b>
Clothing – women’s wear	\$ 1,347.19	\$240
Men’s wear	\$ 896.56	\$240
Clothing material, notions, laundry	\$ 234.14	\$100
Automotive fuels	\$ 1,737.81	\$ 1,260
Maintenance & repair	\$ 580.05	\$120
Medical & pharmaceutical	\$ 267.08	\$0
Eye care goods & services	\$ 162.37	\$0
Dental care	\$ 217.67	\$0
Private & public health insurance	\$ 329.44	\$0
Personal care supplies & equipment	\$ 810.66	\$100
Hair cutting, washing, styling	\$ 378.86	\$120
Sporting & athletic equipment	\$ 180.02	\$0
Toys, games, computer, hobby equipment, etc.	\$ 694.18	\$0
Photographic goods & services	\$ 189.43	\$0
Recreation services (spectator entertainment, recreation & sport facilities, package tour, etc.)	\$ 1,043.63	\$0
Reading material	\$ 307.09	\$0
Education	\$ 585.94	\$0
Money gifts & contributions	\$ 811.84	\$0
Gifts - Other (flowers, toys etc.)	\$ 536.52	\$0
Gifts & Contributions - Religious organizations	\$ 171.78	\$ 200
Gifts & Contributions - Other charitable organizations	\$ 131.78	\$0
Government pool & lottery tickets	\$ 194.14	\$0
	\$16,478.04	\$3,556

### **Food from restaurants**

[9] The Appellant stated that he did not eat out at restaurants during the years under appeal. The Appellant, in this case, is placed in the difficult position of trying to prove a negative, i.e. that he did not spend the amount stated on restaurant meals. The Respondent did not have receipts for any restaurant bills incurred by the Appellant or any evidence of any amount spent by the Appellant on restaurant meals. The amount included is only based on a Statistics Canada average. There was no indication whether the Statistics Canada average was based on income level. It would seem logical that families with higher incomes would be more likely to eat at restaurants than families with lower incomes. The Appellant's wife's income in each of these years was \$15,974 for 2004 and \$19,326 for 2005.

[10] In this case the Appellant's wife did not testify. There was no indication of whether she would eat at restaurants when she was working in 2004 and 2005. The net worth analysis was based on a family of three and therefore would include amounts that the Appellant's wife would have spent on the various items. Without hearing from the Appellant's wife, I am not prepared to accept that the amount spent by the Appellant **and his wife** in 2004 and 2005 was nil. Since their daughter was born in March 2004, the Appellant's wife only worked for part of the year in 2004 and 2005. I accept the Appellant's testimony that he did not eat in restaurants in 2004 and 2005. However since the net worth analysis is also based on amounts that the Appellant's wife would have spent, and since she did not testify, an estimate of the amount that she would have spent should be used. Since she only worked part of each year, the amount spent on food in restaurants should be reduced to \$250 for each year.

### **Shelter – other quarters – traveller accommodation**

[11] The Appellant stated that he did not travel in 2004 or 2005 except to attend auctions to purchase cars. These trips were just day trips and he would return home in the evening. I accept the testimony of the Appellant and find that no amount should have been included in this category for 2004 or 2005.

**Telephone**

[12] The Appellant stated that they had two phones – one for the home and a cell phone that was used for the business. A schedule showing amounts paid to Bell (for the home phone) and Rogers (for the cell phone) was introduced. These schedules show that the cost of the home phone was approximately \$30 per month and the cost of the cell phone varied from approximately \$32 for some months to approximately \$70 for one month.

[13] In computing his income for the purposes of the *Act*, the Appellant claimed \$1,023 as telephone expense for 2004 and \$819 as telephone expense for 2005. It appears that the Appellant has claimed the cost of both phones in computing his income for the purposes of the *Act*. The Respondent did not reassess the Appellant to deny a deduction for any portion of the amount claimed as telephone expense nor did the Respondent raise any argument in relation to this. It seems to me that once an amount has been deducted in computing a person's income, it is not appropriate to include that amount in the net worth analysis. If all or a portion of that amount should not have been deducted, the proper approach would be to reassess that person to deny the expense or that part of the expense that is not deductible. A simple example will illustrate this.

[14] Assume that an individual has the following actual and reported revenue and expenses:

	<b><u>Actual</u></b>	<b><u>Reported</u></b>
Revenue:	\$29,000	\$20,000
Expenses:	\$ 5,000	\$12,000
Net Income:	\$24,000	\$ 8,000

[15] In this example, the \$5,000 of actual expenses means the expenses that were incurred for the purposes of earning income. Assume that the individual spends all of the revenue in the year on personal expenditures of \$24,000 and the business expenses of \$5,000. Assume that the \$12,000 claimed as expenses by the individual includes \$7,000 of personal expenditures that were not incurred for the purpose of earning income.

[16] If, in completing the net worth analysis, the amount of \$24,000 is included as personal expenditures (which would include \$7,000 of personal expenditures that had been claimed as an expense), the unreported revenue of the person would then become:

Personal expenditures:	\$24,000
Subtract: Income reported:	<u>(\$8,000)</u>
Unreported revenue:	\$16,000

[17] This would lead to a conclusion that the total revenue was \$36,000 (the reported revenue of \$20,000 plus the unreported revenue of \$16,000). If the expenses claimed are not adjusted (and remain at \$12,000) then the net income would be correct. However this would be a case of two wrongs trying to make a right. Both the revenue and the expenses would be incorrect. In my opinion, this is not the appropriate approach. The revenue amount should only be adjusted by the amount that was not claimed as a deduction and the expenses claimed should be reduced by the amount of the personal expenditures that were not incurred for the purpose of earning income. If the taxpayer were to be taxed, in this example, on the basis that his revenue was \$36,000 and his expenses were \$12,000 (net income of \$24,000), this could still leave open the possibility that he could be reassessed to deny the portion of the expenses that was not incurred for the purpose of earning income on the basis that this was not the issue in the net worth analysis which was prepared to determine if there was any unreported income. The amount claimed as expenses is known since the amount is stated in the tax return and if the amount claimed was not entirely incurred for the purpose of earning income, the taxpayer should be reassessed to deny that portion of the expenses that were not incurred for the purpose of earning income and not reassessed to increase his revenue to an amount greater than the actual revenue.

[18] In this example the personal expenditures for the purposes of the net worth analysis would be \$24,000 minus the \$7,000 included in the reported expenses or \$17,000. The expenses claimed should be reduced by the portion thereof that is not deductible or \$7,000. In the net worth analysis the following would then be the unreported revenue:

Personal expenditures:	\$17,000
Subtract: Income reported:	<u>(\$8,000)</u>
Unreported revenue:	\$9,000

[19] The net income would then be determined as follows:

Revenue reported:	\$20,000
Add: Unreported revenue:	<u>\$9,000</u>
Total Revenue:	\$29,000
Subtract: Expenses claimed:	(\$12,000)
Add: expenses denied:	<u>\$7,000</u>
Net income:	\$24,000

[20] In this case, the Respondent did not raise the issue of the deductibility of any portion of the telephone expense in the Reply nor did the Respondent raise any argument in relation to this during the hearing. If the issue of the deductibility of the amount claimed as telephone expense would have been raised by the Respondent in the Reply, the Appellant would have had notice of this issue and would have had an opportunity to lead evidence with respect to whether the phone in the home was used at all in the business. By not raising this issue in the Reply the Appellant was not apprised of this issue. The issue in relation to the telephone expenditure in a net worth analysis is whether the amount was expended. The issue in relation to the deductibility of the telephone expenditure is whether the amount was incurred for the purpose of earning income which would require different evidence than would be presented if the issue was only whether the expenditure had been incurred. It does not seem to me that any adjustment should be made to the amount claimed as a deduction for telephone expenses in computing the income of the Appellant for the purposes of the *Act* in these circumstances.

[21] As a result, no amount should have been included for the amount spent in relation to the telephone in the net worth analysis and no adjustment should be made to the amount claimed as a deduction for telephone expenses in computing the income of the Appellant for the purposes of the *Act*.

### **Child care**

[22] The Appellant stated that his wife stayed home with their baby the first year. When his wife went back to work, the Appellant's sister looked after his daughter. The Appellant stated that he did not pay his sister. I accept the Appellant's

testimony and find that the Appellant's estimate of \$360 for 2004 and \$480 for 2005 should be used for child care.

**Cleaning supplies**

**Paper, plastic & foil supplies**

**Clothing material, notions, laundry**

[23] As noted above, the net worth analysis was based on estimates of amounts that would have been spent by the Appellant **and his wife**. Since the Appellant's wife did not testify, it is impossible to determine how much she may have spent on these items. Although the Appellant stated that he did not accept that they had spent the Statistics Canada average amount on these items, without hearing from the Appellant's wife I am not prepared to accept the Appellant's amount and therefore no change will be made to the amount used for these items in either year.

**Clothing – women's wear**

[24] This category in particular is one where it would have been very important to hear from the Appellant's wife. The Appellant's estimate, which would only be \$15 per month in 2004, appears low. Without hearing from the Appellant's wife, I am not prepared to accept the Appellant's amount and therefore no change will be made to the amount used for this item in either year.

**Men's wear**

[25] The Appellant's estimate is that he only spent \$20 per month on his clothes. I accept his testimony that he spent less than the statistical average but it seems to me that the \$240 per year is too low. Therefore the amount will be adjusted to the average of these two amounts or  $(\$896.56 + \$240) / 2 = \$568$  for each year.

**Automotive fuels**

**Maintenance & repair**

[26] There was no indication that any part of the amounts proposed by the Appellant had been deducted in computing his income for the purposes of the *Act* nor that any part of these amounts would be deductible in computing his income. The Appellant's wife was only working for part of the year in 2004 and part of the year in 2005. I accept the Appellant's testimony that the personal amounts spent on these items was \$960 for fuel in 2004, \$120 for maintenance and repairs in 2004, \$1,260 for fuel in 2005 and \$120 for maintenance and repairs in 2005.

**Medical & pharmaceutical**

**Eye care goods & services**

**Dental care**

**Private & public health insurance**

[27] The Appellant stated that he did not spend any amount on any of the items in this category. It seems to me that the Appellant would know if he or his wife spent any amount on eye care, dental care, or private or public health insurance. For medical and pharmaceutical, it seems to me that some amounts would have been spent on these. The Appellant acknowledged that Tylenol would have been bought and without hearing from his wife, I am unable to determine the amount that she would have spent on medical and pharmaceutical items. I accept the testimony of the Appellant that no amounts were spent on eye care goods & services, dental care and private and public health insurance. For medical and pharmaceutical, the amount used should be the Statistics Canada average amount.

**Personal care supplies & equipment**

**Hair cutting, washing, styling**

[28] The Appellant stated his wife's sister is a hairstylist. However, without hearing from the Appellant's wife it is not possible to determine whether his wife would pay her sister to cut her hair. As noted above, the amounts included are for amounts spent by both the Appellant and his wife, not just the Appellant. Without hearing from the Appellant's wife, the amount for personal care supplies & equipment will be the average of the amounts used by CRA and the amount proposed by the Appellant ( $(\$810.66 + \$100) / 2 = \$455$ ). The amount that should be used for hair cutting, washing and styling should be less than the Statistics Canada amount because the Appellant's sister-in-law is a hairstylist. The amount that will be used for hair cutting, washing and styling is \$240.

**Sporting & athletic equipment**

**Recreation services (spectator entertainment, recreation & sport facilities, package tour, etc.)**

[29] The Appellant stated that he did not spend any amount on any of these items. I accept the Appellant's testimony in relation to these items and the amount for these should be reduced to nil.

**Toys, games, computer, hobby equipment, etc.**

**Photographic goods & services**

[30] The Appellant stated that he did not spend any amount on any of these items despite the fact that their first child was born in 2004. Without hearing from the Appellant's wife, I do not accept that the Appellant **and his wife** did not spend any amounts on these items in 2004 or 2005. No change will be made to these items.

**Reading material**

[31] The Appellant stated that he did not spend any amount on reading material. Again, however, without hearing from his wife I am not prepared to accept that neither one of them spent any amount on reading material. The amount that will be used is \$150.

**Education**

[32] The Appellant stated that no amount was spent on education. I accept the Appellant's testimony in relation to this as he presumably would know if he or his wife took any courses. The amount for education is reduced to nil.

**Money gifts & contributions**

**Other (flowers, toys etc.)**

[33] The Appellant stated that he did not spend any amount on any of these items. The Appellant stated that they had received a lot of gifts when the baby was born. It does not seem logical that the Appellant and his wife would receive a lot of gifts from family and friends but neither the Appellant nor his spouse spent any money at all on any gifts for any family or friends in 2004 or 2005. As well, without hearing from his wife, it is impossible to determine what her answer would have been to the question of how much they spent on gifts. I accept his testimony that they would have spent less than the Statistics Canada amounts (which as noted above, do not appear to take into account income levels). Therefore the amount that is to be used for each of these categories should be one-half of the Statistics Canada average (\$406 for money gifts and contributions and \$268 for other (flowers, toys etc.)).

**Religious organizations**

[34] For one year, the amount used by the CRA was greater than the amount proposed by the Appellant and for the other it was less than the amount proposed

by the Appellant. I accept the Appellant's testimony that he gave \$120 to his church in 2004 and therefore this is the amount that should be used for 2004. No change should be made to the amount used for 2005 as the Respondent was not proposing to increase the amount that was used.

**Other charitable organizations**  
**Government pool & lottery tickets**

[35] I accept the Appellant's testimony that no amount was spent on either of these items in 2004 or 2005 and therefore the amounts used for these will be reduced to nil.

[36] As a result the following is a summary of the adjustments to be made to the income of the Appellant for each of these years:

**2004**

<b><u>Item</u></b>	<b><u>Amount included in the Reassessment</u></b>	<b><u>Revised Amount</u></b>	<b><u>Adjustment</u></b>
Food from restaurants	\$1,970	\$250	\$1,720
Shelter – other quarters – traveller accommodation	\$228	\$0	\$228
Telephone	\$914	\$0	\$914
Child care	\$852	\$360	\$492
Cleaning supplies	\$ 340	\$ 340	\$ 0
Paper, plastic & foil supplies	\$ 366	\$ 366	\$ 0
Clothing – women's wear	\$ 1,347	\$1,347	\$ 0
Men's wear	\$ 897	\$ 568	\$ 329
Clothing material, notions, laundry	\$ 234	\$ 234	\$ 0
Automotive fuels	\$ 1,738	\$ 960	\$ 778
Maintenance & repair	\$ 580	\$ 120	\$ 460
Medical & pharmaceutical	\$ 267	\$ 267	\$ 0
Eye care goods & services	\$ 162	\$ 0	\$ 162
Dental care	\$ 218	\$ 0	\$ 218
Private & public health insurance	\$ 329	\$ 0	\$ 329
Personal care supplies &			

<u>Item</u>	<u>Amount included in the Reassessment</u>	<u>Revised Amount</u>	<u>Adjustment</u>
equipment	\$ 811	\$ 455	\$ 356
Hair cutting, washing, styling	\$ 379	\$ 240	\$ 139
Sporting & athletic equipment	\$ 180	\$ 0	\$ 180
Toys, games, computer, hobby equipment, etc.	\$ 694	\$ 694	\$ 0
Photographic goods & services	\$ 189	\$ 189	\$ 0
Recreation services (spectator entertainment, recreation & sport facilities, package tour, etc.)	\$ 1,044	\$ 0	\$1,044
Reading material	\$ 307	\$ 150	\$ 157
Education	\$ 586	\$ 0	\$ 586
Money gifts & contributions	\$ 812	\$ 406	\$ 406
Other (flowers, toys etc.)	\$ 537	\$ 268	\$ 269
Religious organizations	\$ 172	\$ 120	\$ 52
Other charitable organizations	\$ 132	\$ 0	\$ 132
Government pool & lottery tickets	\$ 194	\$ 0	\$ 194
	\$16,479	\$7,334	\$9,145

**2005**

<u>Item</u>	<u>Amount included in the Reassessment</u>	<u>Revised Amount</u>	<u>Adjustment</u>
Food from restaurants	\$ 1,970	\$250	\$1,720
Shelter – other quarters – traveller accommodation	\$ 228	\$0	\$ 228
Telephone	\$ 914	\$0	\$ 914
Child care	\$ 852	\$480	\$ 372
Cleaning supplies	\$ 340	\$340	\$ 0
Paper, plastic & foil supplies	\$ 366	\$366	\$ 0
Clothing – women’s wear	\$ 1,347	\$1,347	\$ 0
Men’s wear	\$ 897	\$568	\$ 329
Clothing material, notions, laundry	\$ 234	\$234	\$ 0

<u>Item</u>	<u>Amount included in the Reassessment</u>	<u>Revised Amount</u>	<u>Adjustment</u>
Automotive fuels	\$ 1,738	\$1,260	\$ 478
Maintenance & repair	\$ 580	\$ 120	\$ 460
Medical & pharmaceutical	\$ 267	\$ 267	\$ 0
Eye care goods & services	\$ 162	\$ 0	\$ 162
Dental care	\$ 218	\$ 0	\$ 218
Private & public health insurance	\$ 329	\$ 0	\$ 329
Personal care supplies & equipment	\$ 811	\$ 455	\$ 356
Hair cutting washing styling	\$ 379	\$ 240	\$ 139
Sporting & athletic equipment	\$ 180	\$ 0	\$ 180
Toys, games, computer, hobby equipment, etc.	\$ 694	\$ 694	\$ 0
Photographic goods & services	\$ 189	\$ 189	\$ 0
Recreation services (spectator entertainment, recreation & sport facilities, package tour, etc.)	\$ 1,044	\$ 0	\$1,044
Reading material	\$ 307	\$ 150	\$ 157
Education	\$ 586	\$ 0	\$ 586
Money gifts & contributions	\$ 812	\$ 406	\$ 406
Other (flowers, toys etc.)	\$ 537	\$ 268	\$ 269
Religious organizations	\$ 172	\$ 172	\$ 0
Other charitable organizations	\$ 132	\$ 0	\$ 132
Government pool & lottery tickets	\$ 194	\$ 0	\$ 194
	\$16,479	\$7,806	\$8,673

[37] In addition to these adjustments, the adjustments that had been agreed upon by the parties must also be taken into account. Therefore the total adjustments are as follows:

	<u>2004</u>	<u>2005</u>
Adjustments agreed upon by the parties	\$ 2,832	\$ 887
Adjustments as determined herein	\$ 9,145	\$8,673
Total Adjustments	\$11,977	\$9,560

[38] These adjustments reduce the unreported income before the GST is deducted therefrom. In this case the amounts that were determined as the unreported income before the GST is deducted therefrom in reassessing the Appellant were \$21,359 for 2004 and \$16,793 for 2005. The unreported business income that was reassessed for the purposes of the *Act* was determined as follows:

**2004**

Unreported business revenue (based on the net worth analysis):	\$21,359
Subtract: GST to be remitted (7/107 x \$21,359):	<u>(\$1,397)</u>
Unreported business income for the purposes of the <i>Act</i> :	\$19,962

**2005**

Unreported business revenue (based on the net worth analysis):	\$16,793
Subtract: GST to be remitted (7/107 x \$16,793):	<u>(\$1,099)</u>
Unreported business income for the purposes of the <i>Act</i> :	\$15,694

[39] To reflect the above adjustments to the personal expenditure amounts, the revised unreported business income for the purposes of the *Act* will be as follows:

**2004**

Unreported business revenue (based on the net worth analysis):	\$21,359
Subtract: adjustments as set out herein:	<u>(\$11,977)</u>
Revised unreported business revenue:	\$9,382
Subtract: GST to be remitted (7/107 x \$9,382):	<u>(\$614)</u>
Unreported business income for the purposes of the <i>Act</i> :	\$8,768

**2005**

Unreported business revenue (based on the net worth analysis):	\$16,793
Subtract: adjustments as set out herein:	<u>(\$9,560)</u>
Revised unreported business revenue:	\$7,233
Subtract: GST to be remitted (7/107 x \$7,233):	<u>(\$473)</u>
Unreported business income for the purposes of the <i>Act</i> :	\$6,760

[40] This will mean the following adjustments to the amount of unreported income included in the reassessments issued under the *Act* and the following adjustment to the net tax payable as reassessed under the *ETA*:

*Act*

	<b><u>2004</u></b>	<b><u>2005</u></b>
Unreported income that was reassessed:	\$19,962	\$15,694
Unreported income as determined herein:	\$ 8,768	\$ 6,760
Adjustment:	(\$11,194)	(\$8,934)

*ETA*

GST included in unreported income as reassessed (\$1,397 + \$1,099):	\$2,496
GST included in unreported income as determined herein (\$614 + \$473):	\$1,087
Adjustment:	(\$1,409)

**Penalties**

[41] Penalties were imposed under subsection 163(2) of the *Act*, and sections 280 and 285 of the *ETA*. The penalties imposed under subsection 163(2) of the *Act* and section 285 of the *ETA* require a finding that the Appellant “knowingly or under circumstances amounting to gross negligence” made false statements in filing his returns under the *Act* and his returns under the *ETA* when the Appellant failed to report the additional income as determined by applying the net worth analysis and failed to report the additional GST collected thereon. The assessment of penalties

under section 280 of the *ETA* are subject to a defence of due diligence (*Pillar Oilfield Projects Ltd. v. The Queen*, [1993] G.S.T.C. 49).

[42] Justice Strayer of the Federal Court Trial Division, in *Venne v. The Queen*, [1984] C.T.C. 223, 84 DTC 6247, made the following comments on the meaning of gross negligence for the purposes of penalties imposed under subsection 163(2) of the *Act*:

“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.

[43] In *Maltais v. The Queen*, [1991] 2 C.T.C. 2651, 91 DTC 1385, Justice Bowman (as he then was) in dealing with a penalty imposed pursuant to subsection 163(1) of the *Act* stated as follows:

7. ...Mr. Ghan on behalf of the respondent contended that subsection 163(1) in the form which is applied to 1989 did not require that there be a wilful intention to evade tax. In support of this position he pointed to the wording of the former 163(1) which referred to “Every person who wilfully attempts to evade the payment of tax payable by him” **and to the wording of subsection 163(2) which uses the expression “knowingly or under circumstances amounting to gross negligence”.** **These provisions require a mens rea of intent or of recklessness.**

(emphasis added)

[44] While the comments of Justice Bowman (as he then was) in relation to subsection 163(2) of the *Act* were *obiter* in that case, these comments were adopted by Justice Hamlyn in *Dunleavy v. The Queen*, [1993] 1 C.T.C. 2648, 93 DTC 417.

[45] In *Boileau v. The Minister of National Revenue*, [1989] 2 C.T.C. 2001, 89 DTC 247, Justice Lamarre Proulx stated that

20. ...It is true that by virtue of subsection 163(2), there is no accused nor is there a criminal charge. It would thus appear that it is not, as such, a criminal proceeding and that it remains a civil proceeding. However, **the application of that subsection requires the evidence of mens rea or culpable conduct**

(emphasis added)

[46] The onus rests with the Respondent to prove the facts required to establish that the Appellant “knowingly or under circumstances amounting to gross negligence” made false statements in filing his returns under the *Act* and his returns

under the *ETA* when the Appellant failed to report the additional income as determined by applying the net worth analysis and failed to report the additional GST collected thereon. In relation to this the Respondent called the auditor and the appeals officer to testify. The auditor stated that when he first met with the Appellant in relation to the proposed audit of the Appellant, the Appellant produced his receipts and records in three shopping bags. The documents were unorganized and there were no worksheets and no reconciliations.

[47] The appeals officer testified that in reviewing the file she discovered that the Appellant also had incurred the following amounts in relation to repairs and maintenance of the vehicles that he held for resale:

<u>Taxation Year</u>	<u>Repairs and Maintenance</u>
2004	\$51,631
2005	\$54,105

[48] The Appellant had not claimed any amount as an expense in relation to these expenditures nor were these amounts added to the cost of the inventory. Since these amounts were incurred in relation to the Appellant's business they would be relevant in determining his net income. While the Respondent was suggesting that the Appellant had even more additional unreported income, the Respondent could not include any additional amount in the income of the Appellant since the Minister cannot appeal his own assessment (*Valdis v. The Queen*, [2001] 1 C.T.C. 2827). As well, since these amounts were not deducted in computing his income for the purposes of the *Act* and would be relevant in determining his income, it would not be appropriate to include these in his income without also adjusting his expenses.

[49] However, instead of suggesting that the Appellant had any intent or was reckless, this suggests that the Appellant simply did not keep proper records. Failing to include in income an amount that would be offset by a deduction or added to inventory cannot be used to support a finding of culpable conduct on the part of the Appellant.

[50] In this case, unreported income amounts as a percentage of the total revised gross income amounts would be as follows:

<u>Taxation Year</u>	<u>Gross Income</u>	<u>Unreported Income</u>	<u>Total Revised Gross Income</u>	<u>Unreported Amount (%)</u>
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2004	\$ 55,550	\$8,768	\$ 64,318	14%
2005	\$171,710	\$6,760	\$178,470	4%

[51] In *Seto v. The Queen*, 2007 TCC 489, 2007 DTC 1647 (Eng.), [2007] G.S.T.C. 116, [2008] 2 C.T.C. 2364, Justice Campbell made the following comments:

29 An interesting question arises when a taxpayer is unsuccessful in challenging the Minister's net worth assessment: Is the taxpayer liable for gross negligence penalties where amounts are determined to be unreported income? In *Wajsfeld v. R.*, [2005] 4 C.T.C. 2341 (T.C.C. [General Procedure]), Justice Rip dealt with the issue and concluded that the Crown must satisfy the onus necessary to impose gross negligence penalties despite finding that the unreported amounts were to be included in the taxpayer's income. At paragraph 56 he stated:

... The Minister must do more than simply rely on the failure of the taxpayer to rebut a net worth assessment and point to as high amount of unreported income to meet the burden under subsection 163(3) ... 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 ... 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 of gross negligence of the contravenor. This, in my view, should be done in a structured, clear and convincing manner.

30 The case of *Wajsfeld* clearly demonstrates that the Crown maintains the onus to prove gross negligence even where the assessment is based on the net worth method. In these appeals, the Crown presented no evidence regarding the Appellant's alleged acts of gross negligence. The Crown did not point to any specific evidence or circumstances that amounted to gross negligence other than the difference resulting from the net worth assessment. The sole basis of the Crown's argument for imposing penalties, under subsection 163(2), is the fact that the net worth assessment indicates that there was unreported income on the respective personal and corporate returns. If the Minister is going to assess gross negligence penalties, the Crown bears the onus and must do more than refer to the unreported amounts which have been added to the taxpayer's income. In the present appeals, the Crown simply asserted that the "substantial difference" between the net worth assessment and the net amount actually reported on the returns are indicative of gross negligence. The relevant jurisprudence requires more. Further, when the adjustments are made to include the Appellant's parents income, the difference is no longer substantial.

[52] In this case, the unreported income amount, as a percentage of the total revised income amount is only 4% in 2005 and the amounts of unreported income are only \$8,768 in 2004 and \$6,760 in 2005. In my opinion the Minister has failed to prove that the Appellant has “knowingly or under circumstances amounting to gross negligence” made false statements in filing his returns under the *Act* and his returns under the *ETA* when the Appellant failed to report the additional income as determined by applying the net worth analysis and failed to report the additional GST collected thereon. As a result the penalties imposed pursuant or subsection 163(2) of the *Act* and section 285 of the *ETA* are deleted.

[53] The Appellant has, however, failed to establish that he acted with due diligence. The state of the records maintained by the Appellant do not support a finding that the Appellant acted with due diligence to ensure that he was complying with the provisions of the *ETA*. In relation to this issue there are also the input tax credits of \$10,737 that were claimed and then denied by the CRA (and which were accepted by the Appellant as not being properly claimed). Therefore the penalties imposed pursuant to subsection 280(1) of the *ETA* are confirmed but are reduced to reflect the revised net tax payable for the Period.

### **Conclusion**

[54] As a result the appeal under the *Act* is allowed, in part, with costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

- (a) the net business income of the Appellant for each of these years was as follows:

	<b><u>2004</u></b>	<b><u>2005</u></b>
Net Business Income as reported on the Appellant’s tax returns	\$ 1,341	\$ 3,488
Amount Reassessed as Unreported Business Income	\$19,962	\$15,694
Adjustments to be made pursuant to this Judgment	(\$11,194)	(\$ 8,934)
Revised Net Business Income:	\$10,109	\$10,248

- (b) The penalties imposed under subsection 163 (2) of the *Act* are deleted.

[55] The appeal under the *ETA* for the Period is allowed in part, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

- (a) the net tax payable by the Appellant for the Period is reduced by the amount of \$1,409;
- (b) The penalties imposed under section 285 of the *ETA* are deleted; and
- (c) The penalties imposed under section 280 of the *ETA* are reduced to reflect the revised net tax payable for the Period but are otherwise confirmed.

Signed at Halifax, Nova Scotia, this 23<sup>rd</sup> day of March 2009.

“Wyman W. Webb”

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Webb J.

CITATION: 2009TCC158

COURT FILE NOS.: 2008-2734(IT)I & 2008-2735(GST)I

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