

Docket: 2011-2668(IT)G

BETWEEN:

JEFFREY H. MAXWELL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on common evidence together with the appeals of  
Jeffrey H. Maxwell (2011-2669(GST)G, 2011-2687(IT)G and  
2011-2688(GST)G) on March 25 and 26, 2014,  
at Kelowna, British Columbia.

Before: The Honourable Justice Steven K. D'Arcy

Appearances:

For the Appellant:                   The Appellant himself  
Counsel for the Respondent:       Christa Akey

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**JUDGMENT**

In accordance with the attached reasons for judgment, the appeal with respect to the assessment bearing number 930819 made under the *Income Tax Act* for the 2007 taxation year is allowed, in part, to reduce the amount of the assessment to the amount shown on the certificate registered in the Federal Court of Canada.

There will be no order as to costs.

Signed at Ottawa, Canada, this 25<sup>th</sup> day of March 2015.

“S. D’Arcy”

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D'Arcy J.

Docket: 2011-2669(GST)G

BETWEEN:

JEFFREY H. MAXWELL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on common evidence together with the appeals of  
Jeffrey H. Maxwell (2011-2668(IT)G, 2011-2687(IT)G and  
2011-2688(GST)G) on March 25 and 26, 2014,  
at Kelowna, British Columbia.

Before: The Honourable Justice Steven K. D'Arcy

Appearances:

For the Appellant:                   The Appellant himself  
Counsel for the Respondent:       Christa Akey

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**JUDGMENT**

In accordance with the attached reasons for judgment, the appeal from the assessment made under the *Excise Tax Act*, notice of which bears the number 931052, is dismissed.

There will be no order as to costs.

Signed at Ottawa, Canada, this 25<sup>th</sup> day of March 2015.

“S. D’Arcy”

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D'Arcy J.

Docket: 2011-2687(IT)G

BETWEEN:

JEFFREY H. MAXWELL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on common evidence together with the appeals of  
Jeffrey H. Maxwell (2011-2668(IT)G, 2011-2669(GST)G and  
2011-2688(GST)G) on March 25 and 26, 2014,  
at Kelowna, British Columbia.

Before: The Honourable Justice Steven K. D'Arcy

Appearances:

For the Appellant:                   The Appellant himself  
Counsel for the Respondent:       Christa Akey

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**JUDGMENT**

In accordance with the attached reasons for judgment, the appeal with respect to the assessment bearing number 718615 made under the *Income Tax Act* is allowed, in part, to reduce the amount of the assessment to the amount shown on the certificate registered in the Federal Court of Canada.

There will be no order as to costs.

Signed at Ottawa, Canada, this 25<sup>th</sup> day of March 2015.

“S. D’Arcy”

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D'Arcy J.

Docket: 2011-2688(GST)G

BETWEEN:

JEFFREY H. MAXWELL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on common evidence together with the appeals of Jeffrey H. Maxwell (2011-2668(IT)G, 2011-2669(GST)G and 2011-2687(IT)G) on March 25 and 26, 2014, at Kelowna, British Columbia.

Before: The Honourable Justice Steven K. D'Arcy

Appearances:

For the Appellant:                   The Appellant himself  
Counsel for the Respondent:       Christa Akey

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**JUDGMENT**

In accordance with the attached reasons for judgment, the appeal from the assessment made under the *Excise Tax Act*, notice of which bears the number 1011264, is allowed, in part, to reduce the amount of the assessment to the amount shown on the certificate registered in the Federal Court of Canada.

There will be no order as to costs.

Signed at Ottawa, Canada, this 25<sup>th</sup> day of March 2015.

“S. D’Arcy”

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D'Arcy J.

Citation: 2015 TCC 74  
Date: 20150325  
Dockets: 2011-2668(IT)G  
2011-2669(GST)G  
2011-2687(IT)G  
2011-2688(GST)G

BETWEEN:

JEFFREY H. MAXWELL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

### **REASONS FOR JUDGMENT**

D'Arcy J.

[1] The issue in the four appeals before me is whether the Appellant is liable as a director, under section 227.1 of the *Income Tax Act* and section 323 of Part IX of the *Excise Tax Act* (the “*GST Act*”), for source deductions and GST that TRAK Energy Engineering Inc. (“TRAK Engineering”) and 6607306 Canada Inc. (“TRAK Mechanical”) failed to remit (collectively referred to as the “Remittances”). The Remittances relate primarily to 2007.

[2] The four appeals were heard together on common evidence.

#### **Summary of Facts**

[3] The Appellant, a professional engineer, established a company in the 1990’s to perform energy audits in buildings. Sometime after 2000, he moved the company to British Columbia.

[4] During the relevant period, the Appellant carried on his business through the following three companies (jointly referred to as the “Three Companies”):

- TRAK Energy Corporation (TEC), which served as the general contractor for various projects and entered into the head contracts with clients.
- TRAK Engineering, which performed the engineering work required under the various head contracts.
- TRAK Mechanical, which served as the payroll company. During the relevant period it had approximately 40 employees in two divisions: the plumbing division and the heating and ventilation division.

[5] The Appellant was the controlling mind and sole director of each of the Three Companies.

[6] Sometime in August 2005, TEC entered into a contract with an entity called Happy Valley Resort to design and build mechanical systems for a condominium project in Kelowna, British Columbia (the “Happy Valley Contract”). This was a very difficult project for the Three Companies for the simple reason that the developer of the project (the “Developer”) refused to pay its bills on a timely basis.

[7] By July 2006, the Developer owed over \$700,000 under the contract with TEC. This forced the Three Companies to take collection actions, including sending a notice of payment default and breach of contract. These actions were somewhat successful, as the receivables fell to \$200,000.

[8] Unfortunately, the Developer continued to defer payments under the Happy Valley Contract, resulting in an increase in the Three Companies’ receivables to \$670,000 by late 2006. The receivables then dropped to \$400,000 after additional collection actions by the Three Companies, but then rose once again to \$600,000 by early 2007. In June 2007, the Three Companies stopped working on the Happy Valley Resort project. They filed a default notice under the Happy Valley Contract and executed a lien on the project. Notwithstanding these actions, the Three Companies have not been able to collect the amounts owed to them by the Developer.<sup>1</sup>

## **The Law**

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<sup>1</sup> Exhibit A-1, page 16; Transcript, March 25, 2014, pages 76 to 86, testimony of Jeffrey Maxwell.

[9] Subsection 227.1(1) of the *Income Tax Act* provides, in part, that the directors of a corporation are jointly and severally liable for a corporation's unpaid source deductions, including any interest on, or penalties relating to, the unpaid source deductions.

[10] Section 227.1 places certain limitations on the director's liability. Two of these limitations are relevant for the purposes of these appeals. Paragraph 227.1(2)(a) provides that a director is not liable under subsection 227.1(1) unless "a certificate for the amount of the corporation's liability referred to in that subsection [227.1(1)] has been registered in the Federal Court under section 223 and execution for that amount has been returned unsatisfied in whole or in part".

[11] The second relevant limitation is contained in subsection 227.1(3), which provides that a director is not liable under subsection 227.1(1) "where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances".

[12] Subsection 323(1) of the *GST Act* imposes a similar director's liability in respect of unremitted GST/HST. Subsection 323(1) of the *GST Act* provides that the directors of a corporation are jointly and severally liable to pay any amount of net tax that the corporation fails to remit. A director's liability under subsection 323(1) includes any interest on, or penalties relating to, the net tax that is not remitted.

[13] The *GST Act* contains the same limitations as those found in the *Income Tax Act*. Paragraph 323(2)(a) of the *GST Act* provides that a director is not liable under subsection 323(1) unless "a certificate for the amount of the corporation's liability referred to in that subsection [323(1)] has been registered in the Federal Court under section 316 and execution for that amount has been returned unsatisfied in whole or in part".

[14] A due diligence defence is contained in subsection 323(3) of the *GST Act*, which provides that a director is not liable under subsection 323(1) "where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."

[15] The Federal Court of Appeal noted in *Buckingham*<sup>2</sup> that subsection 323(3) of the *GST Act* and subsection 227.1(3) of the *Income Tax Act* should be applied in a similar fashion.

### **First Issue Before the Court**

[16] The first issue the Court must address is whether the amounts assessed by the Minister exceed the limitation set out in paragraphs 227.1(2)(a) of the *Income Tax Act* and 323(2)(a) of the *GST Act*.

[17] On May 6, 2010, the Minister assessed the Appellant for \$452,347.49 under subsection 227.1(1) of the *Income Tax Act* in respect of TRAK Mechanical's unremitted source deductions<sup>3</sup> and \$86,222.48 under subsection 323(1) of the *GST Act* in respect of TRAK Mechanical's unremitted net tax.<sup>4</sup> The Respondent indicates in her relevant Replies that these are the amounts at issue in the appeals before the Court relating to TRAK Mechanical.<sup>5</sup>

[18] Paragraph 7 p) of the Reply in 2011-2687(IT)G states that when determining the Appellant's liability, as a director of TRAK Mechanical, for unremitted source deductions, the Minister assumed that "on January 10, 2008, the Minister registered with the Federal Court of Canada a certificate for [TRAK Mechanical's] liability for the Source Deductions, plus penalty and interest, in the amount of \$373,673.61." The Respondent provided the Court with a copy of the certificate.<sup>6</sup> The certificate is for an amount that is some \$78,674 less than the amount the Minister assessed pursuant to subsection 227.1(1) of the *Income Tax Act*.

[19] A similar discrepancy exists with respect to TRAK Mechanical's unremitted net GST. The Appellant was assessed for \$86,222.48. However, the Federal Court certificate is only for \$74,326.29.<sup>7</sup> The amount assessed exceeds the certificate amount by \$11,896.19.

[20] Paragraphs 227.1(2)(a) of the *Income Tax Act* and 323(2)(a) of the *GST Act* clearly provide that the Minister may not assess an amount in excess of the amount

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<sup>2</sup> *Buckingham v. Canada*, 2011 FCA 142, [2013] 1 F.C.R. 86, 2011 DTC 5078 ("Buckingham"), at paragraph 47.

<sup>3</sup> Exhibit R-3.

<sup>4</sup> Exhibit R-4.

<sup>5</sup> Reply in 2011-2687(IT)G at paragraph 4 and Reply in 2011-2688(GST)G at paragraph 6.

<sup>6</sup> Exhibit R-14.

<sup>7</sup> Exhibit R-12.



of the Federal Court certificate. As a result, the Court will direct the Minister to reduce the assessments to the amount of the relevant Federal Court certificate.

[21] The Minister made a similar error when assessing the Appellant in respect of the unremitted source deductions of TRAK Engineering. The Minister assessed the Appellant \$97,517.46 in respect of TRAK Engineering's unremitted source deductions.<sup>8</sup> However, the certificate registered by the Minister with the Federal Court was only for \$86,372.61.<sup>9</sup> The assessment will be reduced to the amount of the certificate: \$86,372.61.

### **Second Issue Before the Court**

[22] The second issue before the Court is whether the Appellant has satisfied the conditions for the due diligence defence contained in subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *GST Act*.

[23] It is a question of fact whether the Appellant, in his role as director of TRAK Engineering and TRAK Mechanical, exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. The standard of care, skill and diligence required under subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *GST Act* is an objective standard.<sup>10</sup> The burden is on the Appellant to show that he has satisfied the conditions of the two subsections.

[24] The Appellant knew by January 2007 that the Three Companies were facing significant cash flow issues due to the failure of the Developer to pay the amounts owing under the Happy Valley Contract.<sup>11</sup> However, the Appellant decided that the Three Companies should continue their work under the contract.

[25] In early 2007, the Appellant took certain steps to deal with the Three Companies' cash flow issues. This included prioritizing some creditors over others. While he continued to pay the net wages to the employees, he only paid certain suppliers and stopped making the Remittances.<sup>12</sup>

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<sup>8</sup> Exhibit R-1 and Reply in 2011-2668(IT)G, at paragraph 4.

<sup>9</sup> Exhibit R-10.

<sup>10</sup> *Buckingham, supra*, at paragraph 37.

<sup>11</sup> Transcript, March 25, 2014, pages 101 and 102, testimony of Jeffrey Maxwell.

<sup>12</sup> *Ibid.*, pages 110 and 111.

[26] The Appellant testified that he firmly believed that the Developer would pay the amounts owed to the Three Companies. He relied on the fact that the Developer required an engineer's certificate before the building could be occupied and on the Three Companies' ability to place a lien on the Happy Valley property, which would have the effect of stopping construction.<sup>13</sup> As a result, the Appellant believed the Three Companies would have the funds to pay the suppliers and make the Remittances by the end of the first quarter of 2007.<sup>14</sup>

[27] The Appellant also relied on the fact that the Three Companies carried on a substantial business, which generated revenue of approximately \$10 million per year.<sup>15</sup>

[28] Unfortunately for the Appellant, the Developer never paid the amounts owing under the Happy Valley Contract. Instead, it retained a second engineering firm to issue the required occupancy report. The Appellant described what happened as follows:

. . . So finally, we file a lien in the claim. The -- the lien amount was \$876,000 at the time. The -- at the time there were terms put forward that if they had made the payment we would continue on with the work and we would have been able to pay down these debts. They did not make that payment. The developer had decided to do a workaround where he brought in another engineering firm. And it was really beyond my expectation that he would find an engineering firm that would lie on the amount of the progress. And that has since been proven and subsequently that same engineering firm later lied on the state of completion so as a letter of credit could be released for the developer. . . .<sup>16</sup>

[29] The Appellant referred to these events as extraordinary circumstances that he "could not possibly be prepared for or have the capacity to deal with . . ." <sup>17</sup> Once it became clear that the Developer would not be paying the outstanding amounts, he stopped working on the project and began the process of winding down the Three Companies' business, a business that the Appellant had carried on successfully for 16 years.

[30] As the Federal Court of Appeal noted in *Buckingham*, the duty of care under subsection 323(1) of the *GST Act* is intended to **prevent the failure** by a

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<sup>13</sup> *Ibid.*, page 102.

<sup>14</sup> *Ibid.*, page 124.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*, page 26.

<sup>17</sup> *Ibid.*

corporation to remit net tax. The Federal Court of Appeal stated that, in order to rely on the subsection 323(3) defence, “. . . a director must . . . establish that he turned his attention to the required remittances and that he exercised his duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the concerned amounts.”<sup>18</sup>

[31] In the current appeals, the Appellant took no steps to prevent the failure by the Three Companies to make the Remittances. In fact, the Appellant made the decision not to make the Remittances.

[32] I accept that the Appellant believed at the time the Three Companies failed to make the Remittances that the companies would collect from the Developer the monies required to make the Remittances. However, the failure to make the Remittances in the belief that this failure could be corrected in the future does not constitute a defence under either subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *GST Act*. As the Federal Court of Appeal stated in *Buckingham*:

. . . In circumstances where a corporation is facing financial difficulties, it may be tempting to divert these Crown remittances in order to pay other creditors and thus ensure the continuation of the operations of the corporation. It is precisely such a situation which both section 227.1 of the *Income Tax Act* and section 323 of the *Excise Tax Act* seek to avoid. The defence under subsection 227.1(3) of the *Income Tax Act* and under subsection 323(3) of the *Excise Tax Act* should not be used to encourage such failures by allowing a due diligence defence for directors who finance the activities of their corporation with Crown monies on the expectation that the failures to remit could eventually be cured.<sup>19</sup>

[33] While the Appellant may not have been able to foresee the events that occurred with respect to the Happy Valley Contract, he was the person who made the decision not to pay certain of the Three Companies’ accounts payable, including the Remittances. In such a situation, he is not entitled to rely upon the due diligence defence contained in subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *GST Act*.

[34] For the foregoing reasons the appeals are allowed, in part, to reduce the amount of the assessments to the amounts shown on the certificates registered in the Federal Court. There will be no order with respect to costs.

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<sup>18</sup> *Buckingham, supra*, at paragraph 40.

<sup>19</sup> *Ibid.*, at paragraph 49.

Signed at Ottawa, Canada, this 25<sup>th</sup> day of March 2015.

“S. D’Arcy”

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D’Arcy J.

CITATION: 2015 TCC 74

COURT FILE NOS.: 2011-2668(IT)G, 2011-2669(GST)G,  
2011-2687(IT)G, 2011-2688(GST)G

STYLE OF CAUSE: JEFFREY H. MAXWELL v. HER  
MAJESTY THE QUEEN

PLACE OF HEARING: Kelowna, British Columbia

DATE OF HEARING: March 25 and 26, 2014

REASONS FOR JUDGMENT BY: The Honourable Justice Steven K. D'Arcy

DATE OF JUDGMENT: March 25, 2015

APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Christa Akey

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

For the Respondent: William F. Pentney  
Deputy Attorney General of Canada  
Ottawa, Canada