Docket: 2008-3358(GST)G

BETWEEN:

LESLIE JOHN BAKER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on April 19, 2010 at Toronto, Ontario

Before: The Honourable Justice J.E. Hershfield

Appearances:

Counsel for the Appellant: James N. Aitchison

Counsel for the Respondent: Shatru Ghan

JUDGMENT

The appeal with respect to an assessment made under the *Excise Tax Act* by notice number A111964 and dated July 16, 2007 is allowed, with costs, for the reasons set out in the attached Reasons for Judgment, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the requirements of subsection 323(3) of the *Excise Tax Act* have been satisfied.

Signed at Ottawa, Canada this 14th day of May 2010.

"J.E. Hershfield"

Hershfield J.

Citation: 2010 TCC 268
Date: 20100514
Docket: 2008-3358(GST)G

BETWEEN:

LESLIE JOHN BAKER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Hershfield J.

Issue

[1] A corporation ("1050560 Ontario Limited") formed in November 1993 failed to remit net tax (GST) payable pursuant to the *Excise Tax Act* (the "*Act*") to the Receiver General of Canada in the amount of $126,497.01 for the period July 1, 1994 to December 31, 2006. The corporation was assessed for the failure and for penalties of $100,296.85 and interest of $62,383.82.

[2] A Certificate of the corporation's liability was registered in November 2004. The collection of the amount payable remains unsatisfied.

[3] By Notice of Assessment dated July 16, 2007 the Appellant was assessed under section 323 of the *Act* for the corporation's liability in the total amount of $289,177.68.

[4] The Appellant admits to being the sole director and sole shareholder of the corporation throughout the relevant period.

[5] The Appellant relies on subsection 323(3) of the *Act* which provides as follows:

> **(3) Diligence** -- 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.

[6] The only issue in this appeal then is whether or not the Appellant has exercised the degree of care, diligence and skill to prevent the failure to remit the subject tax that a reasonably prudent person would have exercised in comparable circumstances.

General Background

[7] Both the Appellant and his daughter gave evidence at the hearing.

[8] The Appellant is 64 years old and resides in Zephyr, Ontario, a community east of Toronto in the Durham region.

[9] He left school after grade 6, completing a term that he said did not include much in the way of attendance.

[10] He left school to do odd jobs at the Greenwood Race Track in Toronto where he cleaned stalls and walked horses. He continued to work at the track for a number of years and eventually did other odd jobs including parking cars and doing part-time maintenance cleaning.

[11] Notwithstanding such odd jobs, his testimony essentially was that since the age of 10 he worked around horses. After the Greenwood Race Track closed down he continued to work around the stables at Woodbine and was able eventually to operate a business as a horse boarder and trainer.

[12] He was married at the age of 19 to his now deceased wife when she was 18 years of age and they had two children. His wife had a high school grade 12 education. The Appellant himself never furthered his education and although he acknowledged that he could read the newspaper and the like, he had no facility with paperwork or understanding forms.

[13] The Appellant's wife worked at the Royal Bank since the age of 18 in various capacities starting as a teller and eventually becoming the assistant to the bank manager. At the age of 35 she developed breast cancer and suffered the removal of one breast. A few years later she developed ovarian cancer and after

treatment and a period of relief she was diagnosed with bone cancer and then ultimately with brain cancer and she died at the age of 55 in July, 2002.

[14] The cancers were treated with chemotherapy and radiation.

[15] Up until her death, the Appellant's wife did all of the household accounts and managed the family's financial affairs to the exclusion of the Appellant. The Appellant had no credit cards or bank cards.

The Formation of the Corporation and Subsequent Events

[16] Prior to the formation of the corporation the Appellant started training horses on his parents' 2.5 acre farm where he and his family lived in the garage.

[17] He worked with some 45 horses boarded at the farm, owning only a few himself. The Appellant's wife did all of the bookkeeping and paperwork including doing all the banking, invoicing and paying the bills related to the operation.

[18] The family farm was sold some 18 years ago and that is when the corporation was formed.

[19] A new farm was acquired with the help of an investor who the Appellant knew through his horse operations. The investor had an interest in the farmland itself but had no interest in the horse boarding and training operation of the corporation.

[20] The corporation operated as the Red Oak Training Centre ("Centre") in Zephyr and it was operated until 2007. The Centre from time to time boarded anywhere from 30 to 70 horses and the Appellant himself may have owned from time to time one or two horses kept at the Centre.

[21] The Appellant's wife continued to do all the paperwork relating the operation of the Centre including doing all the banking, invoicing and paying the bills related to the operation. He knew that horse owners were being invoiced for the boarding and training but testified that he was never aware of any financial problems or issues relating to any liabilities arising from the operation.

[22] The Appellant testified that the incorporation was his wife's idea and that although he knew that he was the sole shareholder and director of the corporation he said that he left absolutely everything to his wife and had no inkling at all as to

what his responsibilities as a director might be. He believed his wife to be an honest and capable person and that she was doing all things necessary to comply with legal, business and tax requirements.

[23] In addition to not understanding his duties as a director he acknowledged that he had no discussions with his wife or anybody else about what being a director entailed. He made no inquiries.

[24] Although he acknowledged that he thought he had signing authority at the bank, he never once wrote a cheque during the time that his wife took care of all of the paperwork associated with the operation.[1]

[25] He acknowledged that he took a small salary from the corporation which he used to pay for gasoline for his truck and to buy a few groceries.

[26] The corporation also employed, from time to time, two or three other employees as needed but again she wrote the cheques and utilized a payroll service to handle the various compliance requirements relating to employee payrolls.

[27] The Appellant acknowledged that there was an accountant that did some work for the corporation but he was not aware of what role he played. He had never seen a financial statement for the corporation or any tax returns for the corporation although he did believe tax returns were filed and that his wife would have signed such returns.

[28] He never received any demands from the Canada Revenue Agency (“CRA”) or any notices that said there were GST remittance failures. He was caught totally by surprise when after his wife’s death his daughter took all of the records she could find that had been maintained by her mother to the accountant who on reviewing such paperwork determined that there was a GST problem.

[29] At that point returns were filed and the remittance failures were revealed to the CRA enabling a determination of the corporation’s liability and the issuance of

[1] The Appellant’s daughter testified that after his wife died and she had taken over doing the bookkeeping and paperwork, her father would call from time to time asking questions as to how to properly complete a cheque.

the assessment.[2] As noted, there is no indication that it was other than a voluntary disclosure that gave rise to the determination of the liability and to the assessment.[3]

[30] Once the daughter discovered the problem, quarterly GST returns were filed going forward from the Appellant's wife's death and remittances were made as required.[4] She continued to look after the corporate paperwork after her mother's death until the corporation ceased doing business in 2007.

[31] The Appellant's daughter has a high school education and has worked for a number of years with the benefits department of the Toronto Transit Commission.

[32] The daughter's testimony was that there was really no explanation as to what caused her mother's failure to comply with the corporation's remittance obligations. Although she was not well, there was no indication that she was not attending to the corporation's affairs. In any event, she stated that she and her father did everything they could once they learned of the problem to rectify it. Indeed, the Appellant testified that he cashed in all of his RRSPs to the tune of some $20,000 in order to satisfy the corporation's liability for arrears.

[33] Both the Appellant and the daughter testified that the corporation ceased carrying on business in 2007 when the CRA seized the bank account of the corporation. Since that time the Appellant's son has been operating a horse training facility and the Appellant has been working for his son.

Appellant's Arguments

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[2] The Court was not presented with a copy of an invoice used in the operation of the Centre nor was there any assumption in the Reply as to whether or not clients or customers of the Centre were actually billed for GST.

[3] There was no indication that any relief was offered on the basis that the remittance failures were voluntarily disclosed.

[4] A schedule to the Notice of Reply apparently indicated some shortfalls in remissions for some filing periods however the schedule appended to the Reply was not tendered as an exhibit and the Respondent did not call a witness who might have been able to identify and speak to such schedule. I am satisfied that the corporation made all remittance payments as required for each reporting period following the Appellant's wife's death in July 2002. The daughter believed that some of the payments may have been applied to arrears but that was not the basis upon which the payments were made. The payments were made as returns were filed on the basis the GST was being remitted in respect of liabilities for the current quarter in respect of which the filing was made.

[34] The Appellant relies on the proposition in the Federal Court of Appeal decision in *Soper v. The Queen*,[5] that a director need not exhibit in the performance of his or her duties a greater degree of skill or care than may reasonably be expected from a person of his or her knowledge and experience. While the test can be objective in employing the standard of the reasonable person, it is subjective in that the reasonable person is judged on the basis that he or she has the knowledge and experience of that particular individual.

[35] The Appellant characterizes himself as a nominal or outside director. The decision in *Soper* recognizes that such directors have more ready access to the due diligence defence.

[36] As well, reliance is placed on the proposition in *Soper* that in the absence of grounds for suspicion it is not improper for a director to rely on company officials to perform, honestly, duties that have been properly delegated to them. Unless there is reason for suspicion, it is permissible to rely on the day-to-day corporate managers to be responsible for the payment of debt obligations such as those owing to Her Majesty. It is not necessarily a condition precedent to the establishment of a due diligence defence that a director must take active precautionary measures to set up controls or monitor compliance in respect of remittance obligations.

[37] The Appellant also relies on *Smith v. Canada*[6] where, once again, the Federal Court of Appeal enunciated the view that a person with no business acumen or experience would have a lesser standard of care. If a problem would not be apparent to a reasonably prudent person in comparable circumstances, then it cannot be suggested that that person has ignored a problem.

[38] In the case of *Kenny v. Canada*[7] it was noted that a husband who relied on his wife to prepare company returns and keep the books was found to have exercised reasonable diligence. The husband, a director in that case, was assured that GST obligations were being met. The Court found that the appellant's lack of sophistication in business accounting affairs and his reliance on what he believed to be accurate information from a trusted spouse who was also a director was

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[5] 97 DTC 5407.

[6] [2001] F.C.J. No. 448.

[7] [2001] T.C.J. No. 58; [2001] G.S.T.C. 20.

sufficient to establish a due diligence defence. The appellant and his wife each owned half the shares of the company.

[39] Another case of reliance by a director without a business or bookkeeping background that satisfied this Court that the due diligence defence was appropriate, is the case of *Pereira v. Canada*.[8] In that case it was found that the personal education, experience and sophistication of the appellant must play a role. From the outset the appellant in that case was never involved in the daily management and administration of the company. His role was limited to actual bricklaying and signing a few cheques. It did not appear that the appellant was a shareholder of the company.

[40] Similarly, the case of *Jeffrey v. Canada*[9] was cited as an example of where one of three directors, who was only a nominal director with a grade 10 education and who had no idea of what was going on in the company, was exonerated from liability under the due diligence defence. He did not know anything about the affairs of the company, never inquired and was never told by the other two directors what was going on. He was an outside director who did not have any information or did not become aware of any facts that might lead him to conclude that there was a potential problem with remittances and accordingly his appeal was allowed. It does not appear that the appellant was a shareholder. His father, one of the other three directors, was a shareholder.

[41] *Tremblay v. Canada*[10] was relied on to underscore that a prudent person should act once an audit determines that there is a problem with unremitted tax. The suggestion is that expecting action is not reasonable where before an audit or other CRA enquiry, there is no reason to be suspicious or make inquiries. The *Tremblay* decision concerned a number of cases involving several different companies heard on common evidence. The appellant was successful under the due diligence defence in one case where he held no shares and in another where he held all the shares. Reasons for Judgment made no distinction between these two cases based on shareholdings.

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[8] [2007] T.C.J. No. 517; 2008 D.T.C. 2238.

[9] [1999] T.C.J. No. 609; [1999] G.S.T.C. 81.

[10] [1996] T.C.J. No. 315; [1996] G.S.T.C. 28.

[42] In *Pascoal v. Canada*,[11] Antonio Pascoal, a *de jure* director, was a construction worker. He relied on his son for the banking, bookkeeping, signing authorities, remittances and related office duties. The other director, Natalie (Antonio's daughter), did not have signing authority and was a full-time hospital worker during the relevant periods. She and her father were in no position to influence events and in particular to ensure that the GST and payroll remittances were paid. The son was the educated one, highly respected and trusted wholly by his father and Natalie. Both the father and the daughter were found to have acted reasonably in relying on a family member and taking his advice as to their duties as directors even if such advice was faulty. The case involved two companies. In one, the son was a third director but in the other, he was not. The father and daughter were held to be outside directors in both cases and not liable for the remittance failures.

[43] The case of *Sanford v. Canada*[12] is another authority for finding that a lower standard of care is required for a director who is simply a nominal director.

[44] In *Stevenson Estate v. Canada*,[13] one of three directors was exonerated from liability on the basis that he was only nominally a director. He was elderly, of minimal education and could not have influenced the course of events. There is no suggestion that not having any idea what was going on made him liable even though it appears he may have had a significant interest in the company.

[45] In *Bains v. Canada*,[14] Bains was held liable for unremitted GST from the moment he was alerted to a problem regarding the GST. At that point, he should have done more to ensure that the GST was paid. A reasonably prudent person would have taken steps to ensure compliance by the person charged with remitting GST. Being alerted to the problem elevates the burden.

Respondent's Arguments

[11] [2009] T.C.J. No. 492; 2009 TCC 608.

[12] [1995] T.C.J. No. 1086; 96 D.T.C. 1912.

[13] [1996] T.C.J. No. 1599; 97 D.T.C. 863.

[14] [1999] T.C.J. No. 518; [1999] G.S.T.C. 75.

[46] The Respondent placed emphasis on the Appellant having made absolutely no inquiries as to any of the financial matters concerning the business. Respondent's counsel also suggested that it was not credible that the Appellant could be so ignorant of all such matters or so oblivious to how the corporation's affairs were doing when he was in constant contact with his wife who was handling those affairs.

[47] The Respondent focused on aspects of the jurisprudence, embraced in *Soper*, that placed reliance on the positive duty of directors. As well, contrary to the approach taken by the Appellant, the Respondent characterizes the Appellant as an inside director. While the evidence does not support a finding that the Appellant was involved in the day-to-day management of the company, the Respondent put emphasis on the sole directorship and sole shareholdings which suggest that the Appellant had influence over the conduct of the company's business affairs. It was submitted that such individuals would not so easily be able to argue convincingly that they had no duty to make enquiries.

[48] The Respondent placed reliance on the case of *Garland v. The Queen*[15] which also involved a sole director shareholder husband who relied on his wife. The appellant in that case was unsuccessful in using the due diligence defence even though he was "by no means a sophisticated businessman."

[49] The Respondent also referred me to *Woo v. Canada*.[16] In that case, a family member director who was intentionally kept in the dark by two other family member directors as to certain financial matters including remittance failures was found to be liable as a director notwithstanding that he was kept in the dark. The appellant was a substantial shareholder found to be an inside director who was so totally passive as to the management of the business as to be found to be irresponsible.

[50] The Respondent also referred me to *Lockhart v. Canada*[17] and *Power v. Canada*.[18] Neither case seems particularly helpful. In *Lockhart* the appellant was

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[15] 2004 TCC 494; 2004 D.T.C. 3242.

[16] [2002] T.C.J. No. 31; [2002] G.S.T.C. 10.

[17] [2001] T.C.J. No. 404; [2001] 3 C.T.C. 2531.

[18] [2000] T.C.J. No. 407; [2000] G.S.T.C. 51.

found to be an intelligent, knowledgeable man with experience in business ventures. He knew there were cash flow problems and apparently reviewed intra-monthly statements but did not make inquiries as to the status of source deductions. In *Power* a director was found liable on the basis that he was a sole director who knew that he was being asked to be the director as a condition of extending his sister's corporation's financing. His sister had been a bankrupt and he should have been aware that she required more than cursory supervision in running the business affairs.

[51] The last case Respondent's counsel referred me to was *Penney v. Canada*.[19] This case found that willful blindness was not a defence to director's liability. In this case stamps were made of the appellant's signature and she did not question the use of her signature which was being stamped on various documents without consulting her as to the nature of the documents. Relying on advice that she could not be legally responsible, she turned a blind eye to everything in relation to the affairs of the business. She held all the shares in the company for her brother. She was not without business experience.

Analysis

[52] The subjective element of the standard of care required of a director relying on the due diligence defence, was, as noted, established by the Federal Court of Appeal in *Soper*. In the *Soper* decision, the standard of care was described, at page 5416, as an objective subjective standard:

> This is a convenient place to summarize my findings in respect of subsection 227.1(3) of the Income Tax Act. 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). (Emphasis added.)
>
> 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.

[19] [1999] T.C.J. No. 803; [1999] G.S.T.C. 102.

> 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". (Emphasis added.)

[53] The flexibility of that standard of care is further illustrated by making more allowances for directors who are less involved in managing the affairs of the corporation than for those who are so involved. In the context of section 227.1 of the *Income Tax Act* and section 323 of the *Act*,[20] directors can delegate their responsibilities as directors and be exonerated from liability by reliance on delegated persons if the circumstances permit. That is, for the purposes of those provisions, nominal or outside directors are not burdened by the duties that attach to directors under corporate law to the same extent as are inside directors who take a more active role.

[54] At page 5417 of *Soper*, the Court made the following observation respecting the use of the objective subjective standard as it applies to inside directors:

> … 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. (Emphasis added.)

[55] The Respondent in taking the position that the Appellant, as the sole shareholder and director, cannot be treated as an outside director in effect presumes that the suggestion in *Soper* is that to be an outside director one must not have a substantial interest in the company and can only be so characterized if there is at least one other director who would be the inside director. While these are factors to consider in determining whether a director is in a position to detect or prevent a potential remission failure, they cannot, even together, be taken as determinative. To suggest that they are determinative or even be given such weight as to make access to the due diligence defence more difficult, undermines the flexibility recognized as being inherently a major component of the defence.

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[20] Both sections place the same liability on directors and both have the same due diligence defence.

[56] It is true that one might ask how a reasonable person acting as the sole director, even with the limited knowledge and skill of the Appellant, can rely on a due diligence defence based on being oblivious to his duties. I do not accept however that a due diligence defence collapses when a sole director is oblivious to his duties as a director. It collapses if a director's reliance was not reasonable. The caution in *Smith* that the due diligence defence will probably not assist a director who is oblivious to the statutory duties of directors is not an inevitable barrier to the application of the due diligence defence in a case like the one at bar. "Oblivious" in this context incorporates the idea of acting irresponsibly or with willful blindness. In my view, it does not deny the due diligence defence to someone like the Appellant with genuine limitations who cannot be found to be acting irresponsibly or with willful blindness.

[57] As well, I note that it was the Appellant's wife who initiated the company. If his reliance on her in respect of her being in charge of remittances does not bar him from the due diligence defence, his reliance on her in accepting the way in which the company was organized cannot, through the back door, change that result.

[58] Further, a sole director, ignorant of the duties of a director, cannot be treated more severely than a sole director who knows a director's duties and relies on a third person to perform a task. A better question to pose would be: had the Appellant known his duties, would he be entitled to rely on his wife in the circumstances of this case so as to be exonerated under the due diligence defence? That is to say that the application of the standard of care cannot change where there is a sole director. A sole director, or a board composed of several directors, can delegate administrative compliance duties and any of them can be exonerated from liability if the conduct of that director does not suggest, in the circumstances, that he should have done something to detect or prevent a potential remission failure.

[59] Indeed, the inside versus outside director orientation to applying the standard of care outlined in *Soper* is only a helpful tool in assessing whether the particular director, sole or not, should have done something to prevent a remittance failure. The subjective objective standard to be applied is applied to answer *that* question. This was underlined by the Federal Court of Appeal in *Wheeliker v. R.*[21] Commenting on the standard of care established in *Soper*, the Court noted at paragraph 45:

[21] [1999] 2 C.T.C. 395 (F.C.A.); (sub nom. *R. v. Corsano*) 99 D.T.C. 5658.

> It is true that in *Soper*, this Court wrote that "the standard of care laid down in subsection 227.1(3) of the Act is inherently flexible". It is obvious, however, on the reading of the decision, that it is the application of the standard that is flexible because of the varying and different skills, factors and circumstances that are to be weighed in measuring whether a director in a given situation lived up to the standard of care established by the Act. For, subsection 227.1(3) statutorily imposes only one standard to all directors, that is to say whether 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. (Emphasis added.)

[60] As well, I point out that in *Soper*, it was acknowledged that not all inside directors have been held liable. That is, even tilting the analysis in the direction of the Appellant being an inside director need not alter a conclusion otherwise arrived at. Holding a person such as the Appellant, given his limitations, liable for his wife's failures in a case like this cannot prevent remittance failures. The due diligence defence should be open to him.

[61] There is one case of this Court, however, that suggests a different conclusion. In his decision in *Weyand v. R.*,[22] Justice Mogan considered the question of an inside director versus an outside director where there was a sole director who relied on her husband to be responsible for corporate management. At paragraph 28, he came to a conclusion that does not assist the Appellant in the case at bar:

> 28 I will consider the Appellant first as an inside director and second as an outside director. When there are two or more directors of a corporation, a particular director may be characterized as "inside" or "outside" depending on the role which that particular director plays in the business affairs of the corporation. When there is only one director of a corporation, and when that person knows that he or she is the only director, that person in my opinion is implicitly an inside director because that person knows that he or she cannot rely on any other individual to bear the responsibilities of a director. Accordingly, I hold that the Appellant was an inside director of Blackberry from and after May 24, 2000. If a sole director (knowing that he or she is the only director) permits some third party to be responsible for corporate management, I would regard the third party as the agent of the sole director, and the conduct of the third party as the conduct of the sole director. To the extent that the Appellant permitted her husband to manage any of the affairs of Blackberry after May 24, I look upon him as her agent and upon his conduct as her conduct. (Emphasis added.)

[22] 2004 TCC 355; [2006] 2 C.T.C. 2075.

[62] In *Sziklai v. R.*,[23] I considered Justice Mogan's views on this matter and came to the same conclusion there as I have in the case the bar:

> 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 defense 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.
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> 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.*[7] 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.

[63] The Respondent would still urge me to give weight to the fact that the Appellant should not be taken to be so innocent of problems where it is his wife that was in charge of remittances. Unlike the Respondent, I find it totally credible that the Appellant's ailing wife would not only not volunteer any such troublesome information around the kitchen table but would intentionally avoid alerting her husband to it. This does not frustrate his reliance on the due diligence defence. It is credible to me that he knew nothing of any circumstances that ought to have compelled him to action. There is nothing in the evidence that suggests he ought to have known of circumstances that would have led a reasonable person to make inquiries or take some action.

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[23] 2006 TCC 68; 2006 D.T.C. 2798.

[64] As to the Appellant being the sole shareholder, I acknowledge the tendency to suggest that remittance failures arise to keep a company solvent to the benefit of the shareholders. That tendency suggests that the Appellant as the sole beneficiary of misapplied funds, should not escape liability to account for them.

[65] It may be that in the present appeal, misusing funds kept the company's operations going. However, I have no evidence that not remitting GST collections, if collected, was necessary to keep the corporation solvent. Even if that was the case, there is no suggestion here that the Appellant knew or ought to have been suspicious of that possibility. As I said, unlike the Respondent, I find it totally credible that the Appellant's ailing wife would not volunteer any such troublesome information to her husband.

[66] As well, I note that the cases relied on by the parties, raise no overriding concerns as to the weight to be given to shareholdings even where a sole director is a sole shareholder. Even in *Garland*, the judge, finding that a sole director shareholder who relied on his wife could not be exonerated under the due diligence defence, noted that although the director was unsophisticated "he took it upon himself to run the company". This is a relevant distinction when compared to the case at bar and puts emphasis where it should be placed.

[67] While the analysis to this point should dispel any concerns regarding the Appellant being the sole shareholder director, a different approach to that aspect of this case does so as well. It is an approach that suggests that, in fact, the Appellant was *not* a sole director.

[68] Accepting that the Appellant's wife was the person in charge of, and had the responsibility for carrying out, the daily management and administration of the corporation, it is appropriate to suggest that she was a *de facto* director. The evidence supports a finding that she was acting well beyond her role of being responsible for administrative compliance relating to all statutory and regulatory compliance matters. On the evidence of two credible witnesses, I am satisfied that she was not only responsible for the management of the business and affairs of the corporation but must inevitably have held herself out to third parties as the person with authority to carry out that role and was thereby acting as a *de facto* director of the corporation.

[69] I have dealt with the question of *de facto* directors in the context of section 227.1 and my views have not changed since expressing them in *Bonotto v. The Queen.* [24]

[70] In *Bonotto*, I noted that subsection 115(1) of the *Business Corporations Act (Ontario)* provides that the duties of a director are to manage or to supervise the management of the business and affairs of a corporation. This statutory provision, confirms my view in the case at bar that the Appellant's wife, as the person managing the business and affairs of the corporation, was performing the duties of a director. She was self-supervised, was in charge of banking as the only active signing officer, she signed tax returns and, practically speaking, she answered to, and was directed by, no one in performing, without challenge, all the duties of a director, qua director. That is, I am satisfied on the evidence that in spite of the Appellant being the sole *de jure* director, his wife purported to act in the eyes of the outside world as a director.

[71] In *Wheeliker*, it was held that persons who purported to act as a director could be liable under section 227.1 as *de facto* directors. The decision as expressed by Nöel J.A., speaking for the majority in that case, fell short of saying that such persons *were* directors.

[72] Létourneau J.A. agreed with the result of the majority but took the view that the term "director" used in section 227.1 included both *de facto* and *de jure* directors. Although the difference between the approach of Nöel and Létourneau has been said to be a red herring, it seems to me that the distinction might be relevant in some cases. Taking the Appellant's wife as a *de facto* director, for example, Nöel's approach would make her liable under section 323 even though she could not be considered a director for any other purpose – such as changing the constitution of the board from a sole directorship to a two person board for the purposes of that section.

[73] I suggested at paragraph 52 in *Bonotto* that Létourneau's view seems ultimately to have prevailed. If that is the case, I am dealing with a two person board, one of whom is more clearly a nominal director. Such directors are more readily accepted as outside directors, regardless of their interest in the company and as noted, the bar for meeting the *Soper* due diligence standard of care in the case of outside directors is dramatically lower than the case of an inside director.

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[24] 2008 TCC 221; 2008 D.T.C. 3562; See paragraphs 48-56.

[74] As well, having two individuals potentially responsible under section 323 of the *Act* in this case might alleviate concern that exonerating the Appellant leaves no one accountable for the remittance failures. While that should not be a factor, finding the Appellant's wife (or her estate) to have been a *de facto* director eases that concern. It seems unlikely that the due diligence defence would be available to the Appellant's wife unless toward the end of her life she was incapacitated which is not the evidence before me. Indeed, if that was the evidence before me, my finding in respect of the Appellant would likely be different. In such case a reasonably prudent person in similar circumstances might have sought someone else's assistance earlier, such as that of his daughter.

[75] I will conclude my analysis by noting that the cases relied on by the Appellant demonstrate considerable tolerance toward innocent directors who have, by reason of trust in another and awareness of there own limited abilities, been found to have exercised sufficient care, diligence and skill to prevent a remittance failure even where they have made no inquiries and paid little or no heed to their duties as directors which were unknown to them. A qualifier to such tolerance is that the failure to make inquiries and pay heed to their duties as directors even if unknown to them, does not stem from turning a blind eye so as to avoid seeing anything suspicious but rather stems from a trust that is subjectively and objectively well founded and where there is, in fact, a genuine limitation on their own abilities to carry out those duties had they know of them.

[76] Further, it is clear from the authorities cited that the positive duty to act arises only where a director becomes aware or ought to have become aware of facts that could reasonably lead one to conclude there might be a potential problem with remittances.

[77] Based on these general observations of the state of the law concerning the circumstances when a director will be exonerated under the due diligence defence, I find that the Appellant should be relieved of liability for the remittance failures of the corporation. His limitations are genuine and he cannot be said, in the circumstances, to have acted irresponsibly or with willful blindness. The care he exercised to prevent a failure to remit was limited to trusting his wife. A reasonably prudent person in comparable circumstances having virtually no business acumen or skill would not have exercised a more diligent approach to understanding his duties as a director or taken a more active role in ensuring compliance with such duties. The Appellant's role was the hands-on caring for and training of horses, tasks not assigned to directors. He was a nominal director put there by his wife.

[78] In coming to this conclusion, I place emphasis on my acceptance of the Appellant's wife, upon whom he relied, being worthy of the trust he afforded her. Her background, experience and character gave him no reason to be suspicious. As a *de jure* director it was open for the CRA to notify him of remittance failures. There is no evidence of that. There was a voluntary disclosure as soon as the failures became known to the Appellant.

[79] Even in *Woo*, a case relied on by the Respondent, being intentionally kept in the dark by a family member as to certain financial matters including remittance failures did not alone prevent the appellant in that case from successfully relying on the due diligence defence. It was also found in that case that the appellant had reason to be suspicious. That is not the case here. In *Bains* liability started on being alerted to a problem. In the case at bar, necessary action was taken to deal with the problem as soon as it became apparent. There was no reason to be suspicious before the death of the Appellant's wife. I am satisfied that the absence of an inquiry is not fatal to the Appellant's case.

[80] As in *Pereira*, the Appellant was an unsophisticated director whose actual role was a far cry from being involved in the daily management and administration of the company. As in *Pascoal*, the Appellant's reliance on a family member should not prevent his being exonerated under the due diligence defence. The parallels in these cases, to the one at bar, are self-evident and support the allowance of the appeals at hand.

[81] In any event, each case must be approached on its particular circumstances that will guide the judge who hears the evidence. In *Cloutier v. Minister of National Revenue*,[25] Bowman, J. (as he was then) set out a reasonable approach that is as relevant now as it was in 1993. He considered the appeal of directors who were facing liability for the corporation not having remitted taxes under the *Income Tax Act*. At page 545 he stated:

> 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

[25] 93 D.T.C. 544.

> have done, knowing what I know now?" It is not that sort of *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." (Emphasis added.)

[82] All said then, I am satisfied that the requirements of subsection 323(3) have been met. The Appellant relied on his wife as the person responsible for administrative functions relating to all statutory and regulatory compliance matters. Such reliance, in this case, meets the requirements of subsection 323(3). Accordingly, the appeal is allowed with costs.

Signed at Ottawa, Canada this 14th day of May 2010.

"J.E. Hershfield"

Hershfield J.

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