Docket: 2019-4420(IT)G

BETWEEN:

GEORGE KARLOZIAN,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeal heard on May 13 and 14, 2024 at Montreal, Quebec; and
Written submissions filed by the Appellant on August 10, 2024 and by the Respondent on August 15, 2024

Before: The Honourable Justice Dominique Lafleur

Appearances:

Counsel for the Appellant at the hearing:	Lazar Sarna
For the Appellant for written submissions:	The Appellant himself
Counsel for the Respondent:	Caroline Berthelet

JUDGMENT

CONSIDERING the concessions made by the Respondent at the hearing;

AND in accordance with the attached Reasons for Judgment:

1. The appeals of the reassessments made under the *Income Tax Act* (the "Act") in respect of the Appellant's 2011, 2012 and 2013 taxation years are allowed, and the matters are referred back to the Minister of National Revenue (the "Minister") for reconsideration and reassessment on the basis that:
   (i) For the 2011 taxation year, the unreported income of the Appellant as per the net worth method will have to be recalculated on the following basis,

and the penalties assessed under subsection 163(2) of the Act shall be adjusted accordingly:

a. "Schedule I, Balance Sheet – assets" shall be modified to add an amount of $100,000 to the list of assets for the 2010 reference year representing the balance of the shareholder's loan account of 4287151 Canada Inc. ("4287151");

b. "Schedule II, Balance Sheet – liabilities" shall be modified to remove the liabilities of $18,000 for the 2010 reference year representing an amount owed to 4287151, and to add the same amount to the list of liabilities for 2011;

(ii) For the 2012 and 2013 taxation years, the unreported income of the Appellant as per the net worth method is confirmed to be $102,818 and $284,875 as assessed by the Minister;

(iii) For the 2012 and 2013 taxation years, the amount of the shareholder's benefit assessed under subsection 15(1) of the Act shall be reduced to nil; and

(iv) For the 2011 taxation year, penalties assessed under subsection 163(1) of the Act shall be vacated.

2. Each party shall bear its own costs.

Signed at Ottawa, Canada, this 19th day of September 2024.

"Dominique Lafleur"

Lafleur J.

Citation: 2024 TCC 121
Date: 20240919
Docket: 2019-4420(IT)G

BETWEEN:

GEORGE KARLOZIAN,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

REASONS FOR JUDGMENT

Lafleur J.

I. OVERVIEW

[1] The Minister of National Revenue (the "Minister") reassessed Mr. George Karlozian ("Mr. Karlozian" or the "Appellant") under the *Income Tax Act* (R.S.C. 1985, c. 1 (5th Supp.), as amended) (the "Act") for the 2011, 2012 and 2013 taxation years.

[2] Using the net worth method, the Minister determined that the Appellant had unreported income totalling $184,734, $102,818 and $284,875 for the 2011, 2012 and 2013 taxation years respectively. The Minister also added in the calculation of Mr. Karlozian's income amounts totalling $29,898 and $33,747 as shareholder's benefits under subsection 15(1) of the Act for the 2012 and 2013 taxation years respectively.

[3] Furthermore, the Minister assessed penalties under subsection 163(2) of the Act for all taxation years and a late filing penalty under subsection 163(1) for the 2011 taxation year.

[4] At the hearing, Mr. Karlozian testified, as did Mr. Pierre Cliche, a chartered professional accountant ("CPA") who prepared Mr. Karlozian's 2013 tax returns and was hired to make corrections to Mr. Karlozian's 2012 tax returns. In addition, Ms. Tania Dahdah, a CPA and the Canada Revenue Agency ("CRA") auditor who was responsible for auditing Mr. Karlozian's tax matters, testified at the hearing.

[5] In these reasons, all references to statutory provisions are references to the Act, unless otherwise indicated. Furthermore, because the exchange rate for the Canadian dollar to the US dollar was approximately 1:1 for the taxation years under review, amounts in US dollars were considered on par with amounts in Canadian dollars.

[6] Additional submissions requested by the Court were filed by the parties on August 10 and on August 15, 2024, and were duly examined by the Court.

[7] However, Mr. Karlozian did not file a motion with the Court, in accordance with the *Tax Court of Canada Rules (General Procedure)*, on or before August 30, 2024 as directed by the Court to address the issues he raised in his letter to the Court dated May 15, 2024. Consequently, these issues were not examined by the Court as they were not properly put before the Court.

II. **ISSUES**

[8] At the beginning of the hearing, the Respondent conceded that no amount shall be added to the income of Mr. Karlozian as a shareholder's benefit under subsection 15(1) for the 2012 and 2013 taxation years. Further, the Respondent conceded that the unreported income as per the net worth method is to be reduced by an amount of $5,000, to equal an amount of $179,734, for the 2011 taxation year.

[9] At the beginning of the hearing, the Appellant advised the Court that he would not take issue with the fact that the Minister reassessed the 2011 to 2013 taxation years beyond the normal reassessment period under subsection 152(4).

[10] Furthermore, the Appellant admitted that the list of bank accounts appearing in "Schedule I, Balance Sheet – assets", as well as the list of current liabilities in "Schedule II, Balance Sheet – liabilities", of the net worth calculations and the respective balances at year end are correct. These amounts are therefore not in dispute.

[11] Therefore, the issues to be determined by the Court in these appeals are the following:

(i) Whether the amounts totalling $179,734, $102,818 and $284,875 have to be included in the calculation of Mr. Karlozian's income for the 2011, 2012 and 2013 taxation years respectively;

(ii) Whether the penalties assessed under subsection 163(2) for the 2011, 2012 and 2013 taxation years are justified; and

(iii) Whether the penalties assessed under subsection 163(1) for the 2011 taxation year are justified.

III. **CONCLUSION**

[12] For the following reasons and given the concessions made by the Respondent at the hearing, the appeals are allowed and the matters are referred back to the Minister for reconsideration and reassessment on the basis that:

(i) For the 2011 taxation year, the unreported income of Mr. Karlozian as per the net worth method will have to be recalculated on the following basis, and the penalties assessed under subsection 163(2) shall be adjusted accordingly:

a. "Schedule I, Balance Sheet – assets" shall be modified to add an amount of $100,000 to the list of assets for the 2010 reference year representing the balance of the shareholder's loan account of 4287151 Canada Inc. ("4287151");

b. "Schedule II, Balance Sheet – liabilities" shall be modified to remove the liabilities of $18,000 for the 2010 reference year representing an amount owed to 4287151, and to add the same amount to the list of liabilities for 2011;

(ii) For the 2012 and 2013 taxation years, the unreported income of Mr. Karlozian as per the net worth method is confirmed to be $102,818 and $284,875 as assessed by the Minister;

(iii) For the 2012 and 2013 taxation years, the amount of the shareholder's benefit assessed under subsection 15(1) shall be reduced to nil; and

(iv) For the 2011 taxation year, penalties assessed under subsection 163(1) shall be vacated.

[13] Each party shall bear its own costs.

IV. **FACTS**

A. **Mr. Karlozian's testimony**

[14] Mr. Karlozian testified that he immigrated to Canada in 1967. He obtained a B.A. in Education (B. Ed.) from McGill University in 1975 and taught French to English speakers. In 1977, he married Rosie Karlozian and they are still married. The Karlozians had two sons, born in Canada. During the years that are the subjects of these appeals, their sons were grown-up, college-age students and were about to start their careers.

[15] From 1977 until 1984, Mr. Karlozian worked in Canada as a high school teacher with the English school board of Montreal. In 1984, Mr. Karlozian left Canada and established his residence in the United States of America ("US"). He obtained his citizenship and lived there with his family until 2005, at which time he returned to Canada.

[16] Mr. Karlozian testified that when he first arrived in the US, he helped in his in-laws' gas station business, which was sold in 1991. He was in charge of the bookkeeping, employee supervision and various administrative tasks.

[17] Around 1981, Mr. Karlozian established a business selling used cars, called Armin's Auto Sales, which business stopped being active around 2000 or 2001. During this time, after he got his work permit, Mr. Karlozian also worked as a high school teacher, first teaching at night in an adult program, and later he obtained a full-time job teaching history and French to American students.

[18] In 1988, Mr. Karlozian purchased a house in California for US$260,000. The house was sold in 2005, resulting in gross capital gains in an amount of US$263,866 (Exhibit A-1, Inter Valley Escrow Statements dated June 30, 2005). Mr. Karlozian testified that he had paid the US taxes in that year on his salary as a teacher and on the capital gains resulting from the sale of his house (Exhibit A-2, Form 1040 U.S. Individual Income Tax Return for 2005).

[19] Mr. Karlozian later purchased another house in California, which was not bought nor sold during the 2011, 2012 or 2013 taxation years and which was mortgaged with Citibank.

[20] Following his return to Canada in 2005, Mr. Karlozian incorporated 4287151, which is wholly owned and managed by him. The shares of the capital of 4287151 were owned by Mr. Karlozian during the whole period from 2010 to 2013.

[21] In 2005, 4287151 purchased a 16-unit apartment building in Pierrefonds, Quebec (the "Pierrefonds building"), for $1,000,000, with a down payment of $350,000. The down payment was financed by Mr. Karlozian, who made a loan to the corporation in the same amount. Mr. Karlozian testified that 4287151 had its own corporate bank account at the Laurentian Bank and later on at the Toronto Dominion Bank ("TD").

[22] Mr. Karlozian managed the day-to-day operations of 4287151, collected rents, and made repairs when necessary. According to Mr. Karlozian, approximately 90% of the rents were paid by cheque, and the balance paid in cash. He kept ledgers for the corporation to keep track of the funds received as rent.

[23] According to Mr. Karlozian, 4287151 never paid expenses for his personal benefit, but he and his wife lived in unit 7 of the Pierrefonds building owned by 4287151.

[24] In 2007, Mr. Karlozian and a partner, Mr. Alfonso Zaino, created a corporation under the name Habitations Vision Inc. ("Vision"), each of them holding 50% of the issued and outstanding shares. In that same year, Vision purchased a building in Pierrefonds consisting of 40 units. Mr. Karlozian testified that at that time he had made a loan of approximately $350,000 to Vision.

[25] The shares owned by Mr. Karlozian in the capital of Vision were sold in June 2012, for proceeds totalling $631,076. Mr. Karlozian also received an amount of $197,756 in reimbursement of an advance he had made to Vision (Exhibit R-2, Respondent's Book of Documents, tab 78, which contains copies of cheques issued to him by Vision). Mr. Karlozian also testified he had received an amount of $19,000 for adjustments. All funds were deposited in one of his bank accounts at the Royal Bank of Canada (Exhibit R-2, Respondent's Book of Documents, tab 31, p. 534 and tab 32, p. 552). For income tax purposes, he reported an amount of $315,542 as a taxable capital gain in 2012 (Exhibit R-2, Respondent's Book of Documents, tab 4) and paid taxes on that gain.

[26] Mr. Karlozian testified that he had prepared and filed his own tax returns for the 2011 taxation year. From the 2012 taxation year onwards, he hired an accountant, Mr. Louis Cliche (CPA), for preparing and filing his personal income tax returns.

[27] For the period from 2011 to 2013, Mr. Karlozian paid for the personal expenses of his family: he would send approximately $10,000 monthly to his sons, who then lived and studied in the US, and he would need approximately $8,000 per month to cover his living expenses in Canada. Mr. Karlozian also used to play a lot at the casino, but was losing money (Exhibit R-2, Respondent's Book of Documents, tab 40).

[28] Mr. Karlozian also acknowledged that he received annual pension income from the US in the amount of approximately US$31,000, which he duly reported on his US tax returns (Exhibit R-2, Respondent's Book of Documents, tab 76), but not on his Canadian tax returns.

B. **Mr. Cliche's testimony**

[29] Mr. Cliche testified that he had prepared Mr. Karlozian's income tax returns for 2013 and afterwards and he had corrected the reporting that had been made for the 2012 taxation year in respect of the sale of the shares of the capital of Vision. Mr. Cliche did not prepare the income tax returns of 4287151 since another accountant was tasked with doing it.

[30] Mr. Cliche testified that he was not aware Mr. Karlozian was receiving US pension income, and the amount of pension income was never included in his income tax returns for Canadian purposes.

C. **The auditor's testimony (Ms. Tania Dahdah (CPA))**

[31] Ms. Dahdah testified that 4287151 was selected for an audit in respect of the shareholder's loan account and income tax returns. Ms. Dahdah also audited Mr. Karlozian's personal books and records.

[32] Because Mr. Karlozian did not provide copies of the bank statements and credit card statements she had requested, she had to ask TransUnion for a credit report (Exhibit R-2, Respondent's Book of Documents, tab 72). However, the information provided by TransUnion only covers Canadian accounts. Because Ms. Dahdah saw transfers originating from the US to bank accounts in Canada, she requested more information from Mr. Karlozian about the bank accounts he held in

the US. Mr. Karlozian provided some US bank account statements, but the evidence showed that he did not provide all the statements.

[33] In addition, Mr. Karlozian did not provide the information requested by the auditor pertaining to the assets he and his spouse owned worldwide as well as to their sources of income (Exhibit R-2, Respondent's Book of Documents, tab 54, letter from Ms. Dahdah dated May 8, 2017).

[34] Ms. Dahdah did a preliminary net worth analysis based on a bank deposit analysis for 2012 and 2013 and concluded that Mr. Karlozian had not reported all his income for 2013 (Exhibit R-2, Respondent's Book of Documents, tab 20). She then did a full review of the bank account statements and credit card statements (Exhibit R-2, Respondent's Book of Documents, tab 21). Ms. Dahdah came to the conclusion that Mr. Karlozian had unreported income for the 2011, 2012 and 2013 taxation years; she also assessed penalties under subsection 163(2) for all those years.

[35] Ms. Dahdah testified as to how she had prepared the schedules for the net worth analysis attached to the Reply to the Notice of Appeal, which I will review below. Her working papers were also adduced in evidence (Exhibit R-2, Respondent's Book of Documents, tab 19).

[36] With respect to the penalties assessed under subsection 163(2), Ms. Dahdah testified that factors such as the materiality of the unreported income as compared to the income reported each year as well as the fact that the documents requested during the audit were not provided by Mr. Karlozian, that Mr. Karlozian is an experienced businessman and is the only person in charge of the business, and that no proper books and records were maintained made her conclude that the penalties were warranted. She was of the view that Mr. Karlozian could not plead ignorance and should have known that his income was underreported.

V. **POSITIONS OF THE PARTIES**

A. **The Appellant**

[37] Mr. Karlozian broadly submits that the alleged unreported income at issue for the 2011, 2012 and 2013 taxation years stems from deposits or transfers from his various bank accounts in the US on which he had duly paid US taxes. Mr. Karlozian

also contends the CRA auditor has mixed up his personal and corporate accounts for the net worth audit.

[38] Mr. Karlozian contends that much of the funds came from two major events that occurred prior to or during the taxation years under review. First, in 2005, Mr. Karlozian sold his house in the US, upon which he realized a gain of about US$262,000. Then, in June of 2012, he sold his shares of the capital of Vision for proceeds of $631,076, and he received an amount of $197,756 in repayment of advances he made to that corporation.

[39] Mr. Karlozian contends that a review of the extensive audit documentation shows that many documents seem to not have been considered by the auditor, particularly those reflecting his financial assets in the US.

[40] Mr. Karlozian argues that the auditor did not take into account the mortgage payments on his house in the US as liabilities (in "Schedule II, Balance Sheet – liabilities") and that she did not take into account that he was receiving a pension from his employment as a teacher in the US. As for various expenses that were added to the net worth calculations as unidentified cheques, withdrawals or transfers (in "Schedule III, Calculation of the Discrepancy in Total Income per Net Worth"), Mr. Karlozian testified that those expenses were to support his sons' education in the US and his and his wife's lifestyle in Canada. Further, Mr. Karlozian contends there were multiple deposits and withdrawals relating to various operations on real estate transactions in the US and in Canada, and at no time should these amounts (both the deposits and the withdrawals) be considered personal in nature and included in his income.

B. **The Respondent**

[41] According to the Respondent, the income reported by Mr. Karlozian in the 2011 to 2013 taxation years was insufficient to maintain his lifestyle, and the difference between the income as reported and the expenditures he incurred shall be included in his income as unreported income.

[42] Given the material discrepancies, the Minister was entitled to reassess the Appellant using the net worth method. The auditor used all the bank statements she had access to in order to create the most accurate picture of Mr. Karlozian's financial situation. This review established he had unreported income for 2011, 2012 and 2013.

[43] The Respondent argues that Mr. Karlozian is in the best position to know his financial situation, and the onus falls upon him to demolish the Minister's assumptions of fact and show that the reassessments are wrong. According to the Respondent, Mr. Karlozian failed to provide credible explanations and documentation to show that the unreported income was not from a taxable source. Notably, he did not lead any evidence that the net proceeds from the sale of his house in the US were deposited in his bank accounts. Nor did he present documentation to support mortgage payments on the house he still owns in the US.

[44] According to the Respondent, general statements made by Mr. Karlozian, absent credible documentary evidence, are insufficient to meet his onus to demolish the Minister's assumptions of fact.

[45] Furthermore, according to the Respondent, the penalties assessed pursuant to subsection 163(2) for the 2011, 2012 and 2013 taxation years should also be maintained given the magnitude of the unreported income and the fact that Mr. Karlozian is a sophisticated businessman and should have known that the reported income was not sufficient to maintain his lifestyle, which shows indifference as to whether the law is complied with. In addition, Mr. Karlozian did not provide the documents requested by the auditor during the audit process; he did not maintain adequate books and records and made recurring omissions.

VI. **ANALYSIS**

A. **The net worth method**

[46] As a general rule, in an appeal to the Court, the burden rests on the appellant. An appellant thus bears the burden of demolishing the Minister's assumptions of fact and of proving, on a balance of probabilities, the facts justifying his or her position. On the other hand, the Minister has the burden of proving, on a balance of probabilities, the facts justifying the assessment of penalties under subsection 163(2) (subsection 163(3)) and the facts justifying reassessment beyond the normal reassessment period (subparagraph 152(4)(a)(i)).

[47] In the case at bar, reassessments for all taxation years were made beyond the normal reassessment period. However, the Appellant conceded at the start of the hearing that he would not challenge the reassessments on that basis.

[48] The reassessments at issue were made by applying the net worth method to Mr. Karlozian's financial situation. This method is "…based on an assumption that

if one subtracts a taxpayer's net worth at the beginning of a year from that at the end, adds the taxpayers expenditures in the year, deletes non-taxable receipts and accretions to value of existing assets, the net result, less any amount declared by the taxpayer, must be attributable to unreported income earned in the year, unless the taxpayer can demonstrate otherwise" (*Bigayan v. R.* (1999), [2000] 1 C.T.C. 2229, [2000] D.T.C. 1619 at para. 2 [*Bigayan*]).

[49] The courts have recognized that a net worth assessment is an arbitrary and imprecise approximation of a taxpayer's income, but:

> 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 (*Hsu v. R.*, 2001 FCA 240, at para. 30).

[50] Accordingly, Mr. Karlozian bears the onus to identify the source of the income and to show, on a balance of probabilities, that it is not taxable. Mr. Karlozian will have to prove, on a balance of probabilities, the facts justifying his position. Alternatively, Mr. Karlozian can also challenge the net worth reassessments by establishing that the net worth method was inherently flawed. As indicated by the Court in *Bigayan* (*supra*, at paras. 3–4):

> 3 The best method of challenging a net worth assessment is to put forth evidence of what the taxpayer's income actually is. A less satisfactory, but nonetheless acceptable method is described by Cameron J. in *Chernenkoff v. Minister of National Revenue*, 49 DTC 680 at page 683:
>
> > In the absence of records, the alternative course open to the appellant was to prove that even on a proper and complete "net worth" basis the assessments were wrong.
>
> 4 This method of challenging a net worth assessment is accepted, but even after the adjustments have been completed one is left with the uneasy feeling that the truth has not been fully uncovered. Tinkering with an inherently flawed and imperfect vehicle is not likely to perfect it. The appellant chose to use the second method.
>
> [Emphasis added.]

[51] More recently, in *Truong v. R.*, 2017 TCC 22 (at para. 36, aff'd 2018 FCA 6, leave to appeal to the Supreme Court of Canada dismissed), the Court has indicated that a taxpayer may challenge an alternative assessment issued under subsection 152(7) in one of the following ways: by challenging its necessity or

method chosen in the first instance, by challenging specific aspects of the quantum, methodology or inclusions or by submitting evidence concerning non-taxable sources of income received by the taxpayer.

[52] Thus, Mr. Karlozian's credibility and the sufficiency of his evidence will be determinative (*Landry v. R.*, 2009 TCC 399, at para. 47; *Roy v. R.*, 2006 TCC 226). It is also well established that where the Act does not require supporting documentation, credible oral evidence can be sufficient, notwithstanding the absence of records (*Kozar v. R.*, 2010 TCC 389 at para. 49, citing *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336).

[53] The Court may also consider the overall reasonableness of the reassessment in its determination of whether to allow the appeal.

[54] For the following reasons, which I shall elaborate upon later herein, I find that Mr. Karlozian had earned income that he failed to report for the 2011, 2012 and 2013 taxation years, but not to the same extent as assessed by the Minister for the 2011 taxation year. I also find that Mr. Karlozian did not provide credible explanations for the discrepancy between his reported income and his net worth. Some parts of Mr. Karlozian's testimony were credible, and, hence, I find that some adjustments shall be made to the Minister's calculations under the net worth assessment. However, I also find that other parts of Mr. Karlozian's testimony were not credible or reliable, and, hence, I did not accept all the adjustments raised by the Appellant. I also want to add that the evidence as adduced at the hearing indicates that Mr. Karlozian must have had assets he did not disclose to the Court and, more specifically, other bank accounts.

[55] Further, I find that the Minister has established, on a balance of probabilities, the facts justifying the assessment of penalties under subsection 163(2) for the 2011, 2012 and 2013 taxation years to the extent of the unreported income as determined by the Court. However, I find that the penalties assessed for the 2011 taxation year under subsection 163(1) should be vacated.

B. **Review and analysis of the net worth method used in these appeals**

[56] As indicated above and more particularly in these appeals, in order to successfully challenge the reassessments at issue, Mr. Karlozian must present detailed and cogent testimony and supporting evidence where possible, to explain

the various transfers and withdrawals found in the bank accounts and the reasons why they should not be added to the net worth calculations.

[57] Mr. Karlozian can also succeed either by establishing, on a balance of probabilities, new facts not considered by the Minister that show that the unreported income was not taxable or by demonstrating that the Minister's assumptions of fact are wrong. For example, Mr. Karlozian can present evidence supporting that he owned additional assets and incurred more liabilities or that the Minister did not consider facts that could reduce the unreported income as calculated under the net worth method.

[58] I will now turn to the Schedules of the net worth calculations attached to the Reply to the Notice of Appeal.

(1) ***Schedule I, Balance Sheet – assets***

[59] Schedule I, Balance Sheet – assets, lists all the assets allegedly owned by Mr. Karlozian as of the end of 2010 (reference year), 2011, 2012 and 2013.

[60] For the following reasons, the Court finds that an amount of $100,000 as a shareholder's loan owed to Mr. Karlozian by 4287151 shall be added to the list of assets in Schedule I for the 2010 reference year. No other changes shall be made to the assets listed in Schedule I.

[61] According to Ms. Dahdah, the assets listed in Schedule I are comprised of the following:

(i) As of the end of 2012 and 2013, a shareholder loan amounting to $166 and $73,500 owed to Mr. Karlozian by 4287151 as indicated in the Financial Statements of the corporation for the years ending February 28, 2012 and February 28, 2013 (Exhibit R-2, Respondent's Book of Documents, tab 75). Ms. Dahdah made adjustments for transactions that occurred during the year in the shareholder's ledger account, which were reported in Schedule III;

(ii) As of the end of 2011 and 2012, a shareholder loan amounting to $211,756 and $194,256 owed to Mr. Karlozian by Vision, which amounts were confirmed by Mr. Karlozian at the hearing; and

(iii) For each year end, the balance of funds in various bank accounts in Canada and in the US held by Mr. Karlozian and his spouse, which balances were agreed upon by the Appellant at the hearing.

[62] Ms. Dahdah testified that she had not included any cars or houses as no information had been provided to her by Mr. Karlozian. According to Ms. Dahdah, because the evidence showed there was no purchase or sale of cars or houses during the period from 2010 to 2013, the fact that Schedule I does not include any assets of these types will not have any impact on the net worth calculations. I agree with Ms. Dahdah.

[63] However, I find that the shares of the capital of Vision owned by Mr. Karlozian in 2010, which were sold in 2012, should have been included in Schedule I. Since the evidence showed that the cost of these shares was nominal, the fact that the shares were not included in the list of assets in Schedule I will have no impact on the net worth calculations. The evidence showed that Mr. Karlozian sold these shares for the price of $631,076, and he reported $315,542 as a taxable capital gain, which amount represents half of the purchase price.

[64] Ms. Dahdah testified that she had however taken into account the sale of the shares of the capital of Vision in 2012 in Schedule III, Calculation of Discrepancy in Total Income per Net Worth, by deducting an amount equal to the non-taxable portion of the capital gain and an amount equal to the amount Mr. Karlozian reported as a taxable capital gain on his tax return in 2012. I will come back to Schedule III below.

[65] However, Mr. Karlozian did not concede that the assets listed in Schedule I represent all of his assets as at the end of each respective taxation year.

[66] Mr. Karlozian adduced in evidence statements from Chase (J.P. Morgan Securities, account no. 2445), showing that he held investments in the US at the end of 2011, 2012 and 2013 (Exhibits A-5 and A-6). According to these statements, the net equity of Mr. Karlozian's portfolio was US$10,316, US$16,449 and US$100,976 at the end of 2011, 2012 and 2013 respectively. At the hearing, the Respondent objected to the marking of these statements as exhibits as there was no evidence of all transactions made in the account over the relevant years, and further, the auditor was not provided with these statements at the audit stage. However, if they had been presented to her, Ms. Dahdah testified that the value of all the investments in this account would have increased Mr. Karlozian's net worth, and therefore, his tax liability under the Act. Given the Respondent's objection, I will

not consider the evidence adduced by Mr. Karlozian in respect of the statements from Chase (J.P. Morgan securities, account no. 2445) for the purposes of the net worth calculations in these appeals.

[67] Mr. Karlozian also adduced in evidence a statement from Union Bank (account no. 7153) (Exhibit A-8), which account was held in the US. However, the evidence showed that this account had been disclosed during the audit and was added to the assets listed in Schedule I (Exhibit R-2, Respondent's Book of Documents, tab 68, at p. 1074). Accordingly, no adjustment shall be made in that respect to the assets listed in Schedule I.

[68] Furthermore, Mr. Karlozian argues that, prior to returning to Canada, he sold his business and most of his real estate in the US, but he "… maintained various bank and investments accounts which he holds until today" (Notice of Appeal, at para. 3), and that would explain where the funds he used during the years under review were coming from. However, Ms. Dahdah stated that if these funds were deposited in bank accounts prior to 2011, all these funds would have been taken into account in the net worth calculations, because they would have been listed under the various balances in bank accounts for the 2010 reference year. According to Ms. Dahdah's testimony, Mr. Karlozian had a balance of $308,605 in various bank accounts at the end of 2010, which amount was duly added to the 2010 reference year for the purposes of her calculations.

[69] I agree with the Respondent. General statements of this nature, without any further evidence, are not enough for Mr. Karlozian to meet his burden to show that the proceeds from the sale of his house in the US in 2005 and the transactions that occurred prior to 2010 were not properly taken into account in the net worth calculations for the 2010 reference year. Mr. Karlozian did not adduce any documentary evidence showing that he held additional funds in other bank accounts or any additional assets as at the end of 2010, except for his house in the US. As mentioned above, because the house was not sold during the years under review, the fact that the house was not listed as an asset in Schedule I will not change the net worth calculations.

[70] At paragraphs 5 to 7 of the Notice of Appeal, the Appellant argues that many transactions took place during the period from 2005 to 2007, resulting in Mr. Karlozian having at his disposal a total sum of approximately US$720,000. However, these facts are not relevant for the purposes of the net worth calculations because these events predated the 2010 reference year. As Ms. Dahdah concluded, the income earned by Mr. Karlozian before the audit period would have been

reflected in the various bank account statements as of December 31, 2010. I agree with her reasoning.

[71] Finally, for the following reasons, I find, on a balance of probabilities, that an amount of $100,000 shall be added as an asset for the 2010 reference year to Schedule I, representing the balance of the shareholder's loan owed to Mr. Karlozian by 4287151 at the end of 2010.

[72] According to the Respondent, the Appellant had the onus to disprove the fact as assumed by the Minister that the balance of the shareholder's loan account as at the end of 2010 was nil. Hence, because Mr. Karlozian did not adduce any evidence, that assumption must stand. For the following reasons, I do not agree with the Respondent.

[73] The evidence shows that 4287151 issued a cheque for $100,000 to Mr. Karlozian in January 2011 (Exhibit R-2, Respondent's Book of Documents, tab 21, p. 248, which is identified as "Due to Shareholder" and an "identified transfer from business to personal" in Ms. Dahdah's working papers). I therefore accept that the amount of $100,000 came from the balance in the shareholder's loan account owed to Mr. Karlozian by 4287151. I also find that the better view is that the balance of the shareholder's loan account at the end of 2010 was $100,000.

(2) ***Schedule II, Balance Sheet – liabilities***

[74] Schedule II, Balance Sheet – liabilities, lists Mr. Karlozian's liabilities at the end of each year.

[75] Ms. Dahdah testified that Mr. Karlozian owed 4287151 an amount of $18,000 at the end of 2010. According to Ms. Dahdah, Mr. Karlozian did not have any other significant liabilities, but only for nominal amounts.

[76] However, the financial statements of 4287151 for the year ending February 28, 2011 show that the liability of $18,000 existed at the year-end on February 28, 2011. I find that the better view is that Mr. Karlozian owed an amount of $18,000 to 4287151 as at the end of 2011 and not at the end of 2010.

[77] Mr. Karlozian did not adduce any evidence other than very general statements in respect of the liabilities listed in Schedule II. Accordingly, I find that Schedule II as prepared by Ms. Dahdah must stand, but for the modification as to the amount of $18,000 being Mr. Karlozian's liability for 2011 and not for 2010.

(3) *Schedule III, Calculation of the Discrepancy in Total Income per Net Worth*

[78] Schedule III, Calculation of the Discrepancy in Total Income per Net Worth, contains a description of amounts to be added in the calculation of Mr. Karlozian's total income per adjusted net worth, as well as amounts to be deducted in the calculation of the total income per adjusted net worth, to arrive at the discrepancy per net worth (taking into account income reported by the Appellant and his spouse).

(a) **Additions to income per adjusted net worth under Schedule III**

[79] I will first examine the amounts to be added, namely the amounts totalling $160,750 (as conceded by the Respondent), $383,138 and $362,674 for 2011, 2012 and 2013 respectively, as calculated by Ms. Dahdah. Included in these amounts are personal expenditures as well as various amounts under the following headings: "Unidentified Cheques", "Unidentified Purchase", "Unidentified Transfer", "Unidentified Transfer USD", "Unidentified Withdrawals" and "Unidentified LIABILITY PMT USD".

[80] For the following reasons, the Court finds that these amounts are reasonable as Mr. Karlozian did not adduce any relevant evidence to rebut the Minister's assumptions. The evidence adduced by Mr. Karlozian mostly related to the sources of the funds, which sources are not relevant for the calculations under the net worth method at this point, or to the purposes of the payments made, which expenditures (namely mortgage payments, his sons' education tuition fees or family expenses) would in any event have to be included in the aggregate personal expenditures he incurred each year.

[81] Mr. Karlozian testified that during that period (2011 to 2013), he was paying for his sons' education in the US (approximately $10,000 monthly) as well as his living expenses in Canada (approximately $8,000 monthly), for a total of $200,000 annually.

[82] Further, the evidence shows that Mr. Karlozian spent a lot of money at the casino during the 2011 to 2013 period (Exhibit R-2, Respondent's Book of Documents, tab 40).

[83] For all these reasons, I find that the figures found in the additions under Schedule III are reasonable, even considering the fact that for 2012 and 2013, the total amount calculated by Ms. Dahdah was twice as high as for 2011.

[84] Personal expenditures of $65,773, $124,301 and $147,883 for 2011, 2012 and 2013 respectively, which were determined through an examination of the expenses actually incurred by Mr. Karlozian (including significant casino expenses) (Exhibit R-2, Respondent's Book of Documents, tab 19), were added under Schedule III. Mr. Karlozian did not adduce any evidence in respect of the personal expenditures as established by Ms. Dahdah, and thus, the Court finds that Ms. Dahdah's calculation in that respect must stand.

[85] Other amounts listed under Additions in Schedule III are described as "Unidentified Cheques", "Unidentified Purchase", "Unidentified Transfer", "Unidentified Transfer USD", "Unidentified Withdrawals" and "Unidentified LIABILITY PMT USD". Ms. Dahdah used the bank withdrawal method, which included a review of all the transfers, purchases and withdrawals as found in bank account statements, to determine the nature of all the transfers and withdrawals. She deducted all transfers made between bank accounts so as to avoid double counting the amounts in that respect. As indicated by the auditor, amounts transferred from one bank account to another bank account were not added to the income as calculated under the net worth method and were also not included in the calculation of the personal expenditures. However, various amounts were added under that heading because they were transferred to other bank accounts that were not disclosed by Mr. Karlozian as his bank accounts and for which Ms. Dahdah did not obtain any statements. Various purchases and withdrawals from bank accounts, which would otherwise have been included in the personal expenditures calculation, were also added under that heading.

[86] The amounts under the heading "Unidentified Transfer" ($2,300 and $101,195 for 2011 and 2013 respectively) and "Unidentified Transfer USD" ($59,600, $152,349 and $35,350 for 2011, 2012 and 2013 respectively) are comprised of transfers from one bank account to another bank account that the auditor was not able to trace in any bank accounts examined as part of the audit.

[87] Ms. Dahdah pointed out that she requested information from Mr. Karlozian as to the source of all the deposits and transfers, but she did not get any responses from Mr. Karlozian (Exhibit R-2, Respondent's Book of Documents, tab 14 – list of unidentified transfers and purchases).

[88] The amounts under the heading "Unidentified LIABILITY PMT USD" are payments on a Citibank MasterCard ($8,550, $2,989 and $350 for 2011, 2012 and 2013 respectively), for which Ms. Dahdah did not receive any statements.

[89] The amounts under the heading "Unidentified Withdrawals" total $13,790, $29,125 and $33,684 for 2011, 2012 and 2013, respectively. Mr. Karlozian argues that these amounts were withdrawn to cover mortgage payments on his house in the US as well as various family expenses. As mentioned above, the purpose for the withdrawals is not relevant, as these withdrawals would have to be included in the calculation of the personal expenses under the net worth calculations.

[90] The amounts under the heading "Unidentified Purchase" are $70,000 and $5,500 for 2012 and 2013 respectively. Mr. Karlozian argues that the funds from the sale of his shares of the capital of Vision were used to send money orders to his sons in the US (Exhibit R-2, Respondent's Book of Documents, tab 14, p. 91 and tab 32, p. 553). As mentioned above, the source of the funds is not relevant at this point in the net worth calculations.

[91] As Ms. Dahdah testified, all the unidentified transfers, purchases and withdrawals are funds going out of bank accounts, so notwithstanding the fact that she was not able to trace the use of the funds, they would have been included in the personal expenditures total. The same reasoning applies to the Citibank MasterCard payments. I agree with Ms. Dahdah on this point, particularly since the personal expenditures were calculated by taking the exact figures from the bank statements, and not by using any statistics for cost of living.

[92] Mr. Karlozian adduced in evidence statements from CitiMortgage (Exhibit A-7) showing interest paid on the mortgage on his house located in the US, as well as the principal balance of the mortgage at the end of 2011, 2012 and 2013 respectively. In 2011, he paid interest of $27,462.84, and the principal balance on the mortgage was $328,067.29. In 2012, he paid interest of $19,505.06 and the principal balance on the mortgage was $321,174.03. In 2013, he paid interest of $9,512.97, and the mortgage was fully paid. As for payments under the mortgage, Ms. Dahdah did not see any payments made under that heading in any of the bank account statements she reviewed, but for two or three payments that were included in amounts under the heading "Unidentified Withdrawals" or "Unidentified Transfer". As determined by the Minister, the Court finds that no adjustments shall be made in that respect, as such payments would in any event have to be part of the personal expenditures calculations.

[93] In the amount to be added in the calculation of income as per net worth, Ms. Dahdah also included income taxes totalling $41,683 paid by Mr. Karlozian in 2013 in respect of the sale of the shares of the capital of Vision. I agree with Ms. Dahdah's calculations in that respect.

(b) **Deductions to income per adjusted net worth under Schedule III**

[94] As amounts to be deducted under Schedule III, Ms. Dahdah deducted amounts for lottery winnings totalling $15,000 for every taxation year under review.

[95] Ms. Dahdah also deducted an amount of $315,542 for 2012 representing the non-taxable portion of the capital gains on the sale of the shares of the capital of Vision. Finally, to calculate the discrepancy per net worth, she deducted various amounts representing income as reported by Mr. Karlozian and his spouse for each taxation year, including an amount of $315,542 representing the taxable portion of the capital gains on the sale of the shares of Vision (Exhibit R-2, Respondent's Book of Documents, tab 4 (Option C for Mr. Karlozian (pre- and post-audit) and tab 71, Twon Report for Ms. Karlozian)).

[96] I agree with the deductions made by Ms. Dahdah and listed in Schedule III. Mr. Karlozian did not adduce any evidence showing, on a balance of probabilities, that additional amounts should be deducted under Schedule III of the net worth calculations. For example, Mr. Karlozian did not adduce any evidence showing that, during the taxation years under review, he had received any amounts as inheritance or that he had borrowed funds or that he had sold any assets other than the shares of the capital of Vision, which sale was correctly accounted for in the net worth calculations. Accordingly, no additional deductions shall be made under Schedule III.

[97] Finally, I will address the following matters:

(i) For 2011: an amount of $100,000 paid by 4287151 to Mr. Karlozian in January 2011;

(ii) For 2012: an amount of $197,756 paid by Vision to Mr. Karlozian, in reimbursement of the loan he had made to Vision; and

(iii) For 2011 to 2013: US pension income received by Mr. Karlozian.

[98] The Respondent takes the view that the amount of $100,000 paid by 4287151 to Mr. Karlozian in January 2011 (which amount I found came from the positive balance in the shareholder's loan account) shall not be considered as a deduction in Schedule III for 2011, as the same amount would already have been included in the assets listed under Schedule I of the net worth calculations for the reference year (2010) and removed from that same Schedule I in 2011. However, the Appellant

argues that this amount should not be taxable as it represents a partial repayment of his initial contribution to the corporation.

[99] The Respondent applies the same reasoning to the amount of $197,756 received by Mr. Karlozian in 2012 as reimbursement of a loan made to Vision, as the amount was included in the assets listed under Schedule I for 2011 and removed from that same Schedule I in 2012. The Appellant argues that this amount shall not be taxable as it represents the repayment of funds he had advanced to Vision over the years.

[100] In the Respondent's additional submissions, the Respondent indicates that:

> …when an amount received from the Appellant comes from an asset that appears in Schedule I, such as a shareholder account balance that can be withdrawn without tax consequences, the change is reflected by a reduction in the assets appearing in Schedule I. As such, there is no need to make an adjustment in Schedule III. Otherwise, the deduction is applied twice.

[101] I agree with the Respondent's argument. Under a net worth calculation, unreported income is determined by adding to the increase in net worth calculated at the end of a given year as compared to the immediately preceding year, starting with the year of reference, all personal expenditures and then deducting for that same year all non-taxable receipts and income reported by the taxpayer. Although the amounts received by Mr. Karlozian as reimbursement of the shareholder's loan accounts in 4287151 and in Vision are not taxable, because the reduction of the shareholder's loan accounts was accounted for in the balance sheet section (assets) of the net worth calculations, a deduction under Schedule III for the same amount should not be made, as otherwise, the same deduction would be accounted for twice in the net worth calculations.

[102] Finally, Mr. Karlozian testified that he received US pension income totalling approximately US$31,000 per year during the 2011 to 2013 taxation years from his prior teaching employment in the US, and that these amounts should be taken into account to reduce his liability under the Act. However, Ms. Dahdah testified that she did not see any deposits of US pension income in any of the bank account statements she examined and concluded that Mr. Karlozian must have had other bank accounts that were not disclosed to the CRA at the audit stage. For these reasons and because the pension income received should have been added in the calculation of Mr. Karlozian's income under the Act (section 3), the Court finds that the amount of US pension income should not reduce the income as per the net worth calculations.

C. **Penalties under subsections 163(2) and 163(1)**

(1) ***Penalties under subsection 163(2)***

[103] Subsection 163(2) provides that "[e]very person who, knowingly, or under circumstances amounting to gross negligence, has made...a false statement or omission in a return" is liable to a penalty.

[104] The burden of establishing the facts justifying the assessment of the penalty is on the Minister, under subsection 163(3).

[105] The penalties assessed under subsection 163(2) of the Act must be imposed only where the evidence clearly justifies it. If the evidence leaves any doubt that the penalties should be applied in the circumstances of the appeal, then the only fair conclusion is that the taxpayer must receive the benefit of the doubt in those circumstances (see *Farm Business Consultants Inc. v. Canada*, [1994] 2 C.T.C. 2450, 95 D.T.C. 200, at para. 27).

[106] According to the very wording of subsection 163(2) of the Act, two elements are required for a penalty to apply: (1) a mental element ("knowingly, or under circumstances amounting to gross negligence") and (2) a material element ("has made...a false statement or omission in a return").

[107] Regarding the material element, as indicated above, the case law holds that an incorrect statement in an income tax return amounts to a misrepresentation. Here, it was established that Mr. Karlozian filed his income tax returns for the taxation years under review. Furthermore, it was established, on a balance of probabilities, that Mr. Karlozian did not report all of his income for the 2011, 2012 and 2013 taxation years. Thus, the material element exists in the case at bar for all the taxation years under review.

[108] Regarding the mental element, two possible scenarios have to be examined for penalties to apply: did Mr. Karlozian knowingly make a false statement or omission, or did he make a false statement under circumstances amounting to gross negligence?

[109] I found that Mr. Karlozian made a false statement in his returns for 2011, 2012 and 2013 by not reporting all of his income. Furthermore, I was not satisfied with his explanations justifying the discrepancy in his reported income and his net worth, as I found that the arguments he raised to try to justify the discrepancy were not

relevant and some parts of his testimony were not credible. Hence, Mr. Karlozian must have known that he had unreported income, and therefore, I find that he knowingly filed incorrect returns for the 2011, 2012 and 2013 taxation years. Mr. Karlozian is a sophisticated and successful businessman with experience, and therefore, he must have known that the income reported was not sufficient to maintain his lifestyle. I find that the evidence shows that Mr. Karlozian was indifferent as to whether the law was complied with.

[110] As indicated by the Federal Court of Appeal in *Deyab v. R.*, 2020 FCA 222 (at para. 69), the failure to provide a credible explanation is sufficient to justify the assessment of the penalty under subsection 163(2).

[111] Here, it is not appropriate to give the benefit of the doubt to Mr. Karlozian. Having assessed all the evidence submitted at trial, I find that large amounts of income remain unexplained for the 2011, 2012 and 2013 taxation years.

[112] For the foregoing reasons, the penalties, as adjusted to take into account adjustments to the net worth calculations, shall be upheld for the 2011, 2012 and 2013 taxation years.

(2) ***Penalties under subsection 163(1)***

[113] The Minister assessed penalties under subsection 163(1) for the 2011 taxation year.

[114] Paragraph 22 of the Reply to the Notice of Appeal states the following:

> In determining that the Appellant was liable to a penalty pursuant to Subsection 163(1) of the *Income Tax Act*, the Minister relied on the following facts:
>
> a) The Appellant filed his 2011 tax return on November 28, 2012;

[115] At the hearing, neither of the parties adduced evidence or made any submissions with respect to subsection 163(1).

[116] For the following reasons, I find that the penalties assessed under subsection 163(1) shall be vacated.

[117] Subsection 163(1) provides that:

> **163 (1)** Every person is liable to a penalty who
>
> > **(a)** fails to report an amount, equal to or greater than $500, required to be included in computing the person's income in a return filed under section 150 for a taxation year (in this subsection and subsection (1.1) referred to as the ***unreported amount***);
> >
> > **(b)** had failed to report an amount, equal to or greater than $500, required to be included in computing the person's income in any return filed under section 150 for any of the three preceding taxation years; and
> >
> > **(c)** is not liable to a penalty under subsection (2) in respect of the unreported amount.

[Emphasis added.]

[118] The Minister assessed penalties under subsection 163(2) for the 2011 taxation year, and as indicated above, the Court found that these penalties were justified. In accordance with paragraph 163(1)(c), penalties under subsection 163(1) cannot be assessed when a taxpayer is also liable to a penalty under subsection 163(2) in respect of unreported income. Accordingly, penalties assessed under subsection 163(1) for the 2011 taxation year shall be vacated.

Signed at Ottawa, Canada, this 19th day of September 2024.

"Dominique Lafleur"

Lafleur J.

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