Docket: 2012-1287(IT)G

BETWEEN:

GERALD ROITELMAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on February 20, 2014, at Winnipeg, Manitoba

Before: The Honourable Justice Diane Campbell

Appearances:

Counsel for the Appellant:	Ronald B. Zimmerman
Counsel for the Respondent:	Julien Bédard

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* with respect to the Notice of Assessment numbered 976437, dated May 28, 2010, for the 2006 and 2007 taxation years are allowed, without costs, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 7th day of May 2014.

"Diane Campbell"

Campbell J.

Citation: 2014 TCC 139
Date: 20140507
Docket: 2012-1287(IT)G

BETWEEN:

GERALD ROITELMAN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Campbell J.

[1] The Appellant, Gerald Roitelman, is appealing a director's liability assessment made pursuant to subsection 227.1(1) of the *Income Tax Act* (the "*Act*") in respect to the 2006 and 2007 taxation years.

[2] The Minister of National Revenue (the "Minister") issued seven assessments to Roy's Electric Company (the "Corporation") for late-remitted or unremitted Federal and Provincial income taxes, employment insurance premiums and Canada Pension Plan contributions plus penalties and interest. On April 3, 2008, a certificate respecting this corporate debt, in the amount of $143,916.11, plus interest, was registered with the Federal Court of Canada.

[3] The Appellant made a lump sum payment on January 14, 2009 in respect to the principal owing by the Corporation for the outstanding source deductions debt.

[4] On May 28, 2010, the Minister assessed the Appellant, as director of the Corporation, for the amount of $50,241.39 ("the debt"), which consisted of the balance remaining unpaid in respect to penalties and interest that had been assessed.

[5] The Corporation was incorporated in Manitoba on March 31, 2004 when the Appellant took over ownership of the business from his father, who had operated it

since 1968. The Corporation was an electrical contracting firm that focussed primarily on commercial and industrial contracting, installations and service work. Prior to becoming owner of the business, the Appellant operated another company called CVA Systems as a sole proprietorship.

[6] The Appellant and his father were both directors of the Corporation until 2006, when his father ceased to act as a director due to ill health. Throughout the period under appeal, the Appellant had control of the corporate operations and activities. The Appellant had experience operating a business and he had obtained his trade designation from a community college. The Appellant testified that he was familiar with business practices and aware of corporate obligations to withhold and remit source deductions and to pay federal and provincial taxes. He paid taxes and remitted source deductions in operating his sole proprietorship, CVA Systems. No evidence was adduced respecting any remittance problems with CVA Systems.

[7] When the Appellant assumed the corporate operations, he created a payroll account in November, 2004 for the employees of the Corporation. At various times throughout the period under appeal, the Corporation employed between 3 to 8 employees.

[8] Initially, in 2004, the Appellant personally completed payroll and GST obligations respecting the Corporation. However, in March of 2005, the Appellant hired a bookkeeper and office manager. The evidence suggests that this was the result of the Corporation's involvement in a province-wide service contract with a national corporation. This necessitated the Appellant being absent from the office for periods of time as several of the large construction projects were in various locations throughout the Province of Manitoba. An advertisement was posted seeking the services of a bookkeeper and the Appellant eventually hired Kathy Shupena ("Shupena"), the operator of Pioneer Consulting. She had completed a bookkeeping course and had some limited experience in this area. She advised the Appellant that she was familiar with the processes involved with source deduction remittances at both federal and provincial levels. The Appellant described Shupena's duties as "run[ning] the office" (Transcript, p. 7). Her tasks included data entry, bookkeeping, administrative duties, opening mail, paying bills and preparing, calculating and remitting the source deductions, employment insurance premiums and CPP contributions.

[9] When Shupena commenced her employment with the Corporation, it was the Appellant who trained her and instructed her on how to perform her assigned tasks. He also personally oversaw her work at the outset:

> At the beginning there was [supervision] to ensure that things were being done correctly and on time. And then when I saw that things were progressing reasonably well, I stepped back to allow her to run the office as necessary.
>
> (Transcript, p. 21)

[10] In this regard, he ensured that the corporate remittances were completed in a timely fashion and eventually Shupena assumed those responsibilities. The Corporation's accountant also provided her with instructions on how he wanted tasks completed. Subsequent to this initial hiring and training period, the Appellant did not consistently or directly supervise her work since the province-wide contracts often took him out of town. However, he did testify that when he hired this bookkeeper, she appeared competent at completing her assigned tasks and he therefore placed reliance on her without much direct supervision during those times when he had to be absent from the office. On average, he was not in the office for approximately half the time.

[11] Due to the Appellant's absences from the office and the bookkeeper's irregular hours (Shupena eventually worked after hours to avoid confrontation with other staff members during the day), the Corporation did not have an established system for sending the remittances. Sometimes the bookkeeper forwarded the cheques to the Receiver General, but at other times the Appellant mailed the cheques himself and occasionally the mailman would pick up the cheques at the office.

[12] The Appellant was the only individual authorized to sign cheques on behalf of the Corporation, although the bookkeeper signed the occasional cheque for smaller amounts. When the Appellant was absent while at worksites, he instructed Shupena to make the necessary remittances and left her signed blank cheques to cover those remittances. He checked her work periodically and he would enquire as to whether the remittances had been made. He relied on her assurances that they had been completed and forwarded. He admitted that he relied on "blind faith" that the remittances had been made in a timely fashion. He stated that he did not do bank reconciliations every month, however, he did personally verify that remittances had been made "as often as I could" (Transcript, p. 23).

[13] The exhibits show that between August 2005 and March 2008, the Minister sent five letters to the Corporation with respect to the failure to remit. Two of these were sent to the Appellant's home address in late 2007 and 2008, which was at the end of and subsequent to the period in issue. Between October, 2006 and March,

2008, seven notices of assessment were sent to the Corporation. The Appellant testified that he did not receive nor was he personally aware of many of these notices and assessments because Shupena kept them from him. She was responsible for opening the mail due to his absences from the office and he stated that she did not forward some of this correspondence to him, although he could not identify which items he had not received. At some point, he became aware of the remittance failures but he denied knowledge of the precise extent of the problem.

[14] After the Appellant became aware of the bookkeeper's failure to remit, he testified that he explained to her that it could not happen again and she assured him that she would not repeat the same mistake. At this time, he temporarily increased the supervision over her work:

> After the first one and after it was paid and resolved, it was explained to her that this cannot happen again and I was overseeing with more detail as to ensuring that these things did not happen again. And as time went on and, for lack of a better term, the trust grew back into her position, she was proving her capabilities in – in achieving these remittances, I stepped back and allowed her to continue with what she was doing.
>
> (Transcript, pp. 9-10)

[15] The Appellant testified that, after each occasion when be became aware of a notice of failure to remit, he would again oversee the bookkeeper's work with more detail to ensure that future remittances would be made on time. As time passed and all deductions were again being remitted on time, the Appellant's supervision would gradually diminish. Despite being aware of a number of failures to remit, the Appellant each time increased his supervision and review of her work until things stabilized. The Appellant testified that he continued to employ Shupena, despite these problems, because it allowed him to continue to work province-wide in the field. The Appellant recalled the receipt of two letters in May, 2007 and, after these letters, he stated that he lost confidence in Shupena's work. After the September 13, 2007 personal notice to him, he stated that the bookkeeper was still responsible for the remittances but "[o]n a diminished level." (Transcript, p. 34). After a period of time, he began to look for someone to replace her. Shupena eventually left her employment after a physical altercation with another employee at a Christmas office party in 2007. Following this, she made herself unavailable to the Appellant's efforts to contact her concerning the problems.

[16] After the bookkeeper's departure in late 2007, the Appellant discovered cheques and documents "hidden" in various locations in the corporate office. He

found two remittance cheques that should have been forwarded to the Receiver General but, instead, were buried in an office desk and filing cabinet by the bookkeeper (see copies of these cheques, Exhibit A-1). These two cheques, totalling approximately $13,000, were signed and addressed to the Receiver General in 2007 but had never been forwarded. He described the location of these cheques as "tucked in under some items" and hidden from view (Transcript, p. 16). Provincial sales tax returns, that had been signed but not forwarded, were also found hidden in filing cabinets. According to the Appellant's evidence, Shupena also attempted to delete financial records from the corporate computer prior to leaving her employment.

[17] The evidence before me suggests that the bookkeeper's actions and the resulting errors were not simple oversights or mistakes. She acted fraudulently with an intention to deceive by not sending signed cheques and documentation to both federal and provincial tax authorities as the Appellant had instructed, by not bringing the failure notices to the attention of the Appellant and by attempting to erase sensitive financial information.

The Issue

[18] The Appellant is not disputing the liability of the Corporation nor the amount of the assessment against the Corporation. The only issue is whether the Appellant is liable for the payment of the personal assessments against him for the penalties and interest or whether he can avoid liability by arguing that he exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. Essentially, I must determine whether the Appellant is entitled to rely upon the director's due diligence defence pursuant to subsection 227.1(3) of the *Act*. The Appellant has the burden of establishing a due diligence defence. Although there is an abundance of jurisprudence on the issue of a director's liability, each case will be decided on its own set of facts.

Analysis

[19] The leading case on this issue is the Supreme Court of Canada decision in *Peoples Department Stores Ltd v Wise*, 2004 SCC 68, [2004] 3 SCR 461. It overruled the Federal Court of Appeal's prior "objective-subjective" test used to evaluate a director's due diligence defence, originally established in *Soper v The Queen*, 97 DTC 5407. The Supreme Court replaced the objective-subjective test with an objective test as the appropriate standard in reviewing this defence.

[20] The Federal Court of Appeal confirmed the objective test in the case of *The Queen v Buckingham*, 2011 FCA 142, 2011 DTC 5078, where the Court, at paragraph 38, explained its underlying rationale and application:

> [38] This objective standard has set aside the common law principle that a director's management of a corporation is to be judged according to his own personal skills, knowledge, abilities and capacities: *Peoples Department Stores* at paras. 59 to 62. To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director are important as opposed to the subjective motivations of the director: *Peoples Department Stores* at para. 63. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions through the establishment of good corporate governance rules: *Peoples Department Stores* at para. 64. Stricter standards also discourage the appointment of inactive directors chosen for show or who fail to discharge their duties as director by leaving decisions to the active directors. Consequently, a person who is appointed as a director must carry out the duties of that function on an active basis and will not be allowed to defend a claim for malfeasance in the discharge of his or her duties by relying on his or her own inaction: Kevin P. McGuinness, *Canadian Business Corporations Law*, 2nd ed. (Markham, Ontario: LexisNexis Canada, 2007) at 11.9.

[21] The Court, at paragraph 52 in *Buckingham*, summarized how a director may establish a due diligence defence:

> [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.
>
> (Emphasis added)

[22] The Federal Court of Appeal in *Buckingham*, in addition to confirming the objective test, also clarified that, in order for directors to successfully rely on a due diligence defence, they must have taken active steps to prevent a failure to remit and not merely to have taken steps to remedy the failure after its occurrence.

[23] Since *Buckingham*, the Federal Court of Appeal illustrated in *Balthazard v The Queen*, 2011 FCA 331, how after-the-fact behaviour and corrective measures can be relevant in certain circumstances. In that case, the Court looked at after-the-fact behaviour, payment schedules and corrective measures adopted by the

taxpayer in concluding that he had performed the required due diligence. The focus of the due diligence analysis remains, however, on the degree of care, diligence and skill exercised in preventing a failure to remit. Further, as Justice Hogan commented in *Kaur v The Queen*, 2013 TCC 227, [2013] TCJ No. 195, at paragraph 18:

> [18] … The director's oversight duties with respect to the GST cannot be delegated in their entirety to a subordinate, as was done in the present case.

[24] The Respondent argued that the Appellant did not take positive steps or actions that would prevent the failure to remit and thus he cannot avail himself of the due diligence defence. The Respondent contended that the steps taken by the Appellant occurred after the fact in order to cure the failures.

[25] With respect to the Appellant's testimony, he provided his evidence in a straightforward and honest manner. I found him to be a credible witness who was forthcoming about his knowledge of remittance obligations and the mistakes he made in trusting his bookkeeper. I accept his testimony in respect to his limited/delayed receipt of knowledge concerning late remittances, as well as the notices and assessments, which were due to the bookkeeper's purposeful actions. I accept that she engaged in misleading and deceitful behaviour regarding the remittances and that the Appellant mistakenly thought the cheques he was signing for those remittances were being forwarded to the Receiver General when, in fact, they were not.

[26] When I look at the overall factual circumstances before me and the Appellant's actions, I conclude that the Appellant must be successful in his appeal based on the application of the objective test. Contrary to the Respondent's contention, the Appellant engaged in proactive steps designed to prevent the failure to remit and I consider those steps to be sufficiently reasonable in the circumstances of this case.

[27] The Appellant has experience in business and with remittance obligations. Consequently, when the business demanded that he travel to out-of-town worksites on a periodic basis, he placed an advertisement and hired a bookkeeper. Although she had a bookkeeping course and a little experience, he personally provided training to her in respect to the duties for which she was hired. In conjunction with this, his accountant provided additional instructions. He continued to supervise her work, including the remittance obligations, until he had a level of comfort in her competence. When he first became aware that she had failed in making

remittances, he instructed her not to make such mistakes and provided increased supervision again over her work until he felt she could carry out those duties on her own. These actions constitute proactive steps to prevent future failures to remit and to ensure compliance. His attempts were frustrated, however, by this bookkeeper's fraudulent and deceitful behaviour.

[28] The test does not dictate that the positive steps taken must be effective in ensuring future compliance but only that a director takes those steps and that those steps would be the proactive steps that a reasonably prudent person would have exercised in comparable circumstances. The Federal Court of Appeal in *Buckingham* confirmed that, although an objective test does not take into account a director's personal skills, experience, education or abilities, it does not mean that the personal circumstances of a director are irrelevant to the analysis. Instead, they will be compared to the actions of the reasonably prudent person in similar circumstances.

[29] Can the Appellant's actions in these circumstances be considered to be those that a reasonably prudent person would engage in if placed in this situation? I conclude that they are. The backdrop to the Appellant's choices and actions is the fact that he was required to be away from the office part of the time at out-of-town worksites. He initially completed remittances himself before he acquired the large provincial construction project. The evidence supports that he hired a bookkeeper to attend to administrative tasks in his absence. It was also reasonable and prudent that one of the bookkeeper's tasks was to open the mail and reasonable to expect that she would bring essential correspondence to the Appellant's attention.

[30] The Appellant personally provided training in the bookkeeper's duties, including calculation and sending of remittances. It was reasonable for him to expect that, when he signed cheques for those remittances, the bookkeeper would mail them in his absence from the office. Upon his return to the office, it was reasonable for him to assume that, in the absence of cheques sitting in the office, they had been forwarded to the Receiver General. This is particularly so when the bookkeeper was giving verbal confirmation that her duties were being fulfilled. While absence from an office is not an excuse for failures to remit, the decision in *Buckingham* makes it clear that an objective standard does not allow the Court to ignore the particular circumstances of the director. Instead, such circumstances must be taken into account and analyzed objectively. I accept that the bookkeeper's deceitful actions, rather than her incompetence, prevented the Appellant from reasonably being able to ascertain the extent of the remittance failures. This impacts upon the analysis of the due diligence defence because an analysis must

take into consideration what the director reasonably had knowledge of in the particular circumstances. In these appeals, the Appellant's knowledge was clearly frustrated by the bookkeeper's misleading actions.

[31] Although the standard to be applied is an objective one, perfection on the part of a director is not required. This was reflected in the comments from Justice Bowman (as he was then) in *Cloutier v MNR*, 93 DTC 544, at paragraph 10:

> [10] The question therefore becomes one of fact and the court must to the extent possible attempt to determine what a reasonably prudent person ought to have done and could have done at the time in comparable circumstances. Attempts by courts to conjure up the hypothetical reasonable person have not always been an unqualified success. Tests have been developed, refined and repeated in order to give the process the appearance of rationality and objectivity but ultimately the judge deciding the matter must apply his own concepts of common sense and fairness. It is easy to be wise in retrospect and the court must endeavour to avoid asking the question "What would I have done, knowing what I know now?" It is not that sort of ex post facto judgement that is required here. Many judgement calls that turn out in retrospect to have been wrong would not have been made if the person making them had the benefit of hindsight at the time.

[32] The Appellant could not reasonably have known or be expected to have known that the bookkeeper would engage in fraudulent and misleading actions. He did not have knowledge of this until after the relevant taxation years that are at issue in these appeals. The Appellant's interaction with the bookkeeper should not be analyzed with the present benefit of hindsight but, rather, with a view to those circumstances as they existed during the relevant period. Therefore, I reject the Respondent's submission that the Appellant acted imprudently and unreasonably by hiring the bookkeeper in the first place. In retrospect, hiring this bookkeeper was a poor business decision but it is not for this Court to make such an *ex-post facto* conclusion.

[33] In addition, the Appellant is not precluded from relying on the due diligence defence where there is no evidence to suggest that the Appellant condoned or encouraged the use of source remittances for other purposes. The Appellant instructed the bookkeeper in making timely appropriate remittances, supervised her work for a period initially, signed cheques and left them with her to forward to the Receiver General and, when he became aware of the problem, he again supervised her for a period to ensure remittances were being properly made. There is no evidence to suggest that the Appellant benefited or intended to benefit in any manner from the failure to remit, nor any evidence that implicates the Appellant in

the withholding of the signed cheques, nor any evidence or suggestion that the cheques were not sent due to insufficient funds in the company account.

[34] In cross-examination, Respondent Counsel suggested to the Appellant that the Corporation had a history of non-compliance with remittances prior to hiring the bookkeeper. However, the Appellant submitted that his remittances were made on time. The evidence would support the Appellant's testimony. In Exhibit R-1, at Tab 26, correspondence dated August 5, 2005, from the Minister to the Appellant, states that there were remittance problems in respect to the Corporation. This appears to be the first letter forwarded to the Corporation regarding the problem. That correspondence states that the Corporation had a "history of non-compliance", which the Respondent, in cross-examination, was referencing. The corporate payroll account was established in November of 2004. The non-compliance referred to in that August 5, 2005 correspondence, therefore, occurred sometime between November, 2004 and August, 2005. The bookkeeper was hired in March, 2005. There was no other evidence, oral or documentary, concerning the timeline of the commencement of this history of non-compliance. There is no evidence to establish that the failure first occurred prior to March, 2005 when Shupena was hired. With no evidence before me, I reject the Respondent's suggestion that the Appellant was not properly submitting corporate remittances during the period he attended to them personally prior to hiring the bookkeeper. The August, 2005 correspondence came approximately a half year subsequent to hiring her and did not reference non-compliance issues prior to March, 2005. Consequently, there is no evidence that would allow me to conclude that the Appellant had a history of non-compliance prior to hiring Shupena.

[35] The Appellant has met the burden of establishing that he took proactive steps to prevent the Corporation's failure to remit and, therefore, he demonstrated the degree of care, diligence and skill required to prevent the failures that a reasonably prudent person would have exercised in comparable circumstances. Despite his actions, he was thwarted in his attempts to ensure compliance by the actions of the bookkeeper.

[36] For these reasons, the appeals for the 2006 and 2007 taxation years are allowed.

[37] The parties shall each bear their own costs.

Signed at Ottawa, Canada, this 7th day of May 2014.

"Diane Campbell"

Campbell J.

CITATION:	2014 TCC 139
COURT FILE NO.:	2012-1287(IT)G
STYLE OF CAUSE:	GERALD ROITELMAN and HER MAJESTY THE QUEEN
PLACE OF HEARING:	Winnipeg, Manitoba
DATE OF HEARING:	February 20, 2014
REASONS FOR JUDGMENT BY:	The Honourable Justice Diane Campbell
DATE OF JUDGMENT:	May 7, 2014

APPEARANCES:

Counsel for the Appellant:	Ronald Zimmerman
Counsel for the Respondent:	Julien Bédard

COUNSEL OF RECORD:

For the Appellant:

Name:	Ronald B. Zimmerman
Firm:	McJannet Rich Winnipeg, Manitoba

For the Respondent:	William F. Pentney Deputy Attorney General of Canada Ottawa, Canada