Date: 20080721

Docket: A-395-07

Citation: 2008 FCA 241

CORAM: **NADON J.A.**
PELLETIER J.A.
TRUDEL J.A.

BETWEEN:

RÉGENT LACROIX

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Hearing held at Montréal, Quebec, on May 14, 2008.

Judgment delivered at Ottawa, Ontario, on July 21, 2008.

REASONS FOR JUDGMENT BY: PELLETIER J.A.

CONCURRED IN BY: NADON J.A.
TRUDEL J.A.

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REASONS FOR JUDGMENT

PELLETIER J.A.

INTRODUCTION

[1] In the case of any reassessment beyond the normal reassessment period (the statutory period), as in the case of the assessment of a penalty, the *Income Tax Act* requires that the Minister prove that there was misconduct on the part of the taxpayer in filing his or her tax return. How does the Minister discharge this burden of proof where the reassessment, or the assessment of the penalty, results from the application of the net worth method? Can the Minister conclude, based on the discrepancy between a taxpayer's assets and the income reported in his or her tax return, on the

one hand, and on the lack of a credible explanation for this discrepancy, on the other hand, that there is an error warranting an out-of-time reassessment or the assessment of a penalty? The Tax Court of Canada judge concluded that the Minister could. Was the judge correct?

THE FACTS

[2] In the year 2001, the Canada Revenue Agency (the Minister) asked Régent Lacroix and his spouse to prepare their personal balance sheets for each taxation year from 1995 to 2000. Mr. Lacroix's balance sheet reported liquid assets totalling $500,000 from the 1995 taxation year. This led to a more in-depth review of Mr. Lacroix's affairs. The Minister conducted this review using the net worth method, which revealed a significant discrepancy between the Mr. Lacroix's opening balance and closing balance. This discrepancy was deemed to be income. The Minister concluded that Mr. Lacroix had unreported income totalling $145,667 for the 1997 taxation year, $231,570 for the 1998 taxation year, $156,333 for the 1999 taxation year and $26,103 for the 2000 taxation year. The Minister made reassessments for the taxation years in question, adding these amounts to Mr. Lacroix's income. However, two of these reassessments were made outside the statutory period. Furthermore, the Minister did not confine himself to simply increasing Mr. Lacroix's income; he assessed penalties against him because Mr. Lacroix, it would appear, knowingly, or under circumstances amounting to gross negligence, filed false tax returns.

[3] In so doing, the Minister rejected Mr. Lacroix's explanation as to the source of the $500,000 in cash appearing in his balance sheet. According to Mr. Lacroix, the cash came from a loan made to him by Gilles Pronovost. The two men first met when Mr. Lacroix saved Mr. Pronovost 's son

from drowning. This was the beginning of a friendship between the two men. In the course of this relationship, Mr. Lacroix told Mr. Pronovost about his dream of setting up a real estate investment portfolio for himself. Feeling ever grateful to Mr. Lacroix for having rescued his son, Mr. Pronovost agreed to loan him $500,000, which he gave him in several instalments over a period of two or three years beginning in 1993. All of these payments were made in cash. Mr. Lacroix states that he kept the money locked in a safe at his home. According to his balance sheet for 1995, Mr. Lacroix let this cash build up for several years before he began setting up his real estate portfolio. In 1996, he started acquiring properties, becoming the owner of 20 buildings, according to his personal balance sheet for the year 1999.

[4] The Minister reassessed Mr. Lacroix's tax returns, and Mr. Lacroix wasted no time in contesting those reassessments. When the Minister confirmed the reassessments, Mr. Lacroix filed a notice of appeal for each of the taxation years in question, namely 1997, 1998, 1999 and 2000. All of those appeals were brought to trial before Justice Bédard of the Tax Court of Canada, who dismissed each appeal: see *Lacroix v. Canada*, 2007 TCC 376, [2007] T.C.J. No. 216. After setting out the evidence and citing long passages from the testimonies of Mr. Lacroix and Mr. Pronovost in support, the judge stated his findings with regard to credibility:

> 12. The assessment of the credibility of the appellant and of Mr. Pronovost have played an important role in my decision, given the almost complete lack of documentary or objective evidence as to how the appellant used the $500,000 in cash or where the $500,000 in cash allegedly held by Mr. Pronovost came from. I would like to point out that I attach little probative value to the testimonies of the appellant, his spouse and Mr. Pronovost . . . .

[5] The judge listed, one after the other, the numerous implausibilities supporting his findings with regard to the witnesses' credibility. Finally, the judge writes the following:

> 20. My analysis of the evidence leads me to find that it is more likely than not that these loans never existed and that the notes (Exhibit A-4), the request for repayment (Exhibit A-8) and the cheques made out to Mr. Pronovost were merely a sham to hide the truth. Accordingly, it is difficult to arrive at any other conclusion than that the appellant deliberately failed to report $516,000 in income. In my opinion, the Minister has discharged the burden of proof on him and was therefore entitled to impose penalties under subsection 163(2) of the Act on the appellant's unreported income. Since the Minister's burden of proof is less under subsection 163(2) of the Act than under subsection 152(4), I am also of the opinion that the Minister was entitled to make reassessments. Finally, I note that the Minister does not, in my opinion, have to identify the source of the appellant's unreported income when this income is established using the net worth method.

[6] The appellant challenges the judge's conclusions, which are merely findings with regard to the credibility of the witnesses who appeared before him. The judge never determined the true source of the funds in question or how they were applied, nor did he determine the true nature of the relationship between Mr. Lacroix and Mr. Pronovost. He simply stated that he did not believe their testimony and that the evidence they submitted had been fabricated. Therefore, there was no evidence before the judge that would have allowed him to conclude that the discrepancy detected using the net worth method was not income.

[7] The appellant submits that, notwithstanding the great deference that a court of appeal must afford to a trial judge's findings of fact, we must intervene because the judge rejected out of hand all of the evidence supporting the appellant's version of the facts. The appellant notes, for example, that there is evidence of a number of certified cheques made to the order of Mr. Pronovost from a trust controlled by Mr. Lacroix. According to the appellant, this proves that there was a loan and that it

was repaid, except for $70,000. The appellant draws the Court's attention to other evidence that the judge wrongly failed to consider or to which he did not give appropriate weight in assessing the appellant's credibility.

[8] The assessment of credibility is the task of the trial judge. There is nothing surprising in the fact that some evidence supports the version of the facts proposed by one party while other evidence undermines it. The trial judge is in a better position to assess the true value of these disparate elements and draw the proper conclusions. In the case at bar, the judge duly noted the evidence which the appellant raises but deemed it to be fabricated and dismissed it. There is nothing in the evidence or in the I*ncome Tax Ac*t, R.S. 1985, c. 1 (5th Supp.), (the Act) that would warrant this Court's intervention. The debate in this appeal is at another level.

ANALYSIS

[9] The rejection of Mr. Lacroix's explanation for the discrepancy between his reported income and his net worth does not in itself justify a reassessment beyond the statutory period or warrant the assessment of a penalty. There are therefore two issues that remain to be decided:

> 1. Was the Minister required to prove the source of the income detected through the application of the net worth method to justify the inclusion of this income in the taxable income of Mr. Lacroix?
>
> 2. Did the Minister discharge the burden of proof on him under subparagraph 152(4)(*a*)(i) and subsection 163(2) before, first, making a reassessment beyond the statutory period and, second, assessing a penalty against the taxpayer?

[10] It should be noted that these are two distinct questions. The question of the source of the income attributed to Mr. Lacroix in applying the net worth method must be raised even when the

Minister attempts to make a reassessment within the statutory period. The first question therefore cannot be answered by relying on case law that only addresses the second.

1- Was the Minister required to prove the source of the income detected through the application of the net worth method to justify the inclusion of this income in the taxable income of Mr. Lacroix?

[11] Mr. Lacroix contests the judgment of the judge of the Tax Court of Canada on the basis of case law of that court holding that the Minister, in applying the net worth method, must not only show that the discrepancy between the taxpayer's assets and his reported income leads to the conclusion that the taxpayer earned unreported income, but also demonstrate that the source of this income can be determined:

> 77. The Minister has the initial onus of proving that a taxpayer made a misrepresentation in filing the tax return. It is insufficient for the Minister to refer to a net worth statement showing discrepancies between available income and reported income. The Minister must prove that this additional income was from a source that should have been included in the taxpayer's return. The onus on the Minister will be greater if the taxpayer presents plausible explanations showing a non-taxable source of this additional income.
>
> [Emphasis added]
> [*Dowling v. Canada*, [1996] T.C.J. No. 301, [1996] 2 C.T.C. 2340, at paragraph 77 (*Dowling*).]

[12] In *Dowling*, a professional golfer's tax returns for a number of taxation years were reassessed using the net worth method. Two of the years reassessed by the Minister fell outside the statutory period. The passage cited above, upon which Mr. Lacroix relies, is taken from the analysis of the burden of proof on the Minister where the Minister attempts to make a reassessment beyond the statutory period.

[13] Just as in the instant case, Mr. Dowling had an explanation for the discrepancy detected using the net worth method. The Court rejected this explanation but also considered the Minister's theory as to the source of the unreported income, namely an underestimation of the income generated by Mr. Dowling's golf pro shop. The Court conducted this analysis to determine whether the Minister had proven that Mr. Dowling had knowingly misrepresented the facts in his tax return. The Court then scrutinized the evidence with great care and concluded that Mr. Dowling's golf pro shop had a profit margin of 60%, not 15% as he claimed. From this, the Court concluded as follows at paragraph 95:

> 95. Since the respondent (the Crown) showed that the appellant misrepresented his income from his business, the next step was to show that this misrepresentation was due to negligence, carelessness, or wilful default. A number of cases have held that a failure to keep adequate business records will constitute negligence. In the present case, the appellant failed to keep the cash register tapes as supporting documentation of his sales. As well, the appellant combined his personal finances with those of his business in one bank account. These actions amounted to negligence on the part of the appellant . . . .

[14] Upon reading the reasons of the Court, it becomes clear that the Court had considered the question of the source of the income in order to decide if the taxpayer had been negligent in respect of this source, or if had acted knowingly or under circumstances amounting to gross negligence. The question of the income's source was raised in the context of evidence of misconduct on the part of the taxpayer.

[15] The same problem arose in *Corriveau v. Canada*, 97-767 (IT)I, [1998] T.C.J. No. 1112. The net worth method did not reveal a significant discrepancy between the income reported in the taxpayer's tax return and the additions to his assets during the period in question. The Tax Court of

Canada was not satisfied with the evidence adduced by the Minister regarding the source of this income, in that the Court still had doubts as to whether the taxpayer's conduct amounted to negligence, carelessness or wilful omission:

> 31. If I cannot be specific as to Mr. Corriveau's gross negligence, I cannot find that the conditions for the application of section 163 of the Act have been met.
>
> [*Corriveau*, at paragraph 31.]

[16] Again, the question of the source of the unreported income was raised wholly in the context of evidence of the taxpayer's misconduct in filing his tax return.

[17] The Court conducted the same analysis in *Léger v. Canada*, 96-4799 (IT)G, [2000] T.C.J. No. 911, at paragraphs 48 to 51.

[18] In my view, this jurisprudence does not establish a rule to the effect that the Minister may not use the net worth method to add unreported income to a taxpayer's income unless the Minister can establish the source of the unreported income. Our tax collection system is based on the taxpayer's self-reporting of the income he or she has earned during a taxation year. Should the Minister doubt, for whatever reason, the accuracy of the taxpayer's return, the Minister may conduct an investigation in such manner as deemed necessary. The Minister may then make a reassessment. If the taxpayer appeals the reassessment, the Minister does not have to prove the facts giving rise to the reassessment. In the reply to the notice of appeal, the Minister need only set out the presumptions of fact used in the reassessment. The onus is on the taxpayer, who knows everything

there is to know about his or her own affairs, to "demolish" the Minister's assumptions; otherwise, they are presumed to be true.

[19] The Supreme Court has endorsed this approach on a number of occasions, including in *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336, to name just one example. In that case, the Court stated the following at paragraphs 92-93:

> 92 . . . The Minister, in making assessments, proceeds on assumptions (*Bayridge Estates Ltd. v. M.N.R.*, 59 D.T.C. 1098 (Ex. Ct.), at p. 1101) and the initial onus is on the taxpayer to "demolish" the Minister's assumptions in the assessment (*Johnston v. Minister of National Revenue*, [1948] S.C.R. 486; *Kennedy v. M.N.R.*, 73 D.T.C. 5359 (F.C.A.), at p. 5361). The initial burden is only to "demolish" the exact assumptions made by the Minister but no more: *First Fund Genesis Corp. v. The Queen*, 90 D.T.C. 6337 (F.C.T.D.), at p. 6340.
>
> 93 This initial onus of "demolishing" the Minister's exact assumptions is met where the Appellant makes out at least a prima facie case: *Kamin v. M.N.R.*, 93 D.T.C. 62 (T.C.C.); *Goodwin v. M.N.R.*, 82 D.T.C. 1679 (T.R.B.) . . . . The law is settled that unchallenged and uncontradicted evidence "demolishes" the Minster's assumptions: see for example *MacIsaac v. M.N.R.*, 74 D.T.C. 6380 (F.C.A.), at p. 6381; *Zink v. M.N.R.*, 87 D.T.C. 652 (T.C.C.) . . . .

[20] Applying the net worth method changes nothing in this method of proof. Where the Minister presumes that the income detected using the net worth method is taxable income, the onus is on the taxpayer to demolish this presumption. If the taxpayer presents credible evidence that the amount in question is not income, the Minister must then go beyond these assumptions of fact and file evidence proving the existence of this income.

[21] In the case at bar, the assumptions of fact on which the Minister relied included the following:

> [TRANSLATION]
> 22. . . .
>
> (l) The appellant did not report all of his income in his tax returns for the years 1997, 1998, 1999 and 2000;
>
> (m) After conducting an audit using the net worth method, the Minister found that the appellant had underestimated his taxable income, in the following amounts . . .
>
> | | |
> |---|---|
> | 1997 | $145,667 |
> | 1998 | $231,570 |
> | 1999 | $156,333 |
> | 2000 | $26,103 |
>
> [Emphasis added]

[22] The amount and the nature of the unreported income having been alleged by the Minister in his assumptions of fact, the onus was on the taxpayer to prove to the judge of the Tax Court of Canada that the amounts detected using the net worth method were not taxable income.

[23] In the case at bar, Mr. Lacroix did not deny that he had access to a source of funds in addition to his reported income; however, he argued that these funds were not income because they were merely loans that had been extended to him by his friend, Mr. Pronovost. The judge of the Tax Court of Canada rejected this explanation, which means that the Minister's assumptions of fact, including the one regarding the taxable nature of the income earned by Mr. Lacroix, are presumed to be true. The Court could therefore conclude that Mr. Lacroix had underestimated his taxable income in the amounts set out in the reply to the notice of appeal for each of the taxation years in question.

[24] This reasoning in no way places an unfair burden on the taxpayer. The taxpayer is aware of the facts and has the means to prove them. It would be most unrealistic to have the Minister bear the onus of uncovering a source of income whose existence can be detected only indirectly, that is, using the net worth method.

2. Did the Minister discharge the burden of proof on him under subparagraph 152(4)(*a*)(i) and subsection 163(2) before, first, making a reassessment beyond the statutory period and, second, assessing a penalty against the taxpayer?

[25] The provisions in question read as follows:

152.(4) The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if	152.(4) Le ministre peut établir une cotisation, une nouvelle cotisation ou une cotisation supplémentaire concernant l'impôt pour une année d'imposition, ainsi que les intérêts ou les pénalités, qui sont payables par un contribuable en vertu de la présente partie ou donner avis par écrit qu'aucun impôt n'est payable pour l'année à toute personne qui a produit une déclaration de revenu pour une année d'imposition. Pareille cotisation ne peut être établie après l'expiration de la période normale de nouvelle cotisation applicable au contribuable pour l'année que dans les cas suivants:
(*a*) the taxpayer or person filing the return	*a*) le contribuable ou la personne produisant la déclaration:
(i) has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under this Act, or	(i) soit a fait une présentation erronée des faits, par négligence, inattention ou omission volontaire, ou a commis quelque fraude en produisant la déclaration ou en fournissant quelque renseignement sous le régime de la présente loi,
…	[…]

163.(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of $100 and 50% of the total of…	163.(2) Toute personne qui, sciemment ou dans des circonstances équivalant à faute lourde, fait un faux énoncé ou une omission dans une déclaration, un formulaire, un certificat, un état ou une réponse (appelé «déclaration» au présent article) rempli, produit ou présenté, selon le cas, pour une année d'imposition pour l'application de la présente loi, ou y participe, y consent ou y acquiesce est passible d'une pénalité égale, sans être inférieure à 100 $, à 50 % du total des montants suivants:…
…	[…]

[26] Although the Minister has the benefit of the assumptions of fact underlying the reassessment, he does not enjoy any similar advantage with regard to proving the facts justifying a reassessment beyond the statutory period, or those facts justifying the assessment of a penalty for the taxpayer's misconduct in filing his tax return. The Minister is undeniably required to adduce facts justifying these exceptional measures.

[27] In *Richard Boileau v. M.N.R.*, 89 D.T.C. 247, Judge Lamarre Proulx stated as follows, at page 250:

> Indeed, the Appellant was unable to contradict the basic elements of the net worth assessments. However, in my view, this is not sufficient for discharging the burden of proof which lies on the Minister. To decide otherwise would be to remove any purpose to subsection 163(3) by reverting the Minister's burden of proof back onto the Appellant.

[28] In a similar vein, in *Farm Business Consultants Inc. v. Her Majesty the Queen*, [1994] 2 C.T.C. 2450, 95 D.T.C. 200, Judge Bowman wrote the following at paragraph 27:

> 27 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 . . . .

[29] This last passage highlights the dialectic specific to certain reassessments made using the net worth method. In the case at bar, the Minister found undeclared income and asked the taxpayer to justify it. The taxpayer provided an explanation that neither the Minister nor the Tax Court of Canada found to be credible. Accordingly, there is no viable and reasonable hypothesis that could lead the decision-maker to give the taxpayer the benefit of the doubt. The only hypothesis offered was deemed not to be credible.

[30] The facts in evidence in this case are such that the taxpayer's tax return made a misrepresentation of facts, and the only explanation offered by the taxpayer was found not to be credible. Clearly, there must be some other explanation for this income. It must therefore be concluded that the taxpayer had an unreported source of income, was aware of this source and refused to disclose it, since the explanations he gave were found not to be credible. In my view, given such circumstances, one must come to the inevitable conclusion that the false tax return was filed knowingly, or under circumstances amounting to gross negligence. This justifies not only a penalty, but also a reassessment beyond the statutory period.

[31] Paragraph 20 of Justice Bédard's reasons for decision, cited above, sets out precisely this situation, which amply justifies his conclusions with regard to the penalties and the reassessment beyond the statutory period.

[32] What, then, of the burden of proof on the Minister? How does he discharge this burden? There may be circumstances where the Minister would be able to show direct evidence of the taxpayer's state of mind at the time the tax return was filed. However, in the vast majority of cases, the Minister will be limited to undermining the taxpayer's credibility by either adducing evidence or cross-examining the taxpayer. Insofar as the Tax Court of Canada is satisfied that the taxpayer earned unreported income and did not provide a credible explanation for the discrepancy between his or her reported income and his or her net worth, the Minister has discharged the burden of proof on him within the meaning of subparagraph 152(4)(*a*)(i) and subsection 162(3).

[33] As Justice Létourneau so aptly put it in *Molenaar v. Canada*, 2004 FCA 349, 2004 D.T.C. 6688, at paragraph 4:

> 4. Once the Ministère establishes on the basis of reliable information that there is a discrepancy, and a substantial one in the case at bar, between a taxpayer's assets and his expenses, and that discrepancy continues to be unexplained and inexplicable, the Ministère has discharged its burden of proof. It is then for the taxpayer to identify the source of his income and show that it is not taxable.

[34] For these reasons, I would dismiss the appeal with costs.

"J.D. Denis Pelletier"
J.A.

"I concur.
M. Nadon J.A."

"I concur.
Johanne Trudel J.A."

Certified true translation
Michael Palles

FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

DOCKET:	A-395-07
APPEAL FROM A JUDGMENT OF THE HONOURABLE MR. JUSTICE PAUL BÉDARD OF THE TAX COURT OF CANADA, DATED JUNE 14, 2007, IN DOCKET NO. 2004-757(IT)G	
STYLE OF CAUSE:	*RÉGENT LACROIX and HER MAJESTY THE QUEEN*
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	May 14, 2008
REASONS FOR JUDGMENT BY:	PELLETIER J.A.
CONCURRED IN BY:	NADON J.A. TRUDEL J.A.
DATED:	JULY 21, 2008

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