Docket: 2004-4015(IT)G

BETWEEN:

NGA THI DAO,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeals heard on November 6 and 7, 2008 at Toronto, Ontario,
April 20, 21, 22, 23 and 24, 2009, at Toronto, Ontario and
August 11, 2009 at Niagara-on-the-Lake, Ontario

Before: The Honourable Justice Diane Campbell

Appearances:

| | |
|---|---|
| Counsel for the Appellant: | John David Buote |
| Counsel for the Respondent: | Lorraine Edinboro |

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**JUDGMENT**

The appeals from the assessments made under the *Income Tax Act* for the 1998, 1999, 2000 and 2001 taxation years are allowed and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

If the parties cannot settle the matter of costs, they may provide written submissions respecting costs on or before March 31, 2010.

Signed at Ottawa, Canada, this 16th day of February 2010.

"Diane Campbell"

Campbell J.

Citation: 2010 TCC 84
Date: 20100216
Docket: 2004-4015(IT)G

BETWEEN:

NGA THI DAO,

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## REASONS FOR JUDGMENT

Campbell J.

[1] These appeals are from reassessments for the Appellant's 1998, 1999, 2000 and 2001 taxation years. The Minister of National Revenue (the "Minister") increased the Appellant's total income by the amounts of $78,000, $107,858, $42,585 and $129,942 respectively, in those taxation years, using the net worth method. Penalties were also imposed pursuant to subsection 163(2) of the *Income Tax Act* (the "*Act*"). The Appellant's 1998 and 1999 taxation years were assessed beyond the normal reassessment period pursuant to subparagraph 152(4)(a)(i) of the *Act*.

[2] The issues are:

(a) Whether the Minister properly included these amounts in the Appellant's income for each of the respective taxation years;

(b) Whether the Minister is entitled to reassess the 1998 and 1999 taxation years beyond the normal reassessment period for those years, and whether this issue is properly before the Court; and

(c) Whether the penalties imposed pursuant to subsection 163(2) of the *Act* are justified in the circumstances of these appeals.

The Facts:

[3] An audit of the Appellant was commenced in 2002, as a result of a newspaper article published in *The Review* in Niagara Falls, which described a police raid at a residence. This residence (the "Bishop residence") was owned solely by the Appellant. The raid resulted in the seizure of marijuana plants and $50,000 worth of hydroponic equipment related to this operation. Both the Appellant and her husband were charged. While the initial charges of production of a controlled substance and the theft of hydro were dropped against the Appellant, her husband, Thu Van Dao, was charged and pleaded guilty. Throughout her testimony, the Appellant denied that she had anything to do with the drug operation or its accompanying hydroponic equipment.

[4] The Bishop residence was owned by the Appellant as a rental unit. The Appellant testified that she and her husband were arrested and charged in September, 2002 while both were attending the property to collect rent from the tenants. Although the rental application (Exhibit A-1, Tab 78), dated July 28, 2001 stated that the rental period was from August 1, 2001 to August, 2002, the Appellant testified that the tenants were in the unit until September 28, 2002.

[5] In addition to ownership of the Bishop residence, the Appellant had substantial funds in her bank accounts as well as in investments. The Appellant asserts that these apparent increases to her net worth in those taxation years are primarily attributable to non-taxable sources, being loans from relatives, friends and co-workers. The Respondent took the position that these loans were non-existent. The Appellant also asserted that her family would spend considerably less than the figures attributed to her family for personal expenditures pursuant to the Statistics Canada calculations.

Analysis:

[6] When the Minister utilizes the net worth method to calculate a taxpayer's income, it is because there are no other means available to the Minister that could verify the information contained in the taxpayer's returns. This may occur because returns have not been filed; records are insufficient and the information provided to the Minister cannot be independently verified and appears inaccurate; or, it may simply be necessary because of the taxpayer's refusal to furnish the required information to the Minister.

[7] Bowman J. (as he was then), in *Bigayan v. The Queen*, 2000 D.T.C. 1619, at page 1619, referred to the net worth method as "… a blunt instrument, accurate within a range of indeterminate magnitude …". As noted in *Ramey v. The Queen*, 93 D.T.C. 791, it is a method of "last resort" because essentially all other avenues of verification normally available to the Minister have failed. Therefore, the method, by its very nature, will result in an inaccurate approximation of a taxpayer's income. While this may produce unsatisfactory results, it is based on the premise that, in a self-assessing system, a taxpayer is in the best position to know the exact amount of income earned over a period of time. If proper records are kept, then it should be an easy task for a taxpayer to factually point out the errors in the Minister's assessment and properly support the proposed changes to the assessment with the appropriate documentation or other evidence. In *Bigayan*, at page 1619, the calculation, used in the net worth method, was described as follows:

> … 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. …

Using this type of calculation will never produce a taxpayer's precise income figures as that which could be produced if a taxpayer simply totals all sources of income and profits as contemplated by the *Act*.

[8] In *Hsu v. The Queen*, 2001 D.T.C. 5459, the Court made it clear that the Minister must only show that the net worth of a taxpayer has increased between two points in time but the Minister does not have to prove a taxable source of income. At paragraph 29 the Court stated:

> [29] Net worth assessments are a method of last resort, commonly utilized in cases where the taxpayer refuses to file a tax return, has filed a return which is grossly inaccurate or refuses to furnish documentation which would enable Revenue Canada to verify the return (V. Krishna, *The Fundamentals of Canadian Income Tax Law*, 5th ed. (Toronto: Carswell, 1995) at 1089). The net worth method is premised on the assumption that an appreciation of a taxpayer's wealth over a period of time can be imputed as income for that period unless the taxpayer demonstrates otherwise (*Bigayan, supra*, at 1619). Its purpose is to relieve the Minister of his ordinary burden of proving a taxable source of income. The Minister is only required to show that the taxpayer's net worth has increased between two points in time. In other words, a net worth assessment is not concerned with identifying the source or nature of the taxpayer's appreciation in wealth. Once an increase is demonstrated, the onus

> lay entirely with the taxpayer to separate his or her taxable income from gains resulting from non-taxable sources (*Gentile v. The Queen*, [1988] 1 C.T.C. 253 at 256 (F.C.T.D.)).

[9] In many cases, net worth assessments invariably rest on the credibility of the Appellant and the witnesses and their explanations of why the Minister's calculations are flawed. In the present appeals, an assessment of credibility plays the key role in the outcome because there was little documentary evidence produced. At paragraph 23 of *Nichols v. The Queen*, 2009 TCC 334, 2009 D.T.C. 1203, V.A. Miller J. provided a most useful overview of the criteria that should be considered in assessing credibility:

> [23] In assessing credibility I can consider inconsistencies or weaknesses in the evidence of witnesses, including internal inconsistencies (that is, whether the testimony changed while on the stand or from that given at discovery), prior inconsistent statements, and external inconsistencies (that is, whether the evidence of the witness is inconsistent with independent evidence which has been accepted by me). Second, I can assess the attitude and demeanour of the witness. Third, I can assess whether the witness has a motive to fabricate evidence or to mislead the court. Finally, I can consider the overall sense of the evidence. That is, when common sense is applied to the testimony, does it suggest that the evidence is impossible or highly improbable.

In applying the aforementioned criteria to the evidence before me, I have concluded that the Appellant has not produced the specific and convincing evidence required to challenge a net worth assessment.

The Loans:

[10] Since the bulk of the evidence focused on the alleged loans, I will address each of them separately. There were allegedly eight loans in total, all in cash, interest-free and none have been repaid.

(A) $70,000 from Luyen Thi Le

[11] Ms. Le has known the Appellant since she was 12 years old. They were neighbours in Vietnam before coming to Canada. This loan was in cash and there was no interest payable according to both the Appellant and Ms. Le. The Appellant testified that she received several instalments, including $45,000 in 1998, some of which she spent to pay for a family trip to England, and another $20,000 in 2001. Her evidence in both direct examination and cross-examination was vague and confusing to follow. She stated she "lost" $20,000 of this money but the evidence was not clear

on what may have happened to it. In examinations for discovery, she stated some of the money was used for furniture, for bail and for legal fees. At another point she stated she "… reserved that to give a gift to my sister …" (Transcript, page 68). She did not deposit any of these instalments at any one time in a bank account. Instead, she testified that she deposited smaller amounts of $1,000 or $2,000 at different times.

[12] Ms. Le worked as a bank teller at the TD Canada Trust during this period. She testified that she was able to make this $70,000 loan to the Appellant because she had won $136,000 gambling at Niagara Casino during the Christmas holidays/period in 1998. She received a cheque from the casino for $80,000 and the balance was supposedly paid to her in cash. However, a casino document (Exhibit R-3) confirmed her winnings as $64,275 and not $136,000 as she claimed. Ms. Le offered two reasons for this significant discrepancy. First, she suggested that the casino does not necessarily keep track of the identity of the winners with identification numbers, or, second, the $64,275 amount may have been the difference between her wins and losses for the entire year. In addition to this discrepancy in the evidence, Ms. Le declared that the $70,000 loan was sourced from two different casino winnings: the $136,000 win originally referred to, as well as a win of $66,000 in February 1999.

[13] Contrary to the Appellant's evidence, Ms. Le stated that she provided this money to the Appellant on three separate occasions: $30,000 on December 27, 1998, $15,000 on December 29, 1998 and $25,000 on January 2, 1999. Yet when the Appellant and her husband met with the Canada Revenue Agency (the "CRA"), the Appellant alleged that this loan was made to her in small increments and eventually it accumulated to the $70,000 amount.

[14] During Ms. Le's testimony, she changed her response as to why she gave $70,000 to the Appellant in cash, with no interest payable and nothing signed, from to "keep it [the money] … safe" (Transcript, page 250) to "I don't want them [the Bank – her employer] to know that I won it from gambling" (Transcript, page 265). This of course implies that she did not consider it a loan at all.

[15] There are numerous inconsistencies and contradictions between the evidence of the Appellant and Ms. Le, as well as within the evidence provided by each witness. The Appellant relied upon her "Summary of Loans Paid Back in Cash to the Daos" (Exhibit A-1, Tab 80) which stated that the $70,000 was loaned to her on December 24, 1998. This contradicts the oral testimony of both the Appellant and Ms. Le and also contradicts Ms. Le's earlier affidavit evidence. In addition to the discrepancies in the instalment payments of the $70,000, the documentary

confirmation from the casino listed Ms. Le's winnings as less than half of the amount which she testified that she won. The casino document does not support Ms. Le's affidavit evidence and the Appellant produced no banking records to support this loan. The Appellant's evidence was also contradictory in respect to how she spent the $70,000. Neither do I accept one of Ms. Le's suggestions that she was concerned that her employer would find out about her gambling wins. Being a bank employee, she must have been aware of other investment options at other lending institutions that she could have pursued. I also have serious doubts that, even if this was a concern to her, she would have loaned/gifted $70,000 without interest, with no paper trail or records of any kind and essentially never actively seek repayment.

(B) $20,000 from Nhung Thi Nguyen

[16] Again this was an interest-free loan provided to the Appellant in cash on February 5, 2001. It was to assist the Appellant with the purchase of the Bishop residence. Ms. Nguyen stated that the Appellant was her ex-fiancé's cousin, that they lived in different cities and saw little of each other except at family gatherings. The Appellant's evidence concerning her relationship with Ms. Nguyen was again vague and confusing with contradictions between her discovery evidence and her evidence during the hearing of the appeals. At the examinations for discovery, the Appellant stated Ms. Nguyen was her cousin's girlfriend, while at the hearing she stated that they were married. When confronted with these contradictory statements about something as basic as their relationship, the Appellant attempted to clarify by stating that they had lived together and that they were now married. Even the clarification contradicts Ms. Nguyen's evidence that she was never married to or lived with the Appellant's cousin and was now no longer with him.

[17] Ms. Nguyen was a hairstylist in 2001 when the loan was allegedly made. Seventy percent of the funds came from funds she had saved for her seven-year-old son. She said that she kept the money in a box at her parents' home where she resided. Her income had never exceeded $15,000 annually.

[18] There was no documentation to support this loan and I find it both highly suspect and improbable that a young, single, working mother of a seven-year-old son, earning no more than $15,000 yearly, would blithely hand over $20,000 of her savings because the Appellant "… really needed it …" (Transcript, page 201). Ms. Nguyen presented as an intelligent witness and I cannot accept that this loan existed. I do not believe it is the type of action that a reasonable and practical person would engage in given Ms. Nguyen's circumstances.

(C) $20,000 Loan from Huynh Thi Lien

[19] This loan was in cash, interest-free and in four instalments: $5,000 on February 10, 2001, $5,000 on February 16, 2001, $5,000 on February 18, 2001 and $5,000 on March 15, 2001. Ms. Lien and the Appellant both worked at Pizza Roll Food Sales between 1997 to 2001 and were neighbours. The loan was supposedly made to assist the Appellant again with the purchase of the Bishop residence, although Ms. Lien's discovery evidence was that she did not know why the Appellant wanted the loan. The source of this money was wins from gambling as well as "red envelope" monetary gifts. The gifting of red envelopes is a Vietnamese tradition in which other family members and friends provide monetary amounts in red envelopes during holidays and special occasions.

[20] No documentation exists. It is Ms. Lien's memory upon which I am asked to place reliance. She cannot recall how much of the $20,000 could be attributed to casino wins or to red envelope gifts. Her affidavit evidence contradicted her testimony at the hearing. However, underscoring all of this is the implausible suggestion that Ms. Lien, a married mother of four children, earning less than $20,000 annually during the period of the loan, would advance the Appellant this unsecured loan without really knowing what it was for and with no apparent means with which the Appellant would be able to repay the amount.

(D) $15,000 from Tra Thi Dang
<u>$15,000 from Quang Vinh Tran</u>

[21] According to the evidence of George Dubiel, electronic commerce audit specialist, these individuals were spouses. The Appellant asserted that together they made a loan to her totalling $30,000. An adjustment was made by the auditor for the $15,000 that originated with Tra Thi Dang, based on a CIBC bank draft dated April 20, 2001 from Tra Thi Dang. There is no documentation for the remaining $15,000 amount and no deposit information could be traced to either the RBC or the CIBC accounts of the Appellant. This witness, Quang Vinh Tran, despite being subpoenaed, as well as a warrant being issued, never appeared at the hearing to testify. The Appellant's evidence was that she deposited the $30,000 amount to her RBC account by way of two bank drafts on April 26, 2001. However, the banking documentation (Exhibit A-1, Tab 19) shows only a cash withdrawal of $30,000 on April 26, 2001. The documentation, when it was produced, did nothing more than contradict the Appellant's testimony. Again, I must conclude that this loan was never made to the Appellant.

(E) <u>$20,000 from Dung Duy Dao</u>

[22] Although Dung Duy Dao did not testify, the Appellant claimed that this amount was loaned to her in cash, interest-free, from her uncle, Mr. Dao, on November 14, 2000. The Appellant's husband claimed that Mr. Dao gave this loan after he sold a boat for $1.2 million. I was referred to a bank deposit of November 14, 2000 (Exhibit A-1, Tab 19) that shows a transfer for the amount of $20,000. However, there is no evidence to establish that the origin of this transfer was from the Appellant's uncle. In addition, the Appellant failed to disclose this alleged loan in her meeting with CRA and she first referred to it during the examination for discovery. I have no evidence, other than the Appellant's testimony, that this loan from Mr. Dao occurred. Because of the many inconsistencies and contradictions in the Appellant's evidence generally, I must reject what she is alleging in respect to this loan.

(F) $13,990 from Duoi Van Nguyen

[23] Mr. Nguyen did not testify but according to the Appellant and her husband, this loan was made to her by wire transfer in October 1998 so that she could purchase a vehicle. The banking records confirm that a "credit memo" was completed to the Appellant's account for $13,990. According to the evidence of Herman Johnson, customer service manager with TD Canada Trust, this banking notation could represent a wire transfer of $14,000 as the banking transfer fee for this type of transaction was typically $10. However, he was unable to specify the origin of the transfer from the documents and could not testify whether it was an international transfer as the Appellant claimed (Mr. Nguyen, according to the Appellant, lived in Finland). Again, this loan was never reported at the meeting with CRA and reference to it only occurred at a subsequent date. Based on all of the evidence before me, I must also reject the existence of this loan as I suspect this, like the other loans, never occurred.

(G) $20,000 from Quang Van Dao

[24] Quang Van Dao is the Appellant's brother-in-law. The Appellant's husband alleged that he held this sum of money for his younger brother. The Appellant herself never referenced this loan at either the hearing or at the examinations for discovery. Quang Van Dao, who was unemployed in 1999 and 2000 and resided with the Appellant and her husband, testified that he had $20,000 in savings from his employment in prior years and from "red envelope" monetary gifts. Although he had a bank account, he asked his brother to hold the money in safekeeping for him as he liked to gamble. He also stated that this was not a loan and that he simply requested his brother to keep it for him. He testified that it was customary within the Vietnamese community to have an older family member hold money without paying

interest. Although the Appellant's husband initially testified that his brother gave him the money for safekeeping, he later stated that it was a loan to his wife, the Appellant (Transcript, page 311). However, on cross-examination, Mr. Dao stated that his brother gave him the money, not the Appellant, and that he retained possession of the funds and, subsequently, spent the money himself.

[25] The glaring contradictions in this testimony make it impossible for me to accept any of it and I reject the suggestion that there ever existed a loan from Quang Van Dao in any amount to either the Appellant or her husband.

Other Non-Taxable Sources:

[26] In addition to the aforementioned loans, the Appellant suggested that some of the gains identified in the net worth assessment could be attributed to such items as child allowance savings and red envelope gifts. Amounts respecting child allowance would have been reflected in the net worth. There is no identification of specific amounts that might have been received in red envelopes; there was no record of amounts received; and there is no record of those amounts being deposited. Finally, any gains identified, in the years under appeal, that may have been from savings, should have shown up and been identified in the bank accounts and investments commencing with the base year 1997.

[27] In summary, I reject the evidence of the Appellant and the witnesses and conclude that none of these loans existed and that none of the gains identified in the net worth can be attributed to non-taxable sources. Some of the Appellant's evidence during the hearing contradicted her discovery testimony given under oath. There were inconsistencies and contradictions between the Appellant's evidence and some of the third party witnesses and, in fact, some contradictions within the evidence of the third party witnesses themselves. No one could seem to get their story straight. Moreover, there was no documentary evidence to support any of the stories. Some of the stories on their own could conceivably contain some truth, but when they are tainted throughout with so many glaring inconsistencies and contradictions, together with the lack of supporting documentation, I must reject all of it as unreliable, improbable and about as dependable as recent sightings of Elvis.

Assets:

[28] The Respondent made the following concessions respecting the Appellant's assets ("Bank/Trust Co./Credit Union Accounts" and "Investments Other") in light of

the evidence of Ludgero Duarte, the CIBC bank manager, and other evidence presented to the Respondent just prior to the hearing:

| *Bank Account & Investments Others* | *Year* | *Audit Amount* | *Concession* |
|---|---|---|---|
| Bank / Trust Co / Credit Union Accounts Account #819735 CIBC – NGA | 1997 | -- | $ 8,511 |
| T5 CIBC NGA at 3.75% NGA | 1997 | $ 10,000 | $ 70,000 |
| T5 CIBC NGA at 3.75% NGA | 1998 | $ 40,000 | $ 90,000 |
| CIBC DM NGA | 2000 | $ 122,728 | $ 125,100 |
| CIBC DM NGA | 2001 | $ 136,192 | $ 131,561 |

There is no other evidence, documentary or otherwise, that would support any other changes to the Appellant's personal balance sheet. According to the evidence of Nick Siena, the Appellant's assets were determined from a number of sources including banks, real estate and vehicle searches and newspaper reports. Based on all of the evidence, I conclude that the hydroponic equipment should also be included as an asset. According to the Appellant's husband, he put most of his money in the Appellant's account and it was the Appellant that had the substantial investments and assets in her name, including the Bishop residence.

Expenditures:

[29] The next component in the net worth, the personal expenditures, was based on Statistics Canada figures and amounts that were supported when Mr. Siena located invoices from the Appellant's documents. Mr. Siena based his calculations on the Statistics Canada figures for a family of two adults and three children for the years in question. According to the husband's testimony, he gave the Appellant the money for household expenses as this was part of Vietnamese tradition. The onus is upon the Appellant, again, to convince the Court that these figures are incorrect. The funds received by the Appellant from her husband are already considered in the net worth as his bank accounts were listed as an asset. The Appellant testified that there were only four people living in the household in 1997 and five people from 1998 to 2001. While this accords with Mr. Siena's basis for his calculations, the Appellant's husband actually testified that he was not living in Ontario during most of this period as he was working in British Columbia. However, during the period when he was supposedly living elsewhere and not visiting the Dao household, a U.S. District Court receipt from Buffalo was issued in his name. Although he denied this, the receipt speaks for itself and points to the likelihood that he was at the household at least some of the time. I prefer the Appellant's version, which happens to coincide with the basis for Mr. Siena's calculations. The Appellant's husband repeated so many contradictory stories, I simply reject the entirety of his evidence.

[30] Again, the Appellant gave conflicting information between her examination for discovery and the evidence she presented at the hearing. In 2006, she stated that the household expenses would be less than the auditor's figures but that she had no records in support of this. During the hearing, she testified to actual amounts expended. The Appellant's husband and their daughter, Huong Dao, testified that the family spending would be significantly less than the Statistics Canada figures. The daughter's testimony was of little assistance. She was a teenager during this period and admitted that she could not testify as to exact amounts that her family might have spent. This actually coincides with the evidence of the Appellant during her examination for discovery in 2006. There were also some discrepancies between the evidence of the daughter and the Appellant which leads to the conclusion that the Appellant's story, taken as a whole, cannot be believed.

[31] The Respondent relied on Mr. Siena's "personal experience" with the Statistics Canada figures that they represent a "conservative" approach (Transcript, pages 530-531). In these appeals, because of the very problematic evidence before me, I am not interfering with the figures used by Mr. Siena. I am accepting them only because they appear more reliable than the alternative, the largely inconsistent evidence of the Appellant and the witnesses. That should not be taken to mean that I endorse Statistics Canada figures as a wholly reliable source. Mr. Siena is not an expert on Statistics Canada figures. This was simply his personal opinion that they are conservative. No one from Statistics Canada was called to support this statement. I have no indication that these figures are necessarily sensitive to regional and cultural differences. I do not have any sense of how data is collected or the methodology employed in arriving at these statistics. Bowman J. (as he was then), in *Bigayan*, expressed the same concerns over the meaning of "national average" in dealing with Statistics Canada figures. I view them with great scepticism and in a different set of circumstances I would not hesitate to consider other reliable evidence if it were presented to refute those figures, particularly where it can be shown that regional and cultural differences exist.

<u>The Minister's Entitlement to Reassess Statute-Barred Years Pursuant to Subsection 152(4) of the *Act* and to Impose Penalties Pursuant to Subsection 163(2) of the *Act*</u>:

[32] The reassessments for 1998 and 1999 were made outside the normal reassessment period and the onus therefore is upon the Respondent to establish a misrepresentation attributable to neglect, carelessness, wilful default or fraud in accordance with subparagraph 152(4)(a)(i) of the *Act*. The Appellant, in submissions,

suggested that this point was not explicitly pleaded as an issue in the Notice of Appeal. However, the Notice of Appeal, as I read it, appears to put the entire net worth assessment, and by implication the two statute-barred years, in issue at paragraph D(1) when it specifically states that the first issue is "whether the net worth assessment is justified under the circumstances". In the "Relief Sought" section of the Notice of Appeal, the Appellant seeks an order vacating the Notice of Confirmation and the Notices of Reassessment for the 1998, 1999, 2000 and 2001 taxation years. The Reply clearly anticipates it as an issue by addressing it specifically at paragraphs 8 and 12.

[33] The purpose of the pleadings stage is to clearly define the issues. I view both the Notice of Appeal and the Reply as accomplishing that. The Respondent referred me to the *Bigayan* case where the Court concluded that, although the assessment was beyond the normal assessment period, since the issue had not been raised in the Notice of Appeal, the net worth calculations for the statute-barred year could not be attacked on the basis that the year was statute-barred. There is no discussion in that decision of the state of the pleadings before the Court and, in addition, no one from CRA testified to specifically address the problem. That was clearly the appropriate conclusion in those circumstances. In these appeals, however, my decision is based on the adequacy of the pleadings before me and the fact that I had the testimony of the CRA officer, Mr. Nick Siena.

[34] Although neither counsel referred me to the decision of *Naguib v. The Queen*, 2004 D.T.C. 6082, the comments at paragraphs 6 and 7 are pertinent to this issue:

> [6] We are of the view that the respondent did not have a duty to raise facts so as to justify the application of section 152(4)(*a*)(i), in the absence of any challenge by the appellant in his Notice of Appeal or at the trial in the Tax Court to the reassessment on the basis that it was issued beyond the normal reassessment period. While the facts in *Crête v. H.M.Q.*, [1997] F.C.J. no. 214 (F.C.A.) are not the same as the present case in that it involved a motion relating to the pleadings, nevertheless, the statement of the Court is perhaps helpful:
>
> > It is clear that the judge erred. He criticizes the Minister for not alleging in the reply to the notice of appeal some facts to show that the reassessment was not out of time. But the Minister, like any other litigant, is never required to reply to an allegation that has not been made and, however you read the taxpayer's notice of appeal, it contains no allegation that the notice of assessment was void for being out of time.

> [7] Furthermore, this Court has made it clear that a new argument may not be raised for the first time on appeal where the responding party would be prejudiced by having had no opportunity to adduce evidence that could, if accepted defeat the argument. *SMX Shopping Centre Ltd. v. Canada*, [2004 DTC 6013] [2003] F.C.J. No. 1870 (F.C.A.).

[35] Although the *Naguib* decision would appear to be the definitive word on the issue in these appeals, I believe it must be distinguished as Bonner J. did in the case of *Trojan v. The Queen*, 2006 D.T.C. 2212. At paragraph 9 of that decision, he referred to the statement by Cameron J. in *M.N.R. v. Taylor*, 61 D.T.C. 1139, as providing the statement of the law respecting the burden of proof in appeals from reassessments made after the expiry of the normal reassessment period. At page 1141 of the *Taylor* decision, Cameron J. states:

> After giving the matter the most careful consideration, I have come to the conclusion that in every appeal, whether to the Tax Appeal Board or to this Court, regarding a re-assessment made after the statutory period of limitation has expired and which is based on fraud or misrepresentation, the burden of proof lies on the Minister to first establish to the satisfaction of the Court that the taxpayer (or person filing the return) has "made any misrepresentation or committed any fraud in filing the return or in supplying any information under this Act" unless the taxpayer in the pleadings or in his Notice of Appeal (or, if he be a respondent in this Court, in his reply to the Notice of Appeal) or at the hearing of the appeal has admitted such misrepresentation or fraud. In re-assessing after the lapse of the statutory period for so doing, the Minister must be taken to have alleged misrepresentation or fraud and, if so, he must prove it.

[36] The decision of Bonner J. in *Trojan* distinguishes the Federal Court of Appeal decision in *Naguib* at paragraph 10 as follows:

> … The rule laid down in *Taylor* (*supra*) that the Respondent must "first establish" misrepresentation appears, at least at first blush, to have been modified by the decision of the Federal Court of Appeal in *Naguib v. Canada* 2004 FCA 40 where Sexton, J.A. stated:
>
> > ... But the Minister, like any other litigant, is never required to reply to an allegation that has not been made and, however you read the taxpayer's notice of appeal, it contains no allegation that the notice of assessment was void for being out of time.
>
> That statement was made, however, in the context of a case in which the taxpayer raised, for the first time, at the appeal to the Court of Appeal, the failure of the Respondent to lead evidence proving that subparagraph 152(4)(*a*)(i) was satisfied. *Naguib* is distinguishable from the present situation in that the Respondent accepted

> from the outset that the burden was on him to establish fraud or misrepresentation. The Respondent has, in effect, waived the Appellant's failure to plead that he relies on subparagraph 152(4)(*a*)(i) …

[37] The *Trojan* decision was pursuant to the informal procedure and, although I am not required to follow it, I believe that the comments of Bonner J.'s conclusions are correct. The Federal Court of Appeal decision of *Naguib* must be distinguished on the basis that the Court in *Naguib* was directing its remarks to a case where the issue was raised for the very first time at the appeal stage. I conclude subparagraph 152(4)(a)(i) to be an issue in these appeals.

[38] There has clearly been a misrepresentation or misrepresentations by the Appellant in her tax returns for the taxation years in respect to the total income she received. Fraud has not been suggested but I have little difficulty, based on all of the evidence before me, in concluding that the Minister was justified in opening the two statute-barred years because the Appellant's misrepresentations relating to her income are attributable, at the very least, to neglect and carelessness and, more likely, to wilful default. The additional income is present and there has been no credible evidence adduced to demolish the Minister's assumptions and the Respondent's evidence tendered during the hearing.

[39] It is clear that the type of conduct of a taxpayer which would permit the Minister to re-open statute-barred years may not necessarily support the imposition of penalties under subsection 163(2). This is the reason that subsection 163(2) employs the term "gross" negligence as opposed to "ordinary" negligence. In some instances there may be some overlapping or blurring of the conduct contemplated by subsection 163(2) and subparagraph 152(4)(a)(i), but in other circumstances there will be a clear demarcation. Because I believe the Appellant's conduct tends more to the wilful default under subparagraph 152(4)(a)(i), this establishes some overlapping between the two provisions in the circumstances of these appeals. However, while subsection 163(2) is a penal provision, subparagraph 152(4)(a)(i) is not. Subsection 163(2) implies a requirement of intent to conceal a taxation transaction. I have concluded that the facts in these appeals justify penalties under subsection 163(2). However, that conclusion in no way implies that conduct that allows the Minister to re-open statute-barred years should automatically warrant subsection 163(2) penalties. Because subsection 163(2) is penal in nature, the provision merits a higher degree of culpability and must be imposed only where the evidence clearly justifies it. If the evidence creates any doubt, that it should be applied in the circumstances of the appeal, then the only fair conclusion is that the taxpayer must receive the benefit of the doubt in those circumstances. In *Farm Business Consultants Inc. v. The Queen*,

95 D.T.C. 200, which was upheld by the Federal Court of Appeal (96 D.T.C. 6085), at pages 205 to 206, Bowman J. (as he was then), stated:

> A court must be extremely cautious in sanctioning the imposition of penalties under subsection 163(2). Conduct that warrants reopening a statute-barred year does not automatically justify a penalty and the routine imposition of penalties by the Minister is to be discouraged … . Moreover, where a penalty is imposed under subsection 163(2) although a civil standard of proof is required, if a taxpayer's conduct is consistent with two viable and reasonable hypotheses, one justifying the penalty and one not, the benefit of the doubt must be given to the taxpayer and the penalty must be deleted …

(Emphasis added)

[40] The authorities in this area of the law are numerous. A case still referred to is the decision of *Udell v. M.N.R.*, (1969) 70 D.T.C. 6019, where Cattanach J. set out some of the principles to be applied in determining if a penalty should be imposed. In interpreting the language of the then subsection 56(2) of the former *Income Tax Act*, which contained similar language to the present subsection 163(2), Cattanach J. stated at page 6025:

> There is no doubt that section 56(2) is a penal section. In construing a penal section there is the unimpeachable authority of Lord Esher in *Tuck & Sons v. Priester*, (1887) 19 Q.B.D. 629, to the effect that if the words of a penal section are capable of an interpretation that would, and one that would not, inflict the penalty, the latter must prevail. He said at page 638:
>
> > We must be very careful in construing that section because it imposes a penalty. If there is a reasonable interpretation which will avoid the penalty in any particular case, we must adopt that construction.

and at page 6026 he went on to state:

> I take it to be a clear rule of construction that in the imposition of a tax or a duty, and still more of a penalty if there be any fair and reasonable doubt the statute is to be construed so as to give the party sought to be charged the benefit of the doubt.

[41] The Court in *Can-Am Realty Limited v. The Queen*, 94 D.T.C. 6069, described the type of conduct that would be required to support gross negligence as exceptional and flagrant conduct.

[42] In *Venne v. The Queen*, 84 D.T.C. 6247, Strayer J. at page 6256 defined gross negligence as follows:

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

This case is quoted often and referred to by both the Tax Court and the Federal Court of Appeal (*Boyer v. The Queen*, 2008 D.T.C. 4891; *Cayer v. The Queen*, 2007 D.T.C. 557; *Findlay v. The Queen*, 2000 D.T.C. 6345; *Mark v. The Queen*, 2006 D.T.C. 2227; *Richard v. The Queen*, 2006 D.T.C. 2568; *Savard v. The Queen*, 2008 D.T.C. 5026; *Sprio v. The Queen*, 2009 D.T.C. 1169; *Vaillancourt v. The Queen*, 2008 D.T.C. 3844; *Zsoldos v. The Queen*, 2004 D.T.C. 6672).

[43] A necessary ingredient to conduct justifying penalties is the "*mens rea*" of intent or recklessness and subsection 163(2) aims to punish this type of behaviour.

[44] This leads me to the most recent decision of the Federal Court of Appeal which discusses both subparagraph 152(4)(a)(i) and subsection 163(2). With respect, the reasons of Pelletier J. in *Lacroix v. The Queen*, [2008] F.C.J. 1092, leave me bewildered and somewhat perplexed when I compare his analysis to the preceding cases in both the Tax Court and the Federal Court of Appeal. At paragraphs 30 to 32 of *Lacroix*, the two provisions are essentially lumped together and the same onus is imposed upon the Minister with respect to both provisions. The effect of this would be to remove the requirement for the element of *mens rea* and, consequently, establish circumstances that would allow penalties in many unsuccessful appeals. Where a taxpayer is accused of reckless and reprehensible conduct bordering on criminal behaviour for which he may be slammed with the punishment of gross negligence penalties, the Minister under subsection 163(2) has a duty to justify its decision which will not be satisfied merely, as *Lacroix* suggests, by showing that the taxpayer has unreported income but could not provide a credible explanation.

[45] In the present appeals, the magnitude of the omissions in relation to the income declared is significant and occurred over a number of years. In reviewing the reasons why the Minister assessed penalties and how they were calculated, Mr. Siena

noted that the amounts were sometimes triple the amount of reported income. In addition, the Appellant used a tax preparer and controlled the information supplied to complete her tax returns. I am satisfied based on all of the evidence that the Appellant's failure to report all of her income in the years in question was attributable to a deliberate deception and wilful misrepresentation of the true state of her affairs with the intent of concealing taxable sources of income. I conclude that the facts in these appeals justify the imposition of penalties.

Conclusion:

[46] The Appellant has failed to discharge the onus which is upon her to produce credible evidence to demolish the Minister's assumptions. The Minister has satisfied the onus respecting the imposition of penalties. To account for the several concessions made to the Appellant's net worth, the appeals are allowed, with the result that the penalties may also be required to be adjusted. If the parties cannot settle the matter of costs, they may provide written submissions respecting costs on or before March 31, 2010.

Signed at Ottawa, Canada, this 16th day of February 2010.

"Diane Campbell"

Campbell J.

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| CITATION: | 2010 TCC 84 |
| COURT FILE NO.: | 2004-4015(IT)G |
| STYLE OF CAUSE: | Nga Thi Dao and<br>Her Majesty The Queen |
| PLACES OF HEARING: | Toronto, Ontario and<br>Niagara-on-the-Lake, Ontario |
| DATES OF HEARING: | November 6 and 7, 2008,<br>April 20, 21, 22, 23 and 24, 2009 and<br>August 11, 2009 |
| REASONS FOR JUDGMENT BY: | The Honourable Justice Diane Campbell |
| DATE OF JUDGMENT: | February 16, 2010 |

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