Docket: 2006-3622(IT)G
2006-3638(IT)G

BETWEEN:

ANTONIO PASCOAL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeal of *Natalie Pascoal, 2006-3620(IT)G* and *Antonio Pascoal, 2006-3621(GST)G,* on September 22, 2009, at Kingston, Ontario.

By: The Honourable Justice C.H. McArthur

Appearances:

Counsel for the Appellant:	Frank E. Van Dyke
Counsel for the Respondent:	George Boyd Aitken

JUDGMENT

The appeals from assessments made under section 227.1 of the *Income Tax Act* notices of which are dated September 23, 2005 and November 23, 2005 and bear number 33922 and 33933, respectively, are allowed with costs, and the assessments are vacated.

Signed at Ottawa, Canada, this 2nd day of December, 2009.

"C.H. McArthur"

McArthur J.

Docket: 2006-3621(GST)G

BETWEEN:

ANTONIO PASCOAL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Natalie Pascoal, 2006-3620(IT)G* and *Antonio Pascoal, 2006-3622(IT)G* and *2006-3638(IT)G*, on September 22, 2009, at Kingston, Ontario

By: The Honourable Justice C.H. McArthur

Appearances:

Counsel for the Appellant:	Frank E. Van Dyke
Counsel for the Respondent:	George Boyd Aitken

JUDGMENT

The appeal from the assessment made under section 323 of the *Excise Tax Act*, notice of which is dated July 12, 2005, and bears number 24775, for the period December 31, 2003 to September 30, 2004, is allowed, with costs, and the assessment is vacated.

Signed at Ottawa, Canada, this 2nd day of December, 2009.

"C. H. McArthur"

McArthur J.

Docket: 2006-3620(IT)G

BETWEEN:

NATALIE PASCOAL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Antonio Pascoal*, *2006-3622(IT)G*, *2006-3638(IT)G* and *2006-3621(GST)I*, on September 22, 2009, at Kingston, Ontario

By: The Honourable Justice C.H. McArthur

Appearances:

Counsel for the Appellant:	Jehuda J. Kaminer
Counsel for the Respondent:	George Boyd Aitken

JUDGMENT

The appeal from the assessment made under section 227.1 of the *Income Tax Act* notice of which is dated November 22, 2005 and bears number 33934 is allowed with costs, and the assessment is vacated.

Signed at Ottawa, Canada, this 2nd day of December, 2009.

"C.H. McArthur"

McArthur J.

Citation: 2009 TCC 608
Date: 20091202
Dockets: 2006-3622(IT)G
2006-3621(GST)G
2006-3638(IT)G
2006-3620(IT)G

BETWEEN:

ANTONIO PASCOAL and
NATALIE PASCOAL,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

McArthur J.

[1] These appeals are from assessments of the Minister of National Revenue (Minister) pursuant to the directors liability provisions of section 227.1 of the *Income Tax Act* (*ITA*) and of section 323 of the *Excise Tax Act* (*ETA*).

[2] Although submissions were made by the Appellants to the effect they were not directors during the relevant period, they rely primarily on what is known as the due diligence subsection 227.1(3) of the *ITA* and subsection 323(3) of the *ETA*. They were represented by separate counsel. I will refer to the two Appellants as Antonio and Natalie, commencing with Antonio's three appeals.

[3] Antonio immigrated to Canada from Portugal as a young man who, for our purposes, was illiterate. He worked most of his life in construction as a mason and

scaffolding expert. He had three children, Tony, Victor and Natalie. From 1989 to 2001, he worked for AJV which was controlled by his son Tony. He retired in 2001 when he was in his late 60s.

[4] He was a *de jure* (at law) director of two corporations AJV Construction Ltd. (AJV) and ANVIC Construction Ltd (ANVIC). The Minister assessed him $446,115 in respect of unpaid income tax deductions, interest and penalties payable by AJV, and $205,254 in respect of unpaid income tax deductions, interest and penalties payable by ANVIC. He was further assessed $191,379 for unremitted GST, penalties and interest payable by AJV. The assumptions of fact by the Minister are similar in all three Replies.

[5] Antonio's position includes that he was not a director of AJV or ANVIC during the relevant period. Alternatively, he exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances pursuant to subsection 227.1(3) of the *ITA* and subsection 323(3) of the *ETA*.

Position of the Respondent

[6] Counsel for the Respondent presented a comprehensive argument which merits being included in some detail as follows.

[7] Section 227.1 of the *ITA* and section 323 of *ETA* address a taxpayer's position to the effect "despite being a director, I did nothing and therefore am not liable."(the ostrich approach). When you have signed documents making you a director, you cannot deny being director on the premise that you did not do anything as a director. Section 19 of the *Ontario Business Corporations Act* (*OBCA*) provides that once you are a *de jure* director, saying that you are not a director in fact is not a defence. If you have not resigned, you are a *de jure* director because you have taken on that quality in law.

[8] Counsel continued by quoting *Soper v. Canada*,[1] where Robertson J. describes the due diligence defence as it relates to section 227:

> A director is not obliged to give continuous attention to the affairs of the company, nor is he or she even bound to attend all meetings of the board. However when, in the circumstances, it is reasonably possible to attend such meetings, a director ought

[1] 97 DTC 5407.

> to do so. It would be silly to pretend that the common law would stand still and permit directors to adhere to a standard of total passivity and responsibility. The law today can scarcely be said to have raised the principle that the less a director does or knows or cares, the less likely it is that he or she will be held liable.

At page 16, he sets out how a director could satisfy the duty to prevent a failure to remit.

> …a director may… take 'positive action' by setting up controls to account for remittances, by asking for regular reports from the company's financial officers on the ongoing use of such controls, and by obtaining confirmation at regular intervals that withholding and remittance has taken place as required by the Act. See Information Circular 89-2, supra at paragraph 7.
>
> …establishment and monitoring of a trust account from which both employee wages and remittances owing to Her Majesty would be paid.

[9] In referring to "due diligence" he continued that the Appellants should have known that there was a potential problem. They were aware that Tony and Victor had an argument, resulting in a fight, in the company office over the finances. Had Antonio or Natalie asked, Victor would have told them about the financial situation. The key words in subsections 227.1(3) and 323(3) are to exercise diligence to "prevent the failure."

[10] Antonio took out a $150,000 mortgage on his home to provide seed capital to AJV, with $100,000 being advanced in 1989. The fact that the amount had never been repaid years later serves as indicia that the company was in trouble. When the fight between Tony and Victor occurred at the company office, Antonio and Natalie should have known that there was clearly an issue with the company. He could have asked at any point whether his sons were remitting tax and GST to the government.

[11] Upon incorporation on December 21, 1994, Antonio, Natalie, and Victor were the only shareholders of ANVIC. Tony had signed union papers so he could not be a director of ANVIC, a non-union corporation set up to operate in the event of a union strike at AJV, a union corporation. Tony believed a third director was needed, and Natalie was recruited. A non-union shop, ANVIC, could bid on smaller jobs and bid lower than the union shop AJV. Natalie, Antonio and Victor transferred their shares to Tony in 2001. At the outset, ANVIC was controlled by Tony and Victor until their falling out. Natalie was a *de jure* director throughout until it ceased operation on March 31, 2005.

[12] Her primary argument is one of due diligence. I have no difficulty accepting that Natalie was *de jure* or legal director during the relevant periods and subject to being liable under section 227.1 of the *ITA*. I accept her evidence that she agreed to be a director upon Tony's undertaking that he would notify her before ANVIC became active. He breached that promise without her knowledge. She was not aware that ANVIC was carrying on business. She had no signing authority, never attended to business, never asked her brother Tony if ANVIC was active. She was a full time hospital worker with no business experience. She relied absolutely on her brother's undertakings. The question is: was this sufficient to establish due diligence. Counsel for the Respondent answers - no. The arguments of Antonio and Natalie are deserving of consideration and the Respondent's arguments should be scrutinized in light of the established jurisprudence.

[13] Antonio submitted that he resigned as a director on February 28, 2001 as evidenced by Exhibit A-1, Tab 3. This document states he resigned as a shareholder. His counsel did not actively pursue this argument. There is an October 2004 resignation by Antonio from AJV, but much of the indebtedness had already accrued.

[14] The amounts are not disputed, nor is the liability of the company. The requisite conditions to assessing the Appellants, such as the filing of a certificate in the Federal Court of Canada and the unsatisfied return of the execution have also been satisfied.

[15] Again, the Appellants' primary defence is that they exercised the degree of care, diligence and skill to prevent the failure of the corporation to make the remittances that a reasonably prudent person would have exercised in comparable circumstances. The words appear in both subsection 323(3) of the *ETA* and subsection 227.1(3) of the *ITA*.

[16] Antonio became a director of AJV in 1989 and of ANVIC on December 21, 1994. Both corporations ceased operations on March 31, 2005. Antonio ceased working for AJV in February 2001 when he resigned as a shareholder thinking he had resigned from all its functions including employment. It is not clear when if ever, he was employed by ANVIC. When it came to office work, directorship and paper work of any kind, he relied without qualification, on his comparatively highly educated son Tony who ruled the corporate management. I have no doubt that he was proud of Tony's educational achievements. He did not understand the clerical work and did not have the background to understand the working of remittances. Antonio was not aware of default until he was advised by Canada Revenue Agency that he

was being held liable. Both Natalie and Tony corroborated his evidence that, for the most part, he was no longer involved in either corporation after February 2001.

[17] Antonio relied on Tony for the banking, bookkeeping, signing authorities, remittances and related office duties. He never attended a corporate meeting. He was solely a construction worker. It can be inferred that his efforts to prevent the failure to remit was by way of facilitating $100,000 to $150,000 in financing to AJV and to applying his years of experience in construction to AJV as an employee at least up to 2001.

[18] Antonio and Natalie were outside directors and Tony was an inside director as those expressions are used in *Soper*. Natalie did not have signing authority with ANVIC and was a full time hospital worker during the relevant period. She was entitled to rely on her brother's undertakings that he would not commence business under ANVIC without consulting her. She and her father were in no position to influence the events and in particular to ensure that the GST and payroll remittances be paid.

[19] Consideration must be focused on whether the Appellants have exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances. In *Clouthier v. MNR*,[2] Bowman J. set out a reasonable approach that is as relevant now as it was in 1993 and is consistent with cases in the Federal Court of Appeal[3] which have modified more stringent standards. He stated the following:

> The question therefore becomes one of fact and the court must to the extent possible attempt to determine what a reasonably prudent person ought to have done and could have done at the time in comparable circumstances. Attempts by courts to conjure up the hypothetical reasonable person have not always been an unqualified success. Tests have been developed, refined and repeated in order to give the process the appearance of rationality and objectivity but ultimately the judge deciding the matter must apply his own concepts of common sense and fairness.
>
> ... It is easy to be wise in retrospect and the court must endeavour to avoid asking the question 'What would I have done, knowing what I know now?' It is not that sort of

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2 93 DTC 544

3 The cases include: *The Queen v. Corsano et al.*, [1999] 3 F.C. 173, *Worrell v. R.*, 2000 G.S.T.C. 91, *Smith v. The Queen*, 2001 DTC 5226, *Cameron v. The Queen*, 2001 DTC 5405, and *Soper v. The Queen* , (*supra*).

> ex post facto judgment that is required here. Many judgment calls that turn out in retrospect to have been wrong would not have been made if the person making them had the benefit of hindsight at the time.
>
> In determining whether that standard has been met one must ask whether, in light of the facts that existed at the time that were known or ought to have been known by the director, and in light of the alternatives that were open to that director, did he or she choose an alternative that a reasonably prudent person would, in the circumstances, have chosen and which it was reasonable to expect would have resulted in the satisfaction of the tax liability. That the alternative chosen was the wrong one is not determinative. In cases of this sort [the failure] usually results either from the making of a wrong choice in good faith, or from deliberate default or willful blindness on the part of the director.

[20] In *Soper*, Robertson J. found that more is expected of individuals with superior qualifications and added that whether a director has met the standard of care is a question of fact to be resolved in light of the personal knowledge and experience of the director.

[21] This case resembles *Fitzgerald et al. v. MNR,*[4] wherein the father dominated his family, as Tony did in these appeals. The following by Mogan J. in *Fitzgerald* applies equally to the present appeals.

> It appears to me that the Appellants were directors in law (i.e., their names appear in the Company's minute book as directors) but they were not in fact directors. They never met as directors. They never acted alone or in concert as directors. They had no knowledge of the management or administration of the Company's business. They had no equity in the Company. They had no way of compelling the fifth director (Eugene Fitzgerald, the sole shareholder) to disclose any information concerning the Company's financial affairs. They were directors in law only because of their family connection to Eugene Fitzgerald. Although any one of them could have resigned as a director if he or she had thought of it, such resignation would have been a source of family friction and, from the viewpoint of the male Appellants (the three sons), the idea of resigning as a director would not have occurred to them before the idea of quitting their employment.

[22] Tony was the educated one highly respected and trusted wholly by his father and Natalie. They appear to have been bullied by Tony to do as he directed. The facts in *Dirienzo v. The Queen*[5] above also resembles this case. The Appellant Dirienzo totally trusted his uncle, as did the Appellants with Tony. Bowman J. found that the

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4 92 DTC 1019.

5 2000 TCC 982052.

appropriate degree of care, skill and diligence required for a successful due diligence defence is much lower when the directors are family members. I adopt the following paragraph in *Dirienzo* as my own.

> Do the conclusions stated above absolve the appellant of his responsibilities under section 227.1? On one view of the matter, it could be said that he did not exercise the degree of care, diligence and skill contemplated by subsection 227.1(3) because he exercised none at all. On the other hand, he was a mere nominal director with no powers, no responsibilities and no say in the way the corporation was run. It is all very well to adopt a hectoring, moralizing tone and say that if people take on the responsibility of corporate directorships they should be expected to assume all the consequences of such a position. I am not however concerned with what the situation would be in a perfect world. I have to make a determination of the facts as they exist in a highly imperfect world where malleable young family members are bullied by domineering patriarchs.

[23] The *Soper* case indicates that subsection 227.3(1) standard of care is objective because it looks at the reasonable person, but subjective because it takes into account individual considerations, like skill and the idea of comparable circumstances. Natalie did not ask questions regarding ANVIC because she did not know it was active. She trusted her brother to volunteer information. Trust in families is why we do not apply same standards among family members. Natalie was prudent and reasonable in relying on an undertaking given by her brother that if ANVIC was activated, she would get out of it as a director.

[24] The Respondent submitted that the argument and physical fight in the office should have signalled financial troubles. The fact that a fight took place at the company office does not necessarily mean it had to do with company affairs, specifically financial affairs.

[25] The Respondent added that the visit to the lawyer regarding cheque signing authority was an opportunity to ask questions. I accept the Appellant's submission that the meeting was merely to maintain family harmony, not to examine the financial circumstances of the corporations.

[26] The Respondent is grasping at straws to conclude that the mortgage not being paid off was a sign of financial trouble.

[27] The Respondent gave examples of how a director can satisfy the due diligence requirement, like setting up a control system and a reporting system such that the directors can find out whether remittances to the government are occurring. ANVIC

and AJV were too small to have financial officers and an established system of governance.

[28] To conclude, Antonio with his limited abilities and business knowledge, was reasonable to rely on his son to apprise him of his duties and obligations as a director when they arose. Natalie who had nothing to do with ANVIC other than being a director on paper, was reasonable and prudent in relying on an undertaking given by her brother that if the corporations were activated, she would get out as a director.

[29] The appeals are allowed, with costs, and the assessments are vacated.

Signed at Ottawa, Canada, this 2nd day of December 2009.

"C.H. McArthur"

McArthur J.

CITATION:	2009 TCC 608
COURT FILE NOs.:	2006-3622(IT)G, 2006-3621(GST)G, 2006-3638(IT)G, 2006-3620(IT)G
STYLE OF CAUSE:	ANTONIO PASCOAL and NATALIE PASCOAL and HER MAJESTY THE QUEEN
PLACE OF HEARING:	Kingston, Ontario
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REASONS FOR JUDGMENT BY:	The Honourable Justice C.H. McArthur
DATE OF JUDGMENT:	December 2, 2009

APPEARANCES:

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Counsel for Natalie Pascoal:	Jehuda J. Kaminer
Counsel for the Respondent:	George Boyd Aitken

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