

Docket: 2010-2264(IT)G

BETWEEN:

PEI PEI ZHENG,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on March 12, 2012 at Toronto, Ontario

Before: The Honourable Justice J.E. Hershfield

Appearances:

For the Appellant: The Appellant herself

Counsel for the Respondent: Ernesto Caceres

JUDGMENT

In accordance with and for the reasons set out in the attached Reasons for Judgment, the appeals from the reassessments made under the *Income Tax Act* for the 2003, 2004 and 2005 taxation years are allowed, without costs, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that:

- with respect to 2003 the unreported income amount shall be reduced by \$16,961 to nil.
- with respect to 2004 the unreported income amount shall be reduced by \$63,000 to \$5,714.

- with respect to 2005 the unreported income amount shall be reduced by \$54,878 to \$39,284.

Signed at Ottawa, Canada this 2nd day of April 2012.

“J.E. Hershfield”

Hershfield J.

Citation: 2012 TCC 103
Date: 20120402
Docket: 2010-2264(IT)G

BETWEEN:

PEI PEI ZHENG,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Hershfield J.

[1] The Appellant appeals assessments in respect to her 2003, 2004 and 2005 taxation years.

[2] The Appellant filed her 2003, 2004 and 2005 T1 General income tax returns on or about May 15, 2007, in which she reported:

	2003	2004	2005
Rental Income	\$11,496	\$13,800	\$21,073
Employment Income from Cara Operations Limited	\$8,572	\$8,959	\$11,441
Other Income	\$2,709	\$1,380	\$2,087
Total	\$22,776	\$24,139	\$34,601

[3] The Minister of National Revenue (the “Minister”) reassessed the Appellant for each of these taxation years to include unreported business income and gross negligence penalties.

[4] The Appellant objected to the reassessments and based on representations made to the appeal section of the Canada Revenue Agency (the “CRA”), the

Minister reassessed the Appellant to reduce the amount of unreported income which resulted in the following amounts being included:

- \$16,961 in 2003
- \$69,120 in 2004
- \$94,162 in 2005

Gross Negligence Penalties were also reduced accordingly.

[5] The Appellant appeals these reassessments based on a number of asserted miscalculations and wrong information relied on by the Minister in issuing them.

[6] The Reply to the Notice of Appeal (“Reply”) indicates that the reassessments were based on a methodology commonly referred to as a net worth assessment. The Minister determined that the Appellant’s reported income could not support her lifestyle, that she earned business income from what might be described as a criminal activity and that she did not keep books and records showing the true source and amount of her income in the subject years.

[7] The Reply goes on to set out particulars of how a comparative analysis of her net assets showed increases from 2002 (the base year) to 2003 and then to 2004 and 2005.

[8] The Appellant testified at the hearing and, in general, on the basis of her testimony, I believe that the methodology employed by the Minister overestimated her unreported income. On the other hand, the absence of records and corroborating evidence in most cases that might have supported much of her self-serving testimony has made it difficult to quantify with any certainty the amount of unreported income in the years in question. Still, certain adjustments are warranted.

[9] While the jurisprudence in this area does not require the Minister to establish the existence of an alleged business or other source of the unreported income,¹ it is worth noting that the Appellant adamantly denied being involved in any business or activity of the nature described in the Reply.

¹ See *Hsu v. R.*, 2001 DTC 5459 (F.C.A.), at para. 29; applied in *Dao v. Canada*, 2010 DTC 1086 (T.C.C.).

[10] I accept her testimony on this point. I believe that it is improbable that the Appellant was in fact personally involved in the alleged activity. Further, I note that the basis for the assumption of a criminal activity was, according to the Respondent's witness, nothing more than a tip that does not appear to have been followed up in any way other than it giving rise to the assessment under appeal. I cannot help but doubt, in this case, the reliability of such a tip. Acting on what might be in this case, an unsupported tip, as the basis for putting a taxpayer through the onerous and difficult task of defending against a net worth assessment is a bit disconcerting. Still, once the assessment is made, and the basis for calculating the unreported income is particularized, the taxpayer is required to demonstrate errors in the methodology employed and/or errors in respect of the calculation of itemized asset growth inclusions and specific expenditures and/or errors in the assumption that such asset growth and such expenditures were funded by unreported income.

[11] Accordingly, regardless that I find that the business source alleged by the Respondent has been refuted, that does not absolve her of the responsibility to account for the increases in her net worth in a manner that would demonstrate that they are not, on a balance of probability, from a taxable source. Indeed, the Appellant does not deny that she had unreported income. Her issue with the assessment approach is that it is filled with erroneous assumptions as to her lifestyle expenditures and sources of funds. She testified emotionally that since coming to this country she has worked very hard at several jobs to get ahead. Both her mother and brother have passed away so there is little evidence that she could produce as to their contribution to her apparent financial well being. One has the impression from her evidence, which in general terms impressed me as credible, that the net worth increases in wealth in this case may well have been attributable to unreported income from long extra hours of employment, from the pooling of family resources which may have included unreported income of other family members and from frugal living and careful management of her family's affairs. Nonetheless, the burden imposed on the Appellant is not relieved by such general impressions. It is not sufficient that the Appellant has satisfied the Court that the assessment is likely wrong, she has to give evidence that undermines specific assumptions and calculations.

[12] The three main areas with which the Appellant took specific exception are as follows:

- The 2004 purchase of a 2003 Audi for \$25,000 was, although registered in the Appellant's name, purchased by her brother with her brother's money.
- \$25,000 of the \$33,425 spent on the purchase of a Lexus in 2005 was a loan from her brother.
- Over the years in question she lent considerable amounts of money to persons she identified at the hearing. She testified that these loans were repaid and therefore should not be included in her income. She identified a \$10,000 loan to her brother, a \$12,000 loan to a friend in China, \$6,000 to her friend's cousin in Newfoundland. There were also advances to her mother and her sister totalling some \$6,400 and an additional \$26,000 given to her ex-husband.

[13] With respect to the loans and repayments, I am not satisfied on the evidence that repayments were required to be considered as part of the net worth income calculations during the subject years. Indeed, it appears that the asserted repayments all occurred well after 2005. That being the case, I am not able to make any adjustments to the assessments based on this part of the Appellant's testimony. As well, I note that the repayment of loans made to her ex-husband that the Appellant testified took the form of services that he performed on rental properties owned by her or them, could not have been included in the increases in her net worth as determined by the Minister and therefore cannot be taken out.

[14] With respect to the source of funds for the purchase of the 2003 Audi, I find that the \$25,000 more likely than not came from her brother and that the vehicle was only registered in the Appellant's name as a matter of convenience. There were insurance records that corroborated that the car was not on the road for long stretches that coincided with times she testified that her brother was in China. There was also evidence (albeit somewhat confused and self-serving) that has satisfied me on a balance of probability that the car went to her brother's son on her brother's death. As well, she had her own car at the time of the purchase of the Audi that she continued to own and use until she acquired the Lexus.

[15] On the other hand her evidence as to her brother lending her \$25,000 to buy the Lexus is wholly uncorroborated. Indeed, it tends to contradict to some extent the Appellant's testimony that she had in the same year lent her brother \$10,000.

[16] There are also personal expenditures included in the net worth calculation that the Appellant testified were excessive, however the discrepancies were minor

and do not explain the extent of the excesses she asserted in respect of the Minister's determinations.

[17] Contributing to the greyness in finding a rational basis for identifying such excessive inclusions is that the Appellant appears to be her family's go-to person in terms of managing everyone's financial affairs. She had access to her mother's money and her brother and former husband both seem to treat her as the head of the family and that has caused a blurring of everyone's financial affairs.

[18] However, the extent the family's financial situation is blurred, is a problem for which she must take responsibility. The Appellant is not lacking in financial sophistication. She invested in rental properties for which she arranged financing and which she managed. I find it hard to accept then that the lack of records that would document her sources of funds is due to ignorance.

[19] That said, there is a problem with the net worth determinations in this case. As suggested earlier, the Respondent called a witness to testify as to the method of assessment. That witness was the auditor that worked on the original assessment. The appeals officer who worked on the actual assessment at issue was not called to testify.

[20] The auditor's testimony did not give me a lot of comfort in relation to his use of Statistics Canada information in determining the Appellant's personal expenditures in some categories but I have little to go on to make adjustments there. However, there is one category of personal expenditures in each of the subject years, namely the inclusion of loans made by the Appellant, that requires attention.

[21] The auditor admitted to a potential flaw in respect of the methodology employed in determining the unreported income amounts by including loans made by the Appellant as personal expenditures. He acknowledged the possibility, if not the likelihood, of double counting arising by virtue of that inclusion.

[22] More specifically, the auditor acknowledged adding the following amounts as personal expenditures:

2003	2004	2005
\$26,949	\$38,406	\$54,876

[23] The auditor acknowledged that these reflected the total of amounts of withdrawals (after adjustments by the appeals officer) that he determined to be loans made by the Appellant based on information and records that she provided. He acknowledged that these inclusions would be a double counting if in fact the source of those loans was the unreported income amounts that he had already added to her income based on the net worth increases in the subject years.

[24] Adding funds as they go in and then again as they go out, imposes a double burden on the Appellant that I find unacceptable. One stroke of a blunt instrument is sufficient, at least in this case.

[25] I am relying then on there being a flaw in the methodology that undermines the assessment in a very significant way in this case. In 2003 the potential for double counting is \$26,949. However, the amount of the reduction in unreported income required on account of this issue is limited to the \$16,961 assessed. The amount of the reduction in respect of the 2004 and 2005 years is not so limited. The reduction in unreported income for 2004 is therefore \$38,406 and the reduction for 2005 is \$54,876. All such reductions are based on the double counting acknowledgement of the auditor and my acceptance in this case that the net worth assessments at issue more likely than not far exceed the actual unreported income amounts in each of the subject years.

[26] I will allow the appeal on that basis. As well, as noted above, the unreported income in respect of 2004 shall be reduced by a further \$25,000 based on the 2003 Audi not being her vehicle and not having been paid for by her.

[27] The appeals are allowed accordingly, without costs.

Signed at Ottawa, Canada this 2nd day of April 2012.

“J.E. Hershfield”

Hershfield J.

CITATION: 2012 TCC 103

COURT FILE NO.: 2010-2264(IT)G

STYLE OF CAUSE: PEI PEI ZHENG AND HER MAJESTY
THE QUEEN

PLACE OF HEARING: Toronto, Ontario

DATE OF HEARING: March 12, 2012

REASONS FOR JUDGMENT BY: The Honourable Justice J.E. Hershfield

DATE OF JUDGMENT: April 2, 2012

APPEARANCES:

For the Appellant:	The Appellant herself
Counsel for the Respondent:	Ernesto Caceres

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

For the Respondent:

Myles J. Kirvan
Deputy Attorney General of Canada
Ottawa, Canada