Docket: 2007-2876(IT)G

BETWEEN:

GIOVANNI SPRIO,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on March 10 and 11, 2009, at Montreal, Quebec.

Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the Appellant: Christopher R. Mostovac

Counsel for the Respondent: Annick Provencher

JUDGMENT

The appeals from the assessments made under subsection 152(7) of the *Income Tax Act* (**ITA**) using the net worth method to determine unreported income are allowed in that account is taken of the deletion from income of the amounts conceded by the respondent (that is, $30,000 (unexplained withdrawals) for 1998, $65,000 (unexplained withdrawals) and half of $2,359 ($1,179.50) (Municipal taxes (condo)) for 2000, and half of $4,717 ($2,358.50) (Municipal taxes (condo)) for 2001), together with the ostensible loss on the residence in 2000 ($9,553), the amount not paid to the lawyers in 2000 out of the insurance proceeds for the loss of the Porsche ($27,983), and the net lottery winnings ($6,679 in 2001 and $49,026 in 2002). I have recalculated the unreported income to be $44,117 for 1996, $45,580 for 1997, $17,063 for 1998, $79,563 for 1999, $0 for 2000, $74,353 for 2001, and $40,407 for 2002. The penalties assessed under subsection 163(2) of the ITA are maintained with respect to this remaining unreported income.

Costs in accordance with Tariff B of the *Tax Court of Canada Rules* (*General Procedure*) are awarded to the respondent.

Signed at Montreal, Quebec, this 26th day of May 2009.

"Lucie Lamarre"

Lamarre J.

Citation: 2009 TCC 275
Date: 20090526
Docket: 2007-2876(IT)G

BETWEEN:

GIOVANNI SPRIO,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Lamarre J.

[1] The appellant was reassessed by the Minister of National Revenue (**Minister**) under subsection 152(7) of the *Income Tax Act* (**ITA**) using the net worth method to compute unreported income totalling $474,356, together with penalties totalling $53,459 assessed pursuant to subsection 163(2) of the ITA for the taxation years 1996 through 2002. The Minister reassessed after the normal reassessment period under subsection 152(4) of the ITA for taxation years 1996 through 1999. For those four years, the Minister must show that there was misrepresentation that is attributable to neglect, carelessness, wilful default or fraud by the taxpayer in filing his returns or in supplying information under the ITA.

[2] In *Venne v. The Queen*, 84 DTC 6247, [1984] F.C.J. No. 314 (QL) (Federal Court, Trial Division), Strayer J. defined as follows, at page 6251 (DTC) the onus placed on the Minister when invoking his power to reassess under subparagraph 152(4)(*a*)(i) of the ITA:

> I am satisfied that it is sufficient for the Minister, in order to invoke the power under subparagraph 152(4)(*a*)(i) of the Act to show that, with respect to any one or more aspects of his income tax return for a given year, a taxpayer has been negligent. Such negligence is established if it is shown that the taxpayer has not exercised reasonable

> care. This is surely what the words "misrepresentation that is attributable to neglect" must mean, particularly when combined with other grounds such as "carelessness" or "wilful default" which refer to a higher degree of negligence or to intentional misconduct. Unless these words are superfluous in the section, which I am not able to assume, the term "neglect" involves a lesser standard of deficiency akin to that used in other fields of law such as the law of tort. See *Jet Metal Products Limited v. The Minister of National Revenue* (1979) 79 DTC 624 at 636-37 (T.R.B.).

[3] Furthermore, in *Molenaar v. Canada*, 2004 F.C.J. No. 1731 (QL), 2004 FCA 349, the Federal Court of Appeal added the following at paragraphs 2 to 4:

> 2 Counsel for the appellant submitted that for this period, from 1993 to 1996, for which the limitation period had run, the Ministère should have the burden of proving that the "cash in" so found was taxable income. In other words, in order to limit the application of the net worth method, there would be a presumption in the taxpayer's favour that unreported and unexplained "cash in" comes from non-taxable income.
>
> 3 With respect, such a presumption would make the net worth method useless and inapplicable for all practical purposes. Additionally, it would undermine the very basis of our taxation system, which is founded on voluntary reporting, since it would amount to favouring a crafty taxpayer who is best able, most effectively and for the longest time, to conceal his or her income and his or her failure to report it.
>
> 4 Once the Ministère establishes on the basis of reliable information that there is a discrepancy, and a substantial one in the case at bar, between a taxpayer's assets and his expenses, and that discrepancy continues to be unexplained and inexplicable, the Ministère has discharged its burden of proof. It is then for the taxpayer to identify the source of his income and show that it is not taxable.

[4] In *Hsu v. Canada*, 2001 F.C.J. No. 1174 (QL), 2001 FCA 240, the Federal Court of Appeal had previously stated, at paragraph 29:

> 29 Net worth assessments are a method of last resort, commonly utilized in cases where the taxpayer refuses to file a tax return, has filed a return which is grossly inaccurate or refuses to furnish documentation which would enable Revenue Canada to verify the return (V. Krishna, The Fundamentals of Canadian Income Tax Law, 5th ed. (Toronto: Carswell, 1995) at 1089). The net worth method is premised on the assumption that an appreciation of a taxpayer's wealth over a period of time can be imputed as income for that period unless the taxpayer demonstrates otherwise (Bigayan, supra, at 1619). Its purpose is to relieve the Minister of his ordinary burden of proving a taxable source of income. The Minister is only required to show that the taxpayer's net worth has increased between two points in time. In other words, a net worth assessment is not concerned with identifying the source or nature of the taxpayer's appreciation in wealth. Once an increase is demonstrated, the onus

> lay entirely with the taxpayer to separate his or her taxable income from gains resulting from non-taxable sources (Gentile v. The Queen, [1988] 1 C.T.C. 253 at 256 (F.C.T.D.)).

[5] Therefore, for the statute-barred years, the Minister must first establish that the taxpayer made a misrepresentation by not reporting all his income for each of those taxation years. The Minister must then show that, in failing to report, the taxpayer did not exercise reasonable care or was simply negligent. This involves demonstrating a lesser degree of deficiency than intentional misconduct.

[6] Where the taxpayer has filed a return which is grossly inaccurate, or refuses to furnish documentation which would enable the Minister to verify the return, the Minister may have resort to the net worth method to determine the amount by which income is understated.

[7] Once the Minister has established that there is a discrepancy between the taxpayer's net worth at the end of the year and his net worth at the beginning of the year plus the amount of personal expenditures in the year (but excluding non-taxable income and accretions to the value of existing assets), the burden is then shifted to the taxpayer to establish that the net result should not be considered income from a taxable source (see *Bigayan v. R.*, 1999 CarswellNat 2288 (TCC) at paragraph 2).

[8] In the present case, the appellant reported a total of $124,232 in income for the whole period from 1996 through 2002 (see paragraph 6 of the Reply to the Notice of appeal), that is, approximately 20 percent of the total income that should have been reported according to the appellant's net worth for that period, as determined by the Canada Revenue Agency (**CRA**).

[9] In 1999, the appellant was arrested and accused of "dry" conspiracy to import drugs. In August 2003, he was incarcerated, having received a sentence of four years.

[10] Mr. Yvon Talbot, the auditor for the CRA, works in the organized crime department. In early 2003, he was asked to audit the appellant following the publication of a newspaper article stating that the appellant had built a large house in Laval, Quebec. The article also stated that the appellant was linked to drug trafficking.

[11] As the income reported by the appellant was relatively small and he did not have a bank account in his name per se, Mr. Talbot explained that he did not have much choice other than to use the net worth method. Mr. Talbot was referred to the

appellant's then lawyer. They refused to fill in a questionnaire prepared by the CRA. From the information he had, Mr. Talbot was aware that the appellant had deposited his cheques in his parents' bank accounts up until 2000, and in his girlfriend's bank account in 2000 and subsequent years. Mr. Talbot did not receive authorization from the appellant and the members of his family to access their bank accounts.

[12] In order to establish the appellant's net worth, Mr. Talbot proceeded on a combined basis, taking into account the assets and liabilities of both parents of the appellant up until 2000, and of the appellant's girlfriend for 2000 and subsequent years. Due to the lack of cooperation from the appellant, Mr. Talbot served notice on the banks that they were to provide information in relation to the appellant's parents' and girlfriend's bank accounts for the period under review.

[13] Following this notice, the banks gave information on the parents' accounts as of the month of March 1996. It appears that the balance in the parents' account on December 31, 1995 was higher than on March 1, 1996 by approximately $1,600. This could have an impact on net worth as long as the withdrawals for the months of January and February 1996 were also taken into account. They were not. As a matter of fact, the evidence (bank books provided by the appellant at trial) revealed that the withdrawals from those bank accounts for that two-month period amounted to approximately $4,500.

[14] If the auditor had had that information, those withdrawals would have been added to the personal expenditures and that would have affected the net worth by increasing the discrepancy as at March 1, 1996 to approximately $2,900 ($4,500 less $1,600). Therefore, the fact that the information was missing was beneficial to the appellant rather than detrimental.

[15] Furthermore, apart from the money in the bank accounts of the parents and the cars owned by the appellant at the beginning of the period under review (December 31, 1995), no other assets that were owned by them were taken into account. At trial, counsel for the appellant said that as at December 31, 1995 the parents held savings bonds and owned a house. Mr. Talbot said that the assets that were owned by the appellant or his parents at the beginning of the period (December 31, 1995) and not disposed of during the period under review, and that were, therefore, still in their possession at the end of the period (December 31, 2002), were not taken into account in the net worth.

[16] Indeed, those assets owned at both the beginning and end of the period are of no use in determining the existence of income during that period. The same reasoning

applies for the girlfriend. Her assets and liabilities were considered in net worth as of 2000. All the assets that belonged to her as at December 31, 1999 and that had not been disposed of at the end of the period were not taken into account. If the parents or the girlfriend had savings bonds or any other property that was cashed or disposed of during the period under review, this was not mentioned to Mr. Talbot at the time of his audit. No further information was provided in court in that regard. With respect to the girlfriend, the money she had in her bank accounts as at December 31, 1999 was taken into account ($8,509 added for the year 2000 in Appendix 1 to the net worth statement and $8,503 deducted in the adjustments, second page of the net worth statement).

[17] Mr. Talbot also added to the assets an amount of $50,005 for the year 1999 as an account receivable. This amount was provided by the appellant’s father as bail for his son pending his hearing on charges of "dry" conspiracy to import drugs. This amount was reimbursed in 2003, that is, after the period under review. The effect of this, therefore, was to increase the appellant’s income for 1999, but the reimbursement in 2003 could not apply so as to retroactively cancel that increase over the period under review.

[18] Cars and motorcycles were an important part of the assets shown in the net worth statement. Most of them were transferred to the appellant’s mother during the period under review at no cost to her. Because Mr. Talbot did a combined net worth determination, the transfer to the mother did not have any impact. The cars and motorcycles that belonged to the appellant prior to the period under review were included in the assets because they were disposed of during the period under review. Mr. Talbot determined the value either from the sales contract or according to the red book for used vehicles. When the vehicles were disposed of, they were removed from assets, which had the effect of decreasing net worth. In the case of the 1992 Harley, an adjustment was made by adding back in assets the proceeds of sale for that motorcycle sold in 1998 because those proceeds were not deposited in a bank account. However, with regard to two motorcycles that were purchased by the appellant’s mother prior to 2000 (the 1997 Harley and the 1998 Harley), assets were reduced by removing the two motorcycles in the year of sale, but the proceeds amounts were not added back in making the adjustments because the sales occurred after 2000 and Mr. Talbot did not take into account the money going through the appellant’s parents’ bank accounts after 2000. Therefore, these two transactions were considered in the appellant’s net worth, to his advantage. Mr. Talbot, however, added back in assets the small losses on each vehicle sold.

[19] The sole vehicle that seems to really be an issue for the appellant is the Porsche 912 (1967) that was stolen in 1999. Mr. Talbot reduced assets by the amount paid by the insurance company to the appellant's then lawyer. The amount was $30,783. However, Mr. Talbot added back that amount in 2000 as an adjustment under "Sommes utilisées pour le Vol de la Porsche 1967 (Payé à Lebovics, Cytrynbaum, ...)" (second page of the net worth statement). Mr. Talbot testified that he was not aware whether that amount was paid to the appellant or to his mother.

[20] It appears that an amount of $30,783 was paid to the lawyers but an amount of $27,983 was paid into the appellant's mother's bank account in January 2001 (Exhibit R-1, Tab 28, page 5). It would appear, therefore, that only the difference between the amount paid by the insurer ($30,783) and that deposited in the mother's bank account ($27,983), that is, $2,800, would have been paid to the lawyer. So the appellant would be right to say that the adjustment in 2000 concerning the amount paid to the lawyers with respect to the Porsche should be $2,800 instead of $30,783. This would reduce the net worth for 2000 by $27,983. However, the amount in the mother's bank account should be increased by $27,983 for 2001, as this amount was deposited in her account. The effect would be to raise net worth by $27,983 for 2001, which cannot be done at this stage. The appeal of the assessment cannot benefit the CRA, since the CRA cannot appeal from its own assessment.[1] Furthermore, for 2001, Mr. Talbot did not include in net worth the amounts in the mother's account since the appellant was no longer living with his parents at that time.

[21] With respect to the personal expenditures, the appellant seems to take issue with the municipal tax amount. Mr. Talbot added that amount on the basis of the information appearing on the city's invoice (Exhibit R-1, Tab 23). A document from the City of Montreal shows that the taxes have been paid (Exhibit R-1, Tab 47). The appellant says that the payment thereof could be part of the withdrawals from the bank accounts, which have also been included in personal expenditures. The appellant says that there could thus be a double counting of these amounts.

[22] Mr. Talbot denied that assertion. First, he said he has not seen any withdrawal from the bank accounts for payment of municipal taxes. Second, the withdrawal items in personal expenditures all relate to small unidentified withdrawals (Exhibit R-1, Tab 15). According to the tax invoice, Mr. Talbot stated, the municipal taxes have been paid and the payment does not seem to have come from the withdrawals added to the personal expenditures. There thus does not appear to have been any double counting in that regard, according to Mr. Talbot, and I agree.

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[1] See *Abed v. R.*, 1982 CarswellNat 167, at paragraph 24; *Cross v. R.*, 2007 CarswellNat 2838, 2007 TCC 532, at paragraph 24

[23] There is another item that was challenged by the appellant: an amount of $9,553 for the year 2000 that was added to net worth through the adjustments under the item "Perte sur vente de la residence 3956 Du Commissaire (Annexe V)" ([TRANSLATION] "Loss on sale of residence at 3956 Du Commissaire (Appendix V)" (second page of the net worth statement). In Appendix V, Mr. Talbot notes that the house located at 3956 Du Commissaire (the house in Laval) was sold for $200,000 in May 2000. He determines the total cost of the house to have been $209,553, and therefore there was a loss of $9,553 on the sale. Mr. Talbot explained in Court that he did not believe that the appellant suffered a loss when the house was sold. He said that the value of the house was much higher at the time. According to the Service de l'évaluation of the City of Laval, the value of the residence for 2003 was $338,300 (Exhibit R-1, Tab 57).

[24] It is my understanding that because Mr. Talbot did not believe that there really was a loss on the sale of the house, he added that ostensible loss to the net worth. In my view, this amount should be struck out. Mr. Talbot had already added to personal expenditures all the withdrawals from the bank account that were used for the construction of the house. Mr. Talbot acknowledged that the contract of sale was for $200,000. He met the purchaser, who did not mention having paid more. He had no evidence that the taxpayer had actually spent more on the house. The value that was provided by Mr. Talbot was for 2003 whereas the house was sold in 2000. I find that Mr. Talbot was not justified in adding the amount of the loss to the net worth.

[25] With respect to the "retraits inexpliqués" ([TRANSLATION] "unexplained withdrawals") in the adjustments (second page of the net worth statement), counsel for the respondent advised the Court at the beginning of the trial that the amounts of $30,000 for the year 1998 and $65,000 for the year 2000 were conceded, which would thus reduce the net worth by those same amounts.

[26] Finally, at trial, Mr. Talbot conceded that the amounts of $2,359 for the year 2000 and $4,717 for the year 2001 under the item "taxes municipales (condo)" in personal expenditures should be cut in half, the reason being that those amounts were taxes on the condominium purchased in 2000 by the appellant's girlfriend and his mother. Because he did not take into account the personal expenditures of the mother for the years 2000 and later, Mr. Talbot acknowledged that the mother's portion should be struck out.

[27] The appellant also challenged the combined net worth method as such. He relied on this Court's decision in *Francisco v. R.*, 2002 CarswellNat 3887, in which

Judge Bowie determined that a net worth assessment done by combining the assets and the liabilities of two different taxpayers for the purpose of computing an estimate of their combined incomes was not valid. Judge Bowie said at paragraphs 15 and 17:

> 15 In my view, there is no validity to the methodology whereby a combined net worth assessment of the unreported income of two people is generated, and then some part attributed to each of them, thus requiring that they then individually disprove the amount that has been assessed against them. . . .
>
> . . .
>
> 17 . . . To put it another way, by combining the net worth assessment process the Minister has given one-half the benefit of Ms. Francisco's decreased net worth to Mr. Kittar. It is obvious that, quite apart from any allocation problem that might arise at the end of the process, it can never be valid to combine the assets and the liabilities of two different taxpayers for the purpose of computing an estimate of their combined incomes because the effect is to assume, quite incorrectly, that any changes in the assets and any changes in the liabilities of either one of them during the period being assessed are shared between them. Without the need for the Appellant to lead any evidence at all, it is evident that the assessment done by this method is simply not valid. . . .

[28] Judge Bowie had earlier stated, at paragraphs 8 and 9:

> 8 It is trite to say that the net worth method is one of last resort, applied where more conventional approaches cannot be used because of a lack of reliable records. It is used most frequently in situations where the taxpayer conducts a business that has many cash transactions and the business records are incomplete, non-existent or unreliable. In the present case, the Appellant was operating a business which had virtually no cash transactions. Its records were not incomplete, although I accept Ms. DeGregorio's evidence to the effect that the state of the books of Aurora made it difficult to be satisfied that all of the compensation had been properly recorded. The assessors had to make substantial adjustments to the two loan accounts of the Appellant and Mr. Kittar before the net worth process could begin. Nevertheless those adjustments were ones that they were able to make and it is not at all clear to me why the Minister felt it necessary to resort to the net worth method in the present case. It is, of course, open to the Minister to use the net worth method of assessment whenever he considers it appropriate: see subsection 152(7) of the *Act*.
>
> 9 This method of assessment has been called a blunt instrument, and there is no question that the Minister in this case took a very blunt instrument to this Appellant. The assessors chose to compute the net worth assessment of the Appellant and of Mr. Kittar on a combined basis. Ms. DeGregorio said that this was done because they lived together and shared household expenses. Rather than do two computations of their incomes on an individual basis, attributing part of the personal

> living expenses to each of them, the assessments were made by combining the assets and the liabilities of Mr. Kittar and the Appellant at the end of each period, and using the change in their combined net worth, together with their combined personal living expenses, to produce an estimate of their combined incomes for each relevant year. . . .

[29] The appellant questioned both the use of the net worth method (instead of using all deposits to determine the appellant's income) and the use of combined net worth. Mr. Talbot explained that the deposits method was not used because he did not know whether all transactions were recorded. With respect to combined net worth, the appellant deposited his cheques in his parents' and girlfriend's bank accounts and had access to these accounts. Up until 2000, the appellant lived with his parents, and from 2000, with his girlfriend. It was therefore logical to combine the assets and liabilities.

[30] I agree with the respondent that the combined net worth method was appropriate in the present circumstances. Subsequent to the *Francisco* decision, there have been cases in which the combined net worth method has been used and accepted by the courts and confirmed by either the Federal Court of Appeal or the Quebec Court of Appeal (see *Morneau v. Canada*, [2003] F.C.J. No. 1828 (QL), 2003 FCA 472, and *Québec c. Chenel*, [2005] J.Q. n° 13110 (QL), 2005 QCCA 794). In *Chenel*, the Quebec Court of Appeal stated at paragraph 38:

> 38 Le ministère peut aussi, à mon avis, utiliser la méthode dite de l'avoir net combiné lorsqu'il y a des indices qu'un contribuable utilise l'unité familiale pour camoufler l'ampleur de ses revenus. Il est évident que le ministère devra faire montre de grande prudence et qu'il ne pourra consolider, pour fins de calcul, les revenus de deux époux ou conjoints de fait que lorsqu'il y a confusion manifeste des patrimoines et des passifs et dépenses.

[31] In the present case, the appellant used indifferently his parents' or girlfriend's accounts to do his transactions. One of his parents' accounts was used by him to pay all the construction costs of the new home in Laval. The appellant transferred almost all his vehicles to his mother for no consideration. The CRA was certainly more than justified in using the combined net worth method, keeping in mind the very low income reported by the appellant and his expensive lifestyle.

[32] The appellant also challenged the fact that all unreported income was assessed in his hands rather than being shared with his parents or with his brother who also lived with the family. The parents' combined reported income was approximately $26,000 for each year. Mr. Talbot explained that the only possible source of income

for the parents was their pension income. Once the respondent has shown a discrepancy, it is up to the appellant to show that the amount of that discrepancy should not be taxable in his hands. Here, the appellant did not produce any evidence to show that his parents had other sources of income or that part of the unreported income should be attributed to his brother. Therefore, the CRA was justified in including the amount of that discrepancy in the income of the appellant, who could easily, considering his involvement in conspiracy to import drugs, have received income from illicit activities related thereto.

[33] Finally, the appellant argued that the discrepancy was attributable to his lottery winnings. He filed some sports bet tickets together with cheques he received from Loto-Québec for the years 2001 and 2002 (Exhibit R-1, Tab 80). I added up the amounts of the winning tickets and their cost. The total of the cheques received in 2001 was $7,709 and the total cost of the winning tickets was $1,030. In 2002, the appellant received a total of $59,118 and the cost of the winning tickets was $10,092. Therefore, the net profit from his sports bets was $6,679 in 2001 and $49,026 in 2002. I am satisfied that these net amounts are non-taxable receipts from lottery tickets.

[34] As for the penalties, they are justified with respect to the remaining portion of the unreported income. The Minister has established, first, that the appellant made a misrepresentation attributable to negligence for the statute-barred years, and further, that he was grossly negligent in not declaring all his income for each of the years under review, as applicable.

[35] The appeals are allowed in that account is taken of the deletion from income of the amounts conceded by the respondent (that is, $30,000 (unexplained withdrawals) for 1998, $65,000 (unexplained withdrawals) and half of $2,359 ($1,179.50) (Municipal taxes (condo)) for 2000, and half of $4,717 ($2,358.50) (Municipal taxes (condo)) for 2001), together with the ostensible loss on the residence in 2000 ($9,553), the amount not paid to the lawyers in 2000 out of the insurance proceeds for the loss of the Porsche ($27,983), and the net lottery winnings ($6,679 in 2001 and $49,026 in 2002). I have recalculated the unreported income to be $44,117 for 1996, $45,580 for 1997, $17,063 for 1998, $79,563 for 1999, $0 for 2000, $74,353 for 2001, and $40,407 for 2002. The penalties assessed under subsection 163(2) of the ITA are maintained with respect to this remaining unreported income.

Signed at Montreal, Quebec, this 26th day of May 2009.

"Lucie Lamarre"

Lamarre J.

CITATION:	2009 TCC 275
COURT FILE NO.:	2007-2876(IT)G
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PLACE OF HEARING:	Montreal, Quebec
DATE OF HEARING:	March 10 and 11, 2009
REASONS FOR JUDGMENT BY:	The Honourable Justice Lucie Lamarre
DATE OF JUDGMENT:	May 26, 2009

APPEARANCES:

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Counsel for the Respondent:	Annick Provencher

COUNSEL OF RECORD:

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Firm:	
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