Dockets: 2008-3636(GST)G

BETWEEN:

TIMOTHY DEAKIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Timothy Deakin* (2008-3637(IT)G), *Brian Deakin* (2008-3639(IT)G) and *Brian Deakin* (2008-3640(GST)G) on June 7, 2012, at Toronto, Ontario

Before: The Honourable Justice Patrick Boyle

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Rita Araujo

JUDGMENT

The appeal from the assessment under the *Excise Tax Act*, notice of which is dated August 14, 2007, is dismissed, with costs, and the decision of the Minister of National Revenue is confirmed in accordance with attached Reasons for Judgment.

Signed at Ottawa, Canada, this 26th day of July, 2012.

"Patrick Boyle"

Boyle J.

Docket: 2008-3637(IT)G

BETWEEN:

TIMOTHY DEAKIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Timothy Deakin* (2008-3636(GST)G), *Brian Deakin* (2008-3639(IT)G) and *Brian Deakin* (2008-3640(GST)G) on June 7, 2012, at Toronto, Ontario

Before: The Honourable Justice Patrick Boyle

Appearances:

For the Appellants:	The Appellants themselves
Counsel for the Respondent:	Rita Araujo

JUDGMENT

The appeal from the assessment dated August 14, 2007 made under the *Income Tax Act* is allowed in part in accordance with the attached Reasons for Judgment.

Costs are awarded to the Respondent.

Signed at Ottawa, Canada, this 26th day of July, 2012.

"Patrick Boyle"

Boyle J.

Docket: 2008-3639(IT)G

BETWEEN:

BRIAN DEAKIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Timothy Deakin* (2008-3636(GST)G), *Timothy Deakin* (2008-3637(IT)G) and *Brian Deakin* (2008-3640(GST)G) on June 7, 2012, at Toronto, Ontario

Before: The Honourable Justice Patrick Boyle

Appearances:

For the Appellants:	The Appellants themselves
Counsel for the Respondent:	Rita Araujo

JUDGMENT

The appeal from the assessment dated August 14, 2007 made under the *Income Tax Act* is allowed in part in accordance with the attached Reasons for Judgment.

Costs are awarded to the Respondent.

Signed at Ottawa, Canada, this 26th day of July, 2012.

"Patrick Boyle"

Boyle J.

Dockets: 2008-3640(GST)G

BETWEEN:

BRIAN DEAKIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Timothy Deakin* (2008-3636(GST)G), *Timothy Deakin* (2008-3637(IT)G) and *Brian Deakin* (2008-3639(IT)G) on June 7, 2012, at Toronto, Ontario

Before: The Honourable Justice Patrick Boyle

Appearances:

For the Appellants:	The Appellants themselves
Counsel for the Respondent:	Rita Araujo

JUDGMENT

The appeal from the assessment under the *Excise Tax Act*, notice of which is dated August 14, 2007, is dismissed, with costs, and the decision of the Minister of National Revenue is confirmed in accordance with attached Reasons for Judgment.

Signed at Ottawa, Canada, this 26th day of July, 2012.

"Patrick Boyle"

Boyle J.

Citation: 2012TCC270
Date: 20120726
Dockets: 2008-3636(GST)G

BETWEEN:

TIMOTHY DEAKIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

DOCKET: 2008-3637(IT)G

AND BETWEEN:

TIMOTHY DEAKIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

DOCKET: 2008-3639(IT)G

AND BETWEEN:

BRIAN DEAKIN,

and

HER MAJESTY THE QUEEN,

Respondent,

DOCKET: 2008-3640(GST)G

AND BETWEEN:

BRIAN DEAKIN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Boyle J.

[1] The only issue in these income tax and goods and services tax ("GST") appeals is whether the two appellants are entitled to rely upon the so-called "due diligence" defence to their potential liability as directors for a corporation's unremitted employee withholdings and GST. It is not disputed that they were directors at all relevant times. Neither the corporation's liability nor the amounts are in dispute.

Facts

[2] The two appellants are brothers. They were directors of Deatech Systems Inc. ("Deatech"). Deatech was in the home-security business. It was incorporated in 1998 following their sale to ADT of Parkwood Security Systems ("Parkwood").

[3] Parkwood had originally been incorporated as Parkwood Home Improvements by Timothy Deakin in 1982, carrying on a business of building fences and decks for new home owners. In 1984, Parkwood switched to home security systems sales, installation and monitoring. In 1994, Brian Deakin became a 50% partner in Parkwood.

[4] The Deakins built Parkwood into a very successful business. At its peak, Parkwood had more than 20 employees and did 100 to 150 installations per month.

[5] In 1998, the Deakins sold the shares of Parkwood to ADT for $1.664 million, reduced by the amount of internal debt in Parkwood. The debt was $664,000 which

left $1,000,000 payable for the shares to the Deakins. When the sale closed, ADT had Parkwood pay off its debts, however the $1,000,000 was to be paid after closing as monitoring accounts transitioned to ADT.

[6] Shortly after closing, another monitoring company to which Parkwood had subcontracted its monitoring services, threatened and then instituted legal action against ADT claiming that Parkwood had granted it a right of first refusal to purchase its alarm-monitoring customers. This dragged on for some time. The Deakins were joined to the action. ADT refused to pay the Deakins the $1,000,000 share purchase price until the matter was resolved. The matter was settled by ADT for an unknown amount four years later. Despite their continuing hopes and expectations, no part of the $1,000,000 has ever been received by the Deakins from ADT. None of the documents relating to this claim or its settlement were put in evidence. The Deakins have never sued ADT for the unpaid $1,000,000.

[7] After selling Parkwood the Deakins incorporated Deatech to carry on a similar home security business. The Deakins expected to have $1,000,000 to invest in their new Deatech business. When that was not forthcoming, Deatech started to encounter financial difficulties with its cashflow. The Deakins owned, worked at and were directors of Deatech. Deatech had a bookkeeper on staff and used an outside chartered accountant. The Deakins were at all times informed of and aware of Deatech's financial position, jointly made its long-term and short-term business decisions, and decided how to deal with the company's cashflow shortfall relative to its operating expenses.

[8] Deatech did not fully remit employee withholdings or net GST collected to Canada Revenue Agency ("CRA"). This money was intentionally used instead to pay other Deatech creditors in order to keep the business afloat. For a long time it was hoped that this could be corrected and repaid once the $1,000,000 was received from ADT. There were also attempts to find other investors and obtain greater bank financing but the financial difficulties persisted and the unremitted taxes grew as some of these amounts were further diverted to pay suppliers and employees in order to keep the business going. According to Deatech's bookkeeper, its key supplier had it on a "cash only" basis and Deatech therefore had to use the GST collected and employee withholdings to buy products.

[9] The Deakins stopped receiving salary and were successful in lining up a $100,000 investor. One of them put a second mortgage on his house to make available to Deatech. However, in the end Deatech made an assignment in bankruptcy in 2005. By then Deatech had failed to remit more than $200,000 in

employee source deductions and more than $50,000 in GST. The amounts assessed exceed $400,000 once penalties and interest are accounted for.

[10] These arrears accrued by Deatech over a number of years. Deatech and the Deakins were in regular contact with the CRA to work out repayment plans for the arrears and otherwise tried to address them. There is no suggestion that the Deakins were not forthright in their dealings with CRA relating to the arrears. Deatech's financial position did not allow it to keep up the agreed repayment plans for the arrears.

Law

[11] Subsection 227.1(3) of the *Income Tax Act* ("*ITA*") provides:

> Idem
>
> (3) A director is not liable for a failure under subsection 227.1(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.

[12] Subsection 323(3) of the *Excise Tax Act* ("*ETA*") provides:

> (3) Diligence [Due diligence defence] – 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.

Analysis

[13] An employer is generally required by law to remit to the CRA the source deductions it has withheld from its employees' salaries and wages for income tax, CPP and EI deductions. This obligation differs from the employer's liability for its own taxes on its income. These amounts were withheld from the employees to be remitted to CRA and CRA, and hence Canadian taxpayers at large, give the employees credit for these amounts against the employees' tax liabilities. For this reason, the legislation gives CRA greater collection powers for such unremitted amounts than for the employer's own income taxes.

[14] Similarly, a business is generally required to remit the amount of GST it collected from its customers, net of the GST the business paid on its purchases, supplies and inputs. The GST was collected by the business from its customers to be

remitted to the CRA to satisfy the customers' GST liabilities. Again, recognizing this, the legislation gives CRA greater collection powers for such unremitted GST amounts.

[15] Subsection 227.1 of the *ITA* and subsection 323 of the *ETA* provide that the directors of a corporation will be personally liable for a corporation's failure to remit employee withholdings and GST as required by law. Directors are not generally liable for a corporation's own income tax. The potential liability of directors reflects the degree of management and control directors have over a corporation's management and its affairs.

[16] Subsections 227.1(3) of *the ITA* and 323(3) of the *ETA* each provide that a director will not be liable for the corporation's failure to remit such amounts as required by law if the director exercised a degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

[17] The Federal Court of Appeal most recently had the occasion to consider the due diligence defence of directors for unremitted source deductions and GST in *Her Majesty the Queen v. Buckingham*, 2011 FCA 142. In that case, the Court wrote:

> [33] On the other hand, subsection 227.1(1) of the *Income Tax Act* and subsection 323(1) of the *Excise Tax Act* specifically provide that the directors "are jointly and severally, or solidarily, liable, together with the corporation, to pay the amount and any interest or penalties relating to" the remittances the corporation is required to make. Subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* do not set out a general duty of care, but rather provide for a defence to the specific liability set out in subsections 227.1(1) and 323(1) of these respective Acts, and the burden is on the directors to prove that the conditions required to successfully plead such a defence have been met. The duty of care in subsection 227.1(3) of the *Income Tax Act* also specifically targets the prevention of the failure by the corporation to remit identified tax withholdings, including notably employee source deductions. Subsection 323(3) of the *Excise Tax Act* has a similarly focus. The directors must thus establish that they exercised the degree of care, diligence and skill required "to prevent the failure". The focus of these provisions is clearly on the prevention of failures to remit.
>
> [. . .]
>
> [40] The focus of the inquiry under subsections 227.1(3) of the *Income Tax Act* and 323(3) of the *Excise Tax Act* will however be different than that under 122(1)(*b*) of the CBCA, since the former require that the director's duty of care, diligence and skill be exercised to prevent failures to remit. In order to rely on

these defences, a director must thus establish that he turned his attention to the required remittances and that he exercised his duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the concerned amounts.

[. . .]

[49] The traditional approach has been that a director's duty is to prevent the failure to remit, not to condone it in the hope that matters can be rectified subsequently: *Canada v. Corsano*, [1999] 3 F.C. 173 (C.A.) at para. 35, *Ruffo v. Canada*, 2000 D.T.C. 6317, [2000] 4 C.T.C. 39 (F.C.A.). Contrary to the suppliers of a corporation who may limit their financial exposure by requiring cash-in-advance payments, the Crown is an involuntary creditor. The level of the Crown's exposure to the corporation can thus increase if the corporation continues its operations by paying the net salaries of the employees without effecting employee source deductions remittances, or if the corporation decides to collect GST/HST from customers without reporting and remitting these amounts in a timely fashion. In circumstances where a corporation is facing financial difficulties, it may be tempting to divert these Crown remittances in order to pay other creditors and thus ensure the continuation of the operations of the corporation. It is precisely such a situation which both section 227.1 of the *Income Tax Act* and section 323 of the *Excise Tax Act* seek to avoid. The defence under subsection 227.1(3) of the *Income Tax Act* and under subsection 323(3) of the *Excise Tax Act* should not be used to encourage such failures by allowing a due diligence defence for directors who finance the activities of their corporation with Crown monies on the expectation that the failures to remit could eventually be cured.

[. . .]

[52] Parliament did not require that directors be subject to an absolute liability for the remittances of their corporations. Consequently, Parliament has accepted that a corporation may, in certain circumstances, fail to effect remittances without its directors incurring liability. What is required is that the directors establish that they were specifically concerned with the tax remittances and that they exercised their duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the concerned amounts.

[. . .]

[56] A director of a corporation cannot justify a defence under the terms of subsection 227.1(3) of the *Income Tax Act* where he condones the continued operation of the corporation by diverting employee source deductions to other purposes. The entire scheme of section 227.1 of the *Income Tax Act*, read as a whole, is precisely designed to avoid such situations. In this case, though the respondent had a reasonable (but erroneous) expectation that the sale of the online course development division could result in a large payment which could be used to satisfy creditors, he consciously transferred part of the risks associated with this

> transaction to the Crown by continuing operations knowing that employee source deductions would not be remitted. This is precisely the mischief which subsection 227.1 of the *Income Tax Act* seeks to avoid.
>
> [. . .]
>
> [57] Once the trial judge found as a matter of fact that the respondent's efforts after February 2003 were no longer directed towards the avoidance of failures to remit, no successful defence under either subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act* could be sustained.
> [Emphasis added]

[18] Similarly, in *HMQ v. McKinnon*, [2001] 2 F.C. 203 CA, subnom *Worrell v. Canada* ("*Worrell*") the Federal Court of Appeal wrote:

> 69. It will normally not be sufficient for the directors simply to have carried on the business, knowing that a failure to remit was likely but hoping that the company's fortunes would revive with an upturn in the economy or in their market position. In such circumstances directors will generally be held to have assumed the risk that the company will subsequently be able to make its remittances. Taxpayers are not required involuntarily to underwrite this risk, no matter how reasonable it may have been from a business perspective for the directors to have continued the business without doing anything to prevent future failures to remit.

[19] By their own evidence, the Deakins were responsible for Deatech's decision not to fully remit source deductions and GST to CRA, and to instead ensure that the suppliers and employees needed to keep the business going were paid. Keeping the company afloat was their prime motivation. I am unable to conclude that the wording of the statutory due diligence defence, as interpreted by the Federal Court of Appeal in *Buckingham*, permits the Deakins to avail themselves of the due diligence defence. The many steps they actively took to try to address the repayment of the arrears simply cannot support a due diligence defence. The Deakins took a business risk and lost.

[20] It must be noted that the Federal Court of Appeal in *Buckingham* addressed and affirmed that Court's earlier decision in *Worrell*. Specifically in *Buckingham* the Court wrote in *Worrell*:

> 50 The respondent however relies on *Worrell* for the proposition that this traditional approach has been modified. *Worrell* concerned the application of the defence of care, diligence and skill in circumstances where the corporation's ability to make remittance payments was at the discretion of its bank and where it was reasonable for the directors to believe that, by continuing the business of the

> corporation, they could restore its fortunes. While recognizing that it will normally not be sufficient for directors to simply carry on a business knowing that a failure to remit was likely but hoping that the company's future would revive with an upturn in the economy or in its market position, the Court also recognized in *Worrell* that where a reasonable expectation supported this belief in order to avoid future failures to remit, the defence of due diligence could be established in certain exceptional circumstances. *Worrell* must however be read in light of the particular facts of that case, including notably "the limitations placed on [the directors] by the bank's *de facto* control of the company's finances" (*Worrell* at para. 79), and it should therefore not be understood as providing for a new approach to the due diligence defence.
>
> 51 It is thus important to note that *Worrell* did not modify the focus of the defence of care, diligence and skill, which is to prevent the failure to remit, not to cure failures to do so. As noted in *Worrell* at paragraph 34:
>
> - However, whether the directors did enough to exempt themselves from liability for the unremitted source deductions and G.S.T. 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 have occurred. Accordingly, of the measures taken in an attempt to rescue [their corporation], the most relevant to this inquiry are limited to the ones that were logically capable of preventing failures to remit the source deductions and G.S.T. when they became due. [Emphasis added]

[21] In these two paragraphs affirming *Worrell*, the Federal Court of Appeal appears to be acknowledging that directors' efforts to try to restore the corporation's fortunes by continuing its business and hopefully allowing it to repay its accrued arrears can, in certain exceptional circumstances, be a relevant consideration in a due diligence defence appeal. It is likely that the extent and scope of this exception and the relevance of such post-default steps will need to be considered and developed by the courts over time. I am satisfied that it is not relevant in the Deakins' case in any event. Firstly, the Deakins' situation is very like that in *Buckingham* in which there was also an expected $1.6 million payment of sales proceeds to alleviate the financial difficulties and allow the arrears to be repaid. Secondly, unlike in *Worrell*, neither the Deakins' bank nor any other person had or exercised power to appoint a monitor and to decide which cheques would be honoured based upon the payee. In *Worrell*, the bank had and exercised such power and refused to honour the cheques regularly drawn to CRA in respect of the required remittances. Thirdly, in this case there was insufficient evidence to allow me to conclude that it was reasonable at any time to

keep the business going with a reasonable expectation or likelihood that its fortunes would be reversed and the arrears would be paid. Even had it been reasonable at the outset, there was no evidence to allow me to conclude that it continued to be reasonable throughout. This is also in contrast with the facts in *Worrell*. For example, absent details of the claim against ADT and its settlement, I am unable to assess whether their anticipation of $1,000,000 was reasonable and for how long it was reasonable.

[22] Based upon the facts of this case, nothing was done to prevent the failures to remit. The Deakins made informed and considered decisions to use the source deductions and GST in part to pay its suppliers and employees and only remitted a portion to CRA. The many earnest efforts of the Deakins to address the arrears cannot help in this case to establish a due diligence defence. For this reason, the appeals must be dismissed except to the extent of the concession made by the Crown at trial in respect of the dividend received from the bankrupt estate of Deatech in the amount of $23,316.99 which reduced the income tax source deduction arrears.

[23] Given the specific wording of the subsections and the Federal Court of Appeal's comments in *Buckingham*, it appears somewhat difficult to imagine circumstances in which an informed and active owner-manager and director of a corporation will not be liable for unremitted employee source deductions and unremitted GST amounts. As mentioned above, the scope of the *Worrell* exception post-*Buckingham* remains to be developed in other cases than the Deakins'.

[24] Source deductions and GST remittances are required by law to be made by a business corporation. These are not the corporation's own funds. The corporation has collected them from its employees and customers. Those employees and customers are given credit for these amounts once withheld and collected, even when not remitted. When owner-managers and directors decide to use these funds to keep their business afloat and support their investments, they are making all Canadian taxpayers invest involuntarily in a business and investment in which they have no upside. In doing so, shareholders and corporate decision-makers are investing or gambling with other people's money. Directors should be aware of that when they cause or permit this to happen. The directors' liability provisions of the legislation should be regarded by business persons as somewhat similar to a form of personal guarantee by the directors that can expose them to comparable liability for the amount involved. It is they who are deciding to invest the funds in their own business, for their own gain, not the government or people of Canada. They are doing so contrary to clear law and it appears appropriate as a policy matter that Parliament has legislated clearly that they will generally be responsible for such decisions and the loss resulting from

them. In essence, if a corporation and its directors choose to unilaterally "borrow" from Canadian taxpayers and the public purse, Canadians get the benefit of security akin to personal guarantees of the directors.

[25] The appeals are dismissed, with costs, except to the extent of the Crown's concession referred to above.

Signed at Ottawa, Canada, this 26th day of July, 2012.

"Patrick Boyle"

Boyle J.

CITATION:	2012TCC270
COURT FILE NO.:	2008-3640(GST)G, 2008-3639(IT)G, 2008-3636(GST)G, 2008-3637(IT)G
STYLE OF CAUSE:	BRIAN DEAKIN, TIMOTHY DEAKIN v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	June 7, 2012
REASONS FOR JUDGMENT BY:	The Honourable Justice Patrick Boyle
DATE OF JUDGMENT:	July 26, 2012

APPEARANCES:

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