Docket: 2007-2004(IT)G

BETWEEN:

IRINA DACHKOV,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on April 15 and 17, 2009, at Montréal, Quebec

Before: The Honourable Justice C.H. McArthur

Appearances:

Counsel for the Appellant:	Isabel Marceau and Alain Ménard
Counsel for the Respondent:	Claude Lamoureux

JUDGMENT

The appeals from the assessments made by the Minister of National Revenue (the Minister) on September 1, 2005, for the 2000 and 2001 taxation years are allowed in accordance with the attached Reasons for Judgment.

The appeal from the assessment made by the Minister for 2002 is dismissed in accordance with the attached Reasons for Judgment.

Since these proceedings have resulted in partial success, no costs are awarded.

Signed at Ottawa, Canada, this 13th day of August 2009.

"C.H. McArthur"

McArthur J.

Citation: 2009TCC403
Date: 20090813
Docket: 2007-2004(IT)G

BETWEEN:

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[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

McArthur J.

[1] This appeal concerns Irina Dachkov (the Appellant), who immigrated from Israel to Canada in 1997. She is challenging the reassessment of the Canada Revenue Agency (CRA) for the 2000, 2001 and 2002 taxation years.

[2] The CRA added the amounts of $18,664 for 2000, $70,272 for 2001 and $31, 149 for 2002 to the Appellant's tax returns and also imposed penalties on those amounts, which were not included in the Appellant's tax return (that is, $811.46 for 2000, $5,706.70 for 2001 and $1,504.13 for 2002).

Issues

[3] The two parties agree on the issues of this case:

a. Was the CRA's reassessment of the Appellant for the 2000 and 2001 taxation years in accordance with subsection 152(4) of the *Income Tax Act* (the ITA) warranted?
b. Did the CRA correctly add to the income reported by the Appellant the amounts set out in paragraph two above as unreported business income?

c. Was the imposition, by the CRA of the penalties against the Appellant warranted under subsection (2) of the ITA?

Arguments of counsel for the Appellant

[4] After having immigrated to Canada in 1997 with her husband and two children, the Appellant had to resort to social assistance. In view of the Appelant's financial difficulties in 1998, her mother told her that she would help her with a “gift” of money in the amount of US$110,500. According to the Appellant, that money came from a family apartment located in Russia and she received that amount in cash.

[5] That money was handed over to a friend of the family, Rita Bond, while she was on visit to Israel with her husband in February 1999. Rita Bond’s husband, who was an Israeli diplomat,[1] brought the money to Chicago, where he was posted. The Appellant’s husband, Alexander Semionov, who operates a trucking business, subsequently went to Chicago for reasons related to the operation of his business and got the money from Rita Bond.

[6] After getting the money, the Appellant’s husband gave it to her and she put all of it in a safety deposit box at her bank. After having received that money, the Appellant submitted a statement to social assistance that she no longer required financial support from the government.

[7] The Appellant submits that, considering that she was without employment from 1997 to 2001, most of the money she received from her mother was used to provide for her and her family.

[8] She started a business as a sole proprietor which consisted in selling food prepared and cooked by her. The business began operating in December 2001 and she suffered losses of $15,255.91 in 2001 and $13,855.31 in 2002.[2]

[9] In 2004, the CRA conducted an audit of the Appellant’s company. She co-operated fully so as to provide as much information as possible. According to the Appellant, the CRA did not identify any unreported income amount originating from the company she operated.

[10] She submits that the CRA erroneously failed to take into account in the Appellant’s assets the amount of US$110,500 that she received from her mother.

[1] According to Exhibit A-7, he died on August 29, 1999.
[2] Notice of Appeal, para. 25.

[11] The limitation period expired as the reassessments for the taxation years were issued more than three years following the initial assessment for each of the taxation years (para. 8 of the Notice of Appeal).

[12] She submits that the net worth method used by the CRA is incorrect (para. 10 of the Notice of Appeal) and that the CRA was not warranted in adding to the reported income the amounts mentioned in paragraph two as unreported business income.

The Minister's arguments

[13] According to the CRA, it was warranted in reassessing the Appellant because in filing her returns she provided false information that is attributable to neglect, carelessness or wilful default.

[14] In addition, on the basis of the results of the net worth assessment of the Appellant's income, the CRA submits that the amounts of $18,663.44, $70,272.98 and $31,149.36 were properly attributed to her.

[15] Finally, the CRA submits that the penalties were properly imposed against the Appellant under subsection 163(2) of the ITA.

[16] One of the questions before me is: Was the CRA's reassessment of the Appellant beyond the normal reassessment period, which is four years, warranted?

[17] The subsection in question is 152(4) of the ITA and it reads 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
>
> (*a*) the taxpayer or person filing the return
>
> (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. . .
>
> [Emphasis added.]

[18] The expression "normal reassessment period" is defined as follows in subsection 152(3.1) of the ITA:

> (3.1) For the purposes of subsections (4), (4.01), (4.2), (4.3), (5) and (9), the normal reassessment period for a taxpayer in respect of a taxation year is
>
> (*a*) where at the end of the year the taxpayer is a mutual fund trust or a corporation other than a Canadian-controlled private corporation, the period that ends 4 years after the earlier of the day of mailing of a notice of an original assessment under this Part in respect of the taxpayer for the year and the day of mailing of an original notification that no tax is payable by the taxpayer for the year; and
>
> (*b*) in any other case, the period that ends 3 years after the earlier of the day of mailing of a notice of an original assessment under this Part in respect of the taxpayer for the year and the day of mailing of an original notification that no tax is payable by the taxpayer for the year.

[19] The taxation years in question for the reassessment are those of 2000 and 2001. As to the 2002 taxation year, the limitation period does not apply and, therefore, is not affected by the above provisions. The CRA submits that the Appellant knowingly omitted to include the amounts of $18,664 (2000) and $70,272 (2001); therefore, under subparagraphs 152(4)(*a*)(i), it can make a reassessment after the period provided for in subsection 152(3.1) of the ITA.

[20] In *Boucher v. R.* ,[3] Sharlow J. of the Federal Court of Appeal made the following comments:

> . . . the existence of a misrepresentation by the taxpayer, without more, does not give the Minister the authority to reassess after the expiry of the normal reassessment period.

[21] When the CRA wants to reassess a taxpayer, it has the onus of proving more than a mere omission on his part. According to Bonner J. in *Jencik v. R.*,[4] the CRA has a number of criteria to establish in order to make a reassessment in accordance with subsection 152(4):

[3] 2004 FCA 46, [2004] 2. C.T.C. 179, par. 5 (C.F.A.)
[4] 2004 TCC 295, [2004] 3 C.T.C. 2115, para. 11 and 13.

> 11 The well-known rule which places on the taxpayer the onus of establishing that facts as found or assumed or assessment are incorrect does not apply in appeals from statute-barred reassessments unless the Minister first establishes facts which show that he was entitled to reassess when he did.
>
> . . .
> 13 I should add that the onus encompasses not only proof of the falsity of the Appellant's representations regarding his business income but also proof that they were attributable to neglect, carelessness or wilful default as pleaded.
>
> (Emphasis added.)

[22] Bowie J. agrees with the principles set out in *Jencik*. He mentions them with approval in *Gardner*.[5] He refers to *M.N.R. v. Taylor*,[6] where Cameron J. wrote as follows:

> . . . 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.'
>
> (Emphasis added.)

[23] In *Ver*,[7] Bowman J. imposed an additional onus on the Minister, that of including the specific facts showing the taxpayer's fraud which must be set out in the Reply to the Notice of Appeal:

> Finally, the Reply to the Notice of Appeal is inadequate in a case of this type. Bald assertions that the Minister "assumed" a misrepresentation are inappropriate where the Minister must prove a misrepresentation. The precise misrepresentation alleged to have been made must be set out with particularity in the reply and proved with specificity. Three essential components must be alleged in pleading misrepresentation:
>
> (i) the representation;
>
> (ii) the fact of its having been made; and
>
> (iii) its falsity.
>
> (Emphasis added.)

[24] In *943372 Ontario Inc. v. R.*,[8] Bowman J. reiterated that it is important that *the Reply to the Notice of Appeal* contain allegations of misrepresentation:

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[5] [2001] 4 C.T.C. 2868.
[6] [1961] C.T.C. 211 (Can. Ex. Ct.)
[7] [1995] T.C.J. No. 593, para. 13(f).

> Before I examine some aspects of the evidence in greater detail, I should say that the replies to the notices of appeal were not helpful. The Minister had the initial onus of establishing misrepresentation justifying the opening up of the statute-barred years. In such cases specificity and precision in the replies are of paramount importance.

[25] Finally, in *Markakis v. M.N.R.*,[9] Rip J. held that, in addition to alleging fraud or misrepresentation in the taxpayer's tax return, the CRA must also prove misrepresentation or fraud. To that effect, Rip J. made the following remarks:

> 13 *For the Minister to show the taxpayer has not exercised reasonable care requires, in my view, something more than simply submitting evidence that the taxpayer has made deposits to his bank accounts in amounts greater than his employment income and advising the Court that he, the Minister, does not accept the taxpayer's explanation of the source of funds.*
>
> . . .
>
> 14 *To assess beyond the four-year limit as set out in subsection 152(4) the Minister must establish that a taxpayer made a misrepresentation that is attributable to neglect, carelessness or wilful* [*sic*] *default, or that the taxpayer committed a fraud in filing his income tax return. It is not enough to <u>suggest</u> misrepresentation or fraud. The Minister's evidence was not sufficient to meet his onus under subsection 152(4) and consequently I must find that Mr. Markakis cannot be said to have made a misrepresentation in 1976.*

<u>The present assessment</u>

[26] The CRA submits that the Appellant omitted to include business income when she filed her income tax return, and that she thereby made a misrepresentation in filing her return.

[27] According to her, the amount of US$110,500 was a gift of money from her mother and, therefore, it was not necessary under the ITA for the Appellant to report the gift in her tax return. According to the Appellant's mother's letter, that money belonged in any case to the Appellant prior to her arrival in Canada. In both cases, the amount must not be reported on her tax return.

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[8] 2007 TCC 294, [2007] 5 C.T.C. 2001.
[9] [1986] 1 C.T.C. 2318.

[28] She changed her story as to how she acquired the US$110,500. In her first version, the Appellant stated that she received that amount directly from her mother when she visited her daughter in Canada in February 1999. That is what the Appellant told the CRA auditor on May 26, 2004.

[29] During a second meeting with the CRA on August 17, 2004, the Appellant stated that the money finally made its way to the Appellant through the hands of friends of the family in Israel and her husband.

[30] According to the test formulated by Bowman J. in *Ver*, the Minister should have made the allegations of misrepresentation in the Reply to the Notice of Appeal. The Minister should have also set out the specific facts demonstrating that a misrepresentation was made and those facts should have been ". . . set out with particularity in the reply and proved with specificity." In looking at the Reply to the Notice of Appeal, and more specifically at paragraphs 47 (h), (i), (m), (n) and 52, the Minister did not set out with particularity the precise misrepresentation of the Appellant's tax return.

[31] Furthermore, the CRA had the burden of proving that the Appellant made a misrepresentation in filing her tax return, but also that the misrepresentation was caused by neglect, carelessness or wilful default. No evidence of fraud, neglect or carelessness was adduced before the Court according to the testimonies of the auditor and technical advisor.

[32] Although counsel for the Respondent may have certainly undermined the Appellant's credibility in some respects, he failed to prove in his oral argument that she made any misrepresentation concerning her tax return. Furthermore, the CRA assessed the Appellant nil business income because the Appellant's business only began in December 2001 (Exhibit A-2). The Minister's submissions that there must have been business income earned from the taxpayer's business for 2000 are groundless as the evidence clearly shows that the business began in 2001, in the month of December.

[33] In that respect, I reject the Minister's presumptions concerning the amounts of $18,664 and $70,272 attributed to the Appellant's business income for 2000 and 2001. In conclusion, the Respondent failed to specify the relevant facts, therefore the Appellant did not know what case she had to meet. The assessments for 2000 and 2001 were issued beyond the period provided for in subsection 152(4) of the ITA. The Respondent had the burden to show that the Appellant made any misrepresentation that is attributable to neglect, carelessness or wilful default or has

committed any fraud—in filing her return for 2000 and 2001; she has not met that burden.

[34] I am therefore of the view that the years 2000 and 2001 are statute-barred and that the CRA did not meet its burden of proving that there was misrepresentation on the Appellant's part.

The net worth method (hereinafter NWM)

[35] In *Hsu v. Canada* [10], no specific method to determine the tax payable by the taxpayer is set out.

[36] In conclusion, the use of the net worth method is provided for in the ITA, and the CRA was thus entitled to treat the undeclared amounts in the Appellant's tax return as business income.

[37] The NWM may be used by the CRA when a taxpayer has not provided a satisfactory answer as to the source of reported income. The CRA has the authority to do so, regardless of the amount claimed on the taxpayer's tax return. Although the burden is on the taxpayer to reject the assessment, it is the CRA who has the burden of proving that the audit was properly conducted.

[38] I believe that the CRA often uses the NWM without having complete knowledge of the facts. The CRA therefore requires the taxpayer to fully disclose to it all of his or her sources of income. That is why the CRA must also fully disclose the bases for measuring the taxpayer's income. The taxpayer must show that the NWM and the information contained therein are invalid. In that respect, Tardif J. made the following remarks in *126632 Canada Ltée v. R.*,[11] in referring to *Hickman Motors Ltd. v. R.*: [12]

> 61 It is the Appellant's responsibility to show that the Minister's presumptions are unfounded; once this is done, the Minister can no longer simply rely on the result of an unacceptable audit to establish assessments.

[39] In *Lai v. The Queen* [13] the taxpayer declared income that was inconsistent with his standard of living as he omitted to include certain information on his tax return.

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[10] 2001 FCA 240, [2001] F.C.J. No. 1174 (FCA), para. 23 and 24.
[11] 2008 CCI 132.
[12] [1998] 1 C.T.C. 213
[13] 2005 TCC 774, [2005] D.T.C. 1823.

The taxpayer claimed that the amounts included in his income were loan repayments from his brother. The amounts came from the sale of a property in his country of origin.

[40] As in the case before us, the auditor in *Lai* asked the taxpayer to provide satisfactory documentary evidence; he was unable to do so.

[41] The Court found as follows:

> 33 As inherently unreliable as net worth assessments may be, the Appellant has not provided me with any basis upon which the Minister's assessment might be challenged. The auditor's evidence was straightforward. She reviewed the methodology she used to arrive at her assessment and her approach was reasonable in these circumstances. In fact she gave the Appellant the benefit of the doubt when using the Statistics Canada figures.

[42] Counsel for the Respondent referred to *Lacroix v. R.* [14] In that case, the Federal Court of Appeal had to decide whether the Tax Court of Canada (Court) was correct in saying that the evidence provided by the Minister was unsatisfactory as to the taxpayer's source of income following the NWM used. The Federal Court of Appeal rejected that claim.

[43] Finally, as to the Minister's burden of proof concerning the issuance of a reassessment beyond the four-year limit prescribed by the ITA, in *Lacroix* the Federal Court of Appeal held that

> The Minister is undeniably required to adduce facts justifying these exceptional measures.

The penalties

[44] According to the auditor, Noëlla Bonici, the Appellant always co-operated with her to provide her with all the documents needed to conduct her investigation.

[14] 2008 FCA 241, 2008 D.T.C. 6551 (Fr.) (C.A.F.)

[45] According to Ms. Tremblay, the second auditor, documents were missing. Therefore, she decided to use the NWM. Also, the testimony of Ms. Tremblay contradicts that of Ms. Bonici in those cases where the Appellant understood or did not understand what the CRA officers were saying to her.

[46] The Appellant opened her books so as not to obstruct the work of the CRA when asked to do so by its officers. This demonstrates a willingness to co-operate with the CRA which weighs in the Appellant's favour.

[47] I have difficulty believing that the Appellant made false statements in her tax return. In addition, despite the fact that counsel for the Respondent made a remarkable attempt to discredit the Appellant, he was unable to demonstrate that the false statements were made knowingly or in circumstances amounting to gross negligence.

[48] The penalties against the Appellant for 2000 and 2001 must therefore be set aside.

[49] Even if I had held that those years were not statute-barred, counsel for the Respondent admitted before the Court that the Minister would be incapable of adducing evidence of the source of income for 2000 and 2001:

[TRANSLATION]

> If you say yes, it is credible and that this source of income is not taxable, then I can tell you today that the Minister is incapable of adducing evidence as to the source of income for 2000 and 2001. It is impossible, because it is illogical to believe that a delicatessen that was inexistent made $18,000. It just does not make any sense.[15]

[50] The Appellant was successful in shifting the burden of proof to the Minister by demonstrating clearly that she did not earn any business income in 2000 and 2001, as alleged in the Reply to the Notice of Appeal. Again, the Minister was unable to meet his burden of proof and, according to *Hickman Motors Ltd.* (*supra*), the Appellant must succeed in her claim for 2000 and 2001.

The year 2002

[51] I must now just rule on the 2002 taxation year which is not statute-barred and therefore the burden is on the Appellant to disprove the Minister's allegations.

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[15] Submissions, page 77, lines 15 to 19.

[52] According to counsel for the Appellant, there is a discrepancy of $31,149.36 for the year 2002 which the Appellant was unable to explain. She has the burden of rebutting the Minister's presumptions at this stage with credible evidence and she could have done so had she clearly shown where the money she received came from. In 2002, the Appellant's business had been in existence since 2001 and therefore the argument already invoked for 2000 and 2001 did not avail to her.

[53] Counsel for the Respondent was quite effective at discrediting the Appellant. A number of points deserve to be made. The first is the fact that she did not keep any record of the amount of money she withdrew from the safety deposit box. Although the Appellant was under no duty to do so, it remains that this would have added more credibility to her version of the facts.

[54] As for the US$110,500, there is no evidence of a locker or safety deposit box. There is no evidence of entrance into Canada or Israel. Counsel for the Respondent reiterated the fact that the taxpayer made up stories about how the money made its way to Canada. That significant amount of money which represents the Appellant's parents' life savings travelled through the hands of perfect strangers of the Appellant's mother.

[55] One of those strangers is Rita Bond, who came from Chicago to testify at trial. The transfer of that money was facilitated by Ms. Bond's partner, an Israeli diplomat working in Chicago. As counsel for the Appellant quite aptly stated, the diplomat risked his career for a perfect stranger by transporting such a significant amount of money to the United States, no less.

[56] Furthermore, that significant amount of money was merely carried in a purse, nonchalantly. Finally, the money was initially in $1,000 bills. The Appellant changed her story again, saying that the bills were in $100 and $50 denominations, which would make for a physically large amount to carry.

[57] Finally, the money was kept in the Appellant's residence. However, the Appellant changed her version once again, saying that the money was kept in a safety deposit box at the bank. According to counsel for the Respondent, the Appellant could have easily sought confirmation from the bank to show that she did actually have a safety deposit box, but the Appellant never provided any evidence to that effect.

[58] Counsel for the Respondent was able to discredit the witness, Alexander Semionov, by showing that there were two auditors who questioned him, and not one, as stated by the Appellant. In addition, Mr. Semionov has been active in international transport for a number of years using his own truck. He must know the consequences of not declaring an amount exceeding $10,000.

[59] A notarized letter by an Israeli notary supports the Respondent's arguments while further discrediting the Appellant. In the notarized letter (Exhibit A-8) it is stated clearly that the money belongs to the Appellant. However, she would have had us believe, throughout the entire trial, that it was a gift from her mother. Also, the letter from the notary is dated December 27, 2004, whereas the money was given to Ms. Bond in February 1999.

[60] Another important fact is that, since her teenage years in the U.S.S.R., the Appellant has had a lack of confidence in financial institutions. Furthermore, she had a bank account in Israel so that she could receive financial assistance from the Israeli government. Also, the Appellant was an accountant in Russia and as stated by counsel for the Respondent [TRANSLATION], ". . . she is not illiterate. . . . She knows how money works.[16]

[61] She wanted to give the impression that she feared banks. The Appellant needed money and was on the brink of bankruptcy and her family did not want to put anything in the bank because, according to her and her family, banks were not a sure thing. Despite that, it was shown that she used four bank accounts and she conducted a number of transactions totalling a few thousand dollars.

[62] Why not have the Appellant's mother come? Why not provide documentation as to the existence of the safety deposit box? Why not provide receipts demonstrating the exchange of US funds into Canadian dollars?

[63] Instead, a friend of the family is called to testify to recount facts that are just peripheral. This seems quite strange to me and the Appellant was unable to rebut the Minister's allegations. For these reasons, the appeal for the 2002 taxation year is dismissed.

Penalty for 2002

[16] Stenographic notes p. 102, lines 12 to 16.

[64] The issue is whether the CRA has failed to meet the burden of proving the facts warranting the imposition of penalties under subsection 163(2) of the ITA for similar reasons given for 2000 and 2001.

[65] I am not sure about the source of the US$110,500 in respect of which there is no explanation. One thing is for sure, the source of the $18,663.44 and the $70,272.98 for 2000 and 2001 was not unreported income from the Appellant's delicatessen, contrary to what was surmised by the CRA. As for the amount of $31,149.36 for 2002, although its source is dubious, the Appellant did not refute the CRA's conclusion concerning the penalty imposed under subsection 163(2) for that year. In that regard, the CRA showed, for 2002, that the Appellant 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 a return, form, certificate, statement or answer filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty. The origin of the $31,149.36 in 2002 remains a mystery. The business, the delicatessen, operated full-time in 2002. The best theory is that of the Respondent that the $31,149.56 was income. I accept that the business suffered operational losses in 2001. The Appellant continues still today to operate her business, which, I believe, has experienced sustained growth.

[66] The appeals for 2000 and 2001 are allowed without costs and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment.

[67] The appeal for 2002 is dismissed without costs.

Signed at Ottawa, Canada, this 13th day of August 2009.

"C.H. McArthur"

McArthur J.

Translation certified true
on this 13th day of October 2009.

François Brunet, Revisor

CITATION:	2009TCC403
COURT FILE NO.:	2007-2004(IT)G
STYLE OF CAUSE:	IRINA DACHKOV AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
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REASONS FOR JUDGMENT BY:	The Honourable Justice C.H. McArthur
DATE OF JUDGMENT:	August 13, 2009

APPEARANCES:

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Counsel for the Respondent:	Claude Lamoureux

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