Citation: 2007TCC98
Date: 20070219
Dockets: 2004-4109(IT)G
2004-4110(IT)G
2004-4111(IT)G

BETWEEN:

JEAN-LUC FORTIN,
ROBERTE BOULANGER FORTIN,
FRANÇOIS PROTEAU,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

(Delivered from the bench on November 7, 2006,
at Sherbrooke, Quebec, and modified for greater clarity and precision.)

Archambault J.

[1] Jean-Luc Fortin, François Proteau and Roberte Boulanger Fortin were assessed by the Minister of National Revenue (the "Minister") under section 227.1 of the *Income Tax Act* (the "Act") and section 83 of the *Employment Insurance Act*. They were held jointly and severally liable for source deductions that different companies ("Groupe St-Romain") in which Mr. Fortin held interests failed to remit to the Minister. The Groupe St-Romain companies that Mr. Fortin was a director of are the following: 9025-0481 Québec Inc., Confection St-Romain (1983) Inc. ("Confection SR") and Confection Thetford Inc. ("Confection TD"). François Proteau was a director of Confection SR. Ms. Boulanger Fortin, was a director of 92113 Canada Ltée ("92113").

[2] In the Appellants' notices of appeal, several reasons were cited to challenge the Minister's assessments. At the beginning of the hearing, their counsel indicated to the Court that the only defence that he was using was the one provided for in subsection 227.1(3) of the Act, *i.e.* that his clients had exercised the degree of care, diligence and skill necessary to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

[3] It should be noted that neither Mr. Proteau nor Ms. Boulanger Fortin testified before the Court; they appeared through their counsel, who also represented Mr. Fortin. Only Mr. Fortin and his daughter, Claudia Fortin, testified. Ms. Fortin was involved in the administration of Groupe St-Romain, in particular with regard to the payment of invoices and salaries and collection of accounts receivable.

[4] It should also be noted that the representatives of the National Bank of Canada who provided financing to Groupe St-Romain and who participated in its recovery did not testify, notwithstanding the fact that they had been served with subpoenas. However, these subpoenas had not been served within the time limit prescribed by the Court Rules. One of the representatives in question, whose testimony would have been important, did not receive a subpoena because he had retired from the bank.

[5] The documentary evidence obtained from the bank revealed that the bank had put $1,000,000 in financing at the disposal of Groupe St-Romain for its current operations needs and the acquisition of new equipment (Exhibit A-1, letter of December 7, 2001).

[6] The evidence is rather incomplete as regards the events that occurred between December 7, 2001, and July 8, 2002. According to Mr. Fortin, he expected to obtain the financing offered to enable him to acquire equipment valued at $150,000. He even obtained a verbal authorization from the bank to order part of the equipment, at a cost of $65,000, and have it delivered.

[7] On July 8, 2002, Mr. Fortin learned that some of Groupe St-Romain's cheques were no longer honoured by the bank and that Mr. Lapointe, the person in charge of the account, had been replaced by Gérard Gagner, an assets realization officer. A few days later, *i.e.*, on July 12, 2002, Mr. Gagner informed Groupe St-Romain by letter of the new terms applicable to loans issued by the National Bank (Exhibit A-7). Paragraph 1 of this letter stipulates that the maximum amount authorized under the line of credit [TRANSLATION] "must not exceed $275,000 and must meet the applicable margination conditions, *i.e.* 75% of eligible accounts receivable. The

Borrower must make its best efforts so that in the coming days the excess of $202,371 . . . is reimbursed in order to bring the account within the maximum authorized and maintain it there."

[8] The evidence also did not reveal what could have brought the asset realization officer to declare that if Mr. Fortin had not called on July 7, 2002, he would have proceeded with the liquidation of Groupe St-Romain's assets. The Court must infer from the letter of July 12, 2002, that the line of credit far exceeded what the bank had agreed to advance and that the bank was obviously very concerned, if not panicked, about the recovery of its loans. The letter of July 12, 2002, also mentions that all of the cheques that Groupe St-Romain intended to put into circulation had to receive prior approval from the bank. For this purpose, a list of cheques had to be delivered to the bank at least 24 hours in advance to obtain its written approval. It is stipulated in paragraph 3 of the letter that [TRANSLATION] "there must be no preferential treatment of the Borrower's creditors."

[9] During their testimony, Mr. Fortin and Claudia Fortin said that — contrary to what is indicated in the letter of July 12, 2002 — Mr. Gagner had informed them that it was out of the question to pay the source deductions in arrears and that, as a result other creditors had to be paid in priority. Analysis of Exhibit A-10 reveals that Claudia Fortin was in contact with Mr. Gagner or one of his colleagues starting on July 12, 2002, to obtain authorization to issue the cheques necessary to pay Groupe St-Romain's creditors. It is clearly shown from the analysis of this exhibit that before September 2002, the creditors other than the tax authorities were paid in priority.

[10] Mr. Fortin acknowledged that he had to give preference to certain creditors, *i.e.* those whose products and services were absolutely essential to the continued operation of Groupe St-Romain's business. Ms. Fortin corroborated her father's testimony. When she made the list of people to pay on a priority basis, she wrote [TRANSLATION] "suppliers more urgent than others".[1] It goes without saying, as Ms. Fortin acknowledged, that it was in her interest to pay the creditors that were in regular contact with Groupe St-Romain and that during this period, the Minister was not in this category. On the contrary, he was invisible.

[11] Mr. Fortin described, during his testimony, the steps he took to prevent Groupe St-Romain from failing to meet its obligations to remit the source deductions. He stated that it was his daughter, Claudia, who decided which creditors to pay and that she knew what had to be done. Both of them also knew that the directors of Groupe

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[1] See fax of August 28, 2002, at Exhibit A-10.

St-Romain could be held jointly liable if the group did not remit the source deductions to the tax authorities. However, the evidence does not reveal what specific measures were taken to prevent failure to meet the obligation to remit the source deductions. According to Mr. Fortin, the banker had not allowed the payment of the salaries or the vacation pay of Groupe St-Romain's executives and he had to borrow from his daughter and two of his sisters-in-law to fulfil his obligation to pay them.

[12] Up until Mr. Fortin obtained a financial guarantee of $100,000 from Groupe Ranger for Groupe St-Romain, the source deductions were not paid to the tax authorities. Groupe Ranger, which wanted to sub-contract part of its production to Groupe St-Romain, had the same banker as Groupe St-Romain. Thanks to Groupe Ranger's guarantee, Groupe St-Romain was able to make payments to the tax authorities starting in September 2002, as shown by the fax of September 23, 2002[2].

Submissions of the Appellants

[13] To show that the Appellants exercised the required degree of care and diligence, counsel for the Appellants argued that the National Bank had effectively taken control of Groupe St-Romain's operations and that the Appellants, as directors of this group, were no longer able to control the group's operations. Considering the important role played by the bank, they did everything they could in the circumstances to ensure the payment of the source deductions.

Analysis

[14] At paragraph 26 of *Canada (Attorney General) v. McKinnon*, [2001] 2 F.C. 203, [2001] 1 C.T.C. 79 and [2000] G.S.T.C. 91, the Federal Court of Appeal quoted Robertson J. in *Soper v. Canada*, [1998] 1 F.C. 124 at paragraph 11, where he described the purpose of section 227.1:

> . . . Non-remittance of taxes withheld on behalf of a third party was likewise not uncommon during the recession. Faced with a choice between remitting such amounts to the Crown or drawing on such amounts to pay key creditors whose goods or services were necessary to the continued operation of the business, corporate directors often followed the latter course. Such patent abuse and mismanagement on the part of directors constituted the "mischief" at which section 227.1 was directed . . .

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[2] Exhibit A-10. This is also shown by several other faxes, i.e. those of September 30, 2002, October 10, 2002, October 11, 2002, October 15, 2002, October 31, 2002, and November 12, 2002.

[Emphasis added.]

[15] If one examines all of the case law pertaining to section 227.1 of the Act, it can be seen that generally noted that the courts have held that it was applicable when a taxpayer had attempted to save a business by favouring certain creditors rather than remitting source deductions and tax collected to the tax authorities. I believe that section 227.1 is indeed directed at the type of situation in which directors decide to pay the salaries of employees that they find essential to the operation of the business, but only pay the portion of the salaries payable to the employees, omitting to remit the source deductions portion to the tax authorities. In effect, they are "borrowing" from the tax authorities to pay the business's other creditors. When directors have authorized such conduct and have not taken the necessary measures to prevent it — despite having acted in good faith to save a business and the jobs of a good number of employees — and this approach fails, this attracts the application of subsection 227.1(1) of the Act, unfortunately for the directors, and they must be held liable for this "loan."

[16] It is clear that the Act is not intended to make all directors liable for source deductions that are not remitted by the corporation they represent. If a director has acted with the degree of care and diligence required to avoid failure to meet the obligation to remit the source deductions, he or she can avoid the application of subsection 227.1(1) of the Act. For example, an external director who had enquired as to the reasonable measures put in place to pay the source deductions and to whom it had been affirmed that everything had been taken care of — when in fact this was not the case — would not be held liable for the source deductions.

[17] Furthermore, in cases where a third party takes control of the business's operations and the directors cease to have effective control of these operations, it is obvious that a director could not be held liable for the subsequent failure of the business to remit the source deductions, since he or she is no longer able to influence the conduct of the business at fault.

[18] Here, for several reasons, I arrive at the conclusion that the subsection 227.1(3) defence has not been convincingly established. The first reason is that it was not shown that the National Bank had taken control of Groupe St-Romain's operations or that it was the only one able to decide who was paid and who wasn't. The evidence does not even show that the bank had the right to take possession of the group's assets. The National Bank's guarantee certificates were not offered in evidence. The Court cannot determine what rights the bank was able to exercise. All that the bank did was inform Jean-Luc Fortin that it was about to

demand the group's liquidation and that it would have done so if Mr. Fortin had not contacted it on July 7, 2002.

[19] As argued by counsel for the Respondent, the evidence is not sufficient to indicate that the directors of Groupe St-Romain effectively lost control of the group's operations. The Court is also disconcerted by the testimony of Mr. Fortin and his daughter, according to which the bank acted contrary to what is indicated in paragraph 3 of the letter of July 12, 2002. In this letter, it was stipulated that there was to be no preferential treatment of creditors. It is possible that the bank did not comply with its own directive. However, it certainly would have been useful, if not necessary, to have the Mr. Fortin's testimony corroborated by that of the bank's representatives, in particular Mr. Gagner, to contradict the letter.

[20] Nonetheless, I hasten to add that, even if that had been proved, I would have had trouble distinguishing the conduct of a creditor like the bank, which wants the recovery of its loans to take priority over the remittance of source deductions and which puts enormous pressure on its debtor, from that of another important creditor of Groupe St-Romain, which supplies all the fabrics necessary for the manufacturing of garments. In both cases, the creditor pressures the debtor to act according to the former's interest, to the detriment of the tax authorities. In those circumstances there is a sort of *de facto* control by the creditors of the conduct of the debtor in financial difficulty. However, the situation would have been very different if the bank had taken legal control of the operations, specifically by naming a receiver.

[21] I do not see any reason to hold that, if the base materials supplier had had such an influence, the directors were liable, but not if it had been the bank exercising its influence to have its loans reimbursed before the remittance of the source deductions.

[22] In my opinion, that would be contrary to the purpose of section 227.1 of the Act, *i.e.* to protect the tax authorities when directors, like Mr. Fortin, allow a business to use sums that belong to the tax authorities to give preference to other creditors of the business.

[23] I have no doubt that Mr. Fortin acted in good faith. He acted like any other businessman who has worked hard to build his business. He helped create 250 jobs that allowed men and women to meet the needs of their families. I don't think the Act necessarily forces taxpayers to declare bankruptcy, but it was certainly one possible way of avoiding the Appellants' liability. If a director who has invested large sums in

his business, like Mr. Fortin had, takes the risk of borrowing money from the tax authorities to finance this business in the hope of bringing about its recovery and, unfortunately, fails, the Court has no other choice than to apply the Act. It saddens me that Mr. Fortin lost enormous amounts of money in Groupe St-Romain and that he is now liable for the source deductions, but such is the legal system in which businesses function in Canada.

[24] With regard to Ms. Fortin, the evidence shows that she was the wife of Mr. Fortin. Although she was the director of 92113, she was not involved in the management of the company. Her work was to control the quality of production in the company's workshops. Unfortunately, the evidence did not show that Ms. Fortin had taken any measures at all to keep 92113 from failing to meet its duty to remit the source deductions.

[25] On page three of his "amended" notice of appeal, counsel for Mr. Proteau states:

> [TRANSLATION]
>
> The Appellant assigned his interests in the previously mentioned company several years ago to Jean-Luc Fortin and/or companies controlled by him.
>
> Concomitantly with the assignment described in the preceding paragraph, the Appellant resigned from his position as director.

Mr. Proteau did not personally appear before the Court and evidence offered at the hearing did not destroy the Respondent's assumption of fact, according to which Mr. Proteau was the director of Confection SR. It appears rather that Mr. Proteau omitted to resign; yet resignation would have released him of all liability.

[26] From a legal point of view, Mr. Proteau was still a director of Confection SR and, as a result, also had a duty, even after the alleged sale of his interests, to act with a degree of diligence to prevent the failure to meet the obligation to remit the source deductions to the Minister. Since the evidence is insufficient as to the actions taken to that end, I have no choice but to hold that he did not succeed in demonstrating that the Minister's assessment was groundless.

[27] For all of these reasons, the appeals of the three Appellants are dismissed. Out of compassion, given the predicament that the Appellants find themselves in, I will not grant costs to the Minister.

Signed at Ottawa, Canada, this 19th day of February 2007.

"Pierre Archambault"

Archambault J.

Translation certified true
on this 29th day of January 2008.

François Brunet, Revisor

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COURT FILE NUMBERS:	2004-4109(IT)G, 2004-4110(IT)G and 2004-4111(IT)G
STYLES OF CAUSE:	JEAN-LUC FORTIN v. THE QUEEN ROBERTE BOULANGER FORTIN v. THE QUEEN and FRANÇOIS PROTEAU v. THE QUEEN
PLACE OF HEARING:	Sherbrooke, Quebec
DATE OF HEARING:	November 7, 2006
REASONS FOR JUDGMENT BY:	The Hon. Justice Pierre Archambault
DATE OF JUDGMENT:	November 16, 2006
DECISION DELIVERED ORALLY:	November 7, 2006
REASONS FOR JUDGMENT:	February 19, 2007

APPEARANCES:

Counsel for the Appellants:	Robert Jodoin
Counsel for the Respondent:	Natalie Goulard

COUNSEL OF RECORD:

For the Appellants:

Name:	Robert Jodoin
Firm:	Jodoin Huppé, S.E.N.C. Granby, Quebec

For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada