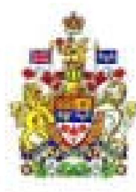
Federal Court of Appeal



Cour d'appel fédérale

Date: 20120308

Docket: A-177-11

Citation: 2012 FCA 80

CORAM: **SHARLOW J.A.**
DAWSON J.A.
TRUDEL J.A.

BETWEEN:

LEONA MADISON

Appellant

and

HER MAJESTY THE QUEEN

Respondent

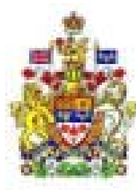
Heard at Edmonton, Alberta, on February 14, 2012.

Judgment delivered at Ottawa, Ontario, on March 8, 2012.

REASONS FOR JUDGMENT BY: SHARLOW J.A.

CONCURRED IN BY: DAWSON J.A.
TRUDEL J.A.

Federal Court of Appeal



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REASONS FOR JUDGMENT

SHARLOW J.A.

[1] The appellant Leona Madison has been assessed under section 227.1(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), for the unremitted employee source deductions of Canfleur Mining Inc., formerly named The Nugget Factory Inc. (referred to in these reasons as the "Corporation"). Ms. Madison appealed the assessment to the Tax Court of Canada without success (2011 TCC 201). She now appeals to this Court.

Statutory framework

[2] Pursuant to subsection 227.1(1) of the *Income Tax Act*, the directors of a corporation may be held liable for, among other things, the corporation's unremitted employee source deductions.

Subsection 227.1(2) shields the directors of a corporation from liability until the Minister has met certain conditions that are intended to ensure that collection remedies against the corporation are exhausted before the directors are assessed (that provision is discussed in more detail below). A director may also avoid liability by establishing the due diligence defence set out in subsection 227.1(3), or by invoking subsection 227.1(4) which provides that a director cannot be assessed under subsection 227.1(1) more than two years after he or she last ceased to be a director. A director who is assessed under subsection 227.1(1) may assert a claim against the corporation and its other directors for any amounts paid to satisfy the assessment (subsections 227.1(6) and (7)).

<u>Background</u>

[3] The Corporation was incorporated on November 1, 2000 under the Alberta *Business Corporations Act*, R.S.A. 2000, c. B-9. In 2001, 2002, and 2003, the Corporation operated a mining business. It failed to remit employee source deductions for those years. In documents issued by the office of the Registrar of Corporations for Alberta, Ms. Madison is named as a director of the Corporation from the date of its incorporation until May 2, 2007, when the Corporation was dissolved for failure to file annual corporate returns.

[4] On March 26, 2009, the Federal Court issued a certificate for the Corporation's indebtedness, which at that time was over $40,000 for unremitted source deductions and accrued interest. On April 15, 2009, execution for the amount of the liability was returned unsatisfied because the bailiff determined that the Corporation had no assets. On April 30, 2009, Ms. Madison was assessed for the same amount pursuant to subsection 227.1(1) of the *Income Tax Act*.

[5] Ms. Madison argued in the Tax Court and in this Court that although she was named as a director in documents issued by the Registrar, in fact she was never permitted to exercise the powers of a director, and in particular she had no control or signing authority with respect to the Corporation's money or bank accounts. She argued that, given her powerlessness, she should be held to have met the due diligence test in subsection 227.1(3) because she continually informed and reminded the active directors that the Corporation had unsatisfied source deduction liabilities, which was all she could have done.

[6] Ms. Madison also argued that she ceased to be a director more than two years before the date of the assessment, so that the assessment was issued outside the statutory time limit in subsection 227.1(4) of the *Income Tax Act*. Ms. Madison argued further that she cannot be held liable because the precondition to liability in paragraph 227.1(2)(*b*) was not met.

[7] Ms. Madison asserted in this Court that she was the only person assessed as a director of the Corporation. It was not appropriate for her to make that assertion in these proceedings because the record contains no evidence on the point, and it is not relevant to the determination of her liability. Nevertheless, counsel for the Crown answered Ms. Madison's assertion. He informed the Court that four other directors had been assessed, two for the same amount and two for a lesser amount.

Standard of review

[8] As this is an appeal from a Tax Court judgment after a trial, the standard of review is correctness for questions of law. Findings of fact or mixed law and fact must stand absent palpable and overriding error, or an extricable error of law (*Housen v. Nikolaisen*, [2002] 2 S.C.R. 235).

Exclusion of evidence

[9] Part of Ms. Madison's appeal rests on her allegation that the judge wrongfully refused to admit a certain document as evidence. That document was described by Ms. Madison as follows (transcript of proceedings in the Tax Court, page 50-1):

> … file notes that I took out of a conversation that I had with one of the directors of the company of a telephone call where that director indicated to me that I was voted out as a director of that company. It's dated September 30th of '06.

(As the document was not admitted as evidence it is not included in the appeal book. However, for the purpose of this appeal I am prepared to assume that Ms. Madison's description is accurate.)

[10] Counsel for the Crown objected to the admission of the file notes. The transcript does not disclose the basis of his objection. However, the judge made the following comments about the file notes (transcript, pages 51-3):

> Q. [JUDGE]: See, that is hearsay evidence. Is that person? Is that director here?
>
> A. [MS. MADISON]: No.
>
> Q. Not going to be a witness?
>
> A. No.

Q. You would not be able to put that in because that is hearsay evidence?

A. My file notes are hearsay?

Q. Your file that somebody else said something to you; that is hearsay, yes. Because that person who is supposed to have said that to you is not here.

A. Okay. That's –

Q. How do we know that is correct? I mean, that could have been put in your notes at any time. Or you could have remembered it and put past conversation. I have no idea the circumstances of it. But anyway, you are saying something, it is a statement made by somebody else out of court who is not a witness before the Court, and it comes down to depending on hearsay evidence, the worst kind of evidence?

A. What about, then, could I, Your Honour, ask you, then, what about documents that are signed by other people who were in control of the company?

Q. Well, you have to show them to counsel and see what he says. If there are any document that is an out-of-court statement made by somebody else who is not before the Court offered for the proof of the truth of the statements made therein is hearsay evidence and is not admissible.

Now, if counsel wishes to bend the rule on some of these things, then he is entitled to do so. But you have to show them to him and see what his position is regarding them.

A. Well, CRA has already denied evidence that I have provided in my appeal that showed –

Q. Not interested in what CRA has done. I am giving you the chance now to put in any piece of evidence which is relevant, which is material, and which is not hearsay. Those are the three restrictions I put on any evidence you put – unless counsel will agree to have some of the document [sic] put in, which might offend one of those principals [sic]. But providing he is agreeable to letting them in.

A. Okay.

Q. All right. So if you have something else there you want to put in, you better show them to counsel and see what he says about them. If he objects to them and they are hearsay, I will not let them in?

A. Okay. (Indiscernible).

[11] It is an error of law to exclude evidence solely on the basis that it is hearsay without first considering whether it is necessary and reliable (see *R. v. Khan*, [1990] 2 S.C.R. 531 and *R. v. Smith*, [1992] 2 S.C.R. 915). More importantly in the present context, it is an error of law to exclude hearsay evidence in a Tax Court proceeding conducted under the informal procedure rules without first considering whether it is sufficiently reliable and probative to justify its admission, taking into account the need for a fair and expeditious hearing (*Selmeci v. Canada*, 2002 FCA 293, at paragraph 8).

[12] This approach to evidence in informal proceedings in the Tax Court is mandated by subsection 18.15(3) of the *Tax Court of Canada Act*, R.S.C. 1985, c. T-2, which reads as follows:

18.15 (3) Notwithstanding the provisions of the Act under which the appeal arises, the Court is not bound by any legal or technical rules of evidence in conducting a hearing and the appeal shall be dealt with by the Court as informally and expeditiously as the circumstances and considerations of fairness permit.	**18.15** (3) Par dérogation à la loi habilitante, la Cour n'est pas liée par les règles de preuve lors de l'audition de tels appels; ceux-ci sont entendus d'une manière informelle et le plus rapidement possible, dans la mesure où les circonstances et l'équité le permettent.

[13] Based on Ms. Madison's description of the file notes, it appears to me that they could be relevant to the question of whether Ms. Madison resigned as a director more than two years before

the assessment, which would be a complete defence to the assessment. In that regard, I note that Ms. Madison also gave oral evidence that she had resigned as a director.

[14] The judge refused to admit the file notes as evidence, without looking at them, solely on the basis that they were hearsay. He did not consider whether they were "sufficiently reliable and probative to justify its admission, taking into account the need for a fair and expeditious hearing," as required by *Selmeci*. I conclude that his refusal to admit this document was an error of law. That is a sufficient basis for setting aside the judgment of the Tax Court and returning this matter to the Tax Court for a new hearing before a different judge.

[15] Before leaving the question of documentary evidence, I will comment on Ms. Madison's argument that she was not permitted to present other documents that she says would have proved her resignation. Specifically, she says that she has a letter of resignation effective December 31, 2002, and a publicly available document prepared by the Corporation containing a list of directors as of 2005 or 2006, a list on which her name does not appear. Ms. Madison admits that she did not present these documents as evidence at the Tax Court hearing, but she explains that this was because she had been told by the judge that she could not do so. From a review of the transcript, it appears that the judge did not say that Ms. Madison could not present these documents as evidence. However, it is reasonable to infer that Ms. Madison could have reached that conclusion based on a misinterpretation of some of the judge's comments, although the judge probably was not aware of her misunderstanding. I mention this point only to emphasize that at the new Tax Court hearing, Ms. Madison may present any documentary evidence that is not in the current record, including her

letter of resignation and the Corporation's 2005 or 2006 list of directors. The relevance and admissibility of such documents, if presented, will be determined by the judge at the new hearing.

Legal argument relating to subsection 227.1(2)

[16] Most of Ms. Madison's grounds of appeal will require a determination at the new hearing as to whether and when she ceased to be a director, and whether she has established her entitlement to the due diligence defence. However, Ms. Madison's argument based on subsection 227.1(2) turns on a question of statutory interpretation and involves undisputed facts. Therefore, it is convenient to deal with that issue now so that it need not be considered at the new hearing.

[17] Subsection 227.1(2) shields a director from liability under subsection 227.1(1) unless one of conditions in paragraph 227.1(2)(*a*), (*b*) or (*c*) is met. That provision reads as follows:

227.1 (2) A director is not liable under subsection 227.1(1), unless	**227.1** (2) Un administrateur n'encourt la responsabilité prévue au paragraphe (1) que dans l'un ou l'autre des cas suivants :
(*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;	*a*) un certificat précisant la somme pour laquelle la société est responsable selon ce paragraphe a été enregistré à la Cour fédérale en application de l'article 223 et il y a eu défaut d'exécution totale ou partielle à l'égard de cette somme;
(*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	*b*) la société a engagé des procédures de liquidation ou de dissolution ou elle a fait l'objet d'une dissolution et l'existence de la créance à l'égard de laquelle elle encourt la responsabilité en vertu de ce paragraphe a été établie dans les six mois suivant le premier en date du jour où les

proceedings and the date of dissolution; or	procédures ont été engagées et du jour de la dissolution;
(*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.	*c*) la société a fait une cession ou une ordonnance de faillite a été rendue contre elle en vertu de la *Loi sur la faillite et l'insolvabilité* et l'existence de la créance à l'égard de laquelle elle encourt la responsabilité en vertu de ce paragraphe a été établie dans les six mois suivant la date de la cession ou de l'ordonnance de faillite.

[18] Subsection 227.1(2) is intended to ensure that a director is not held liable for a tax debt of the corporation unless the Crown has taken specified steps on a timely basis to satisfy the debt from the assets of the corporation. In this regard, there are three alternatives – paragraph 227.1(2)(*a*), (*b*) or (*c*). Only one of these can apply in a given case. Which one applies depends on the particular facts: see *Kennedy v. Canada*, [1992] 2 C.T.C. 59 #1, 92 D.T.C. 6380 (F.C.A.), confirming *Kennedy v. Minister of National Revenue*, [1991] 2 C.T.C. 2333, 91 D.T.C. 1037 (T.C.C.). In this case, there is a debate between the parties as to whether the applicable provision is paragraph 227.1(2)(*a*) or paragraph 227.1(2)(*b*).

[19] Ms. Madison argues that paragraph 227.1(2)(*b*) applies because the Corporation was dissolved. As no proof of claim was filed within the permitted six month period for the Corporation's liability for unpaid source deductions, the requirements of paragraph 227.1(2)(*b*) have not been met. The Crown argues that paragraph 227.1(2)(*a*) applies because a Federal Court

certificate was issued for the Corporation's liability for unpaid source deductions, and execution for that amount was returned unsatisfied when the bailiff determined that the Corporation had no assets.

[20] This debate was settled in the *Kennedy* case, cited above. In that case, this Court adopted the decision of Associate Chief Judge Christie that paragraph 227.1(2)(*b*) does not apply where a corporation is dissolved under a procedure that does not require the appointment of a liquidator or the submission of proofs of claim. In my view, *Kennedy* was correctly decided. It follows that Ms. Madison's legal argument based on paragraph 227.1(2)(*b*) cannot succeed.

[21] Ms. Madison placed significant reliance on *Savoy v. Canada*, 2011 TCC 35. The judge in that case was of the view that, despite the decision of this Court in *Kennedy*, it does not matter that no liquidator is appointed in respect of a dissolution by the Registrar because the Crown may prove its claim, as it did in that case, by the registration of a certificate with the Federal Court. In my respectful view, *Savoy* was incorrectly decided on this point and should not be followed. Given the statutory context, the phrase "proof of claim" as used in paragraph 227.1(2)(*b*) refers to a proof of claim in liquidation or dissolution proceedings.

<u>Conclusion</u>

[22] For these reasons, I would allow the appeal with costs, set aside the judgment of the Tax Court, and return this matter to the Tax Court for a new hearing by a different judge. The new hearing is to be conducted under the informal procedure on the basis of the existing record,

augmented by such further oral and documentary evidence as the parties may wish to present and the new judge may allow on the basis of the applicable legal principles.

"K. Sharlow"
J.A.

"I agree
Eleanor R. Dawson J.A."

"I agree
Johanne Trudel J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-177-11

(APPEAL FROM AN ORDER OF JUSTICE MARGESON OF THE TAX COURT OF CANADA DATED APRIL 6, 2011 (2011 TCC 201))

STYLE OF CAUSE:	LEONA MADISON v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Edmonton, Alberta
DATE OF HEARING:	February 14, 2012
REASONS FOR JUDGMENT BY:	SHARLOW J.A.
CONCURRED IN BY:	DAWSON J.A. TRUDEL J.A.
DATED:	March 8, 2012

APPEARANCES:

Leona Madison	FOR THE APPELLANT (SELF-REPRESENTED)
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SOLICITORS OF RECORD:

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