Docket: 2008-41(GST)I

BETWEEN:

LOUISE ST-YVES,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on September 22, 2008, at Ottawa, Ontario

Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the Appellant:	Chantal Donaldson
Counsel for the Respondent:	Martine Bergeron

JUDGMENT

The appeal from the assessment made under the *Excise Tax Act,* notice of which bears the number PH2005-37 and is dated October 19, 2005, for the period from August 26, 2004, to October 31, 2004, is dismissed.

Signed at Montréal, Quebec, this 3rd day of October 2008.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 6th day of January 2009.

Brian McCordick, Translator

Citation: 2008 TCC 549
Date: 20081003
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Appellant,

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REASONS FOR JUDGMENT

Lamarre J.

[1] This is an appeal from an assessment made by the Minister of National Revenue ("the Minister") under subsection 323(1) of the *Excise Tax Act* ("ETA") claiming payment of $4,470.47 from the Appellant, that being the amount of net tax (with interest and penalties added) that should have been paid by 4253728 Canada Inc. ("4253") on November 30, 2004, under subsection 228(2) of the ETA, in relation to supplies made during the period from August 26, 2004, to October 31, 2004 (Exhibit A-1, tab R-1).

[2] The statutory provisions in question read as follows:

> **228(2) Remittance** – Where the net tax for a reporting period of a person is a positive amount, the person shall, except where subsection (2.1) or (2.3) applies in respect of the reporting period, remit that amount to the Receiver General,
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> (*a*) where the person is an individual to whom subparagraph 238(1)(*a*)(ii) applies in respect of the reporting period, on or before April 30 of the year following the end of the reporting period; and
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> (*b*) in any other case, on or before the day on or before which the return for that period is required to be filed.

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 − 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.

(4) Assessment − The Minister may assess any person for any amount payable by the person under this section and, where the Minister sends a notice of assessment, sections 296 to 311 apply, with such modifications as the circumstances require.

(5) Time limit − An assessment under subsection (4) of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person last ceased to be a director of the corporation.

(6) Amount recoverable − Where execution referred to in paragraph (2)(*a*) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

(7) Preference − Where a director of a corporation pays an amount in respect of a corporation's liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that

> Her Majesty in right of Canada would have been entitled to had the amount not been so paid and, where a certificate that relates to the amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is empowered to make.
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> **(8) Contribution** − A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

[3] During the period in issue, the Appellant was a director of 4253. She relies on subsection 323(3) to claim an exemption from her solidary liability, arguing that she exercised the degree of care, diligence and skill to prevent the failure by 4253 to pay the net tax that a reasonably prudent person would have exercised in comparable circumstances. More specifically, the Appellant argued that she had lost control of the corporation's accounts receivable, with the result that she was then unable to ensure that the corporation paid the net tax.

[4] The Minister determined the amount of net tax as reported by the Appellant in the return she completed for the period from August 26, 2004, to October 31, 2004, to be $4,150.14 (Exhibit A-1, tab R-22) in addition to $91.60 in interest and a $228.73 penalty (Exhibit A-1, tab R-1). According to Stéphane Michaud, the auditor in this case, the return was filed with the Ministère du Revenu du Québec (MRQ) on March 22, 2005, although it should have been filed on November 30, 2004. No payment was made in connection with the amount reported on the form. According to Mr. Michaud, it appears that the return was sent just after the MRQ sent the Appellant a request for a deposit to be paid six months in advance.

Facts

[5] The corporation, 4253, was incorporated on August 26, 2004. At that time, the Appellant and her spouse, Gilles Desmarais, were both shareholders and directors of the corporation, which operated a bricklaying business under the name Maçonnerie Habitation Desmarais (Exhibit I-1). Mr. Desmarais had worked in that field for several years, and had his own company since 2002, which did both commercial and residential work under the name Construction Desmarais. In the spring of 2004, Mr. Desmarais started having problems with the Commission de la santé et de la sécurité du travail du Québec (CSST) and the Commission de la construction du Québec (CCQ). Apparently he was not in compliance with certain standards imposed in Quebec for construction sites. He was fined several thousand dollars (close to $100,000, if I understood correctly) for a number of infractions. His licence as a commercial contractor was taken away. He stopped operating his business, Construction Desmarais, in August 2004. That was when he and the Appellant

incorporated the new company, 4253, which was to operate the business under the name Maçonnerie Habitation Desmarais, so that the contracts already taken on by the former business could be continued by a new entity. One example is the contract awarded by Brigil Construction for phase II of Place Champlain in the Hull sector of Gatineau, first to Construction Desmarais, and then taken over by Maçonnerie Habitation Desmarais on August 30, 2004, for which Brigil Construction was required to pay the $8,937 owed by Desmarais' two companies to the CSST and the $5,950 owed to the CCQ (Exhibit A-1, tabs R-4, R-52, R-53, R-54 and R-55).

[6] The Appellant explained that she had worked in hospital administration for some 15 years. She saw this new project as a challenge. She was familiar with requirements relating to payment of the goods and services tax (GST) and the Quebec sales tax (QST) and felt comfortable with completing the necessary forms. She knew that her spouse had had problems with the CCQ and the CSST and that as a result his previous business had problems getting paid for work done under contracts. Under the *Act respecting labour relations, vocational training and workforce management in the construction industry* ("LRA") and the *Act respecting industrial accidents and occupational diseases* ("IAA"), the entity for which work is done may be held solidarily liable for any amount owing to the CCQ and the CSST by suppliers. Some of Construction Desmarais' customers had received demands for payment in the past for amounts owing by it to those agencies and to the MRQ for tax debts amounting to $350,000 under the *Act respecting the ministère du Revenu du Québec* and $114,000 under the ETA (Exhibit A-1, tabs R-37 to R-39, R-41 and R-42). As well, instead of paying accounts payable to Construction Desmarais, customers paid directly to the CCQ and CSST to cover amounts owing by the company. Some customers, fearing other retaliatory action, withheld the balance owing to Construction Desmarais so as not to have to pay twice.

[7] The Appellant was not aware of the exact extent of Construction Desmarais' debts, but was familiar with its financial problems, and agreed to start up the new business because she believed in its potential and wanted to start fresh. She very quickly realized that customers were no longer making payments. Maçonnerie Habitation Desmarais started paying its employees at the beginning of September 2004 and by October, accounts receivable were piling up, since the customers were holding back all payments, knowing that it was Mr. Desmarais who was operating the new business and that he had not resolved all his problems with the CSST and the CCQ.

[8] On November 2, 2004, 4253 filed an amending statement with the Registraire des entreprises to remove Mr. Desmarais as shareholder and director, leaving the

Appellant as the only one in the corporation (Exhibit I-2) – to no avail; the Appellant said that customers were still not paying their accounts. However, $55,000 was paid in October 2004 and 4253 was also paid about $35,000 in November 2004 by one of its big customers, Les Entreprises Laurent Labrie (Exhibit A-1, tab R-49). In spite of this, there was still about $119,000 in accounts receivable on the corporation's books on July 31, 2005 (the balance sheet was prepared as at that date, but the corporation went out of business on December 11, 2004, Exhibit A-1, tabs R-5, R-12 and R-17).

[9] The Appellant said she had made paying employees' wages her priority, but she had been unable to remit source deductions to the government starting in October 2004 (Exhibit R-23), or make GST and QST remittances for the period in issue (Exhibit R-22). An action brought by the CCQ against the Appellant and one of the customers (Entreprises Laurent Labrie) indicates that the Appellant had also failed to pay wages and other amounts owing to employees for work performed between September 26, 2004, and November 27, 2004 (Exhibit A-1, tab R-45). Chantal Parisien of the CCQ also confirmed that an investigation had begun and that complaints had been filed by employees of 4253 regarding non-payment of their wages. The Appellant and her husband, seeing that there was no way out, shut down the business in December 2004. The new business was thus in operation for only a little more than three months.

[10] The Appellant introduced a series of documents to show that the CSST and the CCQ had arranged things to have payment priority over the other creditors. The customers were afraid they would be held solidarily liable, under the LRA and the IAA, and withheld the money owing to 4253. The Appellant said that she asked both the CCQ and the CSST to provide the certificates of compliance required by the legislation governing the construction industry, so that the company could get paid by its creditors. Some reports entered in evidence indicate that as of October 2004, monthly reports were filed but the corresponding amounts were not paid (see, for example, the CCQ report dated December 9, 2004, Exhibit A-1, tab R-18). The customers therefore withheld the amounts owing, and did not want to give 4253 more contracts.

[11] The Appellant stated that there was nothing more she could do. Given the customers' attitude, there was less money in the bank accounts, and no longer enough to pay the government. In fact, it was the government itself, in the form of the CCQ and the CSST, that gave itself preference to recover the money owing to it, based on section 54 of the LRA and section 316 of the IAA. Those sections read as follows:

Act respecting labour relations, vocational training and workforce management in the construction industry (LRA)

Wages.

54. The wages due by a sub-contractor constitute a solidary obligation between the sub-contractor and the contractor with whom he has contracted, and between the sub-contractor, the sub-contractor with whom he has contracted, the contractor and every intermediary sub-contractor.

Extinction of solidary obligation.

Where the employer holds the appropriate licence issued under the Building Act (chapter B-1.1), such solidary obligation is extinguished six months after the end of the work carried out by the employer, unless the employee concerned filed a complaint with the Commission concerning his wages, a civil action was brought, or a claim was sent by the Commission pursuant to the third paragraph of subsection 1 of section 122 before the expiry of the six-month period.

Solidary obligation.

Such solidary obligation extends to the client having contracted, directly or through an intermediary, with a contractor who does not hold the appropriate licence issued under the Building Act, in respect of the wages due by the contractor and each of his sub-contractors.

Act respecting industrial accidents and occupational diseases (IAA)

316. The Commission may demand payment of the assessment due by a contractor from the employer who retains his services.

Computation.

In the case of the first paragraph, the Commission may establish the amount of the assessment according to the proportion of the price agreed upon for the work corresponding to the cost of labour, rather than the wages indicated in the statement made according to section 292.

Reimbursement.

The employer who has paid the amount of the assessment is entitled to be reimbursed by the contractor concerned and the employer may retain the amount due out of the sums that he owes the contractor.

[12] The Appellant submits that it is because of that branch of the government that 4253 was unable to pay the GST under the ETA. It was the government itself that forced the company to default on its payments.

[13] The Respondent replied that the Appellant did not inform the MRQ of her problems. The Appellant did not try to borrow, knowing that she had accounts receivable. On sales of about $395,000, she paid other suppliers and her employees in preference to remitting the net taxes owing to the government, as indicated by 4253's financial statements for the period from September 1, 2004, to July 31, 2005 (Exhibit A-1, tab R-5). The Respondent further submitted that the net tax must be collected when the services are performed and retained to be paid to the government when the return for the period is filed (in this case, on November 30, 2006), not when accounts receivable are collected by the company. The Appellant's argument therefore cannot be accepted.

Analysis

[14] Directors' liability has been considered in several decisions. In *Soper v. Canada*, [1998] 1 F.C. 124, 1997, the Federal Court of Appeal stated, at paragraphs 53 and 56:

> [53] In my view, the positive duty to act arises where a director obtains information, or becomes aware of facts, which might lead one to conclude that there is, or could reasonably be, a potential problem with remittances. Put differently, it is indeed incumbent upon an outside director to take positive steps if he or she knew, or ought to have known, that the corporation could be experiencing a remittance problem. The typical situation in which a director is, or ought to have been, apprised of the possibility of such a problem is where the company is having financial difficulties.
>
> …
>
> [56] It is important to note that whether a company is in serious financial difficulty, such as to suggest a problem with remittances, cannot be determined simply by the fact that the monthly balance sheet bears a negative figure. For example, many firms operate on a line of credit to deal with fiscal fluctuations. In each case it will be for the Tax Court Judge to determine whether, based on the financial information or documentation available to the director, the latter ought to have known that there was a problem or potential problem with remittances. Whether the standard of care has been met, now that it has been defined, is thus

> predominantly a question of fact to be resolved in light of the personal knowledge and experience of the director at issue.

[15] Thus the standard of care described in the due diligence defence for a director, under the ETA, depends on the facts of each case, having regard to objective and subjective factors.

[16] In *Smith v. Canada*, [2001] F.C.J. No. 448 (QL), 2001 FCA 84, the Court added, at paragraphs 10 and 14:

> [10] The subjective aspect of the standard of care applicable to a particular director will depend on the director's personal attributes, including knowledge and experience. Generally, a person who is experienced in business and financial matters is likely to be held to a higher standard than a person with no business acumen or experience whose presence on the board of directors reflects nothing more, for example, than a family connection. However, the due diligence defence probably will not assist a director who is oblivious to the statutory obligations of directors, or who ignores a problem that was apparent to the director or should have been apparent to a reasonably prudent person in comparable circumstances (*Hanson v. Canada* 2000 CanLII 16336 (F.C.A.), (2000) 260 N.R. 79, [2000] 4 C.T.C. 215, 2000 D.T.C. 6564 (F.C.A.)).
>
> …
>
> [14] In certain circumstances, the fact that a corporation is in financial difficulty, and thus may be subject to a greater risk of default in tax remittances than other corporations, may be a factor that raises the standard of care. For example, a director who is aware of the corporation's financial difficulty and who deliberately decides to finance the corporation's operations with unremitted source deductions may be unable to rely on the due diligence defence (*Ruffo v. Canada*, 2000 D.T.C. 6317 (F.C.A.)). In every case, however, it is important to bear in mind that the standard is reasonableness, not perfection.

[17] In *Canada v. McKinnon*, [2001] 2 F.C. 203, the Federal Court of Appeal also stated:

> [34] However, whether the directors thereby did enough to exempt themselves from liability for the unremitted source deductions and GST will depend, in part at least, on the fourth principle to be found in the case law: the due diligence required of company directors by subsection 227.1(3) is to prevent the failure to remit. This has been held to mean that, if directors become liable *prima facie* for a company's failure to remit, they normally cannot claim the benefit of subsection 227.1(3) if their efforts were capable only of enabling them to remedy defaults after they had occurred. Accordingly, of the measures taken in an attempt to rescue Abel, those

> most relevant to this inquiry are limited to the ones that were logically capable of preventing failures to remit the source deductions and GST when they became due.
>
> [35] … Most recently, writing for this Court in *Ruffo v. M.N.R.* (2000), 2000 DTC 6317, Létourneau J.A. said (at paragraph 6):
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>> The appellant's duty as a director was to anticipate and prevent the failure to pay the sums owing and not to commit such failure or perpetuate it as he did from March 1992 in the hope that at the end of the day the firm would again become profitable or there would be enough money, even if it were wound up, to pay all the creditors.
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> …
>
> [39] Sixth, a director who has lost legal control over the company, on the appointment of a receiver-manager for instance, is not liable to Revenue Canada for company debts that are incurred subsequently. Some cases have extended this principle to situations where directors have lost *de facto* control over the company's finances to another, typically its bank. Non-liability in these situations has been explained both on the ground that the charging provision, subsection 227.1(1), assumes that the directors were able freely to choose whether the company remitted its payroll deductions, and because directors who lacked the necessary control over the company's finances could not be said to have failed to show "due diligence".

[18] In this case, the Appellant was very aware of the financial problems being experienced by Construction Desmarais, which was operated by her spouse until August 2004. The evidence showed that she agreed to incorporate a new company with her spouse, in order to continue, at least in part, the contracts initially entered into by Construction Desmarais. Although this was a separate corporate entity, the customers were perfectly aware that Mr. Desmarais was trying to continue his business by leaving the financial quagmire created by Construction Desmarais behind. The Appellant is not unintelligent, and knew what she was doing. She had solid experience in administration, and was quite familiar with the mechanism for paying GST and QST. During the short operational life of 4253, she conscientiously completed the forms and submitted them to the government. The only problem is that she did not send the amounts owing with the reports.

[19] The Appellant clearly said that she gave priority to paying employees with the funds available in 4253, and the company's financial statements show that other expenses were also paid so the business could continue to operate. The financial statements and the evidence also showed that 4253 had revenue during the short period the business was in operation. There was therefore a difficult but deliberate

choice made, not to remit the GST. Counsel for the Appellant argued that the Appellant no longer had control over the accounts receivable, and that the Government of Quebec had paid itself, through the CCQ and the CSST, in preference to the other creditors. When 4253 was incorporated, the Appellant was aware of the preferences that provincial legislation governing construction in Quebec assigned to those two bodies. When she agreed to continue operating her spouse's business through the new company, she therefore did so at her own risk and peril.

[20] In my opinion, the Appellant cannot claim due diligence to avoid her solidary obligation under section 323 of the ETA. I do not agree with the Appellant that she had lost control of 4253's finances. She still had authority to sign cheques, and apart from requesting the certificates of compliance to try to compel customers to pay, she took no other steps to ensure that remittances were made to the government. She had to have been perfectly aware of the risk to which she was exposing herself from the outset, and she must now bear the consequences. She has not proved, on a balance of probabilities, that she exercised due diligence within the meaning of subsection 323(3) of the ETA.

[21] The appeal is dismissed.

Signed at Montréal, Quebec, this 3rd day of October 2008.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 6th day of January 2009.

Brian McCordick, Translator

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