Docket: 2007-623(IT)G

BETWEEN:

ANWAR SARWARI,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on May 11 and 12, 2009, at Toronto, Ontario

Before: The Honourable Justice Wyman W. Webb

Appearances:

Counsel for the Appellant:	Osborne G. Barnwell
Counsel for the Respondent:	Brent E. Cuddy

JUDGMENT

The appeals from the reassessments made under the *Income Tax Act* (the "*Act*") for the Appellant's 2000, 2001 and 2002 taxation years are allowed, with costs, and:

(a) the reassessment of the Appellant's 2000 taxation year is vacated;

(b) with respect to the reassessment of the Appellant's 2001 taxation year, the penalty imposed pursuant to subsection 163(2) of the *Act* is deleted; and

(c) the reassessment of the Appellant's 2002 taxation year is vacated.

Signed at Halifax, Nova Scotia, this 6th day of July, 2009.

"Wyman W. Webb"

Webb J.

Citation: 2009TCC357
Date: 20090706
Docket: 2007-623(IT)G

BETWEEN:

ANWAR SARWARI,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Webb J.

[1] The Appellant was reassessed for 2000, 2001 and 2002 to include additional amounts in his income for each of these years based on a net worth analysis completed by the Canada Revenue Agency (the "CRA"). At the commencement of the hearing Counsel for the Respondent stated that the Respondent consented to the appeal related to the reassessment of the Appellant's 2002 taxation year being allowed. As a result the only two years in issue at the hearing were 2000 and 2001.

[2] The Appellant is a mechanic. He started his mechanic business as a sole proprietor and prior to the years under appeal he had transferred his business to Helmand Auto Inc. Although it is not entirely clear, it would appear that the Appellant is the sole shareholder of Helmand Auto Inc. It was, however, the Appellant's involvement with Helmand Auto Wreckers Ltd. that attracted the attention of the CRA. The Appellant and his two brothers each owned one-third of the shares of Helmand Auto Wreckers Ltd. In the Reply and during the course of the hearing, Helmand Auto Wreckers Ltd. was described as a "chop shop". In the Reply it is stated that the Appellant was convicted of dealing in stolen property in relation to this "chop shop" operation. It was the Appellant's criminal conviction that attracted the attention of the CRA and resulted in the decision to complete the net worth analysis to determine if the Appellant had any unreported income.

[3] Although the concern arose as a result of an illegal activity, the issue for the purposes of the *Income Tax Act* (the "*Act*") is whether the Appellant had any unreported income as would be determined for the purposes of that *Act*. Any net worth analysis must still be completed in a principled and rationale manner so that the result of the net worth analysis is still an estimate of the income of the Appellant as determined for the purposes of the *Act*. As the then Chief Justice Couture noted in *Shlien* v. *The Minister of National Revenue*, [1988] 1 C.T.C. 2244, 88 DTC 1152:

> 26 Admittedly the respondent is vested with wide powers under the Act but none that allows him to convert capital into income. **His right to determine a taxpayer's income for a taxation year on the basis of a net worth analysis cannot be denied, but the exercise of such a determination must be in compliance with the provisions of the Act and in accordance with the principles laid out in the jurisprudence.** To issue an assessment knowingly which does not meet this test amounts to abusing the application of the pronouncement of the Supreme Court of Canada referred to above that the onus of challenging the validity of an assessment rests with the appellant.
>
> (emphasis added)

[4] The summary of the net worth amounts for 2000 and 2001 as determined by the auditor and as set out in the Reply are as follows:

Description	2000	2001
Assets	$493,450.20	$510,960.67
Liabilities	$248,239.31	$239,794.55
Net Worth	$245,210.89	$271,166.12
Less: Net Worth of Prior Year	$97,475.96	$245.210.89
Increase (Decrease) in Net Worth	$147,734.93	$25,955.23
Adjustments		
Add: Personal Expenditures	$35,844.93	$44,034.56
Less: Income Tax Refund		$1,083.59
Less: Income Tax Refund – spouse	$1,125.53	$668.13
Less: GST Credit	$722.00	$986.00
Less: Child Tax Benefit	$5,751.50	$6,935.14
Total Deductions	$7,599.03	$9,672.86
Net Adjustments	$28,245.90	$34,361.70
Income per Net Worth	$175,980.83	$60,316.93
Less: Reported Income (Appellant)	$10,138.00	$14,248.00
Reported Income (Spouse)	$705.00	$7,509.00
Total Unreported Income	$165,137.83	$38,559.93

[5] The unreported income for 2000 was reduced by $1,537.21 following the filing of the Notice of Objection and therefore the amount of unreported income as determined by the Respondent for the purposes of this hearing for 2000 was $163,600.62. Penalties were also assessed pursuant to subsection 163(2) of the *Income Tax Act* in relation to amounts determined as unreported income for each of these years.

[6] The reassessments issued in relation to these two taxation years were issued after the expiration of the normal reassessment period. As a result the Respondent had the onus of establishing that the Appellant had made a misrepresentation that was attributable to neglect, carelessness or wilful default or had committed fraud in filing his tax return or in supplying information under the *Act* in relation to his 2000 and 2001 taxation years (*Mensah v. The Queen*, 2008 TCC 378, 2008 DTC 4358). The alleged misrepresentations were the understatement of his income based on the income as determined using the net worth analysis.

[7] A net worth analysis is used to attempt to determine if a person has unreported income based on that person's net worth (assets minus liabilities) at the end of a particular year compared with that person's net worth (assets minus liabilities) at the end of the immediately preceding year. The income as reported and the personal expenditures are also determined (or estimated) for the year in question. If the increase in net worth plus the amount of personal expenditures exceeds the reported income and non-taxable sources of cash (not including loans that would already be included in determining the net worth) the excess is considered to be unreported income, unless the taxpayer can demonstrate that it is not income.

[8] In *Ramey* v. *The Queen*, [1993] 2 C.T.C. 2119, 93 D.T.C. 791, Bowman, J. (as he then was) described a net worth assessment as follows:

> 6 … 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 expenditures 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.

[9] Bowman, J. (as he then was) also made the following comments on the net worth method of determining a taxpayer's income in *Bigayan* v. *The Queen*, [2000] 1 C.T.C. 2229, 2000 D.T.C. 1619:

> 2 The net worth method, as observed in Ramey v. R. (1993), 93 D.T.C. 791 (T.C.C.), is a last resort to be used when all else fails. Frequently it is used when a taxpayer has failed to file income tax returns or has kept no records. It is a blunt instrument, accurate within a range of indeterminate magnitude. It 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. It is at best an unsatisfactory method, arbitrary and inaccurate but sometimes it is the only means of approximating the income of a taxpayer.
>
> 3 The best method of challenging a net worth assessment is to put forth evidence of what the taxpayer's income actually is. A less satisfactory, but nonetheless acceptable method is described by Cameron J. in Chernenkoff v. Minister of National Revenue (1949), 4 D.T.C. 680 (Can. Ex. Ct.) at 683:
>
>> In the absence of records, the alternative course open to the appellant was to prove that even on a proper and complete "net worth" basis the assessments were wrong.
>
> 4 This method of challenging a net worth assessment is accepted, but even after the adjustments have been completed one is left with the uneasy feeling that the truth has not been fully uncovered. Tinkering with an inherently flawed and imperfect vehicle is not likely to perfect it.

[10] The auditor who prepared the net worth analysis testified during the hearing. She has been doing net worth statements since 1999. She stated that in doing a net worth analysis the historical cost of assets was used because the fair market value of assets is subjective. Her testimony included the following in relation to this:

> A. …I would look at the assets, in this case properties. They would all be recorded at historical costs, so whatever they were purchased at, they would be reported on the net worth at that cost all the way through. Because increases are subjective with regard to valuation, we use historical costs just for consistency purposes.

…

Q. With respect to the disposition of the principal residence, what would the impact be of the historical value that you discussed in terms of increase in the net worth or the profit element there?

A. We always use historical value or the cost value because the -- it is subjective, the increase is subjective, what people think they can get for their property if they were to put it up for sale. There is no set rules as to a property, say, in this neighbourhood is exactly and you are going to get exactly this dollar amount. To facilitate and make an ease of calculation, we always use cost. It doesn't -- then there is nothing subjective about it. It is the fixed asset at that cost. Even businesses use it. They don't take the appreciating value when they do it. It is at their fixed cost, as when they record it on their books. That is why we do it that way, so that there is consistency in the assets, so that there is no he said, she said; this house should be this price or should be this price. There is no conflict with the subjectivity on it. It is a fixed amount, and that is the way it is. It is what was paid for and that's it.

[11] The reason that assets are recorded at historical cost and not at fair market value in preparing a net worth analysis is not because valuation is subjective but because an appreciation in value of a particular asset, without a disposition (or a deemed disposition of that asset), is not taxable. For example, assume that a particular person owns shares that were purchased for $10,000. If, at the end of the first year following the base year the person still owns the same shares and the shares have a fair market value of $15,000, if the shares are recorded in the net worth analysis at $15,000 at the end of the first year, the increase of $5,000 in net worth would be added to the person’s income. This would not be the correct result as the $5,000 increase in value would not be taxable unless there was a disposition (or a deemed disposition) of the shares during the year.

[12] During 2000 the Appellant’s spouse sold their principal residence. The gain realized on the disposition of the principal residence was not taken into account in the net worth analysis. The explanation of the auditor was as follows:

Q. The Sheppard Avenue property was the principal residence of the appellant and his family?

A. Yes, it was.

Q. Am I correct that generally speaking, gain from the sale of the principal residence is not going to be taxable?

A. It's not taxable.

Q. Is that reflected in the net worth?

A. It would be reflected in the net worth in the fact that they had would have used any profits that they had made on this house after paying off a mortgage to purchase a larger home. The mortgage, they purchased a house for $321,000. At an income level of $10,000. They purchased at $321,000. The money that they would have got from the purchase of the sale, of the 4727 would have been used toward the down payment and then the mortgage itself is actually the difference between the 321 and I believe the 240, which was the principal amount of the mortgage. So that would have been used towards the down payment. Again, principal residences are always recorded at historical cost. Mortgages are always reported at actual book, year-end values, outstanding. So the profit was already built in to the purchase of the new residence, any profit they would have made they used to purchase a bigger house. At a higher price.

Q. Would that have impacted their net worth?

A. It affects their net worth because they have purchased a more expensive asset.

[13] The auditor was aware that the principal residence had been sold but did not deduct any gain realized on the sale of the principal residence in determining the unreported income as determined by the net worth analysis. She also stated as follows:

Q. Did you determine in this case as to whether this taxpayer made any profits on the sale of this house?

A. He didn't supply any information. I didn't have these documents. These are in your books of documents. I never received these documents.

Q. If he had a profit, would it matter to you?

A. No, I wouldn't have mattered, because that would be just in a source, an application of funds to see whether there was anything. It is a totally different entity from a net worth.

[14] Assume that a person acquired a principal residence for $100,000 and this asset was held at the end of the base year. If the property is sold for $225,000 (after expenses) and a new principal residence is purchased for $225,000, it would appear that the auditor would include $125,000 in the person’s income for the year in which the new property is acquired (since the new house would be listed at its cost of $225,000 in the net worth analysis). This is obviously not the correct result. The gain realized on the sale of the principal residence would not be taxable (assuming that the property was the person’s principal residence for each year that such person owned

the property and the person had no other principal residence during that time). If the non-taxable gain realized as a result of the sale of a principal residence is not deducted in determining the unreported income in preparing the net worth analysis, individuals would be taxable on the gain realized on a sale of their principal residences that otherwise would not be taxable.

[15] The Appellant's principal residence was included as an asset as of the end of 1999 (the base year) at a cost of $137,000. The property was sold in 2000 for $161,000. The real estate commission payable in relation to the sale of this property (including GST) was $6,460.13. This property was owned by the Appellant's wife (Fatemeh Hajibaba). Included with the Appellant's documents (which were submitted as an Exhibit with the consent of the Respondent) is a direction signed by Fatemeh Hajibaba related to the distribution of the proceeds arising from the sale of this property. This direction includes the following:

Jaikrishin Ambwani in trust	$2,837.63
Schwartz & Schwartz in trust	$1,142.00
Durno, Shea & McMurter in trust	$47,894.77

[16] This direction is dated October 16, 2000 which is the same date as the Statement of Adjustments for the purchase of their new home at 53 Sayor Drive in Ajax, Ontario. It therefore seems that of the amount received from the sale of the property located at 4727 Sheppard Avenue East (the former principal residence), $47,894.77 was available to be applied towards the purchase price of the new property. It would also appear that the other amounts of $2,837.63 and $1,142.00 must have been amounts paid for other expenses or costs related to the sale of the Sheppard Avenue property. Since the deposit of $5,000 held by the real estate company was less than the commission payable, presumably a portion of the amount paid to Jaikrishin Ambwani (who was the lawyer acting for Fatemeh Hajibaba on the sale of the Sheppard Avenue property) was to pay the balance of the real estate commission ($6,460.13 - $5,000 = $1,460.13).

[17] Although it is not entirely clear, the following appears to be an estimate of the gain realized by Fatemeh Hajibaba on the sale of the Sheppard Avenue property:

Sale Price:	$161,000
Cost:	$137,000

Sale Price less cost:	$24,000
Real estate commission:	$6,460
Legal fees ($2,838 - $1,460)	$1,378
Schwartz & Schwartz	$1,142
Estimate of gain:	$15,020

[18] Since the property was recorded in the base year at its cost of $137,000, this additional amount of $15,020 (which would have increased the net worth of the Appellant) should have been deducted in determining the unreported income as this increase was attributable to a non-taxable source – the gain realized on the sale of a principal residence. There was no dispute that this property was their principal residence for all of the years that this property was owned by them and there was no evidence that they had any other residence during those years.

[19] Another serious concern related to the auditor's testimony related to the liability of the Appellant in the base year. The liability of the Appellant in relation to the mortgage on the principal residence property in the base year was overstated by more than $100,000. This mortgage was paid off in 2000 when the Sheppard Avenue property was sold and the auditor insisted more than once during her testimony that the overstatement of this liability was in the Appellant's favour. She became aware at the time of discovery examinations that the mortgage amount had been overstated but still insisted at the hearing that this benefited the Appellant. She stated that:

> A. This is a document that was brought to my attention showing that the -- as of October 16th, 2000, the actual balance of the mortgage was $104,605, which was subject to be paid out at the close of the sale.
>
> Q. This document at tab 9, does it relate to the $220,000 mortgage that you saw?
>
> A. It is my understanding that this is the actual mortgage that was on the property at 4727 Sheppard Avenue, not the actual $220,000 document that was registered with land registry. That, in effect, then, would have reduced their liabilities. In this case it would have been $113,000, approximately $113,000, which would then have increased their net worth by the actual amount of the difference if an amortization schedule had been run, the variance, of course,

would be different in 1998 and 1999 because it would have decreased, but the value, the amount of the -- the actual mortgages that are recorded on the net worth are actually in favour of the taxpayer. He is actually getting more of a liability that is reducing his net worth than the actual amount that should have been on there based on this document at tab 9.

…

Q. With respect to the benefit that you were indicating with respect to the higher liability on the mortgage of -- that was attributed to 4727 Sheppard, how does it benefit the taxpayer if the mortgage is higher there than it actually turned out to be?

A. Without working through every column, what it would do in the first year for 1998, say the -- I don't know the exact figure, say it is 107,000 in -- for illustration's sake, in '98. That would reduce that by $110,000. So the actual liabilities would be reduced by $110,000. The net worth would increase by $110,000, which would then be 213,511. When you go to, again, and just say this was reduced, this was 107, so then reduce that down to say 110, or 100 -- using figures, it is kind of hard to say, to do -- to reduce that by another -- the difference in this case is $7,000, plus the 100. So you would have to reduce it. But it goes all the way through. The net worth, where it says 113, that would be 213; it goes down to the bottom. Your liability is then reduced by, say, $100,000, which would bring the net worth to say 197,475. And then you are subtracting 223 -- 213. It actually is a flow.

It flows from one down to the other on a diagonal, and you are taking your assets minus your liabilities. It only -- it affects the first two years but then the -- it doesn't affect -- the effect would be that this 97,000 would be coming down and be subtracting from the net worth in the subsequent years. So then if this was 197, this would be reduced by say 100,000, which would be 47. It flows. It appears to flow all the way through.

However, when you get to 2001, the 245 is the same figure that would be taken through to the subsequent year and then the 271, it affects the '99 and 2000 year. It starts from the base year and works its way through to 2000 only, and it doesn't affect 2001 and 2002.

[20] In the net worth analysis the amount shown as the mortgage on the Sheppard Avenue property was $210,766 as of the end of 1999. In the mortgage statement issued by the Royal Bank for the period from January 1, 2000 to October 17, 2000 for the Sheppard Avenue property, the opening principal balance of the mortgage is stated to be $107,090. This would presumably also be the balance outstanding as of December 31, 1999. As a result the mortgage is overstated by $210,766 - $107,090 = $103,676. Based on the assumption that the mortgage amount

was $210,766, the auditor had determined that the Appellant had unreported income of $165,138 in 2000 (which was reduced by CRA following the filing of the Notice of Objection to $163,601). There was no dispute that the amount of the mortgage on the Sayor Drive property was correctly stated as $239,912.42 as of the end of 2000. The following illustrates the net affect of correcting the mortgage payable on the Sheppard Avenue property as of the end of 1999:

Description	1999	2000
Assets	$313,750.41	$493,450.20
Liabilities		
Credit Card:	$5,508.42	$8,326.89
Mortgage payable: 53 Sayor		$239,912.42
Mortgage payable: 4727 Sheppard	$107,090.14	
Total liabilities:	$112,598.56	$248,239.31
Net Worth	$201,151.85	$245,210.89
Less: Net Worth of Prior Year		$201,151.85
Increase (Decrease) in Net Worth		$44,059.04
Adjustments		
Add: Personal Expenditures		$35,844.93
Less: Income Tax Refund		
Less: Income Tax Refund – spouse		$1,125.53
Less: GST Credit		$722.00
Less: Child Tax Benefit		$5,751.50
Total Deductions		$7,599.03
Net Adjustments		$28,245.90
Income per Net Worth		$72,304.94
Less: Reported Income (Appellant)		$10,138.00
Reported Income (Spouse)		$705.00
Total Unreported Income		$61,461.94

[21] Correcting the amount of the mortgage on the Sheppard Avenue property reduces the unreported income for 2000 by $103,676 - from $165,138 to $61,462. The error was clearly not in the Appellant's favour.

[22] When the estimated gain of $15,020 realized on the sale of the Sheppard Avenue principal residence property is also taken into account, the amount identified as unreported income for 2000 would decrease to $46,442. Since the Respondent had acknowledged that the unreported income for 2000 was decreased by $1,537.21

following the filing of the Notice of Objection, the amount of unreported income would reduce to $46,442 - $1,537 = $44,905.

[23] The Appellant and his spouse have three children. Their first child was born in 1994 and they had twins who were born in October 1998. In 1998 they were living in the Sheppard Avenue property which is a two bedroom condominium. Fatemeh Hajibaba's parents lived in Tehran, Iran. Her father (Hossein Hajibaba) had a high position in the military and also rented a farm in Iran. He had also received an inheritance from his parents. In October 1998, shortly before the twins were born, Fatemeh Hajibaba's mother came to Canada to be with her. Her mother stayed with her until February 1999 at which time she returned to Iran accompanied by Fatemeh Hajibaba and her children.

[24] The Appellant also traveled to Iran in the summer of 1999 and stayed for three weeks. The Appellant and Fatemeh Hajibaba returned to Canada together with their children and later Hossein Hajibaba came to Canada in November 1999. I accept the testimony of Fatemeh Hajibaba and the Appellant that while she was in Iran, she received gifts for the twins (who were born the previous year) of $6,000. I also accept the testimony of Fatemeh Hajibaba and the Appellant that Hossein Hajibaba gave $9,000 to the Appellant while they were in Iran to help them buy a new house. Fatemeh Hajibaba's mother was in Canada in 1998 and therefore would have seen the two bedroom condominium that would now have to accommodate the Appellant, his spouse and their three children. Fatemeh Hajibaba stated that her mother, when she was in Canada, had raised the issue of the size of the condominium and that they should move to a larger place. It seems logical that when Fatemeh Hajibaba's mother returned to Iran that this issue would be raised again and, as parents and grandparents, that Fatemeh Hajibaba's parents would want to help them if they could.

[25] I accept the testimony of Fatemeh Hajibaba and the Appellant that the $6,000 and the $9,000 referred to above were used to purchase the Sayor Drive property in 2000. Although it is not entirely clear whether the $9,000 amount was a gift or a loan, for the purposes of determining whether the Appellant had any unreported income in 2000, it is irrelevant whether Hossein Hajibaba lent them $9,000 or gave them $9,000 since in either event the source of the $9,000 was not taxable (and if it was a loan, there was no evidence that any part of it had been repaid). This would reduce the unreported income for 2000 by another $15,000 ($6,000 + $9,000) as this $15,000 amount was not taken into account in the net worth analysis as a non-taxable source of funds.

[26] Both Fatemeh Hajibaba and the Appellant also testified that when Hossein Hajibaba came to Canada he also brought $10,000 with him. This $10,000 was also either lent to the Appellant (and his spouse) or given to them as a gift to help them purchase a new home. As noted above it is logical that parents would try to help their children and I accept that Hossein Hajibaba either lent them $10,000 in late 1999 or in 2000 or gave them this amount as a gift to help them with the purchase of their house. Hossein Hajibaba passed away in 2004.

[27] The $6,000 received as gifts for the twins together with the $9,000 plus the $10,000 received from Hossein Hajibaba (either as a gift or a loan), would reduce the unreported income for 2000 by a total of $25,000. The unreported income for 2000 would then be $44,905 - $25,000 = $19,905.

[28] The Appellant had also arranged for a line of credit, which was not included as his liabilities in the net worth analysis. In 2000 he borrowed $3,000 on his line of credit and this amount was still outstanding as of the end of 2000. This is a liability that would have reduced his net worth as of the end of 2000 by this amount and would have reduced his unreported income for 2000 by the same amount ($19,905 - $3,000 = $16,905).

[29] Fatemeh Hajibaba and the Appellant also stated that while he was in Canada from November 1999 to May 2000, Hossein Hajibaba would also give them money to help with day to day expenses when they were short of funds.

[30] As a result, it does not seem to me that the Respondent has established that the Appellant had made a misrepresentation that was attributable to neglect, carelessness or wilful default or had committed fraud in filing his tax return or in supplying information under the *Act* in relation to his 2000 taxation year. As noted there were significant errors made in the net worth analysis that had a substantial impact on the amount determined to be unreported income for 2000. At the commencement of the hearing the amount that the Respondent was claiming to be unreported income was $163,601. The result of the failure to deduct the gain realized on the sale of the principal residence and the overstatement of the mortgage on the Sheppard Avenue property as of the end of 1999 is that the unreported income amount was overstated by $118,696. Therefore approximately 73% of the unreported income amount was attributable to these two errors, which the auditor insisted would not affect the net worth analysis.

[31] The Appellant also submitted evidence, which I accept, of gifts or loans from his father-in-law and others as well as a line of credit that he utilized in 2000 as a

source of funds that was not taken into account in the net worth analysis. The result of all of these is that the unreported income for 2000 based on the net worth analysis as amended is less than $17,000. Given the significant errors made in the net worth analysis and the inherent uncertainties in any net worth analysis, the evidence as presented does not, in my opinion, support a conclusion that the Appellant had made a misrepresentation that was attributable to neglect, carelessness or wilful default or had committed fraud in filing his tax return or in supplying information under the *Act* in relation to his 2000 taxation year. As a result the Minister did not have the right to reassess the Appellant for 2000 as provided in subsection 152(4) of the *Act* and this reassessment of the Appellant's 2000 taxation year is vacated.

[32] However, the result for 2001 is not the same. The errors made affect the amount determined as income for 2000, not 2001. There were no trips to Iran in 2001 and the Appellant's father-in-law had returned to Iran in May 2000 and therefore he was not in Canada to provide any assistance in 2001. There was also no evidence of any financial assistance from any family members other than the assistance referred to above that was used to help finance the purchase of the Sayor Drive property.

[33] Counsel for the Appellant argued that the Respondent had not connected any unreported income to a source of income. The Appellant's counsel, in argument, acknowledged that the Appellant was funding his lifestyle from Helmand Auto Inc. His argument appears to be that this is not the same source as suspected by the Respondent.

[34] In *Hsu* v. *The Queen*, [2001] 4 C.T.C. 1, 2001 D.T.C. 5459 (leave to appeal to the Supreme Court of Canada was refused (293 N.R. 328 (note))), the Federal Court of Appeal made the following comments on net worth assessments and the source of income:

> 30 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, 5[th] 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**

> **<u>his or her taxable income from gains resulting from non-taxable sources</u>** (Gentile v. R., [1988] 1 C.T.C. 253 (Fed. T.D.), at 256).
>
> 31 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.
>
> (emphasis added)

[35] Therefore once the increase in net worth from the end of 2000 to the end of 2001 is established, the Appellant cannot escape liability for income tax by arguing that the Minister identified the wrong source. The Appellant by his own admission, was withdrawing funds as needed from Helmand Auto Inc. to finance his family's needs. The fact that this source is not the same source as the one with which the Minister was concerned when the net worth was being prepared (which was the chop shop operation), does not assist the Appellant. The Minister is relieved of the burden of proving a taxable source of income as noted by the Federal Court of Appeal in *Hsu*.

[36] The Appellant did not receive any additional advances on his line of credit in 2001. Whether the amounts of $9,000 and $10,000 that the Appellant (and his spouse) had received from Hossein Hajibaba (and which were used in 2000 to pay a portion of the purchase price of the Sayor Drive property) were gifts or loans would not affect the net worth of the Appellant in 2001 as there is no indication that any part of these amounts had been repaid by the end of 2001. Since a net worth analysis compares a person's net worth as of the end of one year with their net worth as of the end of the immediately preceding year, an amount (whether an asset or a liability) that is the same amount at the end of each year, does not contribute to an increase (or a decrease) in that person's net worth.

[37] For example, if the $19,000 is treated as a gift (with no liability in relation thereto outstanding as of the end of 2000 or 2001) or as a loan (with a liability of $19,000 in relation thereto outstanding as of the end of 2000 and 2001), the change in net worth from the end of 2000 to the end of 2001 will be the same. The following will illustrate this:

If the $19,000 is treated as a gift:

Description	2000	2001
Assets	$493,450.20	$510,960.67
Liabilities		
Credit Card:	$8,326.89	$5,554.98
Mortgage payable: 53 Sayor	$239,912.42	$234,239.57
Mortgage payable: 4727 Sheppard		
Loan payable – Hossein Hajibaba		
Total liabilities:	$248,239.31	$239,794.55
Net Worth	$245,210.89	$271,166.12
Less: Net Worth of Prior Year	$201,151.85	$245,210.89
Increase (Decrease) in Net Worth	$44,059.04	$25,955.23

If the $19,000 is treated as a loan:

Description	2000	2001
Assets	$493,450.20	$510,960.67
Liabilities		
Credit Card:	$8,326.89	$5,554.98
Mortgage payable: 53 Sayor	$239,912.42	$234,239.57
Mortgage payable: 4727 Sheppard		
Loan payable – Hossein Hajibaba	$19,000.00	$19,000.00
Total liabilities:	$267,239.31	$258,794.55
Net Worth	$226,210.89	$252,166.12
Less: Net Worth of Prior Year	$201,151.85	$226,210.89
Increase (Decrease) in Net Worth	$25,059.04	$25,955.23

[38] The increase in net worth from the end of 2000 to the end of 2001 is $25,955 whether the $19,000 is treated as a gift or an unpaid loan outstanding at the end of each year. The $19,000 is reflected in the cost of the Sayor Drive property. If the two years being compared were 1999 and 2000, whether the $19,000 was a gift or a loan would affect the determination of the net worth determined as of the end of 2000 but would not affect the amount determined as the unreported income for 2000 since the source is not taxable. If the amount was a gift, the net worth as of the end of 2000 would be greater than it would be if the $19,000 was a loan, but since a gift is not taxable the amount of the gift would be deducted in determining the unreported income for 2000.

[39] While the liability of the Appellant related to his line of credit of $3,000 is relevant in determining if the Appellant had any unreported income for 2000, since

this debt (which arose in 2000) remained unpaid as of the end of 2000 and as of the end of 2001, the failure to include this liability in determining his net worth as of the end of 2000 and as of the and of 2001 does not affect the determination of the increase in his net worth from the end of 2000 to the end of 2001. The following will illustrate this:

If the $3,000 loan is not included:

Description	2000	2001
Assets	$493,450.20	$510,960.67
Liabilities		
Credit Card:	$8,326.89	$5,554.98
Mortgage payable: 53 Sayor	$239,912.42	$234,239.57
Mortgage payable: 4727 Sheppard		
Line of credit		
Total liabilities:	$248,239.31	$239,794.55
Net Worth	$245,210.89	$271,166.12
Less: Net Worth of Prior Year	$201,151.85	$245,210.89
Increase (Decrease) in Net Worth	$44,059.04	$25,955.23

If the $3,000 line of credit amount is included:

Description	2000	2001
Assets	$493,450.20	$510,960.67
Liabilities		
Credit Card:	$8,326.89	$5,554.98
Mortgage payable: 53 Sayor	$239,912.42	$234,239.57
Mortgage payable: 4727 Sheppard		
Line of credit	$3,000.00	$3,000.00
Total liabilities:	$251,239.31	$242,794.55
Net Worth	$242,210.89	$268,166.12
Less: Net Worth of Prior Year	$201,151.85	$242,210.89
Increase (Decrease) in Net Worth	$41,059.04	$25,955.23

[40] The increase in net worth from the end of 2000 to the end of 2001 is $25,955 whether the $3,000 line of credit loan is omitted from the liabilities for both years or is included as a liability at the end of both years. Since this line of credit liability was $3,000 at the end of both 2000 and 2001, the failure to include this liability as of the

end of both 2000 and 2001 in determining the increase in net worth from the end of 2000 to the end of 2001, is irrelevant.

[41] There was a significant amount of testimony related to a wire transfer of $40,000 that the Appellant had received in 1998, which was the year before the base year. The Appellant indicated that this was an amount that he had borrowed from his cousin to help finance his share of the purchase price of the wrecking yard business. Since it appears that no payments were made on this loan, the failure to include a liability of $40,000 as of the end of each of 1999, 2000 and 2001 does not affect the amount determined as the increase in net worth from the end of 1999 to the end of 2000 or from the end of 2000 to the end of 2001, just as the failure to include the $3,000 liability referred to above as of the end of each of 2000 and 2001 did not affect the determination of the increase in net worth from the end of 2000 to the end of 2001.

[42] The Appellant did not lead any evidence to challenge the amounts used as the personal expenditures incurred by the Appellant and his family in 2001 (or in 2000). The amount used as personal expenditures for 2001 was $44,035. The reported income of the Appellant in 2001 was $14,248 and the reported income of his spouse in 2001 was $7,509, for a total reported family income of $21,757. The amount as determined for the personal expenditures of the Appellant and his spouse for 2001 was more than twice the amount of their combined reported income. The mortgage payments on the Sayor Drive property alone were $894.64 every two weeks or approximately $23,261 for 2001 or approximately 107% of their combined reported income.

[43] The explanation provided by the Appellant was that a shareholder’s loan account had been set up when he transferred his sole proprietorship business to the company in 1998 and the company owed him money. He would take money from time to time as he needed funds but it was his understanding that the amounts that he was taking were covered either by his salary ($500 every two weeks) or the amount that the company owed to him.

[44] In the net worth analysis, the following are the amounts that were shown as the amounts that Helmand Auto Inc. owed the Appellant at the end of the following years (and the Appellant did not dispute these amounts):

	1998	1999	2000	2001	2002
Due from Helmand Auto Inc.	$11,767	$17,814	$32,874	$32,341	$35,026

[45] The amount payable by Helmand Auto Inc. to the Appellant increased each year. If the Appellant were receiving payments from Helmand Auto Inc. on this amount payable, this amount should have deceased, not increased. As well, the amount outstanding as of the end of the year that the company was formed was only $11,767. This is not large enough to justify the withdrawals that the Appellant would have had to make each year to support his family. For 2000 his estimated personal expenditures (which were not disputed by the Appellant) were $35,845 and the reported income of the Appellant and his spouse was only $10,138. Based on the estimated personal expenditures of the Appellant and his reported income and the statements of the Appellant that he was funding his lifestyle from his company, it seems to me that the $11,767 that his company owed to him following the transfer of his sole proprietorship assets to the company would have been repaid to him before 2001.

[46] In my opinion, the Respondent has established that the Appellant had made a misrepresentation that was attributable to neglect or carelessness in filing his tax return or in supplying information under the *Act* in relation to his 2001 taxation year. The Appellant referred to the original loan from his company arising as a result of the transfer of his sole proprietorship assets to the company as his source of funds to pay for the personal expenditures of his family. However, since this loan amount (as of the end of 1998) was only $11,767 and increased as of the end of each of the following four years (indicating that the company owed him more money not less) and since his personal expenditures alone in 2001 were more than double the amount of the reported income of the Appellant and his spouse, the Appellant was at least neglectful or careless in completing his tax return for 2001. As a result the Respondent had the right to reassess the Appellant for 2001. Since the Appellant did not lead any evidence in relation to the assets or liabilities that would affect the increase in the net worth of the Appellant from the end of 2000 to the end of 2001, nor any evidence to challenge the personal expenditures of the Appellant in 2001, the unreported income of the Appellant for 2001 will be the amount as determined by the Respondent - $38,560.

[47] A Penalty was also assessed pursuant to subsection 163(2) of the *Act* in relation to the additional tax liability imposed for 2001. Subsection 163(2) of the *Act* imposes the burden on the Respondent of establishing the facts justifying the assessment of the penalty. This subsection provides as follows:

> (3) Where, in an appeal under this Act, a penalty assessed by the Minister under this section or section 163.2 is in issue, the burden of establishing the facts justifying the assessment of the penalty is on the Minister.

[48] Justice Strayer of the Federal Court Trial Division, in *Venne* v. *The Queen*, [1984] C.T.C. 223, 84 D.T.C. 6247, made the following comments on the meaning of gross negligence for the purposes of penalties imposed under subsection 163(2) of the *Income Tax Act:*

> "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.

[49] In *Maltais* v. *The Queen*, [1991] 2 C.T.C. 2651, 91 DTC 1385, Justice Bowman (as he then was) in dealing with a penalty imposed pursuant to subsection 163(1) of the *Act* stated as follows:

> 7. … Mr. Ghan on behalf of the respondent contended that subsection 163(1) in the form which is applied to 1989 did not require that there be a wilful intention to evade tax. In support of this position he pointed to the wording of the former 163(1) which referred to "Every person who wilfully attempts to evade the payment of tax payable by him" **and to the wording of subsection 163(2) which uses the expression "knowingly or under circumstances amounting to gross negligence". These provisions require a mens rea of intent or of recklessness.**
>
> (emphasis added)

[50] While the comments of Justice Bowman in relation to subsection 163(2) of the *Act* were *obiter* in that case, these comments were adopted by Justice Hamlyn in *Dunleavy* v. *The Queen*, [1993] 1 C.T.C. 2648, 93 DTC 417.

[51] In *Boileau* v. *The Minister of National Revenue*, [1989] 2 C.T.C. 2001, 89 DTC 247, Justice Lamarre Proulx stated that:

> 20. … It is true that by virtue of subsection 163(2), there is no accused nor is there a criminal charge. It would thus appear that it is not, as such, a criminal proceeding and that it remains a civil proceeding. However, **the application of that subsection requires the evidence of mens rea or culpable conduct**…
>
> (emphasis added)

[52] In *Seto v. The Queen*, 2007 TCC 489, 2007 DTC 16`47 (Eng.), [2007] G.S.T.C. 116, [2008] 2 C.T.C. 2364, Justice Campbell made the following comments:

> 29 An interesting question arises when a taxpayer is unsuccessful in challenging the Minister's net worth assessment: Is the taxpayer liable for gross negligence penalties where amounts are determined to be unreported income? In *Wajsfeld* v. *R.*, [2005] 4 C.T.C. 2341 (T.C.C. [General Procedure]), Justice Rip dealt with the issue and concluded that the Crown must satisfy the onus necessary to impose gross negligence penalties despite finding that the unreported amounts were to be included in the taxpayer's income. At paragraph 56 he stated:
>
>> ... The Minister must do more than simply rely on the failure of the taxpayer to rebut a net worth assessment and point to as high amount of unreported income to meet the burden under subsection 163(3) ... There is no doubt that the mens rea or the gross negligence may be established by circumstantial evidence, as either can seldom be established by direct proof of the taxpayer's intention. However, that evidence should be clear and convincing ... I am of the view that in the present case, the Minister did not adequately discharge his burden of proof in that he relied almost exclusively on the fact that the Appellant was unable to reverse the net worth assessments. In effect, subsection 163(3) requires evidence of the intent of gross negligence of the contravenor. This, in my view, should be done in a structured, clear and convincing manner.
>
> 30 The case of *Wajsfeld* clearly demonstrates that the Crown maintains the onus to prove gross negligence even where the assessment is based on the net worth method. In these appeals, the Crown presented no evidence regarding the Appellant's alleged acts of gross negligence. The Crown did not point to any specific evidence or circumstances that amounted to gross negligence other than the difference resulting from the net worth assessment. The sole basis of the Crown's argument for imposing penalties, under subsection 163(2), is the fact that the net worth assessment indicates that there was unreported income on the respective personal and corporate returns. If the Minister is going to assess gross negligence penalties, the Crown bears the onus and must do more than refer to the unreported amounts which have been added to the taxpayer's income. In the present appeals, the Crown simply asserted that the "substantial difference" between the net worth assessment and the net amount actually reported on the returns are indicative of gross negligence. The relevant jurisprudence requires more. Further, when the adjustments are made to include the Appellant's parents income, the difference is no longer substantial.

[53] In my opinion the Respondent has failed to establish that the Appellant intentionally or recklessly failed to report the additional income in 2001. While he was careless or neglectful, I am not satisfied that the Respondent has established that he had the requisite *mens rea* to justify the imposition of the penalty under subsection

163(2) of the *Act*. He believed that he could withdraw funds from his company as payment on the amount that the company owed to him, although he was obviously careless about keeping track of whether the funds he was withdrawing exceeded the amount that the company owed to him.

[54] As a result the Appellant's appeals are allowed, with costs, and:

(a) the reassessment of the Appellant's 2000 taxation year is vacated;

(b) with respect to the reassessment of the Appellant's 2001 taxation year, the penalty imposed pursuant to subsection 163(2) of the *Act* is deleted; and

(c) the reassessment of the Appellant's 2002 taxation year is vacated.

Signed at Halifax, Nova Scotia, this 6th day of July, 2009.

"Wyman W. Webb"

Webb J.

CITATION:	2009TCC357
COURT FILE NO.:	2007-623(IT)G
STYLE OF CAUSE:	ANWAR SARWARI AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	May 11 and 12, 2009
REASONS FOR JUDGMENT BY:	The Honourable Justice Wyman W. Webb
DATE OF JUDGMENT:	July 6, 2009

APPEARANCES:

Counsel for the Appellant:	Osborne G. Barnwell
Counsel for the Respondent:	Brent E. Cuddy

COUNSEL OF RECORD:

Counsel for the Appellant:

Name:	Osborne G. Barnwell
Firm:	Osborne G. Barnwell North York, Ontario
For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada