Docket: 2015-4379(IT)I

BETWEEN:

OK CHA KIM,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
Young-Soo Kim (2015-4381(IT)I),
on May 31, 2016, at Toronto, Ontario.

Before: The Honourable Justice Guy R. Smith

Appearances:

Agent for the Appellant:	Young-Soo Kim
Counsel for the Respondent:	Amit Ummat

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* are allowed and the matter is referred back to the Minister for reconsideration and reassessment on the basis that the Appellant had additional net business income of $14,045 and $6,727 for the 2010 and 2011 taxation years, respectively. Gross negligence penalties are to be calculated accordingly.

Signed at Ottawa, Canada, this 10th day of June 2016.

"Guy Smith"

Smith J.

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REASONS FOR JUDGMENT

Smith J.

I. Introduction

[1] Young-Soo Kim and Ok Cha Kim (the "Appellants") appeal from Notices of Reassessment in respect of the 2010 and 2011 taxation years. This matter was heard on common evidence under the informal rules on May 31, 2016.

[2] The first issue is whether the Minister of National Revenue (the "Minister") correctly reassessed the Appellants for additional net business income in the amounts of $30,342 and $25,584 for the 2010 and 2011 taxation years, respectively. The second issue is whether the Minister was entitled to assess gross

negligence penalties pursuant to subsection 163(2) of the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.), as amended (the "Act").

[3] For reasons set out below, the appeals are allowed and the reassessments are referred back to the Minister for reconsideration and reassessment on the basis that each Appellant had additional net business income of $14,045 and $6,727 for the 2010 and 2011 taxation years, respectively, with gross negligence penalties to be calculated accordingly.

II. Background

[4] The Appellants are spouses of one another. Only Young-Soo Kim ("Mr. Kim") testified at the hearing. At all material times, they were equal partners in a laundry and dry-cleaners business (the "business") located in Mississauga, Ontario.

[5] The Appellants filed their personal tax returns reporting income from various sources as well as their share of the net business income calculated as follows:

	2010	2011
Gross Sales	$55,701	$49,327
Expenses	$45,830	$45,961
Net business income	$ 9,871	$ 3,366

[6] Mr. Kim reported total income from all sources of $11,659 and $27,123 for the 2010 and 2011 taxation years, respectively, and Ok Cha Kim reported total income of $11,844 and $11,695, for the 2010 and 2011 taxation years, respectively. This included their respective share of the net business income noted above and represented total combined income of $23,503 and $38,818 for the 2010 and 2011 taxation years, respectively.

[7] The Minister assumed, for the purposes of the reassessment, that the Appellant's income for the subject years was not commensurate with their personal lifestyle.

[8] During the audit stage, the Minister requested that the Appellants provide a budget of their annual personal expenditures and on the basis of the information provided (and on the basis of statistical data from Statistics Canada, as explained

below), the Minister prepared the following Summary of Personal Expenditures ("SPE") for the subject taxation years (Schedule 4 to the Reply):

Summary of personal expenditures

	Dec. 31, 2010	Dec. 31, 2011
Food	8,689	8,942
Shelter	11,291	11,918
Household operations	3,172	3,195
Clothing	2,804	2,886
Transportation	4,417	4,417
Health care	4,106	3,909
Personal care	120	120
Tobacco and alcohol	-	923
Security	3,692	13,540
Gifts & contributions	2,275	4,295
Miscellaneous	1,540	1,540
	42,106	55,685

[9] The Minister assumed for the purpose of the reassessment, that this reflected an accurate statement of the Appellants' annual personal expenditures. Since the total income reported by the Appellants was insufficient to cover those expenditures, the Minister conducted a net worth and bank audit analysis following which it was concluded that the Appellants' net worth had increased by $11,177 in 2010 and by a further $4,804 in 2011.

[10] On the basis of the net worth calculation and taking into consideration the assumed personal expenditures as well as the total income reported, as noted above, the Minister concluded that the Appellants had failed to report additional business income, calculated as follows:

Description:	**2010**	**2011**
Assets	$424,653	$422,588
Less: Liabilities	259,377	252,508
Net Worth	165,276	170,080
Less: Net Worth of Prior Year	154,100	165,276
Increase in Net Worth	11,176	4,804
Add: Personal Expenses	42,106	55,685
Add: Other expenses	563	3,914
Less: Total Income Reported	23,503	38,818
Total Unreported Income	$30,342	$25,585

[11] The reassessment was also based on Mr. Kim's admission that he was the registered owner of a condominium property located in Mississauga, Ontario and that he had received, but not declared, rent of $1,075 per month from July to December 2011. According the Minister, this amount was incorporated in the net worth calculation noted above.

[12] Finally, the Minister assumed that the Appellants' had not received any gifts, inheritances or lottery winnings during the subject years.

III. Position of the Parties

A. Position of the Appellants

[13] As indicated above, Mr. Kim testified at the hearing but his spouse did not.

[14] He took the position that the SPE was grossly exaggerated and took offence with the fact that it included amounts that had not been listed in the summary prepared by him and submitted to the Minister. He produced copies of a fax forwarded to the Minister on January 25, 2016 and again on February 17, 2016 (to which he claims to have not received a response) requesting that a detailed explanation be provided as to why the amounts listed in the Minister's SPE differed from his own. Attached to that document was a hand-written summary of his personal expenditures that totalled $28,378 for 2010 and $28,141 for 2011.

[15] Mr. Kim objected to the fact that the Minister had included an amount for "food" when he had indicated nil. He suggested there were errors in that for one year there was a nil amount for alcohol and tobacco and $943 for the following year. An annual amount had also been included for clothing when he had included none. He felt that other adjustments were unwarranted but did not produce any statements, receipts or other documentary evidence for the Court.

[16] Mr. Kim admitted that as a result of an error made by him in his initial summary for 2010, the amount described under the category of "Security" should be reduced to $1,440 (and the Minister admitted that a corresponding error had been made for the 2011 calendar year which required a similar downward adjustment).

[17] Mr. Kim disputed the net worth and bank analysis summary and challenged the Minister's ability to extrapolate from those number that he had somehow under-reported his business income. He explained that any shortfall in his family

cash flow during the subject years was absorbed by their personal line of credit that had increased by $35,249 in 2010 (that amount was reflected in the Minister's assumptions). According to Mr. Kim, those funds were used to cover his personal expenditures.

[18] Mr. Kim acknowledged that he had not reported rental payments from his condominium totalling $6,450 for the 2011 calendar year but offered no explanation as to why that was so. He did not produce a lease agreement, rental ledger, or any other form of documentation in this regard.

[19] He indicated that he had purchased the condominium property in 1987 and that his mother-in-law had occupied it. She had since passed away but he could not recall in what year. When asked if he had received any gifts, inheritances or lottery winnings during the subject years, he recalled receiving approximately $10,000 from his mother-in-law's estate but could not provide specific details, concluding upon reflection that it pre-dated the taxation years under review.

[20] And finally, in his closing remarks, Mr. Kim insisted that there was no evidence that he had under-reported his net business income for the subject years or that he had not reported cash generated from the business.

B. Position of the Respondent

[21] Josephine Datu testified on behalf of the Minister. She completed a Bachelor in Business Administration and worked for Agriculture Canada before joining the Canada Revenue Agency ("CRA") fifteen years ago. She informed the Court that she had completed the CRA audit of the Appellants.

[22] She explained that the audit began as a result of a GST investigation. She had communicated with Mr. Kim and met him to discuss his business activities. She noted that the books and records for the business were inadequate and unreliable. She also noted that there were discrepancies between the cash balances reported and the bank deposits. When she questioned Mr. Kim, he indicated that he had used some cash generated from the business to pay expenses. She concluded that the cash from the business was not being fully reported.

[23] Ms. Datu indicated that she provided the Appellants with a blank personal expenditure worksheet which they completed. The first estimate submitted during the audit stage indicated personal family expenditures of $9,352 for 2010 and $8,329 for 2011. Since the amounts were very low and the form was incomplete,

she turned to statistical data from Statistics Canada (for a family of three, since their son also lived with them). For example, since the Appellants had indicated nil for the "food" category, she inputted $8,688 for the calendar year, indicating that this was a very conservative amount for a family of three. For restaurants, the Appellants had either indicated $300 or nil but she used $2,200 per year based on Statistics Canada data. She did the same for other categories including the clothing category (for both Mr. Kim, his spouse and son) since it had been left blank for the 2 years in question. Other amounts, notably charitable donations, were completed using the Appellants' personal tax return.

[24] Ms. Datu admitted that there were errors relating to the category of "Security", as identified by Mr. Kim, and agreed that an adjustment was in order. However, she indicated that this error had arisen as a result of figures provided by Mr. Kim in his initial summary.

[25] She explained to the court that on the basis of her observation that the cash receipts from the business had not been fully recorded, she conducted a net worth and bank analysis. She acknowledged that the Appellant's line of credit had increased by about $35,249 in 2010 but explained that since there was a lack of documentation as to the actual use of those funds, she could not conclude that it was used to pay for personal expenditures, explaining that it could have been used to improve his other properties which included the condominium as well as a cottage. No supporting documentation, including monthly statements, was provided by the Appellants despite repeated requests. In the end, she concluded that the increase in the Appellants' net worth was either attributable to the unreported cash from the laundry business or undeclared rent from the condominium.

[26] In closing submissions, the Minister argued that the Appellants had failed to discharge the onus of demonstrating to the Court that the reassessments for the subject years were incorrect, even after taking into consideration the errors noted above. The Minister argued that, given the indication that cash was being under-reported and the Appellants' own admission that rental income had not been reported, she was entitled to proceed with an arbitrary assessment.

[27] In the end, the Minister argued that it boiled down to an issue of credibility and, faced with an admission that rental income had not been reported and the general lack of documentation, the Appellants' version of the facts was not credible.

[28] Finally, the Minister argued that in failing to report the additional business income (which included the unreported rental income), the Appellants had knowingly participated in or acquiesced in the making of false statements or omissions in their income tax returns for the subject years, and that this was an appropriate case for gross negligence penalties under subsection 163(2) of the Act.

IV. The Law and Analysis

A. Arbitrary assessment

[29] The Federal Court of Appeal has indicated in the decision of *Hsu v. Canada*, 2001 FCA 240, that the Minister may make an arbitrary assessment using any method appropriate in the circumstances. As indicated by the Court:

> 22 Subsection 152(7) of the Act empowers the Minister to issue "arbitrary" assessments using any method that is appropriate in the circumstances. That subsection reads thus:
>
> | | |
> |---|---|
> | 152(7) Assessment not dependent on return or information. The Minister is not bound by a return or information supplied by or on behalf of a taxpayer and, in making an assessment, may, notwithstanding a return or information so supplied or if no return has been filed, assess the tax payable under this Part. | 152(7) Cotisation indépendante de la déclaration ou des renseignements fournis. Le ministre n'est pas lié par les déclarations ou renseignements fournis par un contribuable ou de sa part et, lors de l'établissement d'une cotisation, il peut, indépendamment de la déclaration ou des renseignements ainsi fournis ou de l'absence de déclaration, fixer l'impôt à payer en vertu de la présente partie. |
>
> Subsection 152(8) grants a presumption of validity to these assessments and places the initial onus upon the taxpayer to disprove the state of affairs assumed by the Minister (*Dezura v. M.N.R.* (1947), 3 D.T.C. 1101 at 1102 (Ex. Ct.)). Notwithstanding the fact that such an assessment is "arbitrary", the Minister is obliged to disclose the precise basis upon which it has been formulated (*Johnston v. M.N.R.* (1948), 3 D.T.C. 1182 at 1183 (S.C.C.)). Otherwise, the taxpayer would be unable to discharge his or her initial onus of demolishing the "exact assumptions made by the Minister but no more" (*Hickman Motors Ltd. v. The Queen* (1997), 97 D.T.C. 5363 at 5376 (S.C.C.)).

> 23 Subsection 152(7) of the Act does not establish a specific method for determining the tax payable by a taxpayer. In most cases, the Minister follows the "net worth method". The Taxpayers Operations Manual prepared by National Revenue describes the net worth method as follows:
>
> > The use of a net worth approach to major income is based on the premise that a client's income for a period is the increase in the client's net worth (financial position) between the beginning and end of a particular period. A client's net worth is the excess of his total assets, business and personal, over his total liabilities, business and personal, at a specific date.
>
> 24 Simply put, the amount by which the taxpayer's net worth increases over a particular period is imputed to the taxpayer as income.

[30] It is acknowledged that the net worth assessment is arbitrary in nature but it reflects the fact that the Canadian income tax system is based on self-assessing and self-reporting. As further indicated in *Hsu v. Canada*, *supra*:

> 30 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.
>
> [My emphasis.]

[31] A taxpayer cannot simply argue that the Minister's assumptions are wrong, he must demonstrate that by providing supporting documentation. In the absence of such documentation, the only issue before the Court is whether the Minister's assessment "was reasonable and logical in the circumstances…": *Hsu v. Canada*, *supra*, at paragraph 33. I note that this meshes with the notion set out in subsection 152(8) that there is a presumption as to the validity of the reassessments:

> **152(8) Assessment deemed valid and binding** — An assessment shall, subject to being varied or vacated on an objection or appeal under this Part and subject to a reassessment, be deemed to be valid and binding notwithstanding any error, defect or omission in the assessment or in any proceeding under this Act relating thereto.

[32] Where the Minister has disclosed the precise basis upon which the reassessment has been made, the taxpayer has the onus of providing another

reliable calculation method that is both credible and supported by evidence. In this instance, the Minister has clearly disclosed the methodology used to conclude that the Appellants had additional unreported business income for the taxation years in question.

[33] The Appellants have advanced the argument that their personal expenditures were paid using the line of credit and it was apparent from the Minister's assumptions that the line of credit had indeed increased substantially in 2010. The Appellants' argument therefore appears, at first blush at least, to have some merit when one considers that the combined personal income declared for the subject years, together with the unreported rental income and increase in the line of credit adds up to about $101,396, calculated as follows:

	2010	2011	Total
Reported income Tax Young-Soo Kim	$11,659	$27,123	$38,782
Reported income Tax Ok Cha Kim	$11,844	$11,695	$23,539
Unreported rental income	$0	$6,450	$6,450
Increase in line of credit	$35,249	$(2624)	$32,625
Total	$58,752	$42,644	$101,396

[34] Based on that analysis, there would be more than enough cash flow within the family unit to cover the expenditures as compiled in the Minister's SPE. But the Appellants ask the Court to believe their version of the facts without providing any supporting documentation. Even if the Court considers the Appellants' argument as to the use of the line of credit and accepts that it is plausible, in the absence of corroborating documentation, the question is whether it is credible, all things considered.

[35] I am of the view that Mr. Kim's testimony was a mixture of bluster and bravado. It was simply not credible. Rather than assisting the Court with a careful review of books and records or bank statements, he preferred the offensive, challenging every number on the Minister's SPE. This was all the more surprising in that his initial estimate of the personal expenditures had increased from $9,352 to $28,378 for 2010 and from $8,329 to $28,141 in 2011. In other words, his initial estimate had increased almost threefold and he had still not included an amount for "food", despite the fact (I take judicial notice of this) that it is represents one of the largest expenditures in the average family budget. While I appreciate that Mr. Kim

may not have had full control of the family budget, he did have an obligation to make further enquiries and his spouse, who chose not to testify, had an obligation to participate in the preparation of the SPE. I am inclined to believe that she was not involved but that does not assist Mr. Kim with the issue of credibility.

[36] Moreover, having admitted to the CRA auditor that he had used the cash from the business to pay expenses, he proceeded to deny that there was any unreported cash and, in another display of bravado, invited the Government of Canada to purchase his business. He failed to produce sales records, bank deposits or any other form of books and records such that the Court is compelled to conclude that none existed. There was not a scintilla of documentary evidence before the Court.

[37] On the issue of the rental income, his testimony was evasive at best. He admitted to unreported rental income of $1,075 per month from July to December 2011 but failed to fill in the obvious gap with respect to the previous six months. He provided little if any information as to the rental history of the property from the date of acquisition in 1987, suggesting only that it had been occupied by his mother-in-law. No details were provided as to the duration of her occupancy or whether she paid any rent although the implicit suggestion was that she had not. He could not recall the date of her passing. Although not relevant for the purposes of this litigation, Mr. Kim was careful and tight-lipped as to the status of the property after the taxation years in question. This does not help his credibility.

[38] As indicated above, the argument that the line of credit was used to pay for personal expenditures during the subject years is plausible and appears to have some merit. Faced with an arbitrary assessment by the Minister, it represents the Appellants' attempt to provide an alternative or modified method to explain the unreported income for the taxation years in question. However, it was only once Mr. Kim realized or was prepared to admit that his personal expenditures were much higher than he had initially estimated during the audit stage, that this argument was put forward. The Court is unable to come to any conclusion as to whether it is an accurate statement of the facts since Mr. Kim has chosen not to provide any evidence. Had he been more forthcoming with details and documentation, the Court might have come to another conclusion.

[39] The Appellants have the onus of refuting and demolishing the assumptions on which the reassessment is based: *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336. I am of the view that they have failed to do so.

[40] Before concluding on this issue, I note that the Minister's evidence was that it was not possible to reconcile the cash balances with the bank deposits for the business and that the books and records maintained by the Appellants were both inadequate and unreliable. The Appellants have a statutory obligation to maintain proper books and records as provided for in subsection 230(1) of the Act:

> **230(1) Records and books** — Every person carrying on business and every person who is required, by or pursuant to this Act, to pay or collect taxes or other amounts shall keep records and books of account (including an annual inventory kept in prescribed manner) at the person's place of business or residence in Canada or at such other place as may be designated by the Minister, in such form and containing such information as will enable the taxes payable under this Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined.

[41] The absence of such records is another factor that leads the Court to the conclusion that the version of facts put forward by the Appellants is simply not credible.

[42] The Court therefore concludes that the Minister has properly reassessed the Appellants for additional unreported business income for the taxation years in question. Taking into consideration the adjustments to the SPE noted above (notably to the "Security" category), I find that the Appellants had total additional unreported net business income of $28,090 and $13,454 for the 2010 and 2011 taxation years, respectively and consequently, that each Appellant had additional unreported income of $14,045 and $6,727 for the 2010 and 2011 taxation year, respectively.

B. Gross negligence penalties

[43] Having reached the conclusion noted above, I now turn to the issue of whether the Minister was correct to assess gross negligence penalties pursuant to subsection 163(2) of the Act. It provides as follows:

> **163(2) False statements or omissions** — 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 (…)

[44] Pursuant to subsection 163(3), the "burden of establishing the facts justifying the assessment of the penalty is on the Minister". The Minister must prove (1) that the Appellants made a false statement or omission in their income tax returns, and (2) that the statement of omission was either made knowingly, or under circumstances amounting to gross negligence.

[45] The leading case on the definition of gross negligence is *Venne v. The Queen*, 84 DTC 6247 (FCTD), at page 6256, where Strayer J. stated that:

> "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.

[46] As indicated above, the absence of proper books and records and the evidence that the cash receipts were under-reported, leads the Court to conclude that the Appellants had no real intention of reporting their actual income from the business – not that they simply failed to do so. Moreover, it is not disputed that Mr. Kim failed to report rental income in 2011. I find that the conduct of the Appellants involved "greater neglect than simply a failure to use reasonable care" and that it involved "a high degree of negligence tantamount to intentional acting" or "an indifference as to as to whether the law is complied with or not": *Venne, supra*.

[47] Although the Appellants have not admitted the unreported additional net business income assessed by the Minister, I have already concluded that they have failed to demolish the assumptions on which the Minister relied to determine the unreported income, and that they have failed to provide a credible alternative or modified method of determining their business income or to adduce acceptable evidence to support the same. Moreover, I note that the additional unreported business income for the 2010 taxation year represents 50% of the gross sales reported ($28,090 / $55,701) and that the amount for 2011, represents 27% of the gross sales reported ($13,454 / $49,327). These are not large amounts but the difference is material.

[48] I find that the Minister has satisfied his onus with respect to the gross negligence penalties and I have no difficulty in concluding that the Appellants have knowingly or under circumstances amounting to gross negligence, made or participated in, assented to or acquiesced in the making of a false statement or omission in their respective tax returns within the meaning of subsection 163(2) of the Act.

V. Conclusion

[49] For all the foregoing, I would refer the reassessment back to the Minister for reconsideration and reassessment on the basis set out in paragraph 42 above.

[50] The Minister is entitled to gross negligence penalties calculated accordingly.

Signed at Ottawa, Canada, this 10th day of June 2016.

"Guy Smith"

Smith J.

CITATION:	2016 TCC 150
COURT FILE NOS.:	2015-4379(IT)I, 2015-4381(IT)I
STYLE OF CAUSE:	OK CHA KIM v. HER MAJESTY THE QUEEN YOUNG-SOO KIM v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
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DATE OF JUDGMENT:	June 10, 2016

APPEARANCES:

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For the Appellant Young-Soo Kim:	The Appellant himself
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