Docket: 2009-3343(IT)I

BETWEEN:

HUI PING QIAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
Hui Ping Qian, (2009-3344(GST)I)
on June 7, 2010 at Toronto, Ontario

Before: The Honourable Justice G. A. Sheridan

Appearances:

Agent for the Appellant:	Richard Buchan
Counsel for the Respondent:	Khashayar Haghgouyan

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeals from the reassessments made under the *Income Tax Act* for the Appellant's 2003 and 2004 taxation years are dismissed. The appeal from the reassessment of the 2005 taxation year is allowed and referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant incurred a business expense of $4,391 in 2005.

Signed at Ottawa, Canada, this 21st day of October, 2010.

"G. A. Sheridan"

Sheridan J.

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Appearances:

Agent for the Appellant:	Richard Buchan
Counsel for the Respondent:	Khashayar Haghgouyan

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeal in respect of an assessment under Part IX of the *Excise Tax Act* for the period January 1, 2004 to December 31, 2005 is dismissed.

Signed at Ottawa, Canada, this 21st day of October, 2010.

"G. A. Sheridan"

Sheridan J.

Citation: 2010TCC537
Date: 20101021
Dockets: 2009-3343(IT)I
2009-3344(GST)I

BETWEEN:

HUI PING QIAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Sheridan, J.

[1] The Appellant, Hui Ping Qian, is appealing a net worth assessment of her 2003, 2004 and 2005 taxation years under the *Income Tax Act* and under the *Excise Tax Act*, an assessment of net tax, together with penalties and interest, for the period January 1, 2004 to December 31, 2005.

[2] Under the *Income Tax Act*, the Minister added to her reported employment and rental income for 2003, 2004 and 2005, gross business income of $11,319, $47,832 and $50,004, respectively. Gross negligence penalties were assessed under subsection 163(2) of the *Act* on the basis that the Appellant had "… knowingly, or under circumstances amounting to gross negligence, … made or … participated in, assented to or acquiesced in the making of, a false statement or omission in" the income tax returns filed for those taxation years resulting in less tax being payable than would otherwise have been.

[3] The Minister has the onus of proving the conduct justifying the imposition of such penalties in 2003, 2004 and 2005. Because the 2003 and 2004 taxation years were reassessed after the normal reassessment period, the Minister has the further onus of proving pursuant to subsection 152(4) of the *Act* that in filing her returns, the Appellant "… made any misrepresentation that is attributable to neglect, carelessness

or willful default or has committed any fraud in filing the return or in supplying any information…" under the *Act.*

[4] The Minister's reassessment under the *Income Tax Act* having been based on the assumption that the Appellant had been operating a business during the taxation years, the Minister went on to assess net tax, penalties and interest of $6,848 under the *Excise Tax Act* for the Appellant's failure to report and remit GST in respect of that business. In so reassessing, the Minister took the position that in not having kept records as required under section 286 of the *Excise Tax Act*, the Appellant had failed to show due diligence.

[5] The appeals of these reassessments were heard together on common evidence.

[6] In determining the Appellant's tax liability under the *Income Tax Act* for the 2003, 2004 and 2005 taxation years, the Minister made the assumptions of fact set out in paragraph 9 of the Reply to the Notice of Appeal:

> (a) at all material times the Appellant was separated and had one child;
> (b) at all material times, the Appellant operated a health spa business under the name of Sandlewood Health Spa (the "health spa"), and earned income from that business;
> (c) the Appellant did not incur expenses to earn income from the health spa in the years in issue;
> (d) the Appellant did not report in her personal returns of income for the years any of the business income she earned from the health spa in those years;
> (e) the amounts deposited by the Appellant in her bank accounts for the years varied significantly from income reported by her in her personal returns of income for the years under appeal;
> (f) the discrepancy between the amount deposited in the Appellant's bank accounts and the income reported by her in her personal returns of income was due primarily to the unreported business income earned by the Appellant from the health spa;
> (g) the following deposited amounts were in respect of gifts received by the Appellant in the years as follows:
>
> | GIFTS | 2003 | 2004 | 2005 |
> |---|---|---|---|
> | | $ | $ | $ |
> | Cash gifts from Luukkonen | 1,800 | 2,190 | 3,920 |
> | Cheque gifts | | 600 | 500 |
> | Total gifts | 1,800 | 2,790 | 4,420 |
>
> (h) the Appellant did not receive gifts from her mother in the amounts of $7,000 and $38,000;
> (i) no mortgage payments on the second mortgage were made to Lukkonen by the Appellant in the 2004 taxation year;

(j) the Appellant did not receive a cash advance of $ 9,000 from Li Chen, the Appellant's ex-spouse, as a family advance;
(k) the remaining amounts deposited by the Appellant into her accounts were the business income of the Appellant;
(l) the total income of the Appellant for the 2003, 2004 and 2005 taxation years exceeded that which she reported, by the amounts of $11,319, $47,832 and $50,004 respectively.

[7] In assessing net tax under the *Excise Tax Act*, the Minister made the assumptions of fact set out in paragraph 7 of the Reply to the Notice of Appeal:

(a) the Appellant was a sole proprietor, operating a health spa under the name of "Sandlewood Health Spa" throughout the Period;
(b) the Appellant did not file GST returns for purposes of the *Act*;
(c) the Appellant's business activity was that of a health spa operator;
(d) the Appellant did not maintain adequate books and records;
(e) the Appellant's revenues for the 2004 and 2005 taxation years are taxable supplies for purposes of the *Act* and are taxable at 7%;
(f) the Appellant earned revenues for the 2004 and 2005 taxation years from her business activity;
(g) the revenue reported by the Appellant for the Period was not sufficient to support her costs of living;
(h) the following deposited amounts were in respect of gifts received by the Appellant in the years as follows:

GIFTS	2004	2005
	$	$
Cash gifts from Luukkonen	2,190	3,920
Cheque gifts	600	500
Total gifts	2,790	4,420

(i) the Appellant did not receive gifts from her mother in the amounts of $7,000 and $38,000;
(j) no mortgage payments on the second mortgage were made to Lukkonen by the Appellant in the 2004 taxation year;
(k) the Appellant did not receive a cash advance of $9,000 from Li Chen, the Appellant's ex-spouse, as a family advance;
(l) the remaining amounts deposited by the Appellant into her accounts were the business income of the Appellant;
(m) the Appellant did not provide adequate documentation as required, in relation to her commercial activities during the Period.

[8] The Appellant was represented by her agent, Richard Buchan, a retired Canada Revenue Agency official with some 32 years experience. The Appellant testified and also called as a witness her friend, Victor Luukkonen.

[9] The Appellant's mother tongue is Mandarin; as she had some difficulty in English, a translator was provided for her at the hearing. I found the Appellant to be a reluctant witness. On more than one occasion I intervened to invite the Appellant to expand on her answers to help me understand her position but she rarely provided further explanation. She was candid that she kept no records of her business dealings and indeed, at one point in her testimony, wondered aloud who would do such a thing. Even allowing for the barriers imposed by translation and the nature of the Appellant's work, I found her testimony to be, overall, unconvincing.

[10] The Crown's only witness was Susan Duke, the auditor who did the net worth assessment. Ms. Duke was as clear and thorough in her answers at the hearing as she was meticulous in the preparation of the deposit analysis[1] of the Appellant's records during the audit. I am satisfied that she gave the Appellant and Mr. Luukkonen every opportunity to provide information to explain the discrepancy between the Appellant's reported income and her financial records. Mr. Buchan suggested that the Appellant was more harshly assessed than she otherwise might have been because the trigger for the audit by the Canada Revenue Agency had been a lead received from its Special Investigation officials following a crackdown on 'body rub' massage parlours[2]. In my view, the evidence tells a different story: one has only to look at the care taken by Ms. Duke in her analysis and the benefit of the doubt given to the Appellant in respect of Mr. Luukkonen's various gifts to her. There is no evidence to suggest Ms. Duke's conclusions were motivated by some sort of moral judgment of the Appellant.

[11] The Appellant's challenge to the Minister's assessments may be summarized as follows: she denies that she was ever in business for herself. From 2003 to 2005, her only sources of income were from employment and room rental, both of which were duly and accurately reported in a timely fashion in her 2003, 2004 and 2005 income tax returns. She also said she received tips from clients. Mr. Buchan, on behalf of the Appellant, submitted that the Minister had failed to take into account that some of the amounts discovered during the audit were gifts received by the Appellant from Mr. Luukkonen, her mother and her former spouse and further, that the Minister had made no adjustment in respect of the fact that after August 2003, the Appellant had ceased making payments on a $20,000 mortgage held by Mr. Lukkonen.

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[1] Exhibit R-1.

[2] Exhibit R-1, Tab 1.

Analysis

1. Gifts and the Luukkonen Mortgage

[12] Before considering each of the various amounts specifically identified by the Appellant above, it bears repeating that as in any assessment, the taxpayer has the onus of proving wrong the assumptions upon which the Minister based his assessment. As counsel for the Respondent noted in his thorough review of the jurisprudence, in challenging a net worth assessment, the taxpayer's credibility and supporting documentation are crucial[3]. In the present case, both were lacking.

[13] The Appellant's allegations in respect of the gifts and second mortgage are effectively in response to the Minister's assumptions of fact in paragraphs 9(g), (h), (i) and (j) of the Reply in the *Income Tax Act* appeal[4]. For the reasons set out below, I am not persuaded by Mr. Buchan's arguments that adjustments ought to be made to the Minister's calculations.

[14] Cash Advances from Mr. Luukkonen - The Minister accepted, as shown in paragraph 9(g) of the Reply, that the Appellant had received cash and cheques as gifts from Mr. Luukkonen in 2003, 2004 and 2005 totalling $1,800, $2,790 and $4,420, respectively. Additional amounts were rejected at the audit stage because they could not be definitively linked to the Appellant's accounts. The same was true at the hearing. While I found Mr. Luukkonen generally credible, he had no way of corroborating that the amounts withdrawn from his accounts were, in fact, given to the Appellant. In the circumstances of this case, such corroboration was essential.

[15] Family cash advances paid by Li Huang Chen - The Minister assumed at paragraph 9(j) that "the Appellant did not receive a cash advance of $ 9,000 from Li Chen, the Appellant's ex-spouse, as a family advance". The Appellant sought to refute this assumption by putting in evidence a letter apparently from her former spouse to vouch for this payment. Even under the more relaxed rules of the Informal Procedure, this unauthenticated letter (which the Appellant herself said she could not

[3] *Bigayan v. R.* [2000] 1 C.T.C. 2229 (T.C.C.); *Martin v. R.* [2000] 1 C.T.C. 2302. (T.C.C.); *Sturzer c. R.* 2009TCC1. (T.C.C.).

[4] Paragraphs 7(h), (i), (j) and (k) of the Reply to the Notice of Appeal in the GST appeal.

read because it was in English) was incapable of proving that the Appellant had received such an amount from the individual who supposedly wrote the letter.

[16] Cash given by the Appellant's Mother, Xue Mei Qian - The Minister assumed at paragraph 9(h) that "the Appellant did not receive gifts from her mother in the amounts of $7,000 and $38,000". The Appellant told a convoluted story of how at a certain point, she had given her mother a cheque for $8,000 out of gratitude for all the things her mother had done for her over the years. Her mother deposited the cheque but then, having second thoughts, returned the $8,000 and gave the Appellant another $6,000. The mother's bank book was put in evidence but it proved only that certain deposits and withdrawals were made; there was nothing in that document to link them to the Appellant or a payment of $14,150 the Appellant made on her mortgage. Unfortunately, the Appellant's mother has since died leaving the Appellant's testimony uncorroborated. Similarly, although the Appellant's financial records show various amounts going in and out of her accounts, the Appellant kept no explanatory records of these transactions.

[17] Non-payment of Second Mortgage to Mr. Luukkonen - This pertains to the Minister's assumption at paragraph 9(i) that "no mortgage payments on the second mortgage were made to Luukkonen by the Appellant in the 2004 taxation year". As shown in Exhibit R-1, Tab 18, "Second Mortgage from V.K. Luukkomen to Hui Ping Qian", the Appellant made mortgage payments of $395.08 to Mr. Luukkonen from June 1, 2002 to August 1, 2003, inclusive. Although Mr. Buchan argued that the Minister failed to take this fact into account in the net worth assessment, the net worth statement shows the same balance outstanding at the end of 2003 and 2004. I note further that the outstanding balance was adjusted down when the Appellant made a $5,000 lump sum payment on the mortgage in 2005.

2. Was the Appellant Operating a Business?

[18] Turning, then, to whether the Appellant was operating a business during the taxation years, Mr. Buchan attempted to discredit Ms. Duke's analysis by arguing that the Minister had not proven that the Appellant was in business in 2003 and 2004. The flaw in this argument is that it overlooks the fact that the onus is on the Appellant to explain the discrepancies between the income reported and amounts discovered in a subsequent audit. As the Federal Court of Appeal held in *Hsu v. R.*[5]:

[5] [2001] 4 C.T.C. 1. (F.C.A.).

> 30 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.)).
>
> 31 By its very nature, a net worth assessment is an arbitrary and imprecise approximation of a taxpayer's income. Any perceived unfairness relating to this type of assessment is resolved by recognizing that the taxpayer is in the best position to know his or her own taxable income. Where the factual basis of the Minister's estimation is inaccurate, it should be a simple matter for the taxpayer to correct the Minister's error to the satisfaction of the Court.[6]

[19] The Appellant testified that in all years, she was an employee yet could not remember how many spas she had worked in nor did she provide names or addresses of the spas or explain, in even a general way, what her duties might have been. I found such vagueness at odds with the Appellant's marshalling of her financial affairs during the same period: she filed income tax returns for her employment income; rented rooms and reported the income earned; maintained two chequing accounts, acquired three concurrent credit cards with a total credit limit of $13,500; established two lines of credit (the most recent with a $50,000 limit); arranged for financing of $20,000 for the purchase of a new car; purchased a house with a mortgage of approximately $160,000; and got a second mortgage of $20,000 from her friend Mr. Luukkonen[7]. The records obtained by the Minister from the various financial institutions involved[8] show numerous and frequent cash deposits and withdrawals and money being moved from one account to another. These are not the actions of an unsophisticated person. It seems to me that the Appellant's practice of

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[6] At paragraphs 30 and 31.

[7] See the relevant documents for each in Exhibit R-1.

[8] Exhibit R-1.

not keeping records had more to do concealing the true nature of her income-generating activities than a lack of understanding of its importance. In all the circumstances, the Appellant has failed to rebut the Minister's assumption that she was in business on her own account in 2003, 2004 or 2005.

[20] The Appellant's testimony that she was an employee is also inconsistent with other answers given during her direct examination. Her evidence was that in 2005 she had been involved in a 'spa' business as equal partners with one Yin Hua Jin. However, the Appellant had also described Jin in her application for a VISA credit card dated October 2005 as her "employer"[9]. In any event, she testified that she gave Jin advances to pay for the purchase of equipment; such purchases were all in cash and the Appellant had no receipts for any of them. Some of the advances were reimbursed by Jin but the Appellant also said that she repaid amounts taken from her line of credit with money earned in the business with Jin. The Appellant also used her credit card to pay for advertising costs in certain newspapers.

[21] According to the Appellant, Jin had been responsible for the books and records. Jin had also paid all the taxes but on this latter point, the Appellant also said that she did not know if Jin had paid the GST for which the Appellant had been assessed. In any case, by November 2005, the pair had fallen out and Jin had sold the business. The Appellant first said she received no share of the sales proceeds but later said Jin had given her "some" money. As of the date of the hearing, the Appellant had no idea where Jin might be found.

[22] In the event that I found that the Appellant had been operating a business in 2005, Mr. Buchan submitted that the Appellant ought to be allowed a business expense of $4,391[10] for advertising. Notwithstanding all of the inconsistencies in the Appellant's story, it seems to me be that this is a legitimate claim. Because the $4,391 was paid to the Toronto Sun and certain Chinese-language newspapers, the Minister entered the amount in the standard form net worth work sheet under the heading "reading materials". When the Appellant was asked about her expenditures for "reading materials", she seemed puzzled and said something about taking only "free Chinese newspapers", an answer that is consistent with the relatively small amounts shown for "reading materials" in earlier years. On the other hand, she later said in her direct evidence that she had paid for advertising on her credit card, one of

[9] Exhibit R-1, Tab 6.

[10] Exhibit R-1, Tab 12, December 31, 2005 Year End, pages 3-4/7.

the few straight answers provided during her testimony and one that is borne out by the documentation[11]. I also accept her evidence that she did not recoup all of the advances she had made. In all the circumstances, including the Minister's assumption that the Appellant was in business in 2005, I am satisfied on a balance of probabilities that the Appellant incurred an advertising expense of $4,391 in respect of her business in that year.

3. Assessment Beyond the Normal Reassessment Period; Imposition of Penalties

[23] Notwithstanding her limitations in English, the Appellant has demonstrated a certain level of financial sophistication and a deliberate unwillingness to keep proper records of her income from all sources. Her testimony was riddled with inconsistencies and contradictions. The discrepancies between her reported income and the amounts identified in the audit are significant and were not convincingly explained by the Appellant. On the other hand, Ms. Duke's analysis was thorough and persuasive. While gross negligence penalties ought not to be imposed lightly[12], I am satisfied that the Minister has met the higher onus of proof required for their imposition under subsection 163(2) and was justified in assessing the 2003 and 2004 taxation years beyond the normal reassessment period under subsection 152(4) of the *Income Tax Act*. This same behaviour constitutes a lack of due diligence for the purposes of the *Excise Tax Act*.

[24] For the reasons set out above, the appeals under the *Income Tax Act* of the 2003 and 2004 taxation years and under the *Excise Tax Act* for the period January 1, 2004 to December 31, 2005 are dismissed. The appeal under the *Income Tax Act* of the 2005 taxation year is allowed and referred back to the Minister for reconsideration and reassessment on the basis that the Appellant incurred a business expense of $4,391.

Signed at Ottawa, Canada, this 21st day of October, 2010.

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[11] Exhibit R-1, Tab 8.

[12] *Venne v. R.* [1984] C.T.C. 223. (FC-TD); *Njenga v. R.* [1997] 2 C.T.C. 8. (F.C.A.).

"G. A. Sheridan"

Sheridan J.

CITATION:	2010TCC537
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REASONS FOR JUDGMENT BY:	The Honourable Justice G. A. Sheridan
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APPEARANCES:

Agent for the Appellant:	Richard Buchan
Counsel for the Respondent:	Khashayar Haghgouyan

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

For the Respondent: Myles J. Kirvan,
Deputy Attorney General of Canada
Ottawa, Canada