

Docket: 2009-77(IT)G

BETWEEN:

RAYMOND NOWAK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on October 18, 2010, at Toronto, Ontario

By: The Honourable Justice Brent Paris

Appearances:

Counsel for Mr. Nowak:

David W. Chodikoff

Counsel for the Respondent:

Sheherezade Gorashy and Lynn W. Gillis

JUDGMENT

The appeals from reassessments made under the *Income Tax Act* for the 2000 and 2001 taxation years are dismissed, with costs.

Signed at Ottawa, Canada, this 4th day of January, 2011.

“Brent Paris”

Paris J

Citation: 2011 TCC 3
Date: 20110104
Docket: 2009-77(IT)G

BETWEEN:

RAYMOND NOWAK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Paris J.

[1] These are appeals from reassessments of Mr. Nowak's 2000 and 2001 taxation years. The issues raised in the appeals are:

- (i) whether Mr. Nowak failed to report income of \$153,645 in 2000 and \$141,160 in 2001;
- (ii) whether two partnerships of which he was a member overclaimed business expenses in 2000 and 2001; and
- (iii) if he underreported his income as set out in paragraph (i), whether he is liable for penalties in respect of those amounts in accordance with subsection 163(2) of the *Income Tax Act*.

Facts

[2] Mr. Nowak and his spouse were born in Poland and immigrated to Canada with their two children in 1986. Mr. Nowak trained as a chef in Poland and he and his spouse owned and operated a restaurant there from 1972 to 1985. Since coming to Canada, he has carried on a number of different businesses. In the years in issue,

he was a 50% partner with Ryszard Ratajcsak in R & R Country Railings which supplied and installed deck and stair railings. He was also a 50% partner along with his son in K & R Trading which bought and resold used cars. Most of the used cars were bought in the United States, and exported to Poland for resale.

[3] Mr. Nowak's tax returns for 2000 and 2001 showed total income of \$7,510 and \$5,877, respectively. His spouse's income was shown as \$3,480 in 2000 and \$8,216 in 2001. The Canada Revenue Agency considered the combined reported income of Mr. Nowak and his spouse to be low and, therefore, selected Mr. Nowak's 2000 and 2001 taxation years for audit.

[4] The CRA auditor, Ms. Ann Marie Sawh, testified that she attempted on several occasions to contact Mr. Nowak to obtain information for the purposes of her audit. She left several phone messages for him and sent him four letters. One of those letters was sent by registered mail, and one was left at Mr. Nowak's residence. Mr. Nowak did not reply to any of the phone messages or letters.

[5] In his 2000 and 2001 tax returns, Mr. Nowak had filed statements of business activities for R & R and K & R showing the following amounts of revenue, expenses and net income:

	<u>R & R</u>	
	<u>2000</u>	<u>2001</u>
Revenue	\$133,854	\$81,618
Expenses	<u>123,566</u>	<u>70,525</u>
Net Income	10,289	11,194

	<u>K & R</u>	
	<u>2000</u>	<u>2001</u>
Revenue	\$122,210	\$45,040
Expenses	<u>129,008</u>	<u>44,380</u>
Net Income	(6,797)	660

[6] Given Mr. Nowak's lack of response to her requests for information, the auditor proposed to disallow all of the expenses claimed by the partnership. She

sent this proposal in a letter to Mr. Nowak, and again, received no response. She therefore proceeded with the reassessments.

[7] Mr. Nowak, through an agent, objected to the reassessments, and submitted records to support expenses claimed by the partnerships. The appeals division of the CRA, which was dealing with Mr. Nowak's objection, asked Ms. Sawh to review the records provided by Mr. Nowak for the purpose of determining his business income in those years.

[8] Ms. Sawh testified that the receipts that were provided were not organized or sorted into categories, and her attempts to sort them produced different totals for a number of the categories of expenses shown in the partnerships' statements of business activities - some higher than what had been claimed and some lower. However, the overall total of vouchered expenses was lower than the total expenses claimed, by the following amounts for each of the partnerships:

	<u>2000</u>	<u>2001</u>
R & R	\$33,879	\$3,186
K & R	32,879	-

She proposed to disallow these amounts as expenses of the partnerships.¹

[9] Ms. Sawh asked for banking records for the partnerships and for Mr. Nowak in order to verify revenue. After a number of requests, she eventually obtained records for the partnerships' bank accounts and for an account Mr. Nowak held jointly with his spouse. Ms. Sawh's analysis of the partnership accounts revealed total unidentified deposits in the following amounts:

	<u>2000</u>	<u>2001</u>
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One of the expenses shown by R & R was for "Owners' Withdrawals" in the amount of \$23,284. This amount was part of the expenses disallowed by the auditor and Appellant's counsel conceded at the hearing that the partners' draws could not be claimed as an expense.

R & R	\$10,978	\$8,733
K & R	\$50,104	\$60,700

Ms. Sawh considered that these amounts were unreported revenue of the partnerships and proposed to add 50% of those amounts to Mr. Nowak's income.

[10] Ms. Sawh was also unable to verify the source of deposits totalling \$123,104.28 in 2000 and \$106,444.12 in 2001 into the personal joint account of Mr. Nowak and his spouse. Ms. Sawh believed that these amounts were income which Mr. Nowak had failed to report on his 2000 and 2001 returns and proposed to add them to his income.

[11] Ms. Sawh testified that she met with Mr. Nowak and his daughter, Ava, in June 2007 to explain the proposed reassessments and gave them copies of her working papers. Ms. Sawh did not receive any further information from Mr. Nowak and the reassessments that are under appeal were issued.

[12] At the hearing before me, Mr. Nowak and his spouse each testified that the unidentified bank deposits were made with money they had left behind in Poland when they emigrated and which Mr. Nowak had brought back from Poland on trips taken over a number of years. They said that when they left Poland they sold all of their property, including the home they inherited from Mrs. Nowak's parents, their restaurant and two cars. Since they could not take any money out of the country, they left all of the cash they received from selling their property, along with cash they had saved from their restaurant business, with Mr. Nowak's parents to keep for them and to convert gradually into US dollars on the "unofficial market". They said that at that time, no one in Poland trusted the banks and everyone kept their money in cash at home.

[13] Mr. and Mrs. Nowak provided a notary's act dated July 15, 1995 recording an agreement for the sale of property by them in Poznan, Poland for 3 million zlotys. The original document was in Polish and was accompanied by an official English translation. They also provided a second document in Polish, untranslated, and only made available to the Respondent on the day of the hearing, which they said showed that the true selling price of the house was in fact 5.5 million zlotys.

[14] Mr. and Mrs. Nowak testified that they sold their restaurant for between 5 and 7 million zlotys, a one-year old Mercedes for 4 million zlotys and a Fiat for 2 or 3 million zlotys. All of these amounts were said to have been paid in cash. Mrs. Nowak said they also had savings of between 5 and 7 million zlotys.

[15] According to Mr. Nowak, the unofficial exchange rate was around 50 or 60 zlotys to the US dollar in 1986.

[16] Mr. Nowak said he returned to Poland for the first time in 1990, after receiving his Canadian citizenship, to visit his parents and to see if he could take money out of the country. He said that at that time, the situation in Poland had changed completely and that it had become possible to obtain permission to take money out of the country. He did not recall when he began taking money out of Poland, that it was possibly in 1995, but that when he wanted money, he would visit Poland three or four times a year for that purpose. Mrs. Nowak said that she recalled that after Mr. Nowak's initial visit back to Poland, he went back three or four times a year right up until this year.

[17] Three Polish currency export certificates (along with English translations) were produced at the hearing showing that Mr. Nowak was authorized to take the following amounts of money out of Poland on the following dates:

\$36,000 US (June 29, 1996)
\$25,000 US (November 3, 1997)
\$22,000 US (February 19, 1999)

[18] Mr. Nowak explained that he first had to deposit US dollars into a bank account in Poland in order to obtain an export certificate. Once he had the certificate, he would withdraw the cash to bring it back to Canada. He presented three Polish bank receipts (again with English translations) showing that he made the following withdrawals from the Pekao Bank in Poznan on the following dates:

\$22,600 US (April 16, 1998)
\$15,000 US (December 21, 1998)
\$37,000 US (February 19, 1999)

[19] Both Mr. and Mrs. Nowak said that Mr. Nowak had brought back more money than what was evidenced by the receipts but that they could not find any more of the export certificates or withdrawal slips. They also said that at some time after 1999, Polish law changed and it was no longer necessary to obtain permission to export currency. Mr. Nowak said he continued until this year to make trips back to Poland to get money.

[20] Both Mr. and Mrs. Nowak said that they kept the US cash from Poland at home in Mississauga and whenever they needed money for business or personal

reasons, Mrs. Nowak would convert it downtown Toronto to Canadian dollars and deposit it into the bank.

[21] With respect to the partnership income and expenses, Mr. Nowak and his spouse testified that Mr. Nowak's spouse did the bookkeeping for K & R and R & R. She said she had recorded all the revenue and expenses in a notebook, which she gave to their accountant each year to prepare Mr. Nowak's tax returns. The notebook was not put into evidence, nor were any supporting documents and Mrs. Nowak was unable to give any details of the actual expenses incurred by the partnerships.

Appellant's position

[22] Mr. Nowak's counsel argued that the evidence showed that Mr. and Mrs. Nowak had built up assets in Poland before coming to Canada, and that those assets were the source of the bank deposits that the auditor treated as unreported income.

[23] With respect to the disallowed expenses, counsel said that Mr. Nowak had relied on his spouse to keep records for the partnership and she was adamant that she had kept good records and had provided the accountants everything that was needed to prepare the returns. Counsel suggested that Mr. Nowak and his spouse had provided credible evidence that the expenses as claimed had been incurred, and that it was not necessary to provide receipts and records to support the expenses.

[24] Counsel also argued that gross negligence penalties were not warranted because Mr. Nowak believed he was keeping the necessary records to properly report his income, and that any errors in his returns were attributable to persons Mr. Nowak relied on to prepare the books and tax returns for his businesses. It was submitted that Mr. Nowak was not privy to those errors and that there was no evidence that he was deliberately attempting to underreport his income.

Analysis

[25] The first issue is whether the Appellant failed to report income in his 2000 and 2001 taxation years. This issue turns mainly on the credibility of the Appellant and his spouse, and for the reasons that follow, I do not believe their testimony concerning the source of the unidentified bank deposits. I find their explanations unconvincing and implausible, and very little in the way of corroboration was

presented to the Court. The few documents they did produce raise as many questions as they answer.

[26] Firstly, I find that Mr. Nowak's failure to provide an explanation for the unidentified deposits to the auditor at their meeting in June 2007 raises a significant doubt as to the veracity of his and his spouse's testimony concerning the origin of the funds. Mr. Nowak's version of what took place at the meeting was quite different from that given by Ms. Sawh. Mr. Nowak said that he went to the meeting with his daughter expecting to discuss a GST refund he had applied for. He said they were made to wait for an hour, and that when Ms. Sawh finally arrived, her attitude was that Mr. Nowak was "worthless", and that she was unpleasant to him. He said he felt humiliated and left within five minutes, but his daughter stayed, and she was given documents by the auditor. He said his daughter later explained the proposed adjustments to the income tax to him, and showed him those documents, and that he turned the matter over to his accountant.

[27] The auditor made a summary of the meeting in her T2020 diary, and there is no indication that Mr. Nowak left the meeting early. In her testimony, the auditor said that she explained the proposed reassessments step-by-step to Mr. Nowak's daughter who translated for her father and who appeared to understand what she was saying. The auditor said that Mr. Nowak appeared to understand what his daughter was saying to him as well.

[28] I do not accept Mr. Nowak's testimony as to what took place at this meeting. Firstly, Mr. Nowak's daughter, who could have confirmed Mr. Nowak's story, was not called as a witness. There was no suggestion that she was unavailable to come to Court, and I draw the inference that her evidence would have been unfavourable to Mr. Nowak on this point. (see *Blatch v. Archer*²). I also find that the failure to put Mr. Nowak's version of events to the auditor during Mr. Nowak's cross-examination is a factor I am entitled to take into account in weighing Mr. Nowak's evidence relating to the meeting (see *Browne v. Dunn*,³ *R. v. Giroux*⁴). Finally, there was no reference in any of the materials put in evidence to Mr. Nowak's feeling "humiliated" or being frustrated by the auditor, which one might expect to be raised or mentioned in subsequent correspondence or discussions on the file.

² ((1774), 1 Cowp. 63 at p. 65).

³ (1894) 6 T.C. 67.

⁴ 2006 Cars Nat. 2002 (Ontario C.A.) at paragraphs 41-49.

[29] The evidence of what took place at the meeting is important because it was the first opportunity for Mr. Nowak to disclose the source of the unidentified deposits, which he did not do. Nor did he provide any explanation in the weeks that followed. Even if Mr. Nowak had left the meeting with the auditor early, he still admits that his daughter later explained the proposed adjustments to him and, therefore, he was aware at that point that the major part of the adjustments that the auditor was proposing related to bank deposits which Mr. Nowak now says were from a single non-taxable source.

[30] Given the magnitude of the unidentified deposits and given that Mr. Nowak says they all originated from the same source, I would have expected that Mr. Nowak would provide that information at the earliest opportunity. His failure to do so adds to my doubts about the truth of the explanation that he provided subsequently for the deposits.

[31] Other parts of Mr. and Mrs. Nowak's testimony are confusing, such as their explanation for the existence of two documents with different sale prices for their house in Poznan. Mr. Nowak suggested that the notary's act was a "preliminary agreement" and that the sale price was subsequently adjusted upwards. However, the notary's act is dated after the other supposed sale agreement and the notary's act shows that transfer taxes and fees were paid on the basis of the lower sale price amount. Mr. Nowak also said that he was not there when the transaction took place, but the notary's act says that Mr. Nowak and his spouse appeared along with the purchasers, and identified themselves with their passports. Mrs. Nowak said that she thought that the notary's act was prepared by the purchasers of the property, but it appears to me that the notary drafted it and Mr. and Mrs. Nowak both signed it along with the purchasers.

[32] If I were to accept that the true sale price of the house was 5 million zlotys, as they now say it was, this would mean that Mr. Nowak and his spouse, along with the purchasers of the home, misrepresented the price in the notary's act. The only apparent reason they would have done so was to reduce the treasurer's fees payable with respect to the sale. Those fees were calculated at a rate of 10% of the purchase price. It is not clear who was responsible for paying the fees, but even if it was the purchasers' responsibility, Mr. Nowak and his spouse would still have participated in the misrepresentation. This does little for their credibility.

[33] I also find Mrs. Nowak's explanation for the late production of the document showing the sale price as 5 million zlotys hard to accept. She said it was clipped together with the notary's act in a bundle of documents that she had at home, but that she only noticed it the day before coming to Court. It seems to me odd,

though, that Mr. and Mrs. Nowak would not have noticed when they first gave the notary's act to their lawyer that the price in the notary's act was different from what they say the sale price actually was (and by a large margin), and that they did not look into the matter further at that time.

[34] I also note that no documents pertaining to the sale of the restaurant were provided, despite the fact that it sold for as much as their house. It was not suggested that there were no official documents drawn up for the sale, and given Mr. Nowak's frequent trips to Poland up to and including this year, I would have expected that he might have tried to obtain copies of any such documents relating to the sale or transfer of the restaurant.

[35] Moreover, the restaurant sale itself is somewhat problematic. Mr. Nowak testified that his restaurant had been subject to harassment by local authorities in the early 1980s because someone wanted to take it over from him, and that he was finally forced by the "municipal office" to shut it down. In these circumstances, it is surprising that Mr. Nowak and his spouse would have been able to sell the restaurant for the price they allege. On a related note, it is also surprising to me that if, as Mr. Nowak said, his restaurant business had been suffering for a number of years before 1985, how he and his spouse would have had the means to own two cars, including a one-year old Mercedes-Benz in 1985 or that they would have had savings from that business equivalent to \$140,000 US (i.e. 7 million zlotys at 50 zlotys/dollar). I would point out as well that only Mrs. Nowak mentioned that they had savings from the restaurant.

[36] Mr. Nowak's explanation of the timing of the repatriation of funds from Poland also strikes me as unlikely. His first trip back to Poland was in 1990 when he obtained his Canadian citizenship. One of his reasons for going was to find out how to bring money back to Canada because he said he needed money here and wanted to settle down. It was also around that time that he and his wife were starting a banquet hall business. However, even though it was possible by 1990 to get permission to take money out of Poland, Mr. Nowak said he only started doing so in 1995. I am unclear why, if Mr. Nowak needed money in Canada in 1990, he would have waited five years.

[37] In addition, while he said he went three or four times a year to Poland for money when he needed it, he could only find three currency export certificates in total, and three bank withdrawal records, including one that dealt with the same funds as the February 19, 1999 export certificate. All of these records only add up to approximately \$125,000, whereas the bank deposits included in Mr. Nowak's

income in 2000 and 2001 was \$294,805 which would not take into account money used by Mr. and Mrs. Nowak from their Polish savings prior to 2000.

[38] There is also a discrepancy between Mr. Nowak's testimony and the information set out on the February 19, 1999 bank withdrawal form and the export certificate. Mr. Nowak said that he would first deposit the funds he wanted to take to Canada into the bank account, where it would have to stay for three days, and then he would get an export certificate and withdraw the money and take it with him to Canada. However, the February 19th withdrawal form shows that Mr. Nowak withdrew \$37,000 US from the account whereas the export certificate was only for \$22,000 US.

[39] Another puzzling aspect of this arrangement is why Mr. Nowak would have continued to bring back money from Poland on many trips up to 2010, when he said that at some point around the year 2000, there were no longer any restrictions on moving funds out of the country. If it were the case, why would he not have brought back everything at once, after the controls were lifted. I am also surprised that Mr. Nowak would choose to travel with large amounts of cash rather than having the money moved by bank transfer.

[40] Furthermore, I find it difficult to believe that Mr. Nowak and his spouse would have kept hundreds of thousands of dollars in cash at home for long periods of time. When asked why they chose to keep the money at home, Mr. Nowak's spouse said she did not know. Mr. Nowak said it was because the value of the Canadian dollar was declining and he did not want to convert it all at once. This still does not explain why the amounts were kept at home, when more secure options would have been available. It appears that Mr. Nowak had a US dollar chequing account in 2000 for K & R, which tells me that Mr. Nowak was aware of at least one more secure option.

[41] Finally, there did not seem to be any record kept of the deposits allegedly made from Mr. Nowak's cash hoard into the R & R business account, which is peculiar given that R & R was a partnership with an unrelated person. I would have expected that if Mr. Nowak deposited almost \$20,000 of his own money in cash to the partnership account, he would have wanted to keep track of these amounts to ensure he was given credit for them. I would have also expected Mr. Nowak's partner, Mr. Ratajcsak, to be aware of what was happening, but Mr. Ratajcsak was not called as a witness.

[42] I find therefore that the Appellant has not shown on a balance of probabilities that the unidentified bank deposits were not income to him in his 2000 and 2001 taxation years.

[43] Turning now to the question of the disallowed business expenses in K & R and R & R, the evidence that was presented was utterly lacking in detail, and for that reason, does not constitute reliable oral evidence that the claimed expenses were in fact incurred. The notebook that Mrs. Nowak supposedly used to record revenue and expenses was not produced, and no explanation was given for why it was not made available. Her testimony that she wrote everything down and gave that information to the accountant is not, in itself, sufficient to meet the onus of proving that the amount of expenses was higher than what the auditor allowed. For his part, Mr. Nowak said that he relied entirely on his spouse to do the bookkeeping, and upon his accountant to prepare his returns, and he could not give any details of the expenses that had been incurred.

[44] The final issue to be decided is whether Mr. Nowak is liable for penalties on the unreported income. Subsection 163(2) of the *Act* provides for a penalty where a taxpayer “knowingly or in circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of a false statement or omission in a return ... filed in respect of a taxation year”. The Respondent has the onus of proving the facts that would justify the imposition of the penalty.

[45] In this case, the penalties were imposed only in respect of the unreported income. No penalties were imposed in respect of the disallowed business expenses of K & R and R & R. Appellant’s counsel maintains that Mr. Nowak believed that he was keeping proper records to report his income and says he relied on others to do the bookkeeping and file the returns.

[46] However, it is clear that Mr. Nowak did not instruct his accountant to include the unreported income in issue as income in his returns for 2000 and 2001. This is apparent because Mr. Nowak maintains that these deposits came from a non-taxable source – money that was brought from Poland. Therefore, the input of Mrs. Nowak and of his accountant in the preparation of the returns is irrelevant. This is not a case of an accountant’s error or ineptitude. It is a case of Mr. Nowak deliberately failing to disclose income.

[47] While Mr. Nowak said he did not recognize the signature on his 2000 tax return and the 2001 tax return was unsigned, I am satisfied that those returns were filed by Mr. Nowak’s accountant on his behalf and according to his instructions. Mr. Nowak testified that his accountant prepared the returns on the basis of

information he provided or that was provided on his behalf by his spouse, and therefore, I find that he acquiesced in or assented to the misrepresentation of his income that was presented in those returns.

[48] Recently, in the case of *Lacroix v. The Queen*⁵, the Federal Court of Appeal considered what was required of the Minister in order to discharge the onus with regard to the reassessment beyond the statutory period and the imposition of gross negligence penalties in the case of a net worth assessment. At paragraph 32 Pelletier, J.A. wrote:

What, then, of the burden of proof on the Minister? How does he discharge this burden? There may be circumstances where the Minister would be able to show direct evidence of the taxpayer's state of mind at the time the tax return was filed. However, in the vast majority of cases, the Minister will be limited to undermining the taxpayer's credibility by either adducing evidence or cross-examining the taxpayer. Insofar as the Tax Court of Canada is satisfied that the taxpayer earned unreported income and did not provide a credible explanation for the discrepancy between his or her reported income and his or her net worth, the Minister has discharged the burden of proof on him within the meaning of subparagraph 152(4)(a)(i) and subsection 162(3).

The Court also cited its earlier decision in *Molenaar v. The Queen*⁶, another net worth assessment, where Létourneau J.A. wrote at paragraph 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.

[49] These comments would appear equally applicable in a case such as this one where it has been shown that the taxpayer has had a substantial unexplained increase in his assets. I find that the Respondent has shown that there is a substantial discrepancy between Mr. Nowak's income in the form of deposits to his bank account and his reported income, and that at the end of the day, this discrepancy remains unexplained.

[50] In the absence of a credible explanation by Mr. Nowak for the bank deposits in issue, I find that the gross negligence penalties were properly applied.

⁵ 2008 FCA 241 at paragraphs 33 and 34.

⁶ 2004 FCA 349.

[51] The appeals are therefore dismissed, with costs to the Respondent.

Signed at Ottawa, Canada, this 4th day of January, 2011.

“Brent Paris”

Paris J.

CITATION: 2010 TCC

2011 TCC 3

COURT FILE NO.:

2009-77(IT)G

STYLE OF CAUSE:

RAYMOND NOWAK and
HER MAJESTY THE QUEEN

PLACE OF HEARING:

Toronto, Ontario

DATE OF HEARING:

October 18, 2010

REASONS FOR JUDGMENT BY:

The Honourable Justice Brent Paris

DATE OF JUDGMENT:

January 4, 2011

APPEARANCES:

Counsel for Mr. Nowak:

David W. Chodikoff

Counsel for the Respondent:

V. Lynn W. Gillis

COUNSEL OF RECORD:

For Mr. Nowak:

Name:

David W. Chodikoff

Firm:

Miller Thompson LLP

For the Respondent:

Myles J. Kirvan

Deputy Attorney General of Canada

Ottawa, Canada