Docket: 2004-4280(IT)G

BETWEEN:

GABRIEL LEGER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
Gabriel Leger (2004-4274(GST)G)
on January 17, 2007, at Moncton, New Brunswick.

Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant:	Jack M. Blackier
Counsel for the Respondent:	Marcel Prévost

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the periods from April 1 to June 30, 1997, July 1 to September 30, 1997, October 1 to December 31, 1997, April 1 to June 30, 1998, and October 1 to December 31, 1998, is allowed and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment. Each party shall bear its own costs.

Signed at Quebec City, Quebec, this 27th day of June 2007.

"François Angers"

Angers J.

Docket: 2004-4274(GST)G

BETWEEN:

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Appellant,

and

HER MAJESTY THE QUEEN,

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Appeal heard on common evidence with the appeal of
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Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant:	Jack M. Blackier
Counsel for the Respondent:	Marcel Prévost

JUDGMENT

The appeal from the assessment made under the *Excise Tax Act*, the notice of which is dated October 2, 2002, for the periods from April 1 to June 30, 1997, July 1 to September 30, 1997, October 1 to December 31, 1997, April 1 to June 30, 1998, and October 1 to December 31, 1998, is dismissed in accordance with the attached Reasons for Judgment. Each party shall bear its own costs.

Signed at Quebec City, Quebec, this 27th day of June 2007.

"François Angers"

Angers J.

Citation: 2007TCC322
Date: 20070830
Dockets: 2004-4280(IT)G
2004-4274(GST)G

BETWEEN:

GABRIEL LEGER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

AMENDED REASONS FOR JUDGMENT

Angers J.

[1] These two appeals were heard on common evidence. The appellant was assessed under the *Income Tax Act* (ITA) and the *Excise Tax Act* (ETA) on October 2, 2002. The assessments were issued against the appellant in his capacity as director of Richard Security Limited (RSL) in respect of that entity's failure to remit income tax, unemployment insurance premiums and Canada Pension Plan contributions (payroll deductions) for its employees and its failure to remit Goods and Services Tax/Harmonized Sales Tax (GST/HST) for the periods from April 1 to June 30, 1997, July 1 to September 30, 1997, October 1 to December 31, 1997, April 1 to June 30, 1998, and October 1 to December 31, 1998 (the periods). RSL was assessed on January 20, 1995, and on September 1, 1995, for the unpaid payroll deductions. In the statement of account attached to the Reply to the Notice of Appeal, the amount indicated as unremitted as of the date of the September 1, 1995 assessment is $58,012.18 for the year 1994. The other outstanding amounts are penalties and interest that accumulated up to 1999, a few regular remittance cheques that were returned NSF, and amount of $4,915.21 in unremitted federal tax and $2,998.25 in unremitted provincial taxes for 1998. It is unclear when RSL was assessed for the unremitted GST/HST for the above periods. But in both cases, the Minister of National Revenue (the Minister) filed a writ and a certificate with the Federal Court as required by both the ITA and ETA, and both were returned

unsatisfied. The certificate for RSL's net tax liability under the *Excise Tax Act* is in the amount of $39,193.35 plus penalty and interest and the certificate for RSL's net tax liability under the *Income Tax Act* is in the amount of $69,530.37 plus interest. Neither amount is in dispute in these appeals.

[2] The appellant has submitted the following issues to be decided by the Court:

a) Did the appellant cease to be a director of RSL by virtue of the March 9, 1998 dissolution of RSL?
b) If the appellant ceased to be a director of RSL as a result of its March 9, 1998 dissolution, did the appellant become a director of RSL as a result of the revival of RSL on September 18, 1998?
c) Was the assessment issued against the appellant more than two years after the appellant last ceased to be a director of RSL, and if so, is the appellant's liability against precluded by virtue of subsection 227.1(4) of the ITA and by subsection 323(5) of the ETA?
d) If it is determined that the appellant was, at any material time, a director of RSL and if the assessment issued against the appellant is not otherwise statute-barred, should the appellant be afforded the due diligence defence provided by subsection 323(3) of the ETA and subsection 227.1(3) of the ITA?

[3] The respondent has worded the issue as follows: is the appellant liable under the relevant sections for the failure by RSL to remit to the Receiver General an amount of net tax, with penalties and interest thereon, as required by subsection 228(2) of the ETA, and to remit the federal income tax (payroll deductions) with interest and penalties, as required by section 153 of the ITA.

[4] RSL was incorporated on August 6, 1987, under the *Business Corporations Act* of New Brunswick. Norbert Richard and the appellant became directors of RSL on August 18, 1987, but the appellant became the sole director on January 14, 1994. On March 9, 1998, RSL was dissolved by the Director of corporate affairs for failing to file its annual returns, but was later revived on September 18, 1998, when articles of revival were filed with the Director. The articles of revival form shows the name of the appellant as the applicant and is signed with his name, but the appellant says it is not his signature.

[5] RSL was in the business of providing security officers or guards at various sites according to the needs of its clients. The appellant says he was approached on

the subject of becoming an investor by a fellow physician, namely, the other director identified above and one Edmond Richard, who was involved in security.

[6] The appellant is a pediatrician. His educational background is in science: he obtained a bachelor's and a master's degree in science after which he attended medical school and specialized. He has no business degrees nor has he taken any courses in that field. During all material periods, he devoted his time to his medical practice, working at the hospital or at his office and being on call three or four days a week; this meant an average work week of 90 hours plus on-call emergencies.

[7] At all material times, RSL employed an average of 30 employees and day-to-day operations were managed by one employee who was assisted by a bookkeeper. Edmond Richard held the management function until March 1995 when he resigned. His resignation came about when the appellant was informed that Mr. Richard had possibly been misappropriating funds since 1990. An accounting of Mr. Richard's possible misappropriations shows that he may have deprived RSL of an amount of $187,725 over those years. Mr. Richard was replaced by René Martin, who had been a supervisor with RSL for a number of years and who had an accounting background. He stayed with RSL until March 1998 and was replaced by one Jean-Guy Richard, who managed the corporation until it ceased operating in December of that year.

[8] The assistant to the bookkeeper was Pauline Lajoie. She held that function until 1994. When she was asked to leave, she was replaced by one Jeannine Maillet who, in turn, was also asked to leave in 1996. René Martin took over the bookkeeping until he left in March 1998, and Jean-Guy Richard then assumed both functions until RSL ceased operating in December 1998. The appellant was informed of that last fact by Jean-Guy Richard when he met him by chance in a shopping centre in January or February of 1999. Strangely enough, the appellant does not know what went on at RSL to cause it to cease operating in December 1998.

[9] The appellant initially said that he believed he was first made aware of RSL's failure to remit the GST/HST in 1994 but later admitted that it was earlier than that. He signed in September 1993 a letter addressed to Revenue Canada Customs and Excise, as it then was, acknowledging he was a director of RSL, that RSL was indebted to the Crown for unremitted tax and that he knew about the director's liability in the ETA. The letter was provided in consideration of the agreement of the Minister of National Revenue to grant him a release with respect to a requirement to pay that had been issued.

[10] As for the failure to remit the payroll deductions, the appellant was informed thereof by Mr. Richard in the months preceding his resignation in March 1995. He was told that RSL needed additional funds to cover the payroll deductions. As of the end of 1994, and as mentioned earlier, RSL had failed to remit payroll deductions totalling $58,012.18, including penalties and interest, despite the fact that the appellant had injected more funds into the business to cover the outstanding GST/HST debt.

[11] At or around that time, the appellant informed his personal accountant, Pierre Cormier, about RSL's failure to remit and instructed him to take measures to avoid a reoccurrence. He was instructed to supervise the staff and ensure that remittances were made in timely fashion. At the same time, the appellant also informed René Martin (who replaced Edmond Richard) of the situation and instructed him to keep in touch with Pierre Cormier. In addition and in the same year, the appellant instructed his management staff to enrol in an accounting and business course, given by the Province of New Brunswick, in order to improve their skills and become aware of their obligations and responsibilities as managers of a business. They did enrol in the course.

[12] The appellant also instructed the in-house bookkeeper to prepare an income statement for RSL on a monthly basis. That statement itemized as well the monthly expenses and thus provided the appellant with the monthly gross profit or the loss. Those statements were prepared over the periods in issue on a fairly regular basis. Other than that, the appellant has not seen any annual financial statement of RSL or its books, but he understood that the expenses were being paid. The appellant did not sign cheques for RSL or its tax returns. That was done by the day-to-day manager.

[13] From that time until April 1997, RSL made its GST/HST remittances. When RSL failed to remit for the periods from April 1 to June 30 and July 1 to September 30, 1997, and when the appellant became aware of its failure to remit the GST/HST for those periods, he wrote a letter to Aimé Gallant at Revenue Canada on September 11, 1997, in which he referred to the late remittances and explained RSL's financial difficulties, and its problems with its managers and requested a waiver of the interest and penalties on the outstanding payroll deduction remittances for 1994.

[14] The appellant and René Martin met with representatives of Revenue Canada; the appellant at that time instructed René Martin to check the receivables and to

make sure Revenue Canada got paid. He kept being informed by René Martin that everything was getting done, that is, the remittances were being made. According to the appellant, whenever he asked if RSL was current in its remittances, René Martin's answer was always yes. The appellant relied on René Martin, as he had been cleared by the Royal Canadian Mounted Police (RCMP) and was accredited as an investigator. In addition, the appellant says he knew René Martin personally and believed him to be an honest person. In fact, the appellant says he thought the same of Edmond Richard, who had also undergone some form of verification by the RCMP. Notwithstanding, RSL failed to remit GST/HST in the months following September 1997, except for the periods from January 1 to March 31, 1998, and July 1 to September 30, 1998.

[15] René Martin left in 1998 and was replaced by Jean-Guy Richard who had been with RSL for a long time as a guard and had also attended the course referred to earlier. He handled the day-to-day operations of RSL until he left at the end of 1998 and decided to terminate all RSL'S operations without consulting or telling the appellant.

[16] According to the appellant, Mr. Jean-Guy Richard is the person who undertook to revive the corporation when it was dissolved in March 1998 for failure to file its annual returns. According to the appellant, Mr. Richard signed his (the appellant's) name on the articles of revival dated September 16, 1998. The appellant was never informed nor aware of that fact until a few days before the trial. The appellant had no discussions with Mr. Richard concerning the dissolution or the revival of the corporation. Neither of these was authorized or approved by the appellant. The same is also true of the annual return filed on the same day as the articles of revival. The appellant states that he was not reappointed a director of RSL after its dissolution in March 1998.

[17] The appellant also invested in three other corporations or businesses over the years but cannot say if he was a director of any of them. His only interest therein was as an investor; he left everything else to his lawyers or accountants, on whom he relied to assist him. He has no knowledge of how a corporation is structured nor of the role and responsibilities of directors.

[18] The evidence also reveals that RSL's bookkeeping was poorly done over the years in issue, as an accountant retained by Jean-Guy Richard was unable to piece everything together.

[19] The first issue is whether the appellant ceased to be a director of RSL upon its dissolution on March 9, 1998, and if he did, whether the Minister is barred from assessing the appellant by reason of subsection 227.1(4) of the ITA and subsection 323(5) of the ETA, which state that no action or proceedings to recover any amount payable by a director of a corporation under subsection (1) of the ITA or subsection (4) of the ETA shall be commenced more than two years after the director last ceased to be director of that corporation.

[20] The appellant was not aware that the Director of corporate affairs had issued a certificate of dissolution with respect to RSL on March 9, 1998, nor was he aware that his manager had signed his (the appellant's) name on articles of revival on September 16, 1998. It appears to me that this situation is consistent with the appellant's testimony that he delegated the day-to-day operations of RSL to his managers and that they were thus authorized to sign RSL's financial statements and tax returns. I can only assume that an application to revive the corporation would have received approval from the appellant, a fact which was not strongly disputed by the appellant's counsel and rightly so.

[21] That being said, subsection 136(5) of the New Brunswick *Business Corporations Act* (NBBCA) deals with the rights and privileges of a corporation upon its revival; it provides as follows:

> 136(5) Subject to subsection (6), a corporation or body corporate is revived on the date shown on the certificate of revival and thereafter the corporation or body corporate, subject to the rights acquired by any person after its dissolution, has all the rights and privileges and is liable for the obligations that it would have had if it had not been dissolved or had its charter forfeited.

[22] Counsel for the appellant made reference to two New Brunswick cases, namely, *H.A.R. Construction Ltd. v. DeMerchant Construction Ltd.*, [1990] N.B.R (2d) 343 and *ADI Ltd. v. 052987 N.B. Inc.*, [2000] N.B.J. No. 467 (QL). Both cases dealt with the status of dissolved corporations in terms of their contractual obligations, but said nothing about the status of their directors at dissolution. The judgment of this Court in *Pello v. Canada*, [2003] T.C.J. No. 342 (QL), was also referred to by counsel, but again, the issue in that case was the effect of corporate status once a corporation is revived, but that matter was considered in terms of whether the corporation in question was capable of retroactively carrying on business during the tax years in issue and whether the Crown had acquired the right during the corporation's dissolution to assess the appellant with respect to the

business income earned. That decision does not address the issue now before this Court.

[23] Most cases in this area deal with the equivalent sections in the *Canada Business Corporations Act* (CBCA) and the Ontario *Business Corporations Act* (OBCA). The equivalent section in the CBCA is subsection 209(4) and it provides as follows:

> 209.(4) Subject to any reasonable terms that may be imposed by the Director, to the rights acquired by any person after its dissolution and to any changes to the internal affairs of the corporation after its dissolution, the revived corporation is, in the same manner and to the same extent as if it had not been dissolved,
>
> (*a*) restored to its previous position in law, including the restoration of any rights and privileges whether arising before its dissolution or after its dissolution and before its revival; and
>
> (*b)* liable for the obligations that it would have had if it had not been dissolved whether they arise before its dissolution or after its dissolution and before its revival.

[24] And the equivalent section in the OBCA is subsection 241(5) which provides as follows:

> 241.(5) Where a corporation is dissolved under subsection (4) or any predecessor of it, the Director on the application of any interested person, may, in his or her discretion, on the terms and conditions that the Director sees fit to impose, revive the corporation; upon revival, the corporation, subject to the terms and conditions imposed by the Director and to the rights, if any, acquired by any person during the period of dissolution, shall be deemed for all purposes to have never been dissolved.

[25] In a recent decision of the Ontario Superior Court of Justice, *Litemor Distributors (Ottawa) Ltd. v. W.C. Somers Electric Ltd*, 73 O.R. (3d) 228, Justice Panet reviewed the law in this area and said the following about subsection 209(4) of the CBCA and subsection 241(5) of the OBCA, at paragraphs 27 to 31.

> [27] On a plain reading of the wording of the statute, it appears that Parliament intended that the effect of revival is to be retroactive, such that the revival extends back to the moment of dissolution. The dissolution is deemed not to have occurred. This would imply that, upon revival, any acts undertaken in the name of the corporation by its principals during the period of dissolution would be "cured" so that such acts are deemed to have been taken by the corporation itself even though it was dissolved at the time.

> [28] This interpretation of s. 209(4) of the *CBCA* is reinforced by a decision by the Ontario courts dealing with the similarly-worded provisions of the *Ontario Business Corporations Act*, R.S.O. 1990, c. B.16 (the "*OBCA*"). Section 241(5) of the *OBCA* states that upon revival, a corporation "shall be deemed for all purposes to have never been dissolved". Ontario courts have consistently found that this wording implies that the revival of a corporation is retroactive to the date of its dissolution: see especially *602533 Ontario Inc. v. Shell Canada Ltd*. (1998), 37 O.R. (3d) 504, 155 D.L.R. (4th) 562 (C.A.); see also *Zangelo Investments Ltd. v. Glasford State Inc.*, [1988] O.J. No. 1167, 63 O.R. (2d) 542n (C.A.); *546672 Ontario Ltd. v. Perricciolo* (1991), 3 O.R. (3d) 774, [1991] O.J. No. 1034 (Gen. Div.); and *Stein-Peters v. Ontario (Municipal Board)*, [2001] O.J. No. 1839, 20 M.P.L.R. (3d) 1 (Div. Ct.). The finding of retroactive effect for corporate revival under the *OBCA* lends strong support for a finding of retroactive revival under the *CBCA*, especially given that the Ontario statute does not contain the more explicit wording of the federal statute.
>
> [29] This makes good sense from a policy perspective, since any other conclusion would carry serious economic and logistical consequences for dissolved corporations and parties entering into transactions with them. Corporations are dissolved from time to time, sometimes without the knowledge of the corporation's principals. If the corporation is subsequently revived, it would create unwarranted confusion and uncertainty as to the rights and obligations of the revived corporation and third parties if courts were to hold these principals personally liable for acts undertaken in the name of the corporation during its dissolution: see the comments of Hanssen J. to this effect in *Helcor Enterprises Ltd. v. Moore & James Food Services Ltd.*, [1990] 5 W.W.R. 596, 66 Man. R. (2d) 221 (Q.B.).
>
> [30] Interpreting the effect of revival as being retroactive to the date of dissolution would also accord with the purpose of the revival provisions of the *CBCA*, which is to ensure certainty and continuity in corporate affairs despite the temporary dissolution of a corporation.
>
> [31] Furthermore, two decisions which suggest that the *CBCA* does not have a retroactive effect can be distinguished since they dealt with an earlier version of s. 209(4) of the *CBCA*, which contained the word "thereafter" and did not include the explicit wording of the current version of s. 209(4): see *Wolf Offshore Transport Ltd. v. Sulzer Canada Inc.*, [1992] N.J. No. 82, 318 A.P.R. 178 (T.D.), and *Dello v. Canada*, [2003] 4 C.T.C. 2331, [2003] T.C.J. No. 342.

[26] It therefore follows that the revival of a corporation is retroactive to the date of its dissolution and that, for all intents and purposes, it is deemed to have never been dissolved. That being so, the Crown's position that the appellant never ceased to be a director of RSL after his original appointment on August 18, 1987, is

correct. That approach is consistent with subsection 136(5) of the NBBCA and with the relevant case law. The appellant's position as director of RSL was in a state of suspension during the time between RSL's dissolution and its revival. Since the revival of RSL returned that corporation to the same position as it would have been in if it had not been dissolved, the appellant also returned to his position as director. The appellant never resigned as director of RSL even though it ceased operating in December 1998. There is no evidence that it ceased to exist as a corporation after that date.

[27] Accordingly, the two-year limitation period imposed by subsection 227.1(4) of the *Income Tax Act* and subsection 323(5) of the *Excise Tax Act* has not expired and the Minister is therefore not barred from assessing the appellant. This conclusion disposes of the first three issues raised by the appellant. There remains the question of whether the appellant should be able to avail himself of the due diligence defence.

[28] In *Soper v. R.*, [1997] 3 C.T.C. 242, the Federal Court of Appeal has suggested an approach that consists in analyzing director's liability in terms of being an inside or an outside director and in terms of the standards applicable to both. Justice Robertson states early on in his analysis:

> 33 At the outset, I wish to emphasize that in adopting this analytical approach I am not suggesting that liability is dependent simply upon whether a person is classified as an inside as opposed to an outside director. Rather, that characterization is simply the starting point of my analysis. At the same time, however, it is difficult to deny that inside directors, meaning those involved in the day-to-day management of the company and who influence the conduct of its business affairs, will have the most difficulty in establishing the due diligence defence. For such individuals, it will be a challenge to argue convincingly that, despite their daily role in corporate management, they lacked business acumen to the extent that that factor should overtake the assumption that they did know, or ought to have known, of both remittance requirements and any problem in this regard. In short, inside directors will face a significant hurdle when arguing that the subjective element of the standard of care should predominate over its objective aspect.
>
> 34 In some instances, it is easy to see why inside directors have been held liable. Such is true in respect of *Barnett*, *supra*, the first case which dealt with the due diligence defence. In that case the taxpayer, as director and sole shareholder of the company, hired a comptroller. When the latter informed the taxpayer that the company was short of cash, the taxpayer instructed that the business' key suppliers should be paid first. In these circumstances, the Tax Court dismissed the taxpayer's appeal from the Minister's assessment which held the taxpayer

> personally liable for the source deductions withheld but not remitted. Equally understandable is the imposition of liability in the following cases involving inside directors: *Quantz v. Minister of National Revenue* (1988), 88 D.T.C. 1201 (T.C.C.); and *Beutler v. Minister of National Revenue* (1988), 88 D.T.C. 1286 (T.C.C.).
>
> 35 Similarly, the taxpayer in *Fraser (Trustee of) v. Minister of National Revenue*, (1987), 87 D.T.C. 250 (T.C.C.), provides a good example of an inattentive inside director upon whom liability was justifiably visited. The taxpayer in that case was a director, minority shareholder and vice-president of manufacturing operations of a corporation. As of a certain time, he was apprised of the fact that the company was in arrears with Revenue Canada. Nevertheless, the taxpayer did nothing more in respect of that problem than rely on assurances, from the inside directors responsible for the financial side of the business, to the effect that there was no need to worry. Having made no efforts to prevent further defaults, the taxpayer was held personally responsible for the amounts that should have been remitted to the Crown by the corporation.
>
> 36 Of course, not all inside directors have been held liable. The Tax Court has refused to impose liability on an inside director in cases where he or she is an innocent party who has been misled or deceived by co-directors: see *Bianco v. Minister of National Revenue*, (1991), 91 D.T.C. 1370 (T.C.C.); *Edmondson v. Minister of National Revenue*, (1988), 88 D.T.C. 1542 (T.C.C.); *Shindle v. R.* (1995), 95 D.T.C. 5502 (Fed. T.D.); and *Snow v. Minister of National Revenue*, (1991), 91 D.T.C. 832 (T.C.C.). There are also other examples of an inside director being exonerated: see *Fitzgerald v. Minister of National Revenue*, (1991), 92 D.T.C. 1019 (T.C.C.).

[29] The importance of making a distinction between an inside and an outside director is that this determines the degree of the standard of care that may be applicable to each in analyzing liability. The respondent suggested that in cases where there is only one director of a corporation, that person implicitly is an inside director. The respondent cited in support of this position this Court's decision in *Weyand v. R.*, 2004 G.T.C. 306. It is thus more difficult for a sole director to establish the due diligence defence. In another decision by this Court, namely, *Sziklai v. The Queen*, 2006 DTC 2798, Mr. Justice Hershfield did an interesting analysis on the matter of a sole director being implicitly an inside director as well as an analysis of the standard of care for inside and for outside directors, and provided a useful reminder as to the applicable standard.

> [10] The inevitable agency of which Justice Mogan speaks is what he infers makes the sole director both an insider and a person liable for remittance failures. With respect, that is a troublesome inference. In *Soper v. R.* Robertson J.A.

described the basis of the distinction between inside and outside directors by saying at paragraph 44:

> ... inside directors, meaning those involved in the day-to-day management of the company and who influence the conduct of its business affairs, will have the most difficulty in establishing the due diligence defence. For such individuals, it will be a challenge to argue convincingly that, despite their daily role in corporate management, they lacked business acumen to the extent that that factor should overtake the assumption that they did know, or ought to have known, of both remittance requirements and any problem in this regard. In short, inside directors will face a significant hurdle when arguing that the subjective element of the standard of care should predominate over its objective aspect.

As to outside directors not involved directly in the operation of the business he observed at paragraphs 52 and 53 that they could:

> ... rely on the day-to-day corporate managers to be responsible for the payment of debt obligations such as those owing to Her Majesty ...

In my view, the positive duty to act arises where a director obtains information, or becomes aware of facts, which might lead one to conclude that there is, or could reasonably be, a potential problem with remittances. Put differently, it is indeed incumbent upon an outside director to take positive steps if he or she knew, or ought to have known, that the corporation could be experiencing a remittance problem.

[11] By definition then an insider is a person involved in the business. To impute involvement to a person not involved is incompatible with that defining factor. Further, to impute involvement to a sole director, and regard the acts of the person who failed in a duty to be the acts of that director, would mean there is no due diligence defence available to sole directors. That clearly cannot be the case nor, in my view, should Justice Mogan be taken to have meant that as a firm rule in all cases.

[12] This is not to suggest that the Appellant does not have a standard of care higher than that placed on an outside director. The purpose for identifying "inside" versus "outside" directors is to assist in the determination of what a reasonably prudent person would do in the circumstances. In this context, the issue might be better posed by asking more simply whether the Appellant was, by virtue of his position and involvement, in a position to detect the potential problem and deal with it. This was the approach taken by Justice Bonner in *Mariani v. R.* At paragraph 19 he observed:

> I cannot agree with the respondent's position. The segregation of directors into inside and outside categories is not undertaken as part of a mechanical process of classification into rigidly defined categories of winners and losers. Rather it is a recognition of the self-evident. Some directors are better situated than others, usually by reason of participation in day-to-day management, to detect the potential for failure and to deal with it and that situation is a relevant circumstance.

Justice Hershfield went on to say:

> [14] Even then, however, there is flexibility in the application of tests applicable even to insiders. The standard is reasonableness, not perfection, even in the case of an insider of a marginal company. The question is always the same: "What does the situation prescribe a reasonably prudent person in the Appellant's position to do in the circumstances?" Justice Sharlow of the Federal Court of Appeal commented that the standard is not perfection in *Smith v. The Queen.*
>
> > [12] The inherent flexibility of the due diligence defence may result in a situation where a higher standard of care is imposed on some directors of a corporation than on others. For example, it may be appropriate to impose a higher standard on an "inside director" (for example, a director with a practice of hands-on management) than an "outside director" (such as a director who has only superficial knowledge of and involvement in the affairs of the corporation).

[30] The degree of the standard of care applicable in answering the question of what the situation requires a reasonably prudent person in the appellant's position to do in the circumstances depends on the situation and circumstances in each case. An appellant's background and his participation in, and knowledge of, the affairs of a corporation of which he is a director are all matters to be considered, particularly when the appellant is the sole director of the corporation. The question is always, as Justice Hershfield phrased it, whether the director, by virtue of his position and involvement, was in a position to detect the potential problem and deal with it.

[31] There is no doubt that the appellant in this case invested substantial sums of money in businesses, including RSL, with a view to getting a return on those investments and not with the intent of running the businesses himself on a day-to-day basis. The appellant devoted all of his time to his medical practice and entrusted the day-to-day operations of RSL in particular to two or three key employees throughout the entire time that company was carrying on business. The

appellant has no business background nor does he possess business experience other than running his medical practice, of which the management aspect is left to his secretary. The appellant's lack of business acumen is almost disturbing given the amounts of money invested in the aforementioned businesses and particularly in RSL, yet his reasons and explanations for having entrusted his affairs to key employees and his accountant are to a certain extent understandable.

[32] The appellant had his first encounter with director's liability for unremitted taxes under the ETA in September 1993. On September 1, 1993, in a letter to Revenue Canada referred to earlier, the appellant acknowledged that he was jointly and severally liable with RSL for unremitted tax. The amount assessed at the time was $77,443.31, this was paid in full and is not the subject of this appeal. No other failure to remit tax occurred in any of the subsequent periods of RSL's operations until the first period now under appeal, which started in April of 1997 and with respect to which there was a failure to remit at the end of June 1997. Before the end of the second period, namely, July, August and September 1997, the appellant became aware of RSL's failures to remit tax, and, on September 11, 1997, he again wrote a letter to Revenue Canada, asking for indulgence regarding the late remittance of the tax. RSL nevertheless failed to remit for the final period of 1997. No explanations were given as to what actions the appellant may have taken to ensure that GST/HST remittances were made, other than directing his key employees to make them. The tax was remitted for the periods from January to March 1998 and July to September 1998. The remittances for the last period of 1998 were not made.

[33] It is clear from the evidence that the appellant knew in September of 1997 that RSL had failed to remit the tax and that the situation required more than issuing a directive to key employees to make the remittances. I can only assume that the reason the tax remittances were made for two periods in 1998 is that RSL had the funds and that it is not because of any steps the appellant may have taken to deal with the problem and to ensure that the tax remittances were actually made. In my opinion, the appellant had to do more than simply rely on an affirmative answer received on asking René Martin whether they were being made.

[34] The appellant testified that he first became aware of RSL's failure to remit the payroll deductions in the months preceding Edmond Richard's resignation in March 1995. At the end of 1994, the unremitted payroll deductions for that year totalled $ 58,012.18, including interest and penalties. The appellant also testified that it was during that period that he was made aware of certain irregularities and the misappropriation of funds by his key employee, Edmond Richard, and later by

the in-house accountant. The amount of money misappropriated was substantial and may easily explain RSL's failure, through its key employees, to remit the payroll deductions.

[35] The appellant had Mr. Richard's credentials verified by the RCMP and he had been cleared; the appellant trusted him. RSL had been in operation since its creation and had not had any bad experiences with its key employees in terms of how they ran the business. It appeared to the appellant that everything was running as it should and that there was no need to intervene or take any action.

[36] In early 1995, when all these problems surfaced, the appellant informed his personal accountant about RSL's failure to remit payroll deductions and instructed him to take steps to avoid a reoccurrence. He also informed the staff and René Martin of the situation and instructed them to keep in touch with his accountant. He also instructed the staff to enrol in a course, given by the Province of New Brunswick, in order to improve their skills and make them aware of their obligations and responsibilities as managers of a business, and lastly, he requested that he be given a monthly income and expense statement. The result of these actions, including the change in managers, was that there were no other failures to remit except for an amount of $912.81, including interest and penalties, in 1997 and $11,093.90, including interest and penalties, in 1998. Five NSF cheques were returned during the period from November 1996 to April 1998. The appellant was unaware that cheques were returned.

[37] In light of these circumstances, it is difficult to conclude that the appellant was, by virtue of his position and his involvement, in a position to detect the existence of RSL's failure to remit the payroll deductions. The appellant was the sole director of RSL, but had chosen to rely on a key employee to run its day-to-day business operations, in which regard neither his integrity nor that of the in-house accountant was ever open to question. In my opinion, the appellant's duty to act arose when he became aware of RSL's failure to remit payroll deductions. As to these, all remittances were made except for some NSF cheques and a balance owing in respect of the 1997 and 1998 remittances. Although the appellant had some involvement in the business, albeit in a somewhat detached manner, I find that his reliance on his manager and key employees to make the required payroll remittances to be permissible in these circumstances, even though he was a sole director, to whom a higher standard may at times be applicable.

[38] I do not find, though, that the steps taken by the appellant in 1995 were adequate and sufficient to ensure that the failure to remit would not reoccur. The

evidence does not indicate what his personal accountant actually did to prevent the failure or what other mechanisms were put in place to prevent it. I do not find that the monthly income and loss statement provided to the appellant in any way indicated that the payroll deductions were actually remitted, nor do I find that the appellant exercised due diligence after 1995 in making sure that they were remitted, and I say this even though the remittances were made for the most part.

[39] The appellant, having had bad experiences with the way RSL was managed by its key employees in terms of GST and payroll deduction remittances, can no longer be allowed to take refuge behind his reliance on these employees to make the remittances after 1995. It is obvious that in the last year of RSL's operations, the appellant had become so detached from the business that he only found out by accident that it was no longer operating.

[40] The appeal in file 2004-4274(GST)G is therefore dismissed. The appeal in file 2004-4280 (IT)G is allowed and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the appellant is only liable for unremitted payroll deductions, interest and penalties for taxation years beyond 1995 excluding any penalties or interest assessed after 1995 that have been calculated on outstanding balances as at December 31, 1995 or prior to 1996. Each party shall bear its own costs.

Signed at Edmundston, New Brunswick, this 30th day of August 2007.

"François Angers"

Angers J.

CITATION:	2007TCC322
COURT FILE NOS.:	2004-4280(IT)G, 2004-4274(GST)G
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