Federal Court of Appeal | Cour d'appel fédérale

Date: 20220516

Dockets: A-65-20
A-66-20

Citation: 2022 FCA 84

CORAM: **GLEASON J.A.**
RIVOALEN J.A.
MONAGHAN J.A.

Docket: A-65-20

BETWEEN:

DENNIS KHANNA

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Docket: A-66-20

BETWEEN:

VEERU KHANNA

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on April 28, 2022.

Judgment delivered at Ottawa, Ontario, on May 16, 2022.

REASONS FOR JUDGMENT BY:	MONAGHAN J.A.
CONCURRED IN BY:	GLEASON J.A. RIVOALEN J.A.

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REASONS FOR JUDGMENT

MONAGHAN J.A.

[1] In 2016, the Minister of National Revenue (Minister) reassessed Veeru Khanna and her husband, Dennis Khanna, under the *Income Tax Act* R.S.C. 1985, c. 1 (5th Supp.) (the Act) with respect to their 2008 taxation years. The reassessments were made on a net worth basis and included unreported income in excess of $250,000 for each of the Khannas. Mr. Khanna also was reassessed with respect to his 2009 taxation year on the basis that he had received a shareholder benefit that should have been included in his income. All of the reassessments imposed penalties under subsection 163(2) of the Act.

[2] The Khannas appealed the reassessments to the Tax Court of Canada. However, at the commencement of the Tax Court hearing, they conceded that they had unreported income in 2008 as assessed by the Minister. Therefore, the only issues before the Tax Court were whether Mr. Khanna's 2009 assessment was correct and whether the Khannas were liable for penalties under subsection 163(2).

[3] The Tax Court (*per* D'Auray J.) dismissed the appeals for reasons delivered orally on January 21, 2020, finding both Khannas liable for the penalties in 2008, and upholding the assessment of Mr. Khanna's 2009 taxation year. While both Khannas appealed that decision to this Court, Mr. Khanna made no arguments in support of his appeal and thus, as discussed during the hearing, his appeal will be dismissed. Thus, the only remaining issue before this Court is

whether Ms. Khanna (the appellant) is liable for penalties under subsection 163(2) of the Act in her 2008 taxation year.

[4] The appellate standard of review applies to this appeal. The standard of review for questions of fact and of mixed fact and law is palpable and overriding error; for questions of law the applicable standard is correctness: *Housen v. Nikolaisen,* 2002 SCC 33, [2002] 2 S.C.R. 235.

[5] A person is liable for a penalty under subsection 163(2) of the Act where that person "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 […]". Subsection 163(3) states that the burden of establishing the facts justifying the imposition of penalties is on the Minister.

[6] Thus, before the Tax Court the respondent was required to establish, on a balance of probabilities that: (i) the appellant's 2008 tax return contained a false statement or omission (a misrepresentation) and (ii) the appellant made, participated in, assented to or acquiesced in the making of that misrepresentation knowingly or under circumstances that amount to gross negligence.

[7] "'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": *Venne v.The Queen*, 1984] C.T.C. 223, 84 D.T.C. 6247, at para. 37. The "conduct must include a high degree of negligence equal to

intentional acting or indifference as to compliance": *Melman v. Canada* 2017 FCA 83. [2017] 5 C.T.C 1, at para. 4.

[8] The appellant conceded that her return did not report all of her income in 2008, so there is no doubt the respondent established a misrepresentation. However, the appellant submits that the Tax Court erred in concluding that the respondent established the second condition—that she made the misrepresentation knowingly or under circumstances amounting to gross negligence. The appellant submits as no evidence of her knowledge was led; the respondent was required to lead evidence to establish she was grossly negligent. Yet, says the appellant, the respondent failed to do so, neither calling her as a witness nor obtaining information about her from the other witnesses that would support a gross negligence finding.

[9] In particular, the appellant submits that the Tax Court made factual findings concerning the appellant that were not reasonably open to it on the evidence before it. Moreover, says the appellant, without those factual findings, the facts as found by the Tax Court are insufficient to support a finding that she is liable for the subsection 163(2) penalty.

[10] After stating that the Khannas both worked as mortgage brokers for a corporation they jointly owned and that they together owned 18 rental properties, the Tax Court determined that the appellant was liable for the subsection 163(2) penalties in 2008 because the Minister established the following facts:

1. The appellant and Mr. Khanna "were both uncooperative in providing books and records and when they did they were incomplete".

2. The appellant and Mr. Khanna's "personal expenditures exceeded their family reported income by $67,481 in 2008 and $3,456 in 2009".
3. The amount of unreported rental income was important and quite large and she reported less than she should have.
4. The appellant and Mr. Khanna did not report rental income of $166,755 in 2009.
5. The appellant and Mr. Khanna were both knowledgeable and should have known that they had unreported rental income.
6. Neither the appellant nor Mr. Khanna acted as a reasonable person would have because they were professional mortgage brokers and as such dealt with legal documents, clients, lawyers and mortgage companies.

[11] The appellant argues that the evidence before the Tax Court did not support a finding she was uncooperative in providing books and records or that she had unreported rental income in 2009. Therefore, she submits, the Tax Court made a palpable and overriding error. Moreover, says the appellant, to the extent that the facts were established with respect to her, they are not sufficient to meet the legal test for the imposition of subsection 163(2) penalties—that she made the misrepresentation knowingly or in circumstances that amount to gross negligence.

[12] I agree.

[13] I have carefully reviewed the transcripts and the documents in the Appeal Book. Nothing suggests the appellant was uncooperative or that she had unreported rental income in 2009. It appears she signed the bank authorization she was asked to sign, as confirmed in the

Canada Revenue Agency (CRA) penalty recommendation reports for the appellant and her husband. While the appellant may have agreed her husband would represent her during the audit, the circumstances surrounding that agreement are not on the record. Moreover, Mr. Khanna's behaviour during the audit does not establish the appellant's knowledge or gross negligence at the time her 2008 return was prepared and filed, years before the audit, which is the question that subsection 163(2) requires be answered.

[14] The only two witnesses before the Tax Court were Heather Geddes, an auditor from the CRA, and Mr. Khanna. While the appellant did not testify before the Tax Court, the record establishes she was present at the Tax Court hearing. Thus, pursuant to section 146(2) of the *Tax Court of Canada Rules (General Procedure)* SOR/90-688a, the respondent could have called her as a witness without notice, but did not.

[15] It appears from the record that the appellant agreed to accept her husband's testimony. Mr. Khanna was asked many questions about his unreported income in 2009 and from the rental properties in 2008. He was asked about the information he provided to the accountants who prepared the tax returns for the Khannas. He was asked whether he agreed with the assumptions the Minister made in assessing penalties against him as described in the Reply to the Notice of Appeal filed in respect of his Notice of Appeal in the Tax Court. However, he was not asked about the assumptions in the Reply to the Notice of Appeal filed in respect of the appellant's Notice of Appeal in the Tax Court.

[16] Mr. Khanna's testimony was almost entirely about his actions and inactions. Mr. Khanna was not asked what the appellant knew about the rental business or to describe her involvement in it. He was not asked whether the appellant met with the accountants or provided them with information or if she did not, why. The only questions he was asked relevant to the appellant were to identify her 2008 return, about the number of rental properties they owned together and how the income was split between them, and about the amount of gross rental income she reported in 2008.

[17] Similarly, the focus of Ms. Geddes' testimony was about the audit and Mr. Khanna. The only bank account identified as being the appellant's was described by Ms. Geddes as a joint bank account the appellant had with her daughter. Ms. Geddes testified "a lot of the transactions for the rental income was through that bank account in the name of their daughter". However, Mr. Khanna and Ms. Geddes both testified that Mr. Khanna was very hands on with respect to the rental properties, and that he found the tenants, collected the rent and made most of the bank deposits. The penalty report for Mr. Khanna is consistent with this and also states Mr. Khanna orders and pays for all repairs and maintenance for the properties. Indeed, the Replies to the Khannas' Notices of Appeal in the Tax Court repeat many of those statements regarding Mr. Khanna's role in the rental activity as assumptions relied on by the Minister in assessing both of the Khannas. However, there are no assumptions or assertions in either Reply that the appellant played an active or day-to-day role in the rental business. Other than Mr. Khanna's testimony that they shared the income from the rental properties they owned, and Ms. Geddes' testimony that some leases were in the appellant's name, nothing on the record addresses her involvement in or knowledge about the details of the rental business.

[18] The appellant's 2008 return in evidence before the Tax Court is unsigned and counsel for the respondent advised the Tax Court he did not have signed copies of the return. Mr. Khanna testified that he thought he had signed his return but also that he thought the returns were e-filed. He was not asked if the appellant saw, reviewed or signed her return before it was filed and nothing on the record establishes whether she did, or whether the appellant knew she had unreported income prior to receipt of the reassessments.

[19] While the appellant conceded the unreported rental income before the Tax Court, the record does not indicate what motivated that concession. Ms. Geddes said because the Khannas were partners in the real estate business and the net worth was done on a family unit basis, whether "it was 90/10, 60/40, they're a family unit. So we called it 50/50".

[20] While the evidence suggests more than $4,000,000 in withdrawals from the three bank accounts, Ms. Geddes working paper—the only evidence on this point—indicates the appellant's account represented only 13% of the total and more than half of the amounts represented mortgage payments and utilities that Ms. Geddes treated as business expenses. As the appellant's counsel observed, the appellant reported some rental income in her 2008 tax return so that even if she saw her 2008 return before it was filed, she may have believed she was reporting the correct amount.

[21] Ms. Geddes' penalty recommendation report for Ms. Khanna largely recites facts about Mr. Khanna. In that report, the "Taxpayer's Knowledge of Tax Matters" and "Taxpayer's Knowledge of Income" and "Examination of Return Prior to Filing" are all stated to be

"Unknown". No one from CRA met with the appellant and Ms. Geddes testified she never spoke with her.

[22] Nothing on the record establishes what the appellant knew, or believed, or what she did or did not do in connection with the preparation or filing of her 2008 return.

[23] The respondent submitted that because the assessment was a net worth assessment, once the appellant conceded she had unreported income and did not provide a reasonable explanation for it, the Minister has discharged her burden. For this proposition, the respondent relies on the following passage from *Lacroix v. Canada*, 2008 FCA 241, [2011] 3 C.T.C. 105, at para. 32:

> …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).

[24] I disagree. As this Court has stated, "simply finding that an unreported amount is taxable does not inevitably lead to a conclusion that a gross negligence penalty is justified": *Deyab v. Canada* 2020 FCA 222, [2021] 4 C.T.C 83, at para. 65, leave to appeal to S.C.C refused, 39587 (June 10, 2021), [*Deyab*]. When a taxpayer has unreported income, "the circumstances related to the failure to report the income must be examined to determine if such failure was attributable to … gross negligence (to justify the assessment of the gross negligence penalty)": *Deyab* at para. 66.

[25] In *Lacroix*, the taxpayer testified and offered an explanation that was found not to be credible. But, the appellant did not testify. She was not asked to explain why she reported only a part of her rental income. The failure to report the amount by itself does not demonstrate "an indifference as to whether the law is complied with".

[26] Before this Court, respondent's counsel suggested the following facts, found by the Tax Court, are sufficient to establish on a balance of probabilities that the appellant was wilfully blind, and that is sufficient to establish gross negligence:

1. The materiality of the unreported income.
2. The appellant's education and experience as a mortgage broker.
3. The appellant appointed her husband as her representative following the reassessments.
4. The appellant only reported rental income for one property.
5. A lot of the rental income was deposited in the bank account she shared with her daughter.
6. That the net worth assessment led to a significant amount of unreported income.

[27] With respect, these facts do not establish that the appellant was wilfully blind. As this Court has said, "[w]ilful blindness pivots on a finding that the taxpayer deliberately chose not to make inquiries in order to avoid verifying that which might be such an inconvenient truth. The essential factual element is a finding of deliberate ignorance": *Wynter v. Canada* 2017 FCA 195, 2017 D.T.C. 5114, at para. 17. Where is the evidence or finding about the appellant's deliberate choice not to make inquiries or the finding of deliberate ignorance? I see nothing in the record.

[28] Therefore, in my view, the Tax Court erred in concluding that the respondent had met the onus under subsection 163(2) to establish the appellant was grossly negligent and so was liable for subsection 163(2) penalties.

[29] For these reasons, I would allow the appellant's appeal.

[30] The parties have agreed that in the event that the appellant is successful, neither will seek costs in either appeal.

[31] Accordingly, I would dismiss Dennis Khanna's appeal without costs. I would allow Veeru Khanna's appeal, without costs, and make the order the Tax Court should have made, referring the reassessment of her 2008 taxation year back to the Minister for reassessment on the basis that she is not liable for penalties under subsection 163(2) of the Act.

"K.A. Siobhan Monaghan"
J.A.

"I agree
Mary J.L. Gleason J.A."

"I agree
Marianne Rivoalen J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKETS:	A-65-20 and A-66-20

APPEALS FROM THE ORDERS OF THE HONOURABLE JUSTICE JOHANNE D'AURAY DATED JANUARY 21, 2020, NOS. 2016 1312(IT)(G) AND 2016-1310(IT)G

DOCKET:	A-65-20
STYLE OF CAUSE:	DENNIS KHANNA v. HER MAJESTY THE QUEEN
DOCKET:	A-66-20
STYLE OF CAUSE:	VEERU KHANNA V. HER MAJESTY THE QUEEN
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	APRIL 28, 2022
REASONS FOR JUDGMENT BY:	MONAGHAN J.A.
CONCURRED IN BY:	GLEASON J.A. RIVOALEN J.A.
DATED:	MAY 16, 2022

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