

Docket: 2003-607(IT)G

BETWEEN:

PHILIPPE ROULEAU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

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Appeal heard on March 29, 2005 at Sherbrooke, Quebec  
Before: The Honourable Judge Paul Bédard

Appearances:

Counsel for the Appellant: Richard Généreux

Counsel for the Respondent: Anne-Marie Boutin

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### **JUDGMENT**

The appeal from the reassessments made pursuant to the *Income Tax Act* for the 1997, 1998 and 1999 taxation years is allowed, without costs, and the reassessments are referred back to the Minister of National Income for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 18th day of October 2002.

"Paul Bédard"

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Bédard J.

Translation certified true  
on this 21st day of December 2005.  
Carol Edgar, Translator

Citation: 2003TCC234  
Date: 20051024  
Docket: 2003-607(IT)G

BETWEEN:

PHILIPPE ROULEAU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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### **REASONS FOR JUDGMENT**

#### **Bédard J.**

[1] The appellant has contested the assessments made by the Minister of National Income ("the Minister"), using the net worth method, for the 1997 through 1999 taxation years ("the relevant period"). In the appellant's income, the Minister included undeclared income in the amounts of \$13,206 for 1997, \$25,823 for 1998 and \$31,487 for 1999. Although one of those assessments was made after the normal reassessment period had expired, at the beginning of the hearing counsel for the appellant indicated that he would not contest the justification for that reassessment by citing this fact. Also at the beginning of the hearing, counsel for the appellant acknowledged that the Court would be justified in imposing penalties on the appellant for the 1997, 1998 and 1999 taxation years pursuant to subsection 163(2) of the *Income Tax Act*, with regard to any undeclared income to be determined by the Court in the present judgment.

[2] The appellant has argued that the Minister made errors in computing his income using the net worth method. In fact, the main issue is the appellant's living expenses. In order to facilitate understanding of the points at issue, I reproduce here Appendix I to the Reply to the Notice of Appeal, which is a summary of the calculations made by the Minister in computing the amounts of business income undeclared by the appellant; and Appendix A to the Notice of Appeal, which is a summary of the calculations made by the appellant in computing the amounts of his undeclared business income.

## Reply to the Notice of Appeal:

## APPENDIX 1

INDIVIDUAL BALANCE SHEET

Philippe Rouleau

S.I.N.:

	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
<b><u>ASSETS</u></b>					
Cash on hand, Scotiabank	\$26.32	\$2.28	\$7.26	\$35.21	\$63.20
Fixed assets					
Motorcycle	3,000.00	-	-	18,000.00	18,000.00
Snowmobile	-	-	6,800.00	6,800.00	8,000.00
Investment					
Entreprise P. R. enr.	34,596.00	33,633.00	23,418.00	23,971.00	45,940.27
TOTAL ASSETS	<u>\$37,622.32</u>	<u>\$33,635.28</u>	<u>\$30,225.26</u>	<u>\$48,806.21</u>	<u>\$72,003.47</u>
<b><u>LIABILITIES</u></b>					
TOTAL LIABILITIES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
EQUITY AS AT DECEMBER 31	<u>37,622.32</u>	<u>33,635.28</u>	<u>30,225.26</u>	<u>48,806.21</u>	<u>72,003.47</u>
	<u>37,622.32</u>	<u>33,635.28</u>	<u>30,225.26</u>	<u>48,806.21</u>	<u>72,003.47</u>
EQUITY INCREASE (DECREASE)		<u>(\$3,987.04)</u>	<u>(\$3,410.02)</u>	<u>\$18,580.95</u>	<u>\$23,197.26</u>

**SUMMARY OF ADJUSTMENTS**

Philippe Rouleau

S.I.N.:

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Equity at end	\$33,635.28	\$30,225.26	\$48,806.21	\$72,003.47
Equity at start	37,622.32	33,635.28	30,225.26	48,806.21
	<hr/>	<hr/>	<hr/>	<hr/>
Equity change	(\$3,987.04)	(\$3,410.02)	\$18,580.95	\$23,197.26
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
<b>ADJUSTMENTS</b>				
<b>Additions</b>				
Personal expenses, exchange of service, individual portion (house, \$300/month)	\$3,600.00	\$3,600.00	\$3,600.00	\$3,600.00
Individual expenses paid by Tourbe P. R.	2,166.45	2,138.84	2,622.48	4,116.29
Business withdrawals	9,749.00	17,193.00	18,610.71	22,201.00
Untraced deposits	1,500.00	-	-	5,000.00
Untraced deposits (social assistance)	2,435.00	-	-	-
Loss on disposition of property for individual use, inadmissible pursuant to paragraph 40(2)(g)(iii)	1,500.00	-	-	1,800.00
Federal and provincial income tax paid	-	700.00	1,080.445	4,597.18
	<hr/>	<hr/>	<hr/>	<hr/>
Total additions	\$20,950.45	\$23,631.84	\$25,913.64	\$41,314.47
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## Notice of Appeal:

## INDIVIDUAL BALANCE SHEET

	1995	1996	1997	1998	1999
<b>ASSETS</b>					
Short-term assets					
Cash on hand	\$23.62	\$2.28	\$7.26	\$35.21	\$63.20
Cash on hand	\$0.00	\$5,276.32	\$9,000.00	\$3,000.00	\$0.00
	\$23.63	\$5,278.60	\$9,007.26	\$3,035.21	\$63.20
Fixed assets					
Motorcycle	\$3,000.00	\$0.00	\$0.00	\$14,400.00	\$14,400.00
Snowmobile	\$0.00	\$0.00	\$6,800.00	\$6,800.00	\$8,000.00
	\$3,000.00	\$0.00	\$6,800.00	\$21,200.00	\$22,400.00
Investment					
Entreprise P. R. enr.	\$34,595.57	\$33,633.00	\$23,418.00	\$23,971.00	\$45,940.27
Total assets	\$37,619.19	\$38,911.60	\$39,225.26	\$48,206.21	\$68,403.47
<b>LIABILITIES</b>					
Total liabilities	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Equity as at December 31	\$37,619.19	\$38,911.60	\$39,225.26	\$48,206.21	\$68,403.42
Equity increase (decrease)	\$0.00	\$1,292.41	\$313.66	\$8,980.95	\$20,197.21

## EQUITY RECONCILIATION FOR THE PERIOD FROM JANUARY 1, 1966 TO DECEMBER 31, 1999

	1996	1997	1998	1999
Equity at end	\$38,911.60	\$39,225.26	\$48,206.21	\$68,403.42
Equity at start	\$37,619.19	\$38,911.60	\$39,225.26	\$48,206.21
Equity change	\$1,292.41	\$313.60	\$8,980.95	\$20,197.21
<b>ADJUSTMENTS</b>				
Deductions				
Goods and Services Tax (GST) rebate	\$251.50	\$304.00	\$254.06	\$178.06
Non-taxable capital gain	\$0.00	\$0.00	\$43.00	\$250.00
Total deductions	\$251.50	\$304.00	\$297.06	\$428.00
Additions				
Individual expenses paid by the business	\$1,248.32	\$2,138.84	\$2,622.48	\$4,116.29
Individual expenses	\$12,357.68	\$11,848.16	\$14,374.52	\$13,335.71
Income tax paid	\$0.00	\$700.00	\$1,080.45	\$4,597.18
Loss on disposal of property for individual use	\$1,500.00	\$0.00	\$0.00	\$1,800.00
Total additions	\$15,106.00	\$14,687.00	\$18,077.45	\$23,849.18
Total available income	\$16,146.91	\$14,696.60	\$26,761.34	\$43,618.39
Total declared income	\$16,146.91	\$6,712.00	\$18,375.00	\$32,097.00
Net additional income	\$0.00	\$7,984.60	\$8,386.34	\$11,521.39

## Background

[3] During the relevant period, the appellant was the sole owner of a business operating under the name of "Tourbe P. R. enr." ("the business"). The business's activities were laying sod during the summer and plowing snow during the winter.

[4] Ms. Nathalie Gu erin testified that, following her audit of the business for the 1996 taxation year, she had decided to use the net worth method in computing the amounts of the appellant's income during the relevant period. She stated that the business and the appellant had used a single bank account during the 1996 taxation year and throughout the relevant period. She explained that the business's internal controls and cash management were sorely deficient. For example, in 1996 the business had used three different series of numbers on its invoices; one series of numbers was pre-printed, and all three series of numbers were incomplete. She had noted, she added, that in the same taxation year some of the business's sales invoices had been paid in cash and that the appellant had not deposited the cash (amounting to \$16,000) in the bank account.

## Preliminary comments

[5] It should be noted that the appellant was not present at the hearing, apparently because of illness. Only Ms. Gu erin, an auditor for the Canada Customs and Revenue Agency ("the CCRA"), and Mr. Fran ois Bergeron, an appeals officer for the CCRA, testified.

## Analysis

[6] The net worth method consists of valuing the increase in a taxpayer's equity (assets minus liabilities) during a relevant period, and adding to this figure the taxpayer's living expenses. From the resulting amount are subtracted various amounts not subject to income tax such as donations, inheritances, lottery winnings, the non-taxable portion of realized capital gains, and any income already declared. The balance represents additional income, which is arbitrarily assessed. Thus the net worth method is used to compute the change in net worth between the start and the end of a given taxation year.

[7] We must first address the issue of the burden of proof that rests on the appellant. My colleague Tardif J. had occasion to address this issue in a case which, like the present case, had to do with net worth.

[8] In *Bastille v. Her Majesty the Queen*, (1999) 99 DTC 431, 4 C.T.C. 2155, Tardif J. writes as follows at paragraph 5 ff.:

[5] I think it is important to point out that the burden of proof rests on the appellants, except with respect to the question of the penalties, where the burden of proof is on the respondent.

[6] A NET WORTH. assessment can never reflect the kind of mathematical accuracy that is both desired and desirable in tax assessment matters. Generally, there is a certain degree of arbitrariness in the determination of the value of the various elements assessed. The Court must decide whether that arbitrariness is reasonable.

[7] Moreover, use of this method of assessment is not the rule. It is, in a way, an exception for situations where the taxpayer is not in possession of all the information, documents and vouchers needed in order to carry out an audit that would be more in accordance with good auditing practice, and most importantly, that would produce a more accurate result.

[8] The bases or foundations of the calculations done in a NET WORTH assessment depend largely on information provided by the taxpayer who is the subject of the audit.

[9] The quality, plausibility and reasonableness of that information therefore take on absolutely fundamental importance.

[9] Another of my colleagues, Bowman J. (as he then was), writes as follows in *Ramey v. The Queen*, [1993] T.C.J. No. 142 (Q.L.) ([1993] 2 C.T.C. 2119, 93 DTC 791), at paragraph 6:

I am not unappreciative of the enormous, indeed virtually insuperable, difficulties facing the appellant and his counsel in seeking to challenge net worth assessments of a deceased taxpayer. The net worth method of estimating income is an unsatisfactory and imprecise way of determining a taxpayer's income for the year. It is a blunt instrument of which the Minister must avail himself as a last resort. A net worth assessment involves a comparison of a taxpayer's net worth, i.e. the cost of his assets less his liabilities, at the beginning of a year, with his net worth at the end of the year. To the difference so determined there are added his expenses in the year. The resulting figure is assumed to be his income unless the taxpayer establishes the contrary. Such assessments may be inaccurate within a range of indeterminate

magnitude but unless they are shown to be wrong they stand. It is almost impossible to challenge such assessments piecemeal. The only truly effective way of disputing them is by means of a complete reconstruction of a taxpayer's income for a year. A taxpayer whose business records and method of reporting income are in such a state of disarray that a net worth assessment is required is frequently the author of his or her own misfortunes.

[10] On reading the appellant's individual balance sheets computed by the Minister and by the appellant for the 1996, 1997, 1998 and 1999 taxation years, I note that the only discrepancies between the two balance sheets have to do with the value of the motorcycle acquired in 1998 (\$18,000 as opposed to \$14,400), cash on hand at the end of the 1996 taxation year (\$0 as opposed to \$5,276.32), cash on hand at the end of the 1997 taxation year (\$0 as opposed to \$9,000) and cash on hand at the end of the 1998 taxation year (\$0 as opposed to \$3,000). The onus is on the appellant to establish, on a balance of probabilities, that the Minister erred on these points. Certainly failing to attend the hearing, to provide any testimony in this regard, or to adduce any objective credible evidence on these points does not allow the appellant to discharge the onus on him of establishing before me that the value of the motorcycle acquired in 1998, computed by the Minister at \$18,000, is erroneous. With regard to the appellant's cash on hand at the end of the relevant taxation years, I have no reason to question the testimony of Ms. Guérin, whom the appellant had apparently told at their first meeting that he had had no cash on hand at the end of any of the relevant taxation years. For these reasons, I find that the equity changes computed by the Minister in the summary of the Minister's calculations reproduced above are accurate.

[11] In fact, the main issue is the appellant's living expenses. According to the evidence, the Minister computed the appellant's living expenses by adding the first four items listed under "Adjustments", in the summary of the Minister's calculations reproduced above ("the Minister's adjustments"), entitled respectively "Personal expenses, exchange of service, individual portion (house, \$300/month)", (two items are not listed in the summary), and "Untraced deposits". The Minister also computed the appellant's living expenses at \$22,931 for the 1997 taxation year, \$24,832 for the 1998 taxation year, and \$34,917 for the 1999 taxation year. It should be noted that the appellant has not contested the fact that the first two items of the Minister's adjustments should be included in his living expenses. As well, Exhibit A-4, entitled "Calculation of Living Expenses" and prepared by the appellant as a calculation of his actual living expenses during the relevant period, clearly includes the first two items of the Minister's adjustments in the appellant's living expenses. Specifically at issue, then, are the third and fourth items listed in



the Minister's adjustments, entitled "Business withdrawals" and "Untraced deposits".

[12] The Minister has argued that the "Business withdrawals"—that is, the cash the appellant obtained during the relevant period by cashing cheques issued by him, payable to him, and drawn on the only bank account he had during that period—should be included in the appellant's living expenses since the appellant had been unable to provide credible explanations for the use of the cash obtained from these withdrawals. In this regard, Mr. Bergeron testified that he considered the following explanations by the appellant not very credible:

(i) that the cash obtained from eight withdrawals<sup>1</sup> (in amounts varying between \$350 and \$1,050) totalling \$5,400 had been used as partial payment for the "Harley" motorcycle acquired on August 18, 1998;

(ii) that the cash obtained from two withdrawals, each in the amount of \$3,000,<sup>2</sup> had been used as partial payment for the snowmobile acquired on January 29, 1999; and

(iii) that the cash obtained from eight withdrawals<sup>3</sup> (in amounts varying between \$300 and \$600) totalling \$3,450 had been used as partial payment for the snowmobile acquired on December 14, 1999.

[13] As well, Mr. Bergeron stated that the cash obtained from the "Untraced deposits" should also be included in the appellant's living expenses since the appellant had been unable to provide credible explanations for the use of the cash obtained from these "Untraced deposits". In this regard, Mr. Bergeron testified that he considered the following statements by the appellant not very credible: (i) that on November 4, 1999 he had received \$5,000 cash from the sale of the snowmobile acquired in 1997; (ii) that he had used part of the proceeds of the sale (\$450) for personal expenses; and (iii) that he had used the rest of the proceeds of the sale (\$4,550) as partial payment of the purchase price (\$8,000) of the snowmobile acquired on December 14, 1999.

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<sup>1</sup> Withdrawals made between July 2, 1998 and December 1, 1999.

<sup>2</sup> Withdrawals made on February 3 and 18, 1997.

<sup>3</sup> Withdrawals made between November 19, 1999 and December 14, 1999.

[14] On the other hand, counsel for the appellant has argued that the "Business withdrawals" and the "Untraced deposits" listed in the Minister's adjustments should be excluded in computing net worth since they may constitute overlap; in other words, he has claimed that, if the full amount of the cash obtained from these two sources is included in computing undeclared income using the net worth method, the risk of certain taxpayer assets being counted twice is too high. Essentially, he has argued that the method used by the Minister in the present case was unreasonable and illogical.

[15] As a general rule, I find it a dubious practice to include "Business withdrawals" and "Untraced deposits" in computing undeclared income using the net worth method: the risk of certain taxpayer assets being counted twice is indeed too high. Granted, the cash obtained from these sources can be used to cover a taxpayer's living expenses during a given period, but it can also be used for other purposes, particularly to finance the acquisition of assets during the same period.

[16] For these reasons, I consider that theoretically the Minister's adjustments concerned—here, "Business withdrawals" and "Untraced deposits"—should be excluded in computing net worth. In the present case, however, it appears difficult to arrive at this finding. In fact, cash can only be saved or spent. Did the appellant save money during the relevant period? The evidence has shown that the appellant had no liabilities and no cash on hand at the end of each of the 1996, 1997, 1998 and 1999 taxation years. Granted, the cash obtained from these two sources could also have been used to pay for the assets acquired by the appellant during the relevant period. However, the appellant himself told Ms. Guérin and Mr. Bergeron that only part of the cash obtained from these two sources, that is, \$6,000 in 1997, \$5,400 in 1998, and \$8,000 in 1999, had been used to finance the acquisition of assets acquired during the relevant period. In the present case, then, it appears difficult to find that the rest of the cash obtained from these two sources (that is, the cash that was not used to fund the acquisition of assets during the relevant period) could have been used for purposes other than the appellant's living expenses.

[17] For these reasons, I find that only the following amounts should be excluded from the appellant's additional income:

- (i) \$6,000 in 1997;
- (ii) \$5,400 in 1998;
- (iii) \$8,000 in 1999.

[18] The appeal is allowed to this extent only, without costs.

Signed at Ottawa, Canada, this 18th day of October 2002.

"Paul Bédard"

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Bédard J.

Translation certified true  
on this 21st day of December 2005.  
Carol Edgar, Translator

CITATION: 2005TTCC234

COURT FILE NO.: 2003-607(IT)G

STYLE OF CAUSE: Philippe Rouleau and Her Majesty the Queen

PLACE OF HEARING: Sherbrooke, Quebec

DATE OF HEARING: March 29, 2005

REASONS FOR JUDGMENT BY: The Honourable Judge Paul Bédard

DATE OF JUDGMENT: October 24, 2005

APPEARANCES:

    Counsel for the Appellant: Richard Généreux

    Counsel for the Respondent: Anne-Marie Boutin

COUNSEL OF RECORD:

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        Name: Richard Généreux

        Firm:

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