Cour d'appel fédérale Federal Court of Appeal

Date: 20010724

Docket: A-390-00
Neutral citation: 2001 FCA 240

CORAM: **DESJARDINS J.A.**
ISAAC J.A.
MALONE J.A.

BETWEEN:

GEORGE R.H. HSU

Appellant

- and -

HER MAJESTY THE QUEEN

Respondent

REASONS FOR JUDGMENT

DESJARDINS , J.A.

[1] This is an appeal from a judgment of the Tax Court of Canada ((2000), 2000 D.T.C. 2232 (Hamlyn T.C.C.J.)) which dismissed the appellant's appeal from reassessments of his income for the 1993 and 1994 taxation years. At issue is whether the Tax Court judge erred in concluding that the appellant bore the onus of disproving the validity of the reassessments. Also at issue is whether the trial judge erred in concluding that the appellant was in receipt of income that was not declared and whether he correctly sustained the reassessments.

The Facts

[2] The appellant, together with his wife and children, immigrated to Canada from Taiwan on April 25, 1992, and later became Canadian citizens. In support of his application for immigration, the appellant provided on March 4, 1991, a "Personal Worth Statement" listing immoveable property and shares located in Taiwan with an aggregate value of $2,812,327. The list of assets were the following:

(a) property at 259 Sung Chiang Road
(b) property at 167 Min Sheng Road
(c) shares of Chien Ming Hsen Yeh Co. Ltd.
(d) shares of Hotel New Asia Co. Ltd.
(e) shares of Chang June College
(f) shares of San Ho Security Co. Ltd.
(g) shares of China Gypsum Co. Ltd.

[3] For the 1993 and 1994 taxation years, the appellant declared income of $1,207 and $636 respectively. On June 13, 1995, an auditor for the Minister of National Revenue wrote to the appellant to inform him of a planned audit. The auditor met with the appellant and requested that he provide financial information and documentation. The appellant failed to comply and, despite subsequent requests, he never provided the information required by the auditor. As a result, Revenue Canada determined to make arbitrary reassessments based on the available information pursuant to subsection 152(7) of the *Income Tax Act* (the "Act").

[4] By letter dated October 4, 1996, the auditor set out the methodology for the arbitrary reassessments. The auditor assumed that the appellant had not disposed of his assets in Taiwan between the time he submitted his "Personal Worth Statement" and the end of the 1994 taxation year.

Accordingly, he estimated the appellant's net worth to be $3,000,000. The auditor proposed to impute to the appellant as income a 10% "estimated return on capital" arising from this amount. The letter stated that the Minister would reassess on this basis unless the appellant contacted Revenue Canada within ten days.

[5] The appellant failed to respond and the Minister reassessed him on the proposed basis. The Minister included in the appellant's income an additional $298,792.17 for the 1993 taxation year and an additional $300,000 for the 1994 taxation year.

[6] In further support of the reassessments, the Minister relied on the fact that the appellant was the sole provider for himself, his wife and three children during the 1993 and 1994 taxation years. The Minister assumed that the appellant brought $200,000 with him when he immigrated to Canada on April 25, 1992, that he bought a house in Vancouver for $470,000 cash on July 29, 1992, that he made mortgage payments totalling $39,617.28, that he operated a bank account and that he was a shareholder in an offshore company. In addition, the Minister assumed that the appellant, who was frequently absent from Canada during 1993 and 1994, had been conducting business activities abroad.

[7] By notices of objection dated April 23, 1997, the appellant objected to the reassessments.

The Tax Court Pleadings

[8] The appellant filed a notice of appeal in the Tax Court of Canada which stated in paragraphs 6, 7, 10 and 11:

> 6. By Notices of Reassessment dated March 24, 1997 (the "Reassessment") the Minister of National Revenue (the "Minister") reassessed the Appellant by including in his income an additional $298,792.17 for the 1993 taxation year and an additional $300,000 for the 1994 taxation year.
>
> 7. The Minister based the income inclusions upon an estimated appreciation of the following assets (the "Assets"):
>
> (a) property at 259 Sung Chiang Road
> (b) property at 167 Min Sheng Road
> (c) shares of Chien Ming Hsen Yeh Co. Ltd.
> (d) shares of Hotel New Asia Co. Ltd.
> (e) shares of Chang June College
> (f) shares of San Ho Security Co. Ltd.
> (g) shares of China Gypsum Co. Ltd.
>
> 10. In determining the additional amounts that were included in the Appellant's income for the 1993 and 1994 taxation years by the reassessments, the Minister relied upon estimates of the Appellant's net worth (the "Net Worth Statements").
>
> 11. The Net Worth Statements assumed the Appellant's business assets increased in value an average of 10% per annum from 1991 to 1994.

[9] The respondent Minister, in his reply filed in the Tax Court of Canada, admitted those paragraphs of the notice of appeal and made the following further statements in paragraph 5:

> 5. In so reassessing the Appellant, the Minister relied on, *inter alia*, the following assumptions:
>
> a) in reporting income for the 1993, 1994 taxation years the Appellant did not include all of the income received in these years;
>
> b) the incomes of the Appellant during the 1993, 1994 taxation years were understated by the amounts of $298,792.17 and $300,000 respectively;

[...]

k) the understated amounts were determined by the net worth method (a copy of the Net Worth Statement is attached as Schedule "A");

[...]

r) the Appellant did not dispose of his assets in Taiwan between when he submitted his "Personal Worth Statement" on March 4, 1991 and the end of the 1994 taxation year;"

[...]

[10] As paragraph 5k) of the reply shows, the Minister indicated that the understated amounts were determined by the net worth method. Attached was a schedule "A" net worth statement, which contained the assets and liabilities of the appellant in column form. The method of determination was as follows: In schedule I of the net worth statement, the auditor took the total of the assets and business assets of the appellant and calculated the appellant's total personal assets. Next to two business immovables of the appellant, one could read "assumption of 10% increase on of capital". Next to the shares/stocks/bonds were the figures "10%". In schedule II of the net worth statement, the auditor calculated the total of the business and personal liabilities of the appellant and then deducted this amount from the amount of the total personal assets to determine the increase in net worth. In schedule III of the net worth statement, the auditor added in the amounts of personal expenditures calculated in schedule IV of the net worth statement and calculated the "income per adjusted net worth" which was rounded down to $300,000 per year (Appeal Book at 34-37):

[11] At trial, the appellant read into evidence various portions of the examination for discovery of the auditor, Walter Ko. In his examination, the auditor explained that he followed "a very rough net worth" method. He set out his method as follows (Proceedings, Appeal Book at 55-58):

> Q What approach did you take?
>
> A The approach I took first was his capital and I took 10 per cent of return on capital, okay?
>
> Q Okay.
>
> A All right. And then to verify this figure it was just – the net worth was prepared after I did this one, okay?
>
> Q Sorry. I don't quite understand what you're talking about.
>
> A Okay. The proposal letter is based on his personal net worth of $3 million and return of capital of 10 per cent. That's how I came up with $300,000 for each year. And that rough – that personal net worth of $3 million is based on his immigration paper, roughly $2.8 million or something like that, okay, in 1991. And I'm looking at '93, '94 so I figure his net worth must have gone up two, three million dollars. So these figures were arrived at first, okay?
>
> [...]
>
> Q So in 1993 you estimated his personal net worth at $3 million; estimated return on capital of 10 per cent equals $300,000?
>
> A That's right.
>
> Q And then you deducted the reported interest income?
>
> A That's right.

Q To come up with the difference of $298,792.17?

A That's right.

Q And then 1994, estimated return on capital, $300,000?

A That's right.

Q Less reported of nil, adjustment is $300,000?

A That's right. That was the proposal letter I sent out to him and that's the amount of the reassessments. Now, that schedule in the back is basically the Net Worth Schedule that I prepared that I indicated to you was very rough in the sense that I cannot prepare it based on this method here because I do not have – he did not provide me with any information as to his net worth in '93 or '94.

Q So you --

A Or '92.

Q So you're saying that you could not prepare it based on this TOM 1420 Net Worth Reassessments?

A That's right. That's right.

Q Okay. Because in order to do this presumably you need an opening net worth and a closing net worth; is that right?

A We don't have closing net worths.

Q You had opening. You didn't have closing?

A That's right.

Q Okay.

A And as indicated on the net worth statement I prepared, it's an assumption, okay, based on an increase of 10 per cent of the capital each year. So if you look at the net worth statement asset, the asset has just gone up by 10 per cent each year. That's all it was.

[12] He later explained how he chose the increased figure of 10% (Proceedings, Appeal Book at 60):

A [...] The prime rate at that time was about 8 per cent or something like that here in Vancouver.

Q Yes.

A Yeah, '91, '92, '93, '94 around 10 per cent, so prime plus two.

Q And you thought that was his return, prime plus two?

A Well, the mortgage rate was about that amount, too, so 10 per cent was not unreasonable.

Q What sort of return is subsumed within this figure? You state that it's a return on capital at 10 per cent?

A That's right.

Q What type of return?

A Well, for the stocks and bonds that he has there will be dividends, interest.

Q Yes.

A Passive income anyway.

Q Property income?

A Property income.

Q Okay. And on the real estate?

A Rental income.

[13] The auditor summed up, at the end of his testimony, the process he followed (Proceedings, Appeal Book at 63):

Q Did you have any evidence to support these values that you've used in your rough net worth statement?

A The opening figure, yes.

Q You had the opening figure?

A That's right.

Q Did you have anything else?

A No.

The Judgment Below

[14] The Tax Court judge held that the Minister had adopted a variation of the net worth method of assessment (see paragraph 34 of his reasons for judgment). He noted that the appellant had done

nothing to ensure a full, complete and correct audit, despite the auditors repeated requests for information. Accordingly, the Tax Court judge concluded that the auditor's methodology was reasonable and logical in the circumstances.

[15] Since the appellant failed to adduce any evidence contradicting the Minister's assumptions, the Tax Court judge found that he had been in receipt of undeclared income and upheld the reassessments.

The Appellant's Submission

[16] The appellant submits that the Minister's pleadings did not properly disclose the essential facts underlying the reassessments. In the absence of any documentary evidence that the appellant had received any income from the assets, such as through an examination of the appellant, bank records, the pleadings, he says, are central in determining who bears the burden of proof.

[17] The Minister's reply claimed that "the understated amounts were determined by the net worth method". The methodology of a net worth assessment was summarized as follows by Bowman J.T.C.C. in *Bigayan v. The Queen* ((1999), 2000 D.T.C. 1619 at 1619 (T.C.C.)):

> ... [The net worth method of assessment] is based on an assumption that if one subtracts a taxpayer's net worth at the beginning of a year from that at the end, adds the taxpayer's expenditures in the year, deletes non-taxable receipts and accretions to value of existing assets, the net result, less any amount declared by the taxpayer, must be attributable to unreported income earned in the year, unless the taxpayer can demonstrate otherwise.

[18] According to the appellant, the Minister did not follow this approach. Instead, the Minister actually assumed that the appellant received annual property income in the form of rents, dividends and interest in the amount of 10% of the assumed value of his assets. If the Minister intended to rely on this kind of "property income method" of assessment, then, the appellant argues, he must set out expressly the underlying facts in his pleadings as in *Youngman v. The Queen* ((1990), 90 D.T.C. 6322 at 6323-24 (F.C.A.)). Since the property income method was not properly pleaded in this case as a fact, the Minister could not rely on the benefit of the reverse onus ordinarily associated with his assumptions (*Hillsdale Shopping Centre Ltd. v. M.N.R.* (1981), 81 D.T.C. 5261 at 5266 (F.C.A.)). Accordingly, the appellant submits that the Minister failed to plead an assumption key to the validity of his reassessments and he now bears the burden of proving facts which would support his position. (*Pollock v. The Queen* (1994), 94 D.T.C. 6050 at 6053 (F.C.A.); *The Queen v. Bowens* (1996), 96 D.T.C. 6128 at 6129 (F.C.A.)).

[19] The appellant adds that, even if accepted, the pleaded assumptions do not support the Minister's reassessments. The key assumptions of facts pleaded by the Minister (though, he says, not assumed in making the reassessments) were:

> (a) the assets held by the appellant in 1991 appreciated in value by 10% annually;
>
> (b) the appellant did not dispose of any of these assets during the period in question; and

(c) the Minister utilized the net worth method in determining the appellant's income fo 1993 and 1994.

[20] The appellant submits that these assumptions, even if true, do not support the Minister's reassessments because the appreciation of an asset, without disposition, does not give rise to a taxable event. Accordingly, the appellant submits that he has demolished the legal basis of the Minister's reassessments without the need to call evidence.

Analysis

[21] The appellant's principal argument rests on the presumption that the Minister did not rely on a net worth method of assessment. In my view, there is no merit to this position.

[22] Subsection 152(7) of the Act empowers the Minister to issue "arbitrary" assessments using any method that is appropriate in the circumstances. That subsection reads thus:

152(7) Assessment not dependent on return or information. The Minister is not bound by a return or information supplied by or on behalf of a taxpayer and, in making an assessment, may, notwithstanding a return or information so supplied or if no return has been filed, assess the tax payable under this Part.

152(7) Cotisation indépendante de la déclaration ou des renseignements fournis. Le ministre n'est pas lié par les déclarations ou renseignements fournis par un contribuable ou de sa part et, lors de l'établissement d'une cotisation, il peut, indépendamment de la déclaration ou des renseignements ainsi fournis ou de l'absence de déclaration, fixer l'impôt à payer en vertu de la présente partie.

Subsection 152(8) grants a presumption of validity to these assessments and places the initial onus upon the taxpayer to disprove the state of affairs assumed by the Minister (*Dezura v. M.N.R.* (1947), 3 D.T.C. 1101 at 1102 (Ex. Ct.)). Notwithstanding the fact that such an assessment is "arbitrary",

the Minister is obliged to disclose the precise basis upon which it has been formulated (*Johnston v. M.N.R.* (1948), 3 D.T.C. 1182 at 1183 (S.C.C.)). Otherwise, the taxpayer would be unable to discharge his or her initial onus of demolishing the "exact assumptions made by the Minister but no more" (*Hickman Motors Ltd. v. The Queen* (1997), 97 D.T.C. 5363 at 5376 (S.C.C.)).

[23] Subsection 152(7) of the Act does not establish a specific method for determining the tax payable by a taxpayer. In most cases, the Minister follows the "net worth method". The Taxpayers Operations Manual prepared by National Revenue describes the net worth method as follows:

> The use of a net worth approach to major income is based on the premise that a client's income for a period is the increase in the client's net worth (financial position) between the beginning and end of a particular period. A client's net worth is the excess of his total assets, business and personal, over his total liabilities, business and personal, at a specific date.

[24] Simply put, the amount by which the taxpayer's net worth increases over a particular period is imputed to the taxpayer as income.

[25] In his examination for discovery, the auditor admitted that he did not apply the precise methodology set out in the Taxpayers Operations Manual. He explained that an ordinary net worth assessment was impossible because the appellant refused to disclose any information regarding his actual net worth in 1993 and 1994. Consequently, he did not have a closing balance to use as a benchmark for ascertaining any increase in the appellant's worth during the periods in question.

[26] In order to resolve this problem, the auditor assumed that the appellant's 1991 net worth had increased at a rate of 10% annually. He explained that he arrived at this rate of return by adding 2 % to the then prime mortgage rate of 8%. He then applied this rate of return to the assets of the appellant (which were real estate, stocks and bonds), solely as a basis for estimating the appellant's net worth for 1993 and 1994.

[27] Using these estimates, the Minister established a closing balance for determining the probable appreciation of the appellant's net worth during the relevant years. He then assumed that this increase reflected the appellant's income for those years, as he would in an ordinary net worth assessment.

[28] The Minister never actually assumed that the appellant received property income in the form of rents, dividends or interests. Although the Tax Court judge made reference to an "estimated generated income stream" (see paragraph 41 of his reasons for judgment), his reasons clearly indicate that he viewed the auditor's arbitrary approach as being a variation of the net worth assessment.

[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.)).

[30] 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.

[31] Despite his contention that the Minister's pleadings were inadequate, the appellant was not deceived concerning the case against him. In the auditor's October 4, 1996, proposal letter, the basis of the proposed reassessments was communicated to the appellant. Any confusion arising from the methodology set out in that letter was clarified by Schedule "A" of the Minister's reply. In the light of these documents, the appellant cannot now be heard to say that the Minister determined the amount of the tax without giving him a fair opportunity of meeting the case against him.

[32] The Tax Court judge did not err in concluding that the Minister's approach was a variation of a net worth assessment. The Minister's modification did not fundamentally change the nature of the assessment. The Minister was entitled to make a rough estimate of net worth based on an estimated annual appreciation. I do not, therefore, accept the appellant's characterization that the Minister relied on an unpleaded "property income" method. Consequently, the Tax Court judge, in my view, correctly concluded that the burden of disproving the reassessments lay squarely upon the appellant.

[33] I would add that it was open to the Tax Court judge to conclude that the Minister's method for determining the appellant's income was reasonable and logical in the circumstances of this case. Although the Minister's reassessments were clearly arbitrary, it cannot be forgotten that this approach was the direct result of the appellant's refusal to disclose any financial information or documentation. In *Dezura, supra* at 1103-1104, the President of the Exchequer Court of Canada explained:

> The object of an assessment is the ascertainment of the amount of the taxpayer's taxable income and the fixation of his liability in accordance with the provisions of the Act. If the taxpayer makes no return or gives incorrect information either in his return or otherwise he can have no just cause for complaint on the ground that the Minister has determined the amount of tax he ought to pay provided he has a right of appeal therefrom and is given an opportunity of showing that the amount determined by the Minister is incorrect in fact. Nor need the taxpayer who has made a true return have any fear of the Minister's power if he has a right of appeal. The interests of the revenue are thus protected with the rights of the taxpayers being fully maintained. Ordinarily, the taxpayer knows better than any one else the amount of his taxable income and should be able to prove it to the satisfaction of the Court. If he does so and it is less than the amount determined by the Minister, then such amount must be reduced in accordance with the finding of the Court. If, on the other hand, he fails to show that the amount determined by the Minister is erroneous, he cannot justly complain if the amount stands. If his failure to satisfy the Court is due to his own fault or neglect such as his failure to keep proper account or records with which to support his own statements, he has no one to blame but himself.

[34] As the Tax Court judge observed, the appellant has done nothing to ensure a full, complete and correct audit. The appellant has consistently failed to provide any evidence which would prove his actual income during the period in question. Accordingly, he cannot complain that the Minister has proceeded on the basis of speculative assumptions.

[35] Given that the burden of disproving the reassessments lay squarely with the appellant, it is necessary to consider whether the appellant successfully discharged that onus. In *M.N.R. v. Pillsbury Holdings Ltd.* ((1964), 64 D.T.C. 5184 at 5188 (Ex.Ct.)), the Court explained that an appellant can satisfy this burden in three ways:

> (a) challenging the Minister's allegation that he did assume those facts;
>
> (b) assuming the onus of showing that one or more of the assumptions were wrong; and
>
> (c) contending that, even if the assumptions were justified, they do not of themselves support the assessment.

[36] The appellant did not attempt to demonstrate that the Minister's assumptions were wrong in fact. Further, for the reasons set out above, I have rejected the appellant's contention that the Minister proceeded other than by way of a net worth assessment. Therefore, the only issue is whether the assumptions, as pleaded, operate to support the Minister's reassessments.

[37] The appellant argues that the Minister's assumptions do not support the Minister's reassessments because the appreciation of an asset, without disposition does not give rise to a taxable event. In my view, this argument cannot succeed. As I noted above, the net worth approach is based on the assumption that an increase in the taxpayer's net worth over any period can be attributed as his or her income for that period. The onus is on the taxpayer to demonstrate that the increase resulted from a non-taxable source. The appellant's position would unacceptably reverse this onus by requiring the Minister to show that the increase in wealth gave rise to a taxable event.

Disposition

[38] For these reasons, I would dismiss this appeal with costs.

"Alice Desjardins"

J.A.

"I agree
Julius A. Isaac J.A."

"I agree
B. Malone J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-390-00
STYLE OF CAUSE:	GEORGE R.H. HSU Appellant - and - HER MAJESTY THE QUEEN Respondent
PLACE OF HEARING:	Vancouver, British Columbia
DATE OF HEARING:	May 11, 2001
REASONS FOR JUDGMENT BY:	Desjardins, J.A.
CONCURRED IN BY:	Isaac, J.A. Malone, J.A.
DATED:	July 24, 2001

APPEARANCES:

Mr. David Davies	FOR THE APPELLANT
Ms. Patricia Babcock	FOR THE RESPONDENT

SOLICITORS OF RECORD:

Thorsteinssons Vancouver, British Columbia	FOR THE APPELLANT
Morris A. Rosenberg Deputy Attorney General of Canada	FOR THE RESPONDENT