Dockets: 2009-358(GST)I
2009-1443(IT)I

BETWEEN:

GARY USTEL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on May 14, 2010 at Toronto, Ontario.

Before: The Honourable Justice Robert J. Hogan

Appearances:

Agent for the Appellant:	Alex Samardzich
Counsel for the Respondent:	Darren Prevost

JUDGMENT

The appeal from the assessment made under the *Excise Tax Act*, the notice of which is dated February 22, 2008, is dismissed without costs.

The appeal from the assessment made under section 160 of the *Income Tax Act*, which is dated June 16, 2008, is allowed in part, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached reasons for judgment.

Signed at Toronto, Ontario, this 26th day of August 2010.

"Robert J. Hogan"

Hogan J.

Citation: 2010 TCC 444
Date: 20100826
Docket: 2009-358(GST)I

BETWEEN:

GARY USTEL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

AND

Docket: 2009-1443(IT)I

GARY USTEL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Hogan J.

Introduction

[1] The Minister of National Revenue (the "Minister") assessed Gary Ustel (the "Appellant") under section 323 of the Canada *Excise Tax Act* (the "*ETA*") for unremitted goods and services tax ("GST") plus interest and penalties relating thereto (the "GST assessment") owed by Peachtree Gallery Art and Frame Shop Inc. (the "Corporation"). In support of the GST assessment, the Minister alleges that the

Appellant was either a *de jure* or a *de facto* director of the Corporation at the time of the assessment or at some point during the 24-month period preceding the assessment dated February 22, 2008 (the "Relevant Period"). In addition, the Minister assessed the Appellant under subsection 160(2) of the Federal *Income Tax Act* (the "*ITA*") for income tax, penalties and interest owed by the Corporation (the "*ITA* assessment"). In support of the *ITA* assessment, the Minister alleges that, at a time when the Corporation had unpaid income taxes under the *ITA*, the Appellant received dividends aggregating $85,000 on shares that he held in the Corporation. The appeals from the GST assessment and the *ITA* assessment were heard on common evidence.

[2] In his appeal with respect to the GST assessment, the Appellant argues that at no time during the Relevant Period was he a *de jure* director of the Corporation nor did he act as a *de facto* director of the Corporation. With respect to his appeal from the *ITA* assessment, the Appellant alleges that he received only income with respect to services rendered to the Corporation. According to the Appellant, the Corporation's external auditor, Mr. MacDonald, reported incorrectly that the Appellant had received dividends on the shares that he held in the Corporation.

Factual Background

[3] The Corporation was incorporated in the province of Ontario under the *Ontario Business Corporations Act* (the "*OBCA*") on September 25, 1991 for the purpose of owning and operating a retail business selling prints and providing picture-framing services (the "business"). The business was started by the Appellant and two close personal and family friends, Mr. and Mrs. Pacheco. The evidence shows that the Appellant had prior experience in the sale of picture frames and printed art work and in the operation of such a business. Mr. Pacheco purchased 50% of the common shares of the Corporation for $100,000. The Appellant acquired 50% of the common shares of the Corporation in consideration of the skills that he brought to the operation of the business.

[4] The Appellant and his wife and Mr. Pacheco and his wife were named directors of the Corporation following its incorporation. At the same time, the Appellant became the president of the Corporation and Mr. Pacheco became its secretary.

[5] The evidence shows that in the early years following the incorporation the Appellant handled sales and performed administrative and financial duties for the business. Mrs. Pacheco also handled sales and carried out administrative duties.

Mr. Pacheco worked in the back of the store as a manual worker assembling picture frames and mounting art work.

[6] The Appellant testified that in the late 1990's the business faced stiff competition from big box stores such as Walmart, Rona and Home Depot, and it quickly encountered financial difficulties. Mr. Pacheco was required to invest an additional $35,000 to cover mounting losses.

[7] Mr. Pacheco, testifying at trial, corroborated the Appellant's explanation of the circumstances that led to the financial deterioration of the business. He added an additional factor that was not mentioned by the Appellant. According to Mr. Pacheco, the Appellant owned a Harley Davidson motorcycle (the "Harley") that he was fond of riding. Sometime in 1999, the Harley was stolen from the parking lot located at the front of the store. According to Mr. Pacheco, the Appellant's behaviour quickly changed after he had become the victim of that criminal act. He was frequently absent from work, and when he was there he would often refuse to meet with clients. Mr. Pacheco believed that the Appellant was suffering from severe depression. The Appellant's and the Pachecos' relationship deteriorated with the downturn in the business. The Appellant testified that it became obvious that Mr. and Mrs. Pacheco and he could no longer work together.

[8] The Appellant alleges that he met with Anna Pacheco on May 6, 2002 and gave her a copy of a letter signed by him wherein he tendered his resignation as a director and officer of the Corporation effective May 30, 2002. The Appellant explained that he then informed Mr. MacDonald, the external auditor who looked after the Corporation's books and records and filed its tax returns, of his decision to leave the management and administration of the business to Mrs. Pacheco. On June 1, 2002, Mr. MacDonald's staff filed Form 1 with the Minister of Consumer and Business Services, removing the Appellant's wife as a director (she was not an officer), removing the Appellant as president and removing Mr. Pacheco from the positions of secretary and director. The Appellant alleges that Mr. MacDonald inadvertently failed to remove him as a director because he had entrusted the work to a junior staff member. The Appellant also alleges that Mr. MacDonald made numerous other errors in looking after the minute books and filing the tax returns of the Corporation. He believed that Mr. Pacheco and his wife and he himself were paid salaries and wages for the services they rendered in the business and that Mr. MacDonald took it upon himself to report these wages as dividends paid to the co-shareholders. He claims that he did not understand the tax-filing method adopted by Mr. MacDonald, but trusted him to get it right.

[9] At trial, Mr. Pacheco made a similar comment during his testimony with respect to the tax filings of the Corporation. According to Mr. Pacheco, he and the Appellant each earned $500 a week for their work in the business. Mr. Pacheco and his wife Anna would receive $250 each per week when they both worked in the business. His wife was not a shareholder in the Corporation, therefore she could not receive a dividend.

[10] The Appellant produced corroborating documentary evidence supporting his claim that he resigned as a director of the Corporation effective May 30, 2002. On July 8, 2002, a short time after the Appellant's resignation as a director became effective (May 30), Mrs. Pacheco applied for a new business account − with electronic banking access and a small business overdraft facility − with the CIBC branch in Oakville. The documents pertaining thereto were introduced as Exhibit A-3. The electronic banking application indicates that Mrs. Pacheco was the sole person authorized to have access to the corporate account. The overdraft application indicates that Mrs. Pacheco's ownership interest in the Corporation was 100%.

[11] The agent for the Appellant called Mr. and Mrs. Pacheco as witnesses. He did so with great reluctance as it appears that the Canada Revenue Agency ("CRA") has issued a similar GST assessment against Mrs. Pacheco and an income tax assessment based on subsection 160(2) against Mr. Pacheco. At trial, Mrs. Pacheco's demeanour suggested that she was well aware of the fact that it was in her best interest to claim that the Appellant remained a director of the Corporation during the Relevant Period. At times she claimed that she did not recall receiving the Appellant's resignation letter. Yet she appeared to acknowledge that she did sign the banking documents that gave her sole authority over the banking affairs of the Corporation following the Appellant's resignation. Mr. Pacheco's testimony on the mental state of the Appellant and his apparent lack of interest in the business buttresses the Appellant's claim that he resigned as a director on May 30, 2002. Finally, the Respondent's counsel admitted that he received a copy of the Appellant's resignation letter from Mr. MacDonald's accounting firm. The fact that Mr. MacDonald's firm had the letter suggests to me that the Appellant did formally resign as a director and that Mr. MacDonald should have been aware of that fact.

Analysis: GST Assessment

[12] The *ETA* does not define when a person ceases to be a director. As the Corporation was incorporated under the *OBCA*, the provisions of that statute are relevant in determining when the Appellant ceased to be a director of the

Corporation. Subsection 121(2) of the *OBCA* provides that a resignation of a director becomes effective at the time a written resignation is received by the corporation or at the time specified in the resignation, whichever is later. In light of the evidence noted above, the Appellant has established on a balance of probabilities that he did formally resign in writing in a letter that was received by another officer of the Corporation. As a result, he ceased to be a *de jure* director of the Corporation on May 30, 2002.

[13] This brings me to a consideration of the Respondent's alternative argument that the Appellant remained a *de facto* director of the Corporation during the Relevant Period because his conduct was similar to the conduct of a person who was qualified to act as a director of the Corporation. The Respondent points out that the Appellant acknowledges that he signed the 2002 and 2003 tax returns of the Corporation. The Appellant is described as a director of the Corporation next to the signature line on those tax returns. The Respondent argues that this conduct coupled with the fact that the Appellant was not removed as a director in the Corporation's official record created a *bona fide* belief on the part of the Minister and his delegates that the Appellant was a director of the Corporation. According to the Respondent, it was incumbent upon the Appellant to dispel this belief after displaying conduct which would have led a reasonable person to believe he was a properly qualified director of the Corporation. He should therefore be barred from raising as a defence to the assessment the argument that he was not a legally qualified director during the Relevant Period.

[14] I accept the Appellant's submission that the failure of the Corporation to register with the competent authorities any change regarding the directors is not fatal to his claim that he resigned as a director.[1] However, it is a well-established principle of Canadian law that one cannot avoid liability for actions purported to have been carried out by one as a director by arguing that one was not legally qualified to act in that capacity.[2] The Appellant complains that it is entirely Mr. MacDonald's fault that he signed the Corporation's 2002 and 2003 tax returns filed with the CRA and that next to the signature line on those returns it is stated that he was a director of the Corporation.

[15] The Appellant admitted that he resigned as a director, *inter alia*, to limit his liability for the Corporation's unpaid tax liabilities. It is true that it was not entirely within the Appellant's powers to ensure that the Corporation duly filed a notice

---

[1] *Netupsky v. Canada*, [2003] G.S.T.C. 15, [2003] T.C.J. No. 30 (Q.L), and *Miklosi Estate v. Canada*, [2004] G.S.T.C. 67, [2004] T.C.J. No. 213 (Q.L.).
[2] *Wheeliker v. Canada*, 99 DTC 5658, [1999] 2 C.T.C. 395, [1999] F.C.J. No. 401 (Q.L.).

confirming his resignation with the competent provincial authority. That is one thing; however, it is entirely another thing to sign a tax return on the same line that states your position to be that of director. The Appellant should have read what he was signing, and to the extent that his position with the Corporation had changed, he should have pointed it out to Mr. MacDonald so that he could have the change registered.

[16] The above finding, however, does not dispose of this matter. The Appellant signed the 2002 and 2003 tax returns on July 31, 2003 and September 14, 2004 respectively. The GST assessment was issued on February 22, 2008, more than two years after the second of those two tax returns was signed. The argument can therefore be made that the taxpayer ceased to act as a *de facto* director on or about September 14, 2004.

[17] In my opinion, the evidence in the record does not support such a contention. The Appellant admitted that he remained active in the actual operation of the business after he resigned. At no time prior to the issuance of the GST assessment did the Appellant take any steps to advise the CRA that he had ceased to be a director of the Corporation. The evidence shows that the Appellant's son and a business partner operated a similar business under the Peachtree name (the second Peachtree business). The Corporation ceased operating its business in late 2004 or thereabouts. However, the Corporation itself remains in existence today. No steps have been taken by the shareholders to dissolve it.

[18] It would make a mockery of the indoor management rule to allow the Appellant to escape liability under section 323 of the *ETA* when the evidence shows that he did not take proactive steps to ensure that his resignation was publicized in the corporate records and that he continued to hold himself out as a director by signing the Corporation's tax returns in his alleged capacity as director. It would be inappropriate to accept that the onus should fall upon the CRA to verify whether the taxpayer may have secretly resigned or to enquire on a continuing basis into whether the taxpayer's conduct is indicative of the fact that the situation may now have changed. In my opinion, the onus to adopt appropriate conduct and to prove that he was not a director fell squarely on the Appellant's shoulders.

[19] It was incumbent upon the Appellant to establish on a balance of probabilities that he ceased to act as a so-called *de fac*to director of the Corporation after September 14, 2004. The CRA had reasonable grounds to believe that he continued to serve in that capacity and the Appellant should have taken steps to disabuse the CRA of that belief.

[20] Accordingly, I find that the Appellant has failed to establish that he was not a director of the Corporation during the Relevant Period. Consequently, the Appellant's appeal against the GST assessment is dismissed.

Analysis: Income Tax Assessment

[21] The Appellant was assessed under section 160 of the *ITA*, which provides that the transferee (in this case, the Appellant) and transferor (in this case, the Corporation), if they are not dealing at arm's length, are jointly and severally liable to pay the transferor's tax up to an amount equal to the lesser of (a) the amount by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and (b) the amount of the transferor's tax liability (defined as all amounts owing under the *ITA*) for the taxation year in which the property was transferred or a preceding taxation year.

[22] In her pleading the Respondent alleges that during its taxation years ended September 30, 2001, September 30, 2003 and September 30, 2004 the Corporation declared and paid to the Appellant dividends in the amounts of $18,000, $24,000 and $43,000 (the "dividends") respectively when the Corporation owed $1,917.18, $9,841.25 and $12,892.87 for its 2001, 2003 and 2004 taxation years respectively. The Appellant argues that the Corporation did not pay any dividends to him on the shares he owed and, in the alternative, if it did, he received only the amount of $7,500 in the Corporation's 2004 taxation year, and so he was liable only for that amount.

[23] In her pleading the Respondent admits that the Appellant reported nil income for his 2001 taxation year, $13,300 of employment income for his 2002 taxation year, $30,000 of dividend income for his 2003 taxation year and $7,500 of net business income for his 2004 taxation year.

[24] The Appellant testified that John MacDonald prepared his personal tax returns along with those of the Corporation. On cross-examination, the Appellant admitted that his wife, Judy Ustel, declared dividend income of $22,500 paid to her by the Corporation although she was not a shareholder. He agreed that that income belonged to him. It is clear from this evidence that Mr. MacDonald made numerous mistakes in preparing the corporate returns of the Corporation and the personal tax returns of the Appellant. The characterizations of the income are inconsistent. Mr. Pacheco and

Mr. Ustel both testified that they received employment or business income in 2003 and 2004.

[25] While the evidence is not perfect, I find, on the basis of the testimony of the two witnesses, that the Appellant has succeeded in establishing on a balance of probabilities that he did not receive dividends for 2003 and 2004 on his shares in the Corporation. In view of the financial situation of the Corporation, it is doubtful that it could have paid dividends while meeting the corporate solvency test applicable in those years.

[26] More importantly, dividend income is taxed at a lower effective tax rate than employment and consulting income because of the gross-up and dividend tax credit mechanism. It is highly improbable that the Appellant would have had himself taxed on employment and consulting income if it was intended that he receive dividend income. On this basis, I conclude that the Corporation did not pay the Appellant dividends on his shares for the 2003 and 2004 taxation years.

[27] The Appellant elected to have his appeal heard under subsection 17(2) of the *Tax Court of Canada Rules* (*Informal Procedure*). The Appellant has agreed to restrict his appeal to an amount of $12,000 assessed against him, excluding interest. Under section 2.1 of the *Tax Court of Canada Act*, the term "amount" does not include interest. The total amount assessed against the Appellant by the Minister is $24,651.30, comprising $16,190.51 in federal tax, penalties of $635.10 and total interest of $7,825.69. The Appellant thus remains liable for $4,825.61 of the amount assessed against him pursuant to subsection 160(2).

Conclusion

[28] For the reasons set out above, the Appellant's appeal against the GST assessment is dismissed and his appeal against the income tax assessment is allowed in part, and as regards this latter assessment, the matter is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with these reasons for judgment.

Signed at Toronto, Ontario, this 26th day of August 2010.

"Robert J. Hogan"

Hogan J.

CITATION:	2010 TCC 444
COURT FILE NOS.:	2009-358(GST)I, 2009-1443(IT)I
STYLE OF CAUSE:	GARY USTEL v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	May 14, 2010
REASONS FOR JUDGMENT BY:	The Honourable Justice Robert J. Hogan
DATE OF JUDGMENT:	August 26, 2010

APPEARANCES:

Agent for the Appellant:	Alex Samardzich
Counsel for the Respondent:	Darren Prevost

COUNSEL OF RECORD:

For the Appellant:

Name:	
Firm:	

For the Respondent:	Myles J. Kirvan Deputy Attorney General of Canada Ottawa, Canada