Citation: 2009 TCC 66
Date: 20090204
Docket: 2006-2221(IT)G

BETWEEN:

SEAN C. CARROLL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

(Delivered orally from the bench on
November 21, 2008, at Kelowna, British Columbia.)

McArthur J.

[1] This is an appeal from a director's liability reassessment dated May 2, 2006 by the Minister of National Revenue pursuant to subsection 227.1(1) of the *Income Tax Act*. The Appellant acknowledges he was a director of Intracoastal Systems Engineering Corporation ("Intracoastal") from May 1996 to February 2003. The reassessment was in the amount of $166,314.89 in tax, employment insurance premiums and *Canada Pension Plan* contributions deducted from employees' pay cheques, which amount Intracoastal failed to remit to the Minister. There is no dispute that the company was indebted to the Minister in the amount exceeding $166,314 when it was deemed to have made an assignment in bankruptcy in April 2003.

[2] Very simply, Intracoastal was in the business of marketing automated electric meter reading systems in China. The issue is whether the Appellant exercised the degree of care, diligence and skill to prevent the failure of Intracoastal to remit deductions that a reasonably prudent person would have exercised in comparable circumstances. He graduated from the University of British Columbia with a degree in Engineering in 1987. He worked strictly in engineering for three companies after graduation before becoming an employee of Intracoastal in the early 1990s as an electrical engineer. He remained an

employee until 1996, when he moved from the Vancouver area to Kelowna, and continued with Intracoastal as a consultant. Also, he became a director of Intracoastal from May 1996 to February 2003, when he resigned, as well as an officer of Intracoastal from April 1996 to June 1998 (vice-president) and from June 1998 to February 1999 (secretary). He was also a very minor shareholder of Intracoastal.

[3] The Respondent's position, taken in part from the Reply to the Notice of Appeal, includes that the Appellant was knowledgeable as to the responsibilities of a director, was aware of Intracoastal's obligations to remit tax, and knew of his statutory liability as director for Intracoastal's failure to remit payroll source deductions. He knew, or reasonably ought to have known, of financial and accounting problems experienced by Intracoastal, and of its failure to remit payroll source deductions. He took no action to prevent Intracoastal's failure to remit, and as director of Intracoastal, he did not exercise the degree of care, diligence and skill to prevent the failure to remit as required by subsection 227.1(3) of the *Act* that a reasonably prudent person would have exercised in comparable circumstances.

[4] The Appellant was appointed to the board because of his technical experience. The other three, four or more board members had no such expertise, but they had backgrounds in business accounting and finance. In his own words, the Appellant wrote, in part, the following about his experience with Intracoastal:

> I became vice-president of technology on April the 4th, 1996. At that time Intracoastal was a start-up company. When Rob Hanibower became president, I was given the title of vice-president, technology. At that time I was working with two other people who were involved with technology development. The title was mainly given to me so that when I was doing field work in China my business card would look good. I held the position of secretary for a brief period commencing July the 2nd, 1998. I have included a consent resolution that indicates Edison Ho became secretary October the 17th. The board members met quarterly and to my knowledge I attended all meetings, some by conference call. Other than to advise Mr. Ho and Mr. Wadhwani that source deduction payments be made above all other payments, I routinely questioned him to make sure that the payments had been made and would continue to be made. They assured me that this was so and I had no reason to question their honesty. In addition, when I found out these payments had not been made, I continued as director of the company in order to support the company's efforts to make these payments. After Mr. Ho disclosed that payments had not been made, I asked him to make arrangements with CCRA. I recall that he left the room to call them. I do not know the exact arrangements that were made. I did follow up by continuing to ask Mr. Ho about this. However, the necessary funds did not become available. Before becoming a director I had no prior business experience. I, like most people

> who worked for Intracoastal, was given some stock options which represented a small fraction of the shares that the company issued."

I have no reason not to accept the above, which coincides with the Appellant's oral evidence.

[5] As in most director's liability and due diligent cases, the defense is fact driven. It is somewhat unusual in that the Appellant sought legal advice before accepting his directorship, and was warned about personal liability for unremitted employee tax deductions. He was advised to question from time to time those responsible in finance, with respect to remittances, which he did. He relied on the chief financial officer, Mr. Ho, or Mr. Wadhwani, who he questioned on a regular basis. The issue of remittances was raised at the quarterly directors meetings and confirmations that they were current is recorded in three or four minutes contained in the Appellant's book of documents.[1] Over the six years of his tenure, there had been no previous remittance problems.

[6] The accounting firm of Ellis Foster prepared audited financial statements, Intracoastal being a public company. In September 2002, the Appellant received assurances from trusted fellow board members that investments were forthcoming and remittances would be reinstated. With hindsight, he admits he should have resigned when he learned of the default in September 2002, but I believe he felt his expertise was needed in assisting those who were arranging financing. It appeared to him that Intracoastal's product was going to take off.

[7] Obviously, the Appellant had no aptitude or expertise in accounting. He had to rely on those more qualified than he was. As stated, he was an electrical engineer, although he had signing authority for about a year and did sign payroll cheques. He reasonably relied on others to assure source deductions and remittances were made.

[8] Counsel for the Respondent referred to the Federal Court of Appeal decision in *Soper v. The Queen*,[2] and the Supreme Court of Canada decision in *Peoples Department Stores Inc. v. Wise*.[3] *Soper* offers very helpful guidance in these cases, although there have been limitations set by the Supreme Court in

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1 Exhibit A-1.

2 97 DTC 5407.

3 2004 SCC 68.

Peoples, relating to *Soper's* subjective and objective approach.

[9] In *Soper*, Robertson, J. described inside and outside directors. He stated that inside directors are those involved in the day-to-day management of the company and who influenced the conduct of business affairs. They have the most difficulty in establishing a due diligence defense. He adds that outside directors may not remain completely passive, but it is permissible for them to rely on the day-to-day corporation managers to be responsible for payment of debt obligations.

[10] Without a doubt, the Appellant was an outside director. Not only was he involved mostly in science and technology of Intracoastal's business, but he was living hundreds of kilometers away from the mainstream of the operation. He had a positive duty to act after September 4, 2002 when he learned of the remittance default, but by that time I believe it was too late. The company had no money and received none. There were no further defaults after September 2002.

[11] The facts in the Federal Court of Appeal decision of *Cameron v. The Queen*[4] are somewhat similar to the present case. In *Cameron,* the Appellant was a lawyer, but as stated by Linden, J., he was not a hands-on person involved in the day-to-day operation of the corporation. He was more an outside director than an inside one. Linden J. also stated that the Appellant, early in his tenure of office and on many occasions thereafter, because he was aware of some problems, frequently asked management about the status of the tax remittance, and he was always assured that they were in order. He unwisely relied on these false assurances. In fact, the remittances were not in order as management professed and as a result, the Appellant and his fellow directors decided to appoint an accountant who had done a report about the corporation's financial status, to correct and oversee these matters. Linden J. further states:

> These uncontested facts indicate that the Appellant was not passive. He did as much as he could reasonably be expected to do in order to protect the interests of Revenue Canada. He may not have been as attentive, as skeptical and as assertive as he might have been, especially in allowing himself to be misled by management. But it's not easy to see what more he was required to do in the circumstances to comply with his director's duty to be reasonably prudent in the circumstances.

This final paragraph applies equally to the present situation. I cannot see what the Appellant could have done more.

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4 2001 FCA 208.

[12] The following as provided by Angers J. in *Head v. The Queen*,[5] also applies to the situation in this appeal:

> 18 We know from the evidence that the Appellant's responsibilities with Mainstream had nothing to do with the company's day-to-day business and financial operations. By virtue of his background and experience as a draftsman he was put in charge of the construction based on Mainstream's activities. As regards the business side, he relied on O'Reilly and left that aspect to him. Not only was he out of commission in early July because of an accident, but he was only made aware that the HST had not been remitted at the end of August and in early September 2003. At that time it was almost too late …
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> 20 Given that his background and qualifications are in the construction field and that his involvement in Mainstream had nothing to do with the financial business aspects of the operations, I find that the Appellant did all that could be expected of him in the circumstances and conclude that he has made out the defense of due diligence. …

[13] With four or five businessmen on the board, one wonders why the Minister had to resort to reassessing Mr. Carroll, but that is not the issue before me, and in any event, the appeal is allowed, with costs.

Signed at Ottawa, Canada, this 4th day of February, 2009.

"C.H. McArthur"

McArthur J.

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5 2007 TCC 227.

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