Tax Court of Canada Cour canadienne de l'impôt

Français

Date: 20020319

Docket: 1999-4002-IT-G

BETWEEN:

ROBERT COX,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Reasonsfor Judgment

Bowman, A.C.J.

[1] These appeals are from net worth assessments for the taxation years 1991 to 1997 inclusive.

[2] The appellant did not file returns for 1995, 1996 and 1997. After being requested by the Minister of National Revenue to file returns for 1991, 1992, 1993 and 1994 he filed returns which were prepared by "volunteers" from Revenue Canada or CCRA. I am not entirely sure what role these volunteers have — whether they are employees of the CCRA or are public spirited individuals who donate their time for no remuneration. At all events they assisted the appellant to file his returns based on information he supplied to them.

[3] The assessments were made by Mr. Euclide Michaud, an auditor with Revenue Canada (now CCRA). I found Mr. Michaud an impressive witness and he performed the audit with meticulous thoroughness and although I propose to make certain adjustments to the amounts assessed this is no reflection on Mr. Michaud or the appeals officer Ms. Paquette, both of whom were credible and conscientious witnesses.

[4] I shall begin these reasons by a brief description of the appellant. He is 37 years old and suffers from paranoid schizophrenia and has been so diagnosed. I refused to permit the appellant to put in two letters from the appellant's family doctor and his psychiatrist without calling them. However the appellant's brother, Donald Cox, a graduate psychologist with extensive experience in the field, testified. He described the appellant's behaviour and symptoms and he has all of the classic symptoms traditionally associated with schizophrenia — learning disability, anxiety disorder, inability to retain information, hallucinations and delusions, very disorganized, inability to follow anything through, very withdrawn, poor social skills, hears voices, has suicidal thoughts, very forgetful.

[5] The appellant graduated from high school but dropped out of a community college. He has since then worked for a minimum wage as a dishwasher or janitor. The appellant's description of himself was essentially the same as his brother's (who was excluded from the courtroom during the appellant's testimony). Moreover, I had ample opportunity to observe the appellant. His answers to questions were monosyllabic and without elaboration. He appeared to have no interest in the proceedings either when testifying or when sitting at the

back of the courtroom. He kept his eyes on the floor in front of him. In short he gave every appearance of being out of touch with reality, and not caring.

[6] During the years in question he was not taking any medication for his schizophrenia. Now he takes several medications — Olzapine, Paxil and Diazapin. During the years in question he saw his family doctor, Dr. Birosh, once every two months, and his psychiatrist, Dr. Doyle, every month. His appearance in court was of a person with no regard for his own personal appearance and hygiene. The contrast with his clean-cut and articulate brother could not have been more striking.

[7] His counsel, Mr. Alpert, stated in opening that the appellant was of limited intelligence. Although I set out a fairly detailed psychological profile of Mr. Cox I would not say that it leads conclusively to a finding of low intelligence. Intelligence is something that is not readily susceptible of either definition or measurement (see *Radage v. The Queen*, 96 DTC 1615).

[8] The appellant may or may not be of limited intelligence, whatever that means. He has, however, severe psychiatric problems. I have described them in some detail because they are relevant to a number of matters raised in this case — for example the penalties and the extreme difficulty that Mr. Michaud had in extracting information from the appellant as well as the appellant's inability to dispute some of the assumptions upon which Mr. Michaud based his conclusions, or at all events his apparent lack of interest in doing so.

[9] The net worth method of assessing tax is described in some detail in *Ramey v. The Queen*, 93 DTC 791, and in *Bigayan v. The Queen*, 2000 DTC 1619.

[10] In *Bigayan* the following was said.

[2] The net worth method, as observed in *Ramey v. The Queen*, 93 DTC 791, is a last resort to be used when all else fails. Frequently it is used when a taxpayer has failed to file income tax returns or has kept no records. It is a blunt instrument, accurate within a range of indeterminate magnitude. It 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 taxpayer's expenditures in the year, deleted non-taxable receipts and accretions to value of existing assets, the net results, less any amount declared by the taxpayer, must be attributable to unreported income earned in the year, unless the taxpayer can demonstrate otherwise. It is at best an unsatisfactory method, arbitrary and inaccurate but sometimes it is the only means of approximating the income of a taxpayer.

[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.

[11] This was the method used by Mr. Michaud and I can find no fault with it. Nonetheless, there are a number of facts that were established in evidence that warrant adjustments to some of the figures used in the net worth statement. I should preface my examination of the evidence and the assessments with one preliminary observation. The assessments are, as stated, based on the net worth method and they were carried out with meticulous observance of the rules. Nonetheless, a disinterested observer cannot avoid a

disquieting concern that the numbers may be significantly wrong simply because the appellant's mental state prevented his contesting some of the inferences the assessor drew. I say this not as a basis for changing the assessments so much as indicating the need to proceed with extreme caution when evaluating an assessment made against a person who does not seem to have the normal instincts or abilities of self-preservation.

[12] The net worth statement starts with 1990 as the base year on the assumption that the appellant had no net assets at the end of that year — in fact a minus net worth of $4,900. The appellant testified that he had $75,000 in a bank account at the beginning of 1990. I have seen no evidence that would substantiate this assertion. All of his of bank accounts were opened after January 1, 1991.

[13] The net worth statement proceeds on the assumption that the appellant received nothing from the estate of his father. I find as a fact that his brother Robert paid him $21,600 for his share of the family home. This may explain in part the rather surprising increase in net worth in 1991 of $71,326.23.

[14] The net worth statement proceeds on the assumption that the appellant's personal living expenditures are as set out in Schedule B to the net worth statement. This schedule is over three pages of figures consisting of an attempt to determine the appellant's personal living expenses. A very large part of these expenses are based on Statistics Canada's ("StatsCan") estimates of what it costs two people to live, reduced by ½. These figures suffer from the same unreliability as those in *Bigayan*, where I said

> [14] I am faced here with two sets of unreliable numbers. The Department of National Revenue in many instances used figures taken from Statistics Canada ("StatsCan") for the expenditures made by a family consisting of a husband and wife and three children. No one from StatsCan was called, nor was the assessor who used them. The appellant's counsel had therefore no opportunity to cross-examine on the figures used. I was given no evidence of the way the StatsCan figures are arrived at. Both counsel agreed that the StatsCan figures are a "national average", whatever that may mean. What figures go into the determination of that average, what methodology is used, what areas were taken as representative, whether any weighting was done by reference to the area from which the figures were taken - all these and many other questions remain unanswered.

[15] In that case I declined to make any adjustments to the figures based on StatsCan numbers, notwithstanding their inherent unreliability, because I was not provided with any more reliable figures. Here I have some basis for a small downward adjustment because I have an idea of how the appellant lived. It was said that he lived frugally. That is not a word I would have used. The appellant compulsively put money into mutual funds and a large part of his unreported income was attributable to capital gains realized from them. Apart from that his lifestyle was meagre and does not conform to the average StatsCan norm. If the appellant were the norm the living conditions of average Canadians would be pretty abysmal.

[16] The total annual personal expenses of the appellant assumed in the net worth statement were something over $11,000. I think they should be reduced as follows:

(a) Food: The amounts for food should be reduced by 25% based on my observations of the appellant and his style of living.

(b) Shelter: There should be no change. These are the appellant's own figures.

(c) Household operations including cleaning and household supplies. The telephone expense should stand but the cost of household supplies and cleaning of $324.50 per year should be reduced to $100 per year. This may be high, but I cannot imagine, from looking at the appellant, that he spends more than a minimal amount on keeping the house clean.

(d) Clothing. The assessor assumed that each year the appellant spent $750 on clothing and $147.50 on dry cleaning. It may be that the StatsCan average person does but I cannot believe that the appellant who turned up on both days in court wearing the same stained and dirty T shirt and jeans spends anywhere near that amount. I suppose there is a possibility that his T shirts and jeans wear out but I would consider $150 per year for both clothing and cleaning to be a maximum.

(e) Public Transportation. I see no reason for reducing these amounts.

(f) Health care. I would leave these as assessed.

(g) Personal care, including supplies, washing and haircutting. The appellant's personal hygiene is dreadful. His hair was long, unkempt and unwashed. The annual figure of $292 plus $120 ($412) is high. It should be reduced to a maximum of $100.

(h) Recreation (sports, toys, TV, etc.). I think that the notion that this person with severe psychiatric problems spends $1,044 per year on these recreational activities and products is wholly unrealistic and inconsistent with my observation of him. $200 per year is more realistic.

(i) Reading material, $148 per year. This figure is high. The appellant can no doubt read but I do not think he does. This should be reduced to a maximum of $50 per year.

(j) Gifts and contributions (flowers, toys, gifts to religious organizations and charitable organizations). Here, the assessment assumes that each year the appellant made gifts of one sort or another totalling $584.50. This may be the type of largesse that the average StatsCan normal person spreads around but it is wholly inconsistent with the sort of person that I saw in court over two days. This figure should be reduced to zero.

[17] I do not criticize Mr. Michaud for making his estimates on the basis of StatsCan norms but we are dealing here with a person who is entirely abnormal. He does not fit into a StatsCan norm.

[18] The next item is the alleged gifts to the appellant over these years by his girlfriend Nancy Brown. Although the appellant and Nancy Brown did not live together their relationship extended over the period 1985 to 2001 when they broke up and she went back to London from North Bay. She was a schizophrenic as well and she came from a rich family and was given money by her widowed mother. Both the appellant and his brother testified that Nancy Brown gave the appellant money. The appellant said she gave him amounts each year ranging from $9,360 to $10,800. The appellant's brother testified that the appellant received about $10,000 per year. Since the amounts were paid in cash I have some difficulty in determining the precise amount. The appellant testified that Nancy Brown received between $700 and $1,200 monthly from her mother. If this, plus a disability pension that she received, was the only source of her gifts, $10,000 per year is high. I cannot justify ignoring the gifts completely because I find as a fact that the girlfriend was fairly generous with the appellant, although the extent of her largesse is hard to quantify. Since the net worth assessment is to a large extent based on estimates and given the fact that the appellant's psychiatric condition puts him at a disadvantage in being able to rebut the presumption of correctness of the assessments my best estimate of the amounts received from the girlfriend is $7,000 per year.

[19] The respondent concedes that the appellant received $1,568 in 1991 when he cashed in an insurance policy. Also, I find as a fact that he sold some furniture and stereo and TV equipment for $1,200. These amounts should reduce the amounts included in income in his net worth statement.

[20] I shall mention briefly the variety store business that he bought from his brother in about 1995. On this point the evidence is clear. It was a failure, and, from my observation of

the appellant, I can see why. There was a suspicion on the part of the CCRA that the appellant was engaged in selling stolen goods. It was no more than a suspicion and it was never substantiated by the respondent.

[21] Subject to the adjustments I have mentioned above there is really very little I can do for the appellant. We are faced with one ineluctable fact that over the years 1991 to 1997 the appellant amassed a rather substantial fortune in mutual funds. The appellant's increase in net worth is not fully accounted for so the assessments must stand subject to the reductions outlined above.

[22] Finally there is the matter of the penalties under subsection 163(2) of the *Income Tax Act* imposed in the years in which he filed returns.

[23] For a penalty to be imposed under subsection 163(2) two elements must be present: a misstatement or omission in a return and a requisite mental state. The first element is obviously present. But can it be said that a person who suffers from the type of paranoid schizophrenia that I have described above, who has hallucinations, hears voices, and is divorced from reality for a large part of the time, can have the requisite mental state to justify a penalty under subsection 163(2)? Perhaps. But then again, perhaps not. From my observation of the appellant I think the better view is that he did not. Others might see it differently and I would respect that view. It would not be without merit. He was after all smart enough to make money from his investments. He did also have the wit to defraud the welfare authorities for which he went to jail. He subsequently made full restitution. Where, however, the court has such doubt I think the safer course is to give the benefit of that doubt to the appellant.

[24] There are cogent arguments in favour of upholding the subsection 163(2) penalties but in my view it would be dangerous to sanction their imposition against this psychiatrically disturbed individual.

[25] The appeals are allowed and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with these reasons.

[26] Success is divided and so there will be no order for costs.

Signed at Toronto, Canada, this 19th day of March 2002.

"D.G.H. Bowman"

A.C.J.

COURT FILE NO.:	1999-4002(IT)G
STYLE OF CAUSE:	Between Robert Cox and Her Majesty The Queen
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	February 28 and March 1, 2002
REASONS FOR JUDGMENT BY:	The Honourable D.G.H. Bowman Associate Chief Judge
DATE OF JUDGMENT:	March 19, 2002

APPEARANCES:

Counsel for the Appellant: Howard J. Alpert, Esq.

Counsel for the Respondent: Catherine Letellier de St-Just

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1999-4002(IT)G

BETWEEN:

ROBERT COX,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on February 28 and March 1, 2002 at Toronto, Ontario, by

The Honourable D.G.H. Bowman

Associate Chief Judge

Appearances

Counsel for the Appellant: Howard J. Alpert, Esq.

Counsel for the Respondent: Catherine Letellier de St-Just

JUDGMENT

It is ordered that the appeals from assessments made under the *Income Tax Act* for the 1991, 1992, 1993, 1994, 1995, 1996 and 1997 taxation years be allowed and the assessments be referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the reasons for judgment.

There will be no order for costs.

Signed at Toronto, Canada, this 19th day of March 2002.

"D.G.H. Bowman"

A.C.J.
