Docket: 2009-3419(GST)G

BETWEEN:

JAMES K. MARTIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
James K. Martin (2009-3420(IT)G),
on May 30, 2012, at Moncton, New Brunswick.

Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant:	Edward J. McGrath
Counsel for the Respondent:	Cecil S. Woon Melanie Petrunia

JUDGMENT

The appeal from the reassessment made under the *Excise Tax Act* is allowed in part and the reassessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment. Each party will bear its own costs.

Signed at Ottawa, Canada, this 27th day of August 2012.

"François Angers"

Angers J.

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JUDGMENT

The appeal from the assessment made under the *Income Tax Act* is allowed in part and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment. Each party will bear its own costs.

Signed at Ottawa, Canada, this 27th day of August 2012.

"François Angers"

Angers J.

Citation: 2012 TCC 239
Date: 20120827
Dockets: 2009-3419(GST)G,
2009-3420(IT)G

BETWEEN:

JAMES K. MARTIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Angers J.

[1] These appeals were heard on common evidence. They both concern assessments issued to the appellant in his capacity as director of a corporation known as Codiac Boring and Drilling Ltd. (Codiac). The appellant was assessed amounts under subsection 323(1) of the *Excise Tax Act* (*ETA*) with respect to Codiac's failure to remit net tax and under section 223 of the *Income Tax Act* (*ITA*) with respect to payroll deductions and employer contributions payable by Codiac, plus interest and penalties. In both appeals, the issue is whether the appellant exercised the degree of care, diligence and skill to prevent the failure to remit the net tax and payroll deduction amounts that a reasonably prudent person would have exercised in comparable circumstances.

[2] The appellant was at all relevant times the director and shareholder of Codiac as well as director and shareholder of more than a dozen other, related corporations, including one known as Robinson Construction Company Ltd. (Robinson). They were all part of a group of corporations that were used by Robinson for various reasons in the performance of various contracts prior to the events leading to this appeal. The appellant is a licensed electrician who acquired these corporations in the early 1980's from his father, who in turn had succeeded the appellant’s grandfather.

[3] At first, Robinson was an electrical contractor, but it eventually specialized in underground utilities and expanded to other underground pipes, as it was one of the few companies in New Brunswick that did directional drilling. Robinson and Codiac ultimately became water line and sewer line contractors. Robinson had around 30 employees and Codiac 10.

[4] In the spring of 2000, Robinson entered into a contract with MRM Technical Group Inc., known as Exelon, which was an American corporation that had obtained a contract with Enbridge Gas New Brunswick Inc. (Enbridge) for the development of a natural gas distribution system in New Brunswick. Robinson became the main subcontractor and the other Robinson group corporations became subcontractors for Robinson, Codiac being the most important of them all because of the directional drilling.

[5] Robinson decided to join with Exelon in early 2000. Exelon placed bids on seven contracts that were put out to tender by Enbridge and was successful on four of them. These contracts ranged in value between three and four million dollars each and all the work was to be performed by Robinson. One of these contracts alone represented the equivalent of one year of operations for Robinson. It was evident that Robinson could not finance all four contracts. It therefore had to either increase its line of credit or find a way to invoice and get paid on a weekly basis. Exelon agreed to the latter, which assured Robinson of sufficient cash flow or working capital to finance a project of that size. Codiac had no line of credit.

[6] Robinson and Codiac had to hire three times more employees than they had ever had and grew to a size three times greater than they had ever been. The weekly payment arrangement was the only way the Robinson group of companies could work with Exelon in order to keep the work going.

[7] The contract was for the installation of pipes on a paid-per-unit basis. The contract did not provide for any extras unless they were approved and only a holdback of 10% was to be retained by Exelon. The work was to begin in June 2000, and Robinson and Codiac were ready to proceed. They had hired their workers and rented the necessary equipment. Enbridge, on the other hand, had not obtained the necessary permits on time and start-up was delayed until August. The resulting standby time and the non-payment of extras created an upfront loss of between $800,000 and $900,000. By July, Robinson's line of credit of $600,000 had been used up.

[8] That delay in start-up meant that much of the work had to be done in the winter months at a higher cost. In addition to the 10% holdback, an additional 15% was held back, and there were also extras, all of which contributed to the creation of severe financial hardship for Robinson and its group of companies. Robinson's suppliers were also beginning to suffer financially. After about three months of operations, one million dollars or about 40% of Robinson's billings was being held back.

[9] On December 11, 2000, the appellant hired one David Ross, a chartered accountant, as chief financial officer for Robinson and its group of companies. Once he became apprised of the situation, he immediately called for a meeting with representatives from Exelon and Enbridge to discuss the mounting costs due to winter drilling, and to discuss as well the holdbacks, the extras and the costs occasioned by late start-up. Promises were made but not kept. Robinson was promised $500,000 but only received $200,000. Other problems surfaced as well. They were asked to dig the trenches deeper and to use more sand bedding. By mid-February, Robinson and its group of companies knew that these projects would not end well. Up to February 2001, Robinson and Codiac had been able to pay its GST/HST and payroll taxes owing, but the appellant became seriously concerned with the situation in that regard.

[10] In February 2001, Mr. Ross consulted Kent Robinson, the lawyer for Robinson and its group of companies, who in turn suggested they retain a bankruptcy expert in the person of David Stevenson, a chartered accountant. At the time, the appellant was concerned with the suppliers and the taxes. The following provides the context in terms of possible arrears in taxes:

> A. If we were, it was as it evolved through February. I think he was there in. . . because of the things that would have been eminent [*sic*] was that taxes would be due in a couple of weeks or something. So that's one of the things he was brought in for, to help us address or to help us prepare for what, by January or February, we could tell was going to be a rough deal.
>
> Q. So you met with Mr. Stevenson and you met with Kent Robinson?
>
> A. Yes.

[11] The appellant's understanding of the entire process at the time and even at trial was that the GST/HST remittances would fall off in that, if you send a bill and you cannot collect on that bill, there will be no GST/HST. If you do not collect, there is no GST/HST to remit. As for the deduction amounts to be remitted, he understood

that they had a different priority level and that, in spite of everything, he still had to pay what he called the payroll taxes.

[12] Other meetings were also held in February in order to settle the financial difficulties arising from the contracts in question. The matter had become even more important at that time because the bank wanted to reduce Robinson's line of credit from $600,000 to $450,000.

[13] As of January 31, 2001, Codiac's shortfall was $249,000. By August 31, it had risen to $833,000. As for Robinson, as of June 2001, it had $3,750,000 that was receivable from Exelon. Mechanic's liens were put on the project and David Ross made representations to senior bureaucrats and senior ministers of the New Brunswick government as well as to the New Brunswick Public Utilities Board assistance with a view to obtaining assistance. For David Ross, it was clear by April 15, 2001 that the die was cast. It was going to be a struggle to collect the receivables. Exelon was paying the minimum necessary to keep the project going. They paid Robinson enough to keep the suppliers going and to pay only the out-of-pocket payroll. He corresponded with Exelon's chief operating officer as early as January 2001, saying they needed more in order to meet their tax obligations and bank obligations and keep things current in that regard.

[14] In the second quarter of 2001, David Ross and others met regularly with representatives of the Moncton Canada Revenue Agency (CRA) office. They kept the CRA informed of all the actions they were taking to collect their receivables and they provided the CRA with monthly reports.

[15] In the fall of 2001, Enbridge began to pay Robinson's suppliers directly. Robinson requested of the CRA that third party demands be issued to Enbridge and Exelon, which was done.

[16] Robinson eventually settled its $3,750,000 lawsuit for $545,000 in 2005. The appellant had it in mind, and instructed his lawyer to make sure, that $200,671 of the settlement fund would be used to pay Codiac's payroll deduction amounts and to pay Robinson's other liabilities toward the CRA. Again, in his own mind, the appellant was convinced that Codiac's GST/HST account would disappear because Codiac could not collect GST/HST from Robinson and that this would result in what he describes as a wash. He believed that all of Robinson's and Codiac's tax issues would be cleared up, as the entire settlement proceeds went to the CRA. Notwithstanding the instructions given, the proceeds were all applied to Robinson's tax liabilities by the CRA.

[17] Robinson, Codiac and the other members of the group of companies all operated under a consolidated treasury, i.e., there were no separate accounts. The payroll was met through a payroll service company and the books were kept in such way that they knew which company in the group needed to have its remittances paid. For the project, Robinson billed Exelon and then the internal accounting allowed each company to receive the funds required in order to meet its obligations. Codiac would bill Robinson.

[18] The details of the reassessment issued to Codiac with regard to the payroll deductions and employer contributions, for which the appellant was assessed, are set out in Schedule A of the Reply to the Notice of Appeal (2009-3420(IT)G). The breakdown is as follows:

Taxation Year	**Federal Taxes** **$**	**Provincial Taxes** **$**	**CPP** **$**	**EI** **$**	**Penalties & Interest** **$**	**Total** **$**
2001	66,287.95	34,255.89	26,617.16	20,756.90	136,679.21	284.597.11

[19] The details of the assessment issued to Codiac with regard to its failure to remit an amount of net tax, for which the appellant was assessed, is detailed as follows in the respondent's Reply to the Notice of Appeal (2009-3419(GST)G):

Period End Date	**[Unremitted Net] Tax**	**Interest**	**Penalty**	**Total**
2001-03-31	—	$ 5,501.75	$ 6,784.90	$ 12,286.65
2001-06-30	$ 81,940.30	$ 42,846.00	$36,157.63	$160,943.93
2001-09-30	$ 26,173.48	$ 11,142.19	$ 8,317.95	$ 45,633.62
2001-12-31	$105,623.89	$ 61,512.06	$13,858.90	$180,994.85
TOTAL:	$213,737.67	$121,002.00	$65,119.38	$399,859.05

[20] Codiac had been assessed for GST/HST for the period from January 1, 2001 to December 31, 2003. Following an appeal before this Court, the assessment was adjusted to reflect the Tax Court's decision, which resulted in the same adjustment to the appellant's assessment under subsection 323(1) of the *ETA*. According to Mr. Ross, the chief financial officer for Robinson, had Codiac been able to claim a

bad debt credit, the GST/HST payable would have been considerably diminished. They were unable to claim the bad debt credit as Robinson and Codiac were related and thus not dealing at arm's length. Subsection 231(1) allows a bad debt credit only if the parties are dealing at arm's length. Had the companies been closely related persons as that term is defined for GST purposes and had they made the election made under section 156 of the *ETA* to have supplies made among them treated as having been made for nil consideration, the result would have been quite different.

[21] Mr. Ross also testified that Codiac could, under subsection 232(2) of the *ETA*, have reduced its invoiced amounts by the amounts charged but unpaid and thus reduced the GST/HST owing in accordance with the rules contained in subsection 232(3) of the *ETA*. They found out about those provisions too late, however, as they have to be invoked within four years. Mr. Ross did in fact introduce some calculations he had made which show a substantial difference in the GST/HST owing (Exhibit A-3), so much so that Codiac would have had no GST/HST owing. He went on to say that the effect of allowing these credits would be that the payroll taxes and GST/HST of both Robinson and Codiac were overpaid by about $160,000.

Relevant sections

[22] The liability of directors for failure to remit an amount of net tax under the *ETA* is set out in section 323 of the *ETA*, the relevant subsections of which read as follows:

> **323. (1) Liability of directors** — 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.
>
> **(2) Limitations** — A director of a corporation is not liable under subsection (1) unless
>
> (a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 316 and execution for that amount has been returned unsatisfied in whole or in part;
> (b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six

months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

(c) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the date of the assignment or bankruptcy order.

(3) Diligence [due diligence defence] — 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.

[23] The liability of directors for failure to remit an amount withheld as required by the *Income Tax Act* is set out in section 227.1, the relevant subsections of which read as follows:

227.1 (1) Liability of directors for failure to deduct — Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.

(2) **Limitations on liability** — A director is not liable under subsection 227.1 (1), unless

(a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 223 and execution for that amount has been returned unsatisfied in whole or in part;

(b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

(c) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or bankruptcy order.

(3) **Idem [due diligence defence]** — A director is not liable for a failure under subsection 227.1(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.

[24] The only issue before the Court is whether the appellant exercised the degree of care, diligence and skill to prevent the failure to remit that a reasonably prudent person would have exercised in comparable circumstances. In two recent decisions of the Federal Court of Appeal (*Balthazard v. Canada*, 2011 FCA 331, and *Canada v. Buckingham*, 2011 FCA 142), Justice Mainville dealth with the legal framework applicable to the care, diligence and skill defence. In *Balthazard*, he summarized that framework as follows, at paragraph 32:

> a. The standard of care, skill and diligence required under subsection 323(3) of the *Excise Tax Act* is an objective standard as set out by the Supreme Court of Canada in *Peoples Department Stores Inc.(Trustee of) v. Wise*, 2004 SCC 68, [2004] 3 S.C.R. 461. This objective standard has set aside the common law principle that a director's management of a corporation is to be judged according to his or her own personal skills, knowledge, abilities and capacities. However, an objective standard does not mean that a director's particular circumstances are to be ignored. These circumstances must be taken into account, but must be considered against an objective "reasonably prudent person" standard.
> b. The assessment of the director's conduct, for the purposes of this objective standard, begins when it becomes apparent to the director, acting reasonably and with due care, diligence and skill, that the corporation is entering a period of financial difficulties.
> c. In circumstances where a corporation is facing financial difficulties, it may be tempting to divert these Crown remittances in order to pay other creditors and thus ensure the continuity of the operations of the corporation. That is precisely the situation which section 323 of the *Excise Tax Act* seeks to avoid. The defence under subsection 323(3) of the *Excise Tax Act* must not be used to encourage such failures by allowing a care, diligence and skill defence for directors who finance the activities of their corporation with Crown monies, whether or not they expect to make good on these failures to remit at a later date.
> d. Since the liability of directors in these respects is not absolute, it is possible for a corporation to fail to make remissions [*sic*] to the Crown without the joint and several, or solidary, liability of its directors being engaged.
> e. What is required is that the directors establish that they were specifically concerned with the tax remittances and that they exercised their duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the amounts at issue.

[25] There is no doubt that the events that led to Robinson's and Codiac's financial difficulties were, to say the least, somewhat unforeseeable. The appellant saw in this project an opportunity for his companies to acquire expertise for the future, particularly in what was to become a new industry for New Brunswick. That project

was, however, an undertaking larger by far — three times larger, in fact — than any that Robinson and its group had ever been involved in before. It required a lot of manpower and equipment, and, most importantly, sufficient cash flow to finance it.

[26] The appellant is an electrician by trade, who, over the years, became the shareholder and director of Robinson and its group. He is very familiar with the construction aspect of the business and had appropriate staff to manage the administration side of the business, even with Robinson's limited line of credit. He knew that the size of this project would require different conditions in terms of payment and he was successful in obtaining from Exelon their undertaking to pay Robinson on a weekly basis. This, apparently, was exceptional in the construction industry but was an essential element for this project and the relationship between Exelon and Robinson.

[27] Despite the delays in start-up and the additional related costs created thereby, and notwithstanding the holdbacks and the extras that did not get approved, Robinson and particularly Codiac were able to meet their obligations in terms of the remittance of payroll deductions and also of the GST/HST Codiac collected on its billings to Robinson. These remittances were kept up to date until at least the end of February 2001. The appellant knew very early on in the project, and more particularly in the fall of 2000, that the delays in obtaining payment on its billings would eventually lead to serious financial difficulties with the project. The upfront losses and the cost of standby time were in the $900,000 range. Winter was approaching and by January the holdbacks alone had reached one million dollars, which represented 40% of Robinson's billings.

[28] In order to address this particular financial crisis caused by Enbridge's refusal to pay Exelon and Exelon's being unable to resolve the situation, the appellant hired a chief financial officer on December 11, 2000. Two days later, the chief financial officer met with the parties involved but he was ultimately only able to get $200,000 of the $500,000 asked for.

[29] The appellant also consulted Robinson's lawyer and, in February 2001, retained a chartered accountant as he was afraid Robinson and its group of companies would go bankrupt. Although Robinson and Codiac were up to date with their remittances at that time, concern over GST/HST and payroll deduction remittances was being felt by everyone, including the appellant. The appellant was of the belief that, with regard to the GST/HST remittances, the end result would eventually be a wash for the simple reason that you do not remit what you cannot collect. That belief was also shared by both the chief financial officer and the accountant who had just

been retained. The payroll deductions were a more serious concern and as early as March 2001 meetings were held with representatives of the CRA to keep them apprised of the financial difficulties and the efforts that were being made to collect from Exelon and Enbridge.

[30] The belief of the appellant and his two advisors that the situation with regard to the GST/HST would be a wash was not wrong. What was unknown to everyone was that Robinson's group of companies were not a closely related group of companies as defined for GST/HST purposes and therefore could not benefit from subsection 231(1) of the *ETA*. Consequently no bad debt was available to Codiac nor could Codiac benefit from a reduction with respect to the unpaid invoices under subsection 232(2) of the *ETA* and thus reduce by means of credit notes under subsection 232(3) of the *ETA* the tax owing. Codiac was therefore left with no recourse. These events occurred in the spring of 2001, about ten years after the GST was introduced. Given this short period after its introduction, it is not surprising that all of the workings of the GST were not known. What is surprising, given the good rapport Robinson and its group of companies had with CRA officials, is that information as to the relief available to Codiac with regard to its GST/HST remittances was not communicated to the appellant and his advisor, nor were any suggestions made to them in that regard when they met with the aforementioned CRA representatives to discuss the problem in the spring of 2001. Although the amount of GST/HST owed by Codiac is not at issue herein, I have no reason to disbelieve that, as a result of the appropriate measures not being taken, Codiac's GST/HST debt has been overpaid by many thousands of dollars, as suggested by David Ross. But for that overpayment, there could have been sufficient money left to pay the payroll deductions.

[31] The appellant could easily have walked off the job, but the consequences would have been disastrous for his group of companies. Exelon was giving Robinson just enough money to keep him crawling forward, as he said, in the hope that one day he would get paid. Although his efforts were made on behalf of Robinson, they no doubt included all companies in the group as all were dependent on Robinson being able to get paid.

[32] It became apparent to the appellant in the fall of 2000 that Robinson and its group of companies were going to run out of money. Notwithstanding the fact that Codiac remained up to date in its remittances until the end of February 2001 as regards payroll deductions and the end of March 2001 as regards GST/HST, the appellant hired a chief financial officer, a lawyer and a chartered accountant to assist

him in resolving the financial crisis. His concern during the winter months was to pay the taxes first. He refused to have suppliers get paid directly by Enbridge as he could use that money to pay the taxes. In addition, had Robinson and its group of companies been properly advised on the GST issues, there would have been sufficient money to make the payroll deduction remittances.

[33] In my opinion, the appellant did turn his attention to the required remittances and he did, in the circumstances of this case, exercise the degree of care, diligence and skill that a reasonably prudent person would have exercised in similar circumstances. For those reasons, I would vacate the reassessment against the appellant with respect to the GST/HST owed for the periods ending March 31, June 30 and September 30, 2001 and with respect to the payroll deductions for the 2001 taxation year.

[34] As for the GST/HST owed for the period ending December 31, 2002, I find that the appellant's effort were no longer directed at that point toward avoidance of failures to remit.

[35] The appeals are allowed in part and the assessments are referred back to the Minister for reconsideration and reassessment in accordance with these reasons. Each party will bear its own costs.

Signed at Ottawa, Canada, this 27th day of August 2012.

"François Angers"

Angers J.

CITATION:	2012 TCC 239
COURT FILE NOS:	2009-3419(GST)G 2009-3420(IT)G
STYLES OF CAUSE:	James K. Martin v. Her Majesty the Queen
PLACE OF HEARING:	Moncton, New Brunswick
DATE OF HEARING:	May 30, 2012
REASONS FOR JUDGMENT BY:	The Honourable Justice François Angers
DATE OF JUDGMENT:	August 27, 2012

APPEARANCES:

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