Docket: 2011-3508(IT)I

BETWEEN:

VALERI TCHEBOTAR,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeals of *Katrina Tchebotar* (2011-3509(IT)I) and *Ekaterina Tchebotar,Valeri Tchebotar* (2011-3510(GST)I) on October 31, 2012, at Kelowna, British Columbia

Before: The Honourable Justice Diane Campbell

Appearances:

Agents for the Appellant:	Esther Dirksen Darren B. Wilms
Counsel for the Respondent:	Shane Aikat

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* with respect to the 2006, 2007 and 2008 taxation years are allowed, without costs, to the extent only of permitting the Respondent's proposed adjustments to the net worth analysis. The assessments are referred back to the Minister of Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 29th day of January 2013.

"Diane Campbell"

Campbell J.

Docket: 2011-3509(IT)I

BETWEEN:

KATRINA TCHEBOTAR,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeals of *Valeri Tchebotar* (2011-3508(IT)I) and *Ekaterina Tchebotar,Valeri Tchebotar* (2011-3510(GST)I) on October 31, 2012, at Kelowna, British Columbia

Before: The Honourable Justice Diane Campbell

Appearances:

Agents for the Appellant:	Esther Dirksen Darren B. Wilms
Counsel for the Respondent:	Shane Aikat

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* with respect to the 2006, 2007 and 2008 taxation years are allowed, without costs, to the extent only of permitting the Respondent's proposed adjustments to the net worth analysis. The assessments are referred back to the Minister of Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 29th day of January 2013.

"Diane Campbell"

Campbell J.

Docket: 2011-3510(GST)I

BETWEEN:

EKATERINA TCHEBOTAR, VALERI TCHEBOTAR,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Valeri Tchebotar* (2011-3508(IT)I) and *Katrina Tchebotar* (2011-3509(IT)I) on October 31, 2012, at Kelowna, British Columbia

Before: The Honourable Justice Diane Campbell

Appearances:

Agents for the Appellant:	Esther Dirksen Darren B. Wilms
Counsel for the Respondent:	Shane Aikat

JUDGMENT

The appeal from the assessment made under the *Excise Tax Act* for the period January 1, 2007 to December 3, 2008 is allowed, without costs, to the extent only of permitting the Respondent's proposed adjustments to the net worth analysis. The assessment is referred back to the Minister of Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 29th day of January 2013.

"Diane Campbell"

Campbell J.

Citation: 2013 TCC 32
Date: 20130129

Docket: 2011-3508(IT)I

BETWEEN:

VALERI TCHEBOTAR,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Docket: 2011-3509(IT)I

AND BETWEEN:

KATRINA TCHEBOTAR,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Docket: 2011-3510(GST)I

AND BETWEEN:

EKATERINA TCHEBOTAR, VALERI TCHEBOTAR,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Campbell J.

[1] The Appellants, Valeri Tchebotar and Katrina (also known as Ekaterina) Tchebotar, are husband and wife and together they operate a business under the name "Katrina's Fashion Design & Alterations" from a small shop located in West Kelowna, British Columbia. They operate the business as an equal partnership. It is an alterations and tailoring business that repairs items such as clothing, blankets, drapes and sofa cushions. The Appellants came to Canada from Moldova in 1992 and purchased this business in 1999.

[2] The Appellants were assessed for three taxation years, 2006, 2007 and 2008, in respect to the two income tax appeals and for the period January 1, 2007 to December 3, 2008 in respect to the excise tax appeal. Due to the condition of the books and records, the lack of supporting documentation and the fact that the majority of the business was operated on a cash basis, the auditor, Gwen Nygaard, completed an indirect verification of income audit. The audit increased reported business income, by including unreported amounts, disallowed claimed business expenses, increased amounts of GST collectible and disallowed income tax credits ("ITCs") in excess of those allowed and levied penalties.

[3] Customers paid by either cash or cheque. The shop contained no debit or credit card machines. The auditor described the shop, from which the business operated, as a small storefront with a small sales counter. Inside this counter was a "… drawer, an old kitchen cabinet drawer that had cash and cheques …" (Transcript, page 159, Examination-in-Chief of the auditor). In addition, the shop contained a small change room and a work space containing the supplies, sewing machines, pressers and irons.

[4] When customers paid by cheque, those cheques were all deposited. However, the cash amounts, according to the Appellants' submissions, were not always deposited and, instead, were sometimes used directly for purchasing personal items such as food and for paying bills. The sales were tracked through customer receipts, as the shop did not contain a cash register or computer. Through those receipts, the Appellants totalled the sales at the end of each day and recorded them in a notebook. These totals were tracked weekly, monthly and yearly. All of the supporting invoices were shredded, as well as the written recordings of the totals made using those receipts (with the exception of the yearly totals).

[5] The Appellants testified that they destroyed all of their sales receipts because they were concerned that the public could find and access the names and phone

numbers of their customers. According to the Appellants, they destroyed the daily, weekly and monthly totals, even though they did not contain that personal customer information, because it was too much paperwork to retain.

[6] While only the handwritten yearly sales totals were retained, the Appellants kept monthly totals of the business expenses together with their supporting invoices.

[7] The Appellants claim to have received various cash loans from family members during the years and period under appeal, however, they could not produce any documentation in support of these loans and did not call any witnesses to verify their testimony. According to their evidence, the cash from these loans was kept in an envelope on the fireplace instead of being deposited to their bank account. The cash was used to make credit card payments, buy food and pay other household expenses. They indicated that they repaid some amounts on these loans but, again, except for their oral testimony, there was no documentation or records kept to support repayment.

[8] The Appellants also claimed that their children repaid loans during this period which the parents had provided to them and that the Appellants then used this money to make payments on credit cards. The primary example was the purchase by the Appellants of furniture valued at approximately $8,000 for their daughter, Ludmilla Tchebotar. The Appellants claimed that this amount was repaid by the daughter from "her honeymoon money", but there was no supporting documentation and, in cross-examination, the daughter could not provide details of that repayment, as it was her husband who had control over their money. She only assumed that her husband, who was not a witness, would have repaid her parents.

Adjustments:

[9] During the hearing, it became apparent that a number of adjustments to the net worth analysis would be required. Because the parties were unable to agree on the extent of those adjustments, I directed that they provide written submissions. These adjustments were required in order to address and correct:

(a) double-counting of some items by the auditor;
(b) incorrect use by the auditor of a payment analysis in respect to the credit cards instead of using the correct method of purchase analysis;

(c) MBNA credit card adjustments respecting only one card when, in fact, there were two cards; and finally,

(d) addition errors by the auditor in respect to liabilities.

[10] Instead of specifically addressing those adjustments as I instructed, the Appellants simply reproduced the entire net worth containing their revised amounts but without reasons and explanations to support those suggested adjustments. I accept the Respondent's proposed adjustments, as he provided an explanation to support the proposed adjustments and attached schedules showing the calculations and effect of those adjustments on the net worth analysis. The auditor also acknowledged the requirement for these adjustments to her analysis.

[11] The personal expenditure amounts relating to restaurant and automotive that were double-counted by the auditor were removed from the total expenditures considered in the net worth analysis.

[12] In calculating the Appellants' personal expenditures, the auditor conducted a "payment analysis" of the credit cards when, in fact, an analysis of purchases made on those cards should have been employed. Counsel for the Respondent outlined in his submissions and schedules how the payment analysis was converted to the correct purchase analysis in respect to the Appellants' audit and the resulting adjustments to the total personal expenditures.

[13] In the payment analysis, the auditor included in her total personal expenditures those payments on the cards that had no traceable source. Such payments, which reduce liabilities, will be reflected, however, on the balance sheet analysis. Therefore, to correct the problem in respect to each year, the previous year-end credit card liabilities must be subtracted from the total expenditures while the current year-end credit card liabilities must be added.

[14] While both Appellants had MBNA credit cards in both 2007 and 2008, the auditor considered only one card in calculating liabilities at year end. The Respondent's schedules show the adjustment to the liabilities to include balances for both cards. No adjustment to liabilities was required for December 31, 2005 and December 31, 2006 because only one Appellant had an MBNA card in that period.

[15] Finally, the revised net worth schedules confirm the corrections made in respect to the auditor's additions of the Appellants' revised liabilities as of December 31, 2008.

[16] I accept all of these adjustments as necessary and properly implemented according to the revised schedules submitted by the Respondent.

Analysis:

[17] It is clear in these appeals why the auditor resorted to the net worth method in order to calculate the Appellants' income. Records and supporting documentation were not only insufficient but were totally non-existent. Consequently, the information provided in their returns could not be independently verified. Both the sales invoices and the handwritten daily, weekly and monthly totals, that supported the handwritten yearly totals given to the accountant, had been destroyed.

[18] In *Bigayan v. The Queen*, 2000 D.T.C. 1619, Bowman J. (as he was then), at page 1619, called the net worth method "… a blunt instrument, accurate within a range of indeterminate magnitude." It is commonly referred to as a method of "last resort" because all other methods of verification of the taxpayer's income figures have failed. By its very nature, the net worth method will result in an approximation of the income of a taxpayer and generally an inaccurate one at best. However, since we live in a self-assessing system, it is the taxpayer who will always be in the best position to know his precise income in a particular period of time. Where the taxpayer has retained the proper records and books, it should be an easy task to identify the Minister's errors in the net worth assessment and to support the proposed changes with the supporting documentary evidence.

[19] In *Hsu v. The Queen*, 2001 D.T.C. 5459 (F.C.A.), the Court pointed out that the Minister must only show that the taxpayer's net worth has increased between two points in time and that the Minister does not have to prove a taxable source of income. At paragraph 29, the Court stated:

> [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.)).

[20] The burden is therefore upon a taxpayer to show, to the satisfaction of the Court, that the net worth assessment is incorrect. In *Saikely v. M.N.R.*, 93 D.T.C. 397, Hamlyn J., at page 401, summed up how a taxpayer may attack such an assessment:

> … A taxpayer may prove that some of his increase arose from non-taxable receipts, such as inheritances or gambling; that his net worth at the beginning of the period was undervalued or that his assets at the end were overvalued; that liabilities existing at the end were omitted or undervalued; that the money had been borrowed or that income losses were greater than assessed. Whatever is alleged by the taxpayer must be proved by him; a mere statement is not enough. Moreover, cogent evidence is required to disprove a net worth assessment.

[21] The Appellants submitted no documentary evidence to support the handwritten yearly sales totals that they provided to their accountant because they had destroyed all of those records. I cannot accept the evidence respecting the family loans which the Appellants allegedly received in U.S. currency from their American relatives. These funds were supposedly carried across the border into Canada, kept in an envelope on their fireplace and used to pay expenses. Again, I have no records to support this testimony. When they used this cash to pay expenses such as credit cards, groceries, electric charges and so forth, there should have been some records in some of those instances of the conversion of U.S. currency to Canadian, but none were produced. None of those individuals who allegedly made those loans were called as witnesses. While affidavits were provided, none of those had attached withdrawal information from bank accounts, credit cards and so forth belonging to the lender. I must, therefore, reject the Appellants' assertion respecting the loans, as it was reasonable to expect some additional evidence, besides the Appellants' testimony, that would support the existence of such loans.

[22] Similarly, I have no evidence respecting the alleged cash payments of household expenses by the children. Neither the father nor the son could recall even approximate contributions. If none of the witnesses before me can provide me with a guesstimate, how can I be expected to pull a figure out of the air to attribute to such contributions? That is the responsibility of the taxpayers and they have been unable to do so. I have no doubt that the adult children who were working and living at home made some contributions, but I am unable to quantify those amounts in any manner based on the vague evidence before me.

[23] I might add that, if I had been presented with some concrete and plausible evidence respecting both the loans and cash payments, I would have allowed amounts in this regard. Vague recollections are one thing, but the witnesses in these appeals could offer no recollections. My observation can also be applied to the Appellants' representations respecting credit card purchases. I require clear and precise recollection of at least some of these purchases in order to conclude that, on a balance of probabilities, it is more probable than not that the Appellants made such purchases with funds given to them from outside sources. For example, the Appellants' daughter was unable to provide any evidence respecting when amounts were repaid to her parents for the furniture loan, the amounts of those payments, or the method. In fact, she testified that it was her husband who was in charge of their money and that it was her husband who would have repaid the loan. This does not establish that the loan was, in fact, repaid and does not support the contention that these repaid amounts may have been used to make credit card payments.

[24] Finally, there is the issue of amounts that the Appellants claim to have paid to their daughter for working occasionally in the business. While the father stated that her rate of pay depended on the work she completed and that he kept a record of this, the daughter did not recollect that there was a record kept. The father had represented to the auditor that he had no records at all of the daughter's wages. With such conflicting testimony and with no records to substantiate any particular testimony, I must reject the Appellants' contentions in this regard as well.

[25] It is interesting to note that the Appellants were fastidious in recording and categorizing their business expenses. While they were able to support those expenses with receipts and other documentation, they shredded or otherwise destroyed all documentation that would have supported their sales.

[26] Gross negligence penalties were imposed on the Appellants. The Minister has the duty to justify its decision to impose those penalties. The authorities in this area are numerous. In *Venne v. The Queen*, 84 D.T.C. 6247, Strayer J., at page 6256, defined gross negligence in the following manner:

> With respect to the possibility of gross negligence, I have with some difficulty come to the conclusion that this has not been established either. 'Gross negligence' must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not. I do not find that high degree of negligence in connection with the misstatements of business income. To be sure, the plaintiff did not exercise the care of a reasonable man and, as I have noted earlier, should have at least reviewed his tax returns before signing them. A reasonable man

> in doing so, having regard to other information available to him, would have been led to believe that something was amiss and would have pursued the matter further with his bookkeeper.

In establishing whether gross negligence exists, a number of factors must be reviewed. These include: the magnitude of the omission in relation to the income declared, the opportunity the taxpayer has to detect the error and the taxpayer's education and intelligence.

[27] The unreported amounts of business income are significant when compared to the actual reported amounts. Although the Appellants had difficulty with English, as it is their second language, they recognized the importance of keeping records to support the expenses they claimed and that this would directly affect taxes that they would eventually owe. While using a cash basis is a legitimate way to conduct business activities, it also requires more stringent bookkeeping so that a paper trail is supportive of a taxpayer's explanations of those cash transactions. The Appellants were, in fact, in possession of those supporting records but chose to destroy all of them, except for the expense documentation. If they were concerned over protecting customer identity, there were alternative options available to them for doing so, such as manually blocking the identity information on the invoices and receipts or asking their accountant if they were tracking sales appropriately when they were destroying all sales invoices. In addition, there was no need to destroy the daily, weekly and monthly handwritten totals, which supported the Appellants' claimed income, as they did not contain customer identity information. When asked why they destroyed all of these records, the responses were vague and unclear. Although they had an accountant prepare their returns, they controlled the information and decided what to provide the accountant to complete those returns. In these circumstances, the Minister's imposition of penalties was justified.

[28] In summary, I am allowing the appeals to permit the adjustments to the net worth analysis as outlined in the Respondent's submissions due to the auditor's errors and as more specifically detailed in the supporting schedules to those submissions. The Appellants destroyed all supporting records except those that would substantiate their expense claims. They could not supply any concrete evidence to support other sources of income. Simply put, they failed to meet their onus by establishing that the net worth assessment is inherently incorrect.

[29] Since the Appellants provided no concrete evidence of what their actual income was in the years under appeal and have been unsuccessful in disputing the assessment, the appeals are allowed, without costs, to the extent only of permitting

the Respondent's proposed adjustments to the net worth analysis. I also conclude that the evidence justified the imposition of the penalties levied by the Minister.

Signed at Ottawa, Canada, this 29th day of January 2013.

"Diane Campbell"

Campbell J.

CITATION:	2013 TCC 32
COURT FILE NOS.:	2011-3508(IT)I 2011-3509(IT)I 2011-3510(GST)I
STYLES OF CAUSE:	VALERI TCHEBOTAR, KATRINA TCHEBOTAR, EKATERINA TCHEBOTAR and VALERI TCHEBOTAR AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Kelowna, British Columbia
DATE OF HEARING:	October 31, 2012
REASONS FOR JUDGMENT BY:	The Honourable Justice Diane Campbell
DATE OF JUDGMENT:	January 29, 2013

APPEARANCES:

Agents for the Appellants:	Esther Dirksen Darren B. Wilms
Counsel for the Respondent:	Shane Aikat

COUNSEL OF RECORD:

For the Appellants:	
Name:	
Firm:	
For the Respondent:	William F. Pentney Deputy Attorney General of Canada Ottawa, Canada