Docket: 2006-1861(GST)G

BETWEEN:

ROBERT VERRET,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 21, 2007, at Fredericton, New Brunswick.

Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant: Terrence P. Lenihan

Counsel for the Respondent: Caitlin Ward

JUDGMENT

The appeal from the assessment made under the *Excise Tax Act*, the notice of which is dated February 16, 2004, is allowed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 26th day of May 2008.

"François Angers"

Angers J.

Citation: 2008TCC240
Date: 20080526
Docket: 2006-1861(GST)G

BETWEEN:

ROBERT VERRET,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Angers J.

[1] The appellant was assessed by the Minister of National Revenue (the Minister) under the *Excise Tax Act* (the *Act*) on February 16, 2004 as the director of Brunswick Rent-a-Car Ltd. (hereinafter referred to as "Brunswick") for that company's failure to deduct, withhold or remit the Goods and Services Tax/Harmonized Sales Tax (GST/HST) payable by it for periods beginning August 1, 1996 and ending April 30, 1999. The assessment was later confirmed on March 27, 2006.

Paragraph [2] continues next page.

[2] The amount of the assessment is $54,431.69, broken down as follows:

Period	Net Tax	Interest	Penalty	Total

ending				
96-10-31	3,052.77	1,527.83	2,290.38	6,870.78
97-01-31	643.37	176.67	274.66	1,094.70
97-04-30	538.52	137.17	212.86	888.55
97-07-31	9,686.51	2,467.65	3,828.73	15,982.89
97-10-31	9,276.30	2,363.17	3,666.51	15,305.98
98-01-31	1,282.81	328.35	509.52	2,120.68
98-04-30	150.20	3,507.49	5,606.64	9,264.33
99-01-31		51.67	69.86	121.53
99-04-30	1,644.70	384.27	603.08	2,632.05
03-01-09	150.00			150.00
TOTAL				**54,431.49**

[3] The respondent has acknowledged in her Reply to the Notice of Appeal that the net tax amount of $150 for the period ending January 9, 2003 relates to what have been termed “law costs” and did not form part of the amount certified in the Federal Court. The respondent therefore consents to judgment with regard to that period and the amount of $150.

[4] The Minister registered with the Federal Court of Canada on August 15, 2002, a certificate for Brunswick's net tax liability of $49,894.41, plus penalty and interest, and on or about January 28, 2004, the execution for Brunswick's net tax liability stated in the certificate was returned unsatisfied. The amounts owed are not in dispute in this appeal.

[5] The appellant was at all material times the only shareholder and director of Brunswick as well as its president; he admitted being an experienced businessman but did not elaborate on this. Brunswick was incorporated under the laws of New Brunswick on November 27, 1976 and until the year 2000 operated a car rental business which included the sale of second-hand car parts; Brunswick also had rental income. It is admitted by the appellant that Brunswick was registered under Part IX of the *Act* and was required to file returns on a quarterly basis. The evidence discloses that Brunswick did in fact file returns on a quarterly basis and paid on that same basis the net tax owed. It was as a result of an audit conducted in 1999 that amounts of net tax owing were determined for periods beginning August 1, 1996 and ending April 30, 1999, and this led to an assessment against Brunswick and eventually against the appellant. The appellant, as mentioned, does not contest the amount originally assessed against Brunswick and admits that Brunswick failed to remit the tax.

[6] At all material times, the appellant operated two other businesses, namely, Verret’s Funeral Homes Ltd. and Gloval Auto Broker (NB) Ltd. The day-to-day operations of Brunswick and the funeral home were delegated to and left in the hands of one Patrick Benoit and, to a lesser degree, the appellant’s son. Mr. Benoit was himself a qualified funeral director and had worked for both the funeral home business and Brunswick for almost 20 years. According to the appellant, Mr. Benoit was a man he could trust and, much to his chagrin, he sometimes trusted him more than his own son. That trust came to a sudden stop when it was discovered that Mr. Benoit had been misappropriating Brunswick's funds for a number of years, six or seven years in fact, of which, according to the appellant he was found guilty approximately a year and a half prior to the date of this hearing.

[7] Given the fact that Mr. Benoit was considered a loyal and a key employee, the appellant constantly relied on his skills for the running of both companies and could spend almost six months every year in Florida. The appellant had even less involvement in Brunswick and the funeral home after he suffered two health setbacks: he was involved some ten or eleven years ago in a motor vehicle accident caused by a serious aneurysm that resulted in him being in a coma for 21 days, and he also suffered from prostate problems and had to undergo two surgeries.

[8] The appellant's state of health left him weak for a long period of time and he did not work on a daily basis. He testified that he considered himself as being, in a way, retired for the last ten or eleven years. He continued spending approximately half the year in Florida and the other half in Montreal and in Bathurst, New Brunswick.

[9] Although the appellant signed the financial statements for Brunswick, these were prepared by Brunswick's chartered accountant and the appellant did not review them. He relied on Mr. Benoit to provide the information to the accountant. He also relied on Mr. Benoit to do the in-house bookkeeping, which was later provided to Brunswick's accountant. The appellant does not know who signed the quarterly HST reports, but knows that the accountant prepared them using Mr. Benoit's information. As mentioned earlier, the quarterly reports were filed on time and the net tax was paid in accordance with the content of the quarterly reports.

[10] Brunswick's business began to decline when it was discovered that the land on which its premises were situated were contaminated with oil. This eventually led to the business’s closure in 2000.

[11] The appellant's counsel argues that there was no wilful lack of care or diligence on the part of the appellant. He submits that the appellant had entrusted Brunswick's day-to-day operations to one key employee and that he had no reason to question the accuracy of the information that was later conveyed to Brunswick's accountant for the preparation of the quarterly reports. He submits that the reports were filed on time and the net tax paid, leaving the appellant no cause to question the system put in place. It was only when the audit was conducted that new amounts were determined that appeared to reveal that not all the net tax was reported.

[12] Counsel for the appellant also submits that the fact that the appellant was ill around the same time should be a factor to be considered, as he became less involved and less interested and relied even more on his key employee, thinking that everything was being done properly.

[13] Counsel for the respondent submits that the appellant put himself in a position where he did not know and did not care to know. In counsel's opinion, such an attitude constitutes wilful blindness. The appellant completely lost interest, had no way of knowing what was happening and thus opened himself up to liability by virtue of his not caring.

[14] The issue before this Court is whether the appellant is liable under subsection 323(1) of the *Act*, or more precisely, whether he exercised the degree of care, diligence and skill to prevent Brunswick's failure to remit the amount referred to above that a reasonably prudent person would have exercised in comparable circumstances, such that subsection 323(3) of the *Act* would be applicable.

[15] Subsections 323(1) and 323(3) read as follows:

> **Liability of directors**
>
> 323 (1) If a corporation fails to remit an amount of net tax as required under subsection 228(2) or (2.3) or to pay an amount as required under section 230.1 that was paid to, or was applied to the liability of, the corporation as a net tax refund, the directors of the corporation at the time the corporation was required to remit or pay, as the case may be, the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay the amount and any interest on, or penalties relating to, the amount.

Diligence

323 (3) A director of a corporation is not liable for a failure under subsection (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.

[16] The most often quoted decision on director's liability cases is *Soper v. Canada*, [1997] F.C.J. No. 881 (QL), [1997] 3 C.T.C. 242, in which Mr. Justice Robertson of the Federal Court of Appeal made a comprehensive analysis of the defence of due diligence available to directors in tax liability cases. The true test in proving due diligence comprises both subjective and objective elements. Below are excerpts taken from paragraphs 29 to 33 (21 – 25 C.T.C.) of the above decision, which are a good illustration of the meaning to be given to the words "skill", "care" and "diligence".

Skill

29 . . . In my view, it is correct to distinguish in this way between a reasonably prudent person and a reasonably skilled person so as to conclude that the subjective element of the common law standard of skill has not been altered by federal statute.

Care

30 . . . Hence, in the event that the reasonably prudent person is unskilled (which possibility is discussed above), the statute requires only the exercise of a degree of care which is commensurate with that person's level of skill. It is in this manner that skill and care are clearly interconnected. That being said, it is worth emphasizing that it is insufficient for a director to assert simply that he or she did his or her best if, having regard to that individual's level of skill and business experience, he or she failed to act reasonably prudently. . . .

Diligence

31 Upon reflection, it seems arguable to me that the term "diligence" is synonymous with the term "care". That is, diligence is simply the degree of attention or care expected of a person in a given situation. At least, that is the way the term is employed in City Equitable. . . .

32 Professor Welling posits that the reasonably prudent person serving as a director would surely exercise diligence in attending to his or her duties; a skilled individual should use his or her skills to perform said duties while an unskilled individual should obtain "competent outside advice" in respect of same (supra at

> 334). I am reluctant to embrace that analysis unreservedly. Even if a director is unskilled, I fail to see why he or she should not be entitled to rely, as contemplated in City Equitable, on advice provided by officials inside the corporation unless the circumstances are such that the reasonably prudent but unskilled person acting as a director would seek outside advice. . . .
>
> 33 . . . The reasonable person standard is thus hardly inflexible. It adjusts to the circumstances and to the individual qualities of the actor. This is all the more true in the context of federal company or taxation law where that standard, at least as it applies to directors' duties, is explicitly modified by the phrase "in comparable circumstances."

[17] At paragraphs 37 and 38 (29 – 30 C.T.C.), Mr. Justice Robertson came to the following conclusion:

> 37 . . . The standard of care laid down in subsection 227.1(3) of the Act is inherently flexible. Rather than treating directors as a homogeneous group of professionals whose conduct is governed by a single, unchanging standard, that provision embraces a subjective element which takes into account the personal knowledge and background of the director, as well as his or her corporate circumstances in the form of, inter alia, the company's organization, resources, customs and conduct. Thus, for example, more is expected of individuals with superior qualifications (e.g. experienced business-persons).
>
> 38 The standard of care set out in subsection 227.1(3) of the Act is, therefore, not purely objective. Nor is it purely subjective. It is not enough for a director to say he or she did his or her best, for that is an invocation of the purely subjective standard. Equally clear is that honesty is not enough. However, the standard is not a professional one. Nor is it the negligence law standard that governs these cases. Rather, the Act contains both objective elements embodied in the reasonable person language and subjective elements inherent in individual considerations like "skill" and the idea of "comparable circumstances". Accordingly, the standard can be properly described as "objective subjective".

[18] The Supreme Court of Canada in *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68, later adopted an objective standard and made the following comment in relation to the objective subjective test and the duty of care in paragraphs 63 and 67 of that decision which read as follows:

> 63 The standard of care embodied in s. 122(1)(b) of the CBCA was described by Robertson J.A. of the Federal Court of Appeal in *Soper v. Canada*, [1998] 1 F.C. 124, at para. 41, as being "objective subjective". Although that case concerned the interpretation of a provision of the *Income Tax Act*, it is relevant here because the language of the provision establishing the standard of care was identical to that of s. 122(1)(b) of the CBCA. With respect, we feel that Robertson

> J.A.'s characterization of the standard as an "objective subjective" one could lead to confusion. We prefer to describe it as an objective standard. To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director or officer are important in the case of the s. 122(1)(b) duty of care, as opposed to the subjective motivation of the director or officer, which is the central focus of the statutory fiduciary duty of s. 122(1)(a) of the CBCA.
>
> 67 Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(b) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.

[19] The degree of the standard of care was also dealt with by the Federal Court of Appeal in *Soper*, *supra*. The distinction to be made between an outside and an inside director was somewhat downplayed by the Federal Court of Appeal in suggesting that the characterization as an inside or an outside director could not in itself be conclusive on the question of liability, although that court did say 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", (*Soper*, *supra*, paragraph 41 (33 C.T.C).

[20] On the issue of whether a sole director is inevitably an inside director, Mr. Justice Hershfield in *Sziklai v. the Queen*, 2006 DTC 2798, determined that whether or not one is an inside director depends on one's degree of involvement in, and knowledge of, the daily operations of the business. His analysis on the subject is a reminder that the degree of a director's involvement in the business is the backdrop to the application of the standard in determining what a reasonably prudent person would have done in the circumstances.

> [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.

[21] 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).

[22] The question at issue in this case is whether the appellant, as a director and by virtue of his position and involvement in the business, was in a position to detect the potential problem and deal with it. Liability must be determined on the basis of the facts of each case and the applicable legal principle. Was the appellant in this case sufficiently involved in the business — as an inside director would

have been — to have realized that the remittances had not been made or that there was a possibility they had not been made?

[23] The appellant testified that he had entrusted the day-to-day operations to a person in whom he had total confidence. He had no reason to suspect that the GST/HST returns were not being properly made. In fact, the evidence disclosed that Brunswick was filing its quarterly returns on time and paying the net tax owing. It was only after the audit was conducted that the appellant was informed and made aware of the fact that there were errors in the quarterly reports, errors which were not detailed or explained at the hearing but which produced the results that we now know.

[24] The evidence leads me to believe, on a balance of probabilities, that the appellant, even though he admits being an experienced businessman, was not sufficiently involved in the daily activities of Brunswick for him — acting as any reasonably prudent person would have — to have had any reason to doubt the reliability of his manager in complying with the *Act*. In fact, the appellant was himself a victim of his manager's fraud and dishonesty. It appears to me reasonable in the circumstances of this case that the appellant would have had faith in, and trusted, someone whom he had believed for almost 20 years to be a trustworthy person and manager.

[25] In the absence of doubt or suspicion it appears reasonable to rely on the honesty and integrity of one's manager, particularly when the company is not experiencing financial difficulties. Brunswick's business began to decline when it was discovered that the land on which its premises were located was contaminated with oil, which led to the business's closure in 2000 after the audit was conducted. In addition, the fact that the appellant had a serious accident and experienced health problems before and during the time that the incorrect quarterly reports were being submitted has some relevance in the application of the test. Those circumstances gave the appellant all the more reason to rely on the honesty and competence of his manager. That he was outside the country or away from the business lends additional support to the fact that he was not involved in the daily activities of the business.

[26] The point at which due diligence is expected from a director is when he has knowledge, or ought to have knowledge, of the failure to remit or that the remittances may not be correct. At that point, a director must, in order to meet the required standard, take a truly meaningful positive step toward preventing the failure. I find that the appellant in this case had no reason to suspect that the

quarterly reports were incorrect as they were being filed regularly and the net tax paid was being paid. He had no reason to doubt the honesty and integrity of his manager, who provided the necessary information to his accountant, who in turn prepared the quarterly reports. In light of these circumstances, I find that the appellant acted reasonably prudently.

[27] The appeal is allowed with costs and the assessment is vacated.

Signed at Ottawa, Canada, this 26th day of May 2008.

"François Angers"

Angers J.

CITATION:	2008TCC240
COURT FILE NO.:	2008-1861(GST)G
STYLE OF CAUSE:	Robert Verret and Her Majesty The Queen
PLACE OF HEARING:	Fredericton, New Brunswick
DATE OF HEARING:	November 21, 2007
REASONS FOR JUDGMENT BY:	The Honourable Justice François Angers
DATE OF JUDGMENT:	May 26, 2008

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