

Dockets: 2012-1715(IT)G
2013-1836(GST)I

BETWEEN:

SCOTT MCDONALD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence on September 29, 2014
at Kamloops, British Columbia

Before: The Honourable Justice Diane Campbell

Appearances:

For the Appellant: The Appellant himself

Counsel for the Respondent: Robin Whittaker

JUDGMENT

The appeals from assessments made under the *Income Tax Act* for the 2005, 2006, 2007, 2008 and 2009 taxation years are dismissed.

The appeal from an assessment made under Part IX of the *Excise Tax Act*, for the period June 1, 2008 to April 30, 2009, is dismissed.

The Respondent is awarded costs, but only as they relate to the general procedure appeal, as these appeals were heard together on common evidence.

Signed at Ottawa, Canada, this 24th day of October 2014.

“Diane Campbell”

Campbell J.

Citation: 2014 TCC 315
Date: 20141024
Dockets: 2012-1715(IT)G
2013-1836(GST)I

BETWEEN:

SCOTT MCDONALD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Campbell J.

Introduction

[1] These appeals are from assessments made under section 227.1 of the *Income Tax Act* (the “ITA”) and section 323 of the *Excise Tax Act* (the “ETA”). They were heard together on common evidence. Both sections impose personal liability on corporate directors in respect to unpaid goods and services tax (“GST”) and source deduction withholdings which a corporation owes but has failed to remit.

[2] The Appellant was assessed as a director of Arc Electrical Technicians Ltd. (the “Company”) for the period in which the Company failed to remit the net tax and source deductions pursuant to each *Act*. Although he was not legally or formally named as a director, the Respondent contended that he was a *de facto* director who “... performed the functions of a director of the Company” and who “... carried out the duties normally expected of a director for the Company.” (Reply to the Notice of Appeal in the income tax matter, Assumptions (a) and (b), respectively). Almost identical wording was relied upon in the GST appeal (Reply to the Notice of Appeal, Assumptions 10(j) and (k)).

[3] The income tax appeals are in respect to the Appellant’s 2005, 2006, 2007, 2008 and 2009 taxation years. The GST appeal is in respect to the period from June 1, 2008 to April 30, 2009.

The Issue

[4] The issue, as set out in the Notices of Appeal and at the hearing, was confined to the question of whether the Appellant, although not technically a director, was a *de facto* director during the relevant periods. The only indirect reference to a due diligence argument was fact specific in regard to a few steps taken subsequent to the assessments issued against the Company. Otherwise, the Appellant confined his argument to the issue of his directorship.

The Evidence

[5] Both the Appellant and his spouse, Deborah McDonald, were witnesses. The Respondent relied on the evidence of Linda Robertson, the appeals officer.

[6] The Appellant testified that he is an experienced electrical contractor. Prior to the incorporation of the Company, in June of 2005, he was operating a similar business which was sold because, although the business side was going well, he was “struggling with the book side of things.”

[7] The Appellant testified that it was his father-in-law, Gordon Cross, now deceased, who encouraged the Appellant’s wife to incorporate and commence operations. The Appellant, at this time, had been injured and was temporarily unable to work at the job sites so they were dependent upon Mrs. McDonald’s assistance to support the family. He stated that it was his father-in-law and his wife who made the decision to incorporate and start the business. The Company was incorporated, with Mr. Cross and his daughter, Mrs. McDonald, as its directors. The Appellant was employed by the Company to manage the field operations. Although the Appellant had a leg brace, he was able to do what he did best: find work, complete the bids, decide on the number of employees required for a specific job and supervise those employees.

[8] According to the Appellant’s evidence, since he didn’t “... know how to do books”, he did not want to be involved in this side of the business and it was his wife who dealt with the financial aspects of the Company operations. The Appellant stated that his wife had training with regard to bookkeeping and obtained an accounting program to assist. However, when she encountered problems, she took the entire system to a chartered accountant who retained it for months. When the program was returned, the Appellant’s wife, who was spending more time with the children, hired a friend, who was also a bookkeeper, to look after the books and the office. When this bookkeeper quit in 2008, a replacement

was hired. This individual discovered a number of problems and enlisted her mother, a retired accountant, to assist with identifying those problems. These individuals advised the Appellant and his wife that they needed to contact the Canada Revenue Agency (the "CRA") and advise that there were existing problems.

[9] Throughout this period, the Appellant testified that, as an officer of the Company, he did sign cheques, as well as various remittance forms, but it was the bookkeeper who completed them and he simply signed when they were presented to him. He stated that he did not know how she arrived at final calculations. He did complete invoices and also periodically collected on those.

[10] With respect to the role played by his father-in-law, he stated that it was his wife who took a more active role but that she talked matters over with her father. When he suggested that the Company start to acquire larger commercial projects, his wife and father-in-law prevented him from pursuing this avenue and confined him and the direction of the Company to the smaller contracts that the Company had been completing. He testified that they made this decision in order to prevent potentially incorrect estimates by the Appellant on these larger contracts.

[11] While the Appellant did have a bank card, he had to clear its use, like the other employees did, through the office manager.

[12] On cross-examination, the Appellant acknowledged that he was aware of corporate responsibilities toward tax withholdings and source deductions respecting employees. He stated that the reason he signed the cheques for remittances was because the bookkeeper had completed the calculations.

[13] It was also clear on cross-examination that the Appellant and his spouse had dealings with the CRA over remittance problems and non-filing in each year between 2006 and 2009, when the Company finally ceased operations. However, the Appellant stated that it was only his wife who was involved in the financial affairs of the Company and that, even when she was not in the office a great deal, he relied on the bookkeepers that were hired.

[14] The Appellant's wife confirmed much of his testimony. She stated that it was her father's idea to incorporate a new company, which both of them would operate, and that the Appellant would deal with the actual electrical work, his area of expertise. His role was to be that of service manager: getting contracts, doing the bids and supervising employees. Originally, she was to do the books but

quickly realized she was “in over my head” and required assistance. An accountant was engaged to help with the accounting program. A bookkeeper was eventually hired to assist and replace Mrs. McDonald in the office. There were problems with this individual and another bookkeeper was hired as office manager.

[15] Deborah McDonald testified that she did not advise the Appellant about these ongoing problems in the office as he was busy with the actual field operations. She attempted to deal with the office problems herself by hiring professionals. However, she acknowledged that she chose the wrong individuals. When the second bookkeeper abruptly left, the replacement who was hired discovered source deduction issues. This bookkeeper obtained permission to have her mother, a retired accountant, assist with these problems.

[16] The CRA was contacted and spent a week at the corporate offices trying to resolve the issues.

[17] With respect to the direction of the Company, Mrs. McDonald testified that it was she and her father who controlled the type of contracts the Company could take and had vetoed the Appellant’s request to bid on large commercial contracts. Although her father was not a presence in the office, she stated that she did discuss her decisions with him.

[18] On cross-examination, she confirmed that it was the Appellant, and not her father, who accompanied her to the meetings with the CRA trust examiners. She stated that, at this time, her father was becoming incompetent with age, although she maintained that her father was still involved.

[19] Linda Robertson, the appeals officer, stated that there had been a number of collection officers that had dealt with the Appellant and the Company over the years beginning in 2005, shortly after its incorporation. Between 2005 and 2009, this account never left collections. She testified that the CRA most frequently dealt with the Appellant on these matters. When trust examiners attempted to determine the balance owing, the Appellant attended those meetings on behalf of the Company, along with his wife. Trust exams were conducted because, although the Company had been incorporated in 2005, no remittances had been reported or paid and no filings completed, despite promises to do so. In January of 2008, the Appellant paid an outstanding balance owed at that time, but the accompanying returns were not filed. In the end, notional assessments were issued. In the fall of 2009, the Minister registered certificates in the Federal Court with subsequent Writs of Seizure and Sale being returned unsatisfied on November 19, 2009.

[20] With respect to the Appellant's argument that the CRA reneged on an alleged payment agreement and proceeded with collection proceedings, resulting in the Company shutting down, the appeals officer testified that the Company had significant debt that had accrued and no payments had been made. Searches by the CRA indicated that there may have also been problems with suppliers being paid.

Analysis

[21] What I must decide is whether the Appellant, although never formally appointed a director of the Company, was nonetheless functioning as a director. If he was not functioning as a director, then section 227.1 of the *ITA* and section 323 of the *ETA* will not apply and he will not be liable for the remittances that the Company failed to remit. If he is found to be functioning as a director, then he will be liable for those remittances.

[22] In accordance with the decision of the Federal Court of Appeal in *Wheeliker v The Queen*, 99 DTC 5658, where an individual is not legally a director on the books of a corporation, he or she may still be held liable as a director if that individual is functioning in the capacity of a corporate director.

[23] At paragraph 12 of Justice Bédard's reasons in *Beauchemin v The Queen*, 2007 TCC 105, [2007] TCJ No. 43, he listed the following two factors that should be used to determine whether a person can be considered a *de facto* director of a corporation:

[12] ...

(i) he or she usurps that function by taking actions normally required of or reserved for the directors of a corporation under the incorporating legislation of the corporation concerned: for instance, participating in board of directors meetings, signing board resolutions, etc.

(ii) he or she introduces himself or herself to third parties as a director of the corporation concerned.

While he cautioned against applying the concept of *de facto* director too readily, he emphasized that, although individuals may possess and exercise certain powers within a corporation, this may not necessarily lead to the conclusion that they are *de facto* directors. Justice Bédard went on to state the following, at paragraph 13:

[13] ... I am of the opinion that a person who takes such actions can be considered a de facto director by third parties only if he or she introduces himself or herself as the director of the corporation or clearly suggests that he or she performs such actions as the director of the corporation. ...

[24] However, in the case of *Hartrell v The Queen*, 2006 TCC 480, 2006 DTC 3548 (affirmed 2008 FCA 59), Justice Paris suggests that, in certain circumstances, taxpayers need not explicitly represent themselves as directors to third parties in order to be held liable, as Justice Bédard in *Beauchemin* contends. At paragraph 27, Justice Paris stated the following:

[27] However, in circumstances such as those in this case, where a corporation operates without having been properly organized and the only director of record plays no part in running the corporation, those persons who take it upon themselves to direct the affairs of the company may be held to be *de facto* directors, whether or not they have explicitly represented themselves as directors to any third party. The essential question is whether those individuals have, in fact, taken on the role of director of the corporation.

(Emphasis added)

[25] Justice Paris qualifies his statement in this paragraph by concluding that, in the circumstances of the appeal before him, the holding out or representation to third parties would not be an essential factor where the corporation had not been properly organized and the only director of record played no part in the operation of the company. I believe the only conclusion that can be drawn from these statements is made clear by Justice Paris in the first sentence of paragraph 28:

[28] Therefore, the absence of any representation by the Appellant to a third party that he was a Lynx director is not conclusive of whether he was a *de facto* director. ...

I do not believe that Justice Paris is stating that this will never be a factor, but simply that it is not a factor that must be present in a decision to find someone a *de facto* director as the reasons in *Beauchemin* conclude. *Hartrell* was upheld by the Federal Court of Appeal, although no specific comments were made in respect to representations to third parties.

[26] I agree with the reasons in *Hartrell*. Although representing or holding out to third parties, that you are a director, may play an important, even necessary, part in a finding of a *de facto* directorship in some factual scenarios, I do not believe that it will be such an essential factor that its presence or absence would be conclusive

in a determination of whether a taxpayer is or is not a *de facto* director in every case. In my view, it is one of many factors that may or may not be present and it will be one of the factors to be weighed in the overall circumstances of each individual appeal in arriving at a conclusion. As the Respondent pointed out, this is particularly so in family-operated companies, where the lines between individuals in control, or with particular responsibilities, often appear blurred to the outside world. In some circumstances, the actions of an individual, taken in directing the affairs of a company, may be far more important in deciding the *de facto* director query than the fact that the individual makes claims to third parties that he is a director.

[27] Based on the facts in these appeals, was the Appellant playing a subordinate role in the corporate affairs and activities compared to his wife and his father-in-law? Based on the facts, I do not believe that he was in a subordinate position. He played an important and active role in the overall corporate operations. He signed cheques, had access to the corporate books and records, was free to question the bookkeepers on remittances, filings and other office procedures and solely managed and controlled the employees, the field work, the contracts obtained and the bids. He also attended, along with his wife, the meetings with the trust examiners and, in doing so, held himself out as one of the individuals with intimate knowledge of the affairs of the Company. His father-in-law was never a presence in the office or in the life of the corporate activities and, in later years, his mental capacity was declining. The evidence was that he was attempting to assist his daughter when the Appellant was temporarily unable to work and that it was his idea to incorporate a new company. However, there is no evidence that he was actively involved with the affairs of the Company, financial or otherwise, except to the extent that Deborah McDonald testified that she kept him informed. To what degree this occurred is unclear, as she testified that she was “in over my head” with the bookkeeping and actually stepped away from the office and left these activities to bookkeepers that she hired. In fact, she testified that she did not advise her husband of these problems although he had access to the records and was responsible for signing cheques and returns.

[28] The Appellant had prior experience in operating a business and was aware of the necessity of submitting corporate returns and remittances. Although both the Appellant and his wife relied on the one example provided of the Appellant’s lack of input into the Company acquiring larger commercial contracts, no other evidence was adduced that would support a conclusion that the Appellant lacked input in directing and controlling the overall affairs of the Company. It was the Appellant’s expertise that was at the heart of the operation of the Company. The

evidence supports that the Appellant's spouse had stepped away from the Company and had relegated her office responsibilities to bookkeepers that she hired. According to the evidence of the appeals officer, the remittance problems had existed over the life of the Company and it was primarily the Appellant with whom the CRA dealt.

[29] I am of the view that an individual need not be involved in all facets of the management of the corporate operations to be held to be a *de facto* director. Depending on the corporate structure and the complexity of the corporate operations, it will be a question of fact as to whether an individual has performed duties that one would expect only a *de jure* director to complete. Whether the individual is held out by the corporation as one of its directors will be one of many relevant factors but not a decisive factor on its own.

[30] The facts support my conclusion that the Appellant had sufficient control, both direct and indirect, over the corporate affairs, to be held liable as a *de facto* director for the Company's liabilities to the CRA, which it had failed to remit. As these reasons illustrate, there is no significant test to determine whether an individual is a *de facto* director that can be applied to every set of circumstances. Caselaw has determined that there will be a number of factors that should be addressed but it is not an exhaustive list and the weight to be given to each may vary depending on the individual facts in each appeal. In the end, as the caselaw indicates, the question to be answered is whether individuals can be considered part of the corporate governing structure so as to make them liable for matters over which they assumed and exercised power, to some degree, as if they had been appointed a director of that corporation.

Conclusion

[31] The Appellant was at the centre of the heartbeat of this Company's activities and structure, even though he was not technically a director. Based on the evidence before me, I conclude that the Appellant played a significant role in the Company's affairs and either controlled or had the right to control a majority of the corporate operations. He has not provided sufficient evidence to overcome the Minister's assumptions that he performed the functions and duties expected of a director. For these reasons, both of the appeals are dismissed. The Respondent is awarded costs, but only as they relate to the general procedure appeal, as these appeals were heard together on common evidence.

Signed at Ottawa, Canada, this 24th day of October 2014.

“Diane Campbell”

Campbell J.

CITATION: 2014 TCC 315

COURT FILE NOS.: 2012-1715(IT)G
2013-1836(GST)I

STYLE OF CAUSE: SCOTT MCDONALD and HER MAJESTY
THE QUEEN

PLACE OF HEARING: Kamloops, British Columbia

DATE OF HEARING: September 29, 2014

REASONS FOR JUDGMENT BY: The Honourable Justice Diane Campbell

DATE OF JUDGMENT: October 24, 2014

APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Robin Whittaker

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

For the Respondent: William F. Pentney
Deputy Attorney General of Canada
Ottawa, Canada