Federal Court of Appeal  Cour d'appel fédérale

Date: 20110421

Dockets: A-224-10
A-225-10

Citation: 2011 FCA 142

CORAM: **NADON J.A.**
PELLETIER J.A.
MAINVILLE J.A.

BETWEEN:

Docket: A-224-10

HER MAJESTY THE QUEEN

Appellant

and

KEVIN RICHARD BUCKINGHAM

Respondent

Docket: A-225-10

KEVIN RICHARD BUCKINGHAM

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Fredericton, New Brunswick, on April 6, 2011.

Judgment delivered at Ottawa, Ontario, on April 21, 2011.

REASONS FOR JUDGMENT BY: MAINVILLE J.A.

CONCURRED IN BY: NADON J.A.
PELLETIER J.A.

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REASONS FOR JUDGMENT

MAINVILLE J.A.

[1] In reasons cited as 2010 TCC 247 ("Reasons"), Webb J. of the Tax Court of Canada found that the respondent was not liable as a director of various corporations for the amounts the corporations failed to remit as source deductions under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), the *Canada Pension Plan*, R.S.C 1985, c. C-8 and the *Employment Insurance Act*, S.C. 1996, c. 23, but was so liable after February 2003 for the failure to make GST/HST remittances under the *Excise Tax Act*, R.S.C. 1985, c. E-15.

[2] The Crown appeals the judgment concerning the employee source deductions remittances in file A-224-10, while the respondent appeals the judgment concerning the GST/HST remittances in file A-225-10. Both appeals have been consolidated.

[3] These consolidated appeals raise the issue of the appropriate standard of care, diligence and skill required of a director under subsection 227.1(3) of the *Income Tax Act* (and related provisions of the *Canada Pension Plan* and of the *Employment Insurance Act*) and under subsection 323(3) of the *Excise Tax Act*.

Context

[4] The respondent and his family acquired control of Mosaic Technologies Corporation ("Mosaic") around 1997 in order to carry on an education services business. Shortly thereafter,

Mosaic secured educational facilities in various locations across Canada. Mosaic also had a division that prepared online courses for large corporations and governments.

[5] The shares of Mosaic started to trade on the TSX Venture Exchange in 1998 or 1999. The company incurred an operating loss of $970,866 in 1999, made a profit of $253,110 in 2000 and then incurred losses of $451,161 in 2001 and $1,446,396 in 2002. After various unsuccessful efforts in 2002 and in early 2003 to secure additional capital and financing, the corporation unsuccessfully attempted to sell its assets and part of its business in order to pay its creditors. Mosaic ceased all operations in or shortly after September of 2003.

[6] The respondent was the chairman of the board of Mosaic and its largest shareholder. The trial judge found that he was involved in its day-to-day operations and played a significant role in these operations.

[7] The respondent was assessed pursuant to section 323 of the *Excise Tax Act* for GST/HST remittances which Mosaic had failed to make in March and June of 2003, as well as for associated penalties and interest. He was also assessed pursuant to section 227.1 of the *Income Tax Act*, section 21.1 of the *Canada Pension Plan* and section 83 of the *Employment Insurance Act* for Mosaic's failure to remit employee source deductions for the period of October 2002 to August 2003, as well as for associated penalties and interest. Similar assessments were made against the respondent for the failures to remit employee source deductions by the various subsidiaries of Mosaic, namely Multimedia Ventures (Alberta) Inc., Multimedia Ventures Inc., and 6678 British Columbia Ltd.

[8] The respondent appealed all of these assessments to the Tax Court of Canada solely on the basis that he was not liable for these amounts as a result of the provisions of subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* which exonerate a director of liability where he "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."

The Reasons of the trial judge

[9] Relying on his decision in *Higgins v. Canada*, 2007 TCC 469, the trial judge concluded, at paragraphs 16 to 18 of his Reasons, that the "objective subjective" test set out in *Soper v. Canada*, [1998] 1 F.C. 124 (C.A.) ("*Soper*"), regarding the standard of care, diligence and skill required under subsection 227.1(3) of the *Income Tax Act* had been modified by the Supreme Court of Canada's decision in *Peoples Department Stores Inc.(Trustee of) v. Wise*, 2004 SCC 68, [2004] 3 S.C.R. 461 ("*Peoples Department Stores*"). The trial judge found that an objective standard should thus be used for the purposes of applying both subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act*, and that this standard incorporated the reasonable business decision test laid out in *Peoples Department Stores*.

[10] The question for the trial judge was therefore whether the respondent had acted prudently on a reasonably informed basis and whether his business decisions were reasonable in light of the circumstances about which he knew or ought to have known in order to prevent the failures to remit (Reasons at paras. 31, 56 and 82).

[11] The trial judge was however of the view that the analysis required in relation to remittances of employee source deductions should be dealt with separately from the analysis related to remittances of GST/HST. The need for a distinct analysis flowed, in the trial judge's view, from the fact that the "amounts for payroll deductions are not funded from a third party but are paid from whatever resources the company might have available to it" (Reasons at para. 33). For the trial judge, the remittance obligations related to source deductions are part of employee costs and are funded through the general revenues of the corporation which may be insufficient to fund these remittances. On the other hand, remittances of the GST/HST are funded by third parties from whom the GST/HST is collected. This distinction lead the trial judge to conclude that two separate analyses of the standard of care, diligence and skill were required, one for the remittances of source deductions, and one for the remittances of GST/HST (Reasons at paras. 33 and 74-75).

[12] Turning his attention to the employee source deductions remittances, the trial judge accepted the respondent's evidence that reasonable business measures were taken in 2002 and in January and February of 2003 to address the financial difficulties of Mosaic and to avoid failures to remit taxes, including work on a proposed equity issue, attempts to secure a line of credit, reductions in expenditures, and attempts to merge with another company.

[13] The trial judge found, at paragraphs 58 to 65 of his Reasons, that the facts before him were similar to those in *Canada v. McKinnon*, [2001] 2 F.C. 203 (C.A) 2000 D.T.C. 6593 (*sub nom. Worrell v. Canada*) [2001] 1 C.T.C. 79 ("*Worrell*"), where emphasis was placed on the continued effort to find new investors. The trial judge also referred to this Court's decision in *Smith v. Canada*,

2001 FCA 84, 198 D.L.R. (4th) 257, for the principle that a director is only required to act reasonably. He concluded, at paragraphs 66 to 73 of his Reasons, that the respondent had done all that he could in the circumstances to secure additional funding for Mosaic through various means, and that consequently he had met the standard of care required of him under subsection 227.1(3) of the *Income Tax Act*.

[14] The trial judge further noted that following the failure to secure new funding, as of February 2003 the efforts of Mosaic turned towards the sale of its assets in order to pay creditors, including the arrears in employee source deductions remittances. Mosaic notably entered into a $1.6 million arrangement in May of 2003 for the sale of its online course development division. An amount of $600,000 was received from this sale in June of 2003 and used to pay various creditors, of which $100,000 was sent to the Receiver General as a partial payment of the outstanding remittances. However, the $1 million balance of the sale price was never subsequently received.

[15] The trial judge further recognized, at paragraphs 69 to 72 of his Reasons, that even if the focus of the respondent's efforts after February of 2003 was directed towards selling assets in order to pay arrears or to correct failures in remittances, rather than towards preventing failures to occur, and even if the employee source deductions remittances had been diverted, a defence under subsection 227.1(3) of the *Income Tax Act* could nevertheless be successful:

> [69] It also seems reasonable that while the Appellant is trying to arrange for a capital injection or a merger or the sale of a division or assets, that the company should continue to operate as long as there is a reasonable expectation that such events would occur. It does not seem to me that this reasonable expectation would have ended before the deal with GITI collapsed. After the deal with GITI collapsed in February 2003, the steps changed from seeking capital injections to

> liquidating assets. It seems to me that the liquidation of assets was more directed towards paying arrears (or correcting defaults) than it would be in preventing defaults from occurring. [Emphasis added]
>
> [70] There would be a time delay from the time when the GITI deal collapsed and the employment of employees could be terminated. Reasonable notice is required to terminate employment without cause. As Justice Major noted in *The Queen in right of the Province of British Columbia* v. *Ossie Sylvester,* [1997] 2 S.C.R. 315:
>
> > 1 Employment involves, among other things, a contract between the employer and employee. An employee who is wrongfully dismissed without reasonable notice of termination is entitled to damages for breach of contract. These damages represent the salary the employee would have earned had the employee worked during the notice period, less any amounts credited to mitigation.
>
> [71] Employees simply cannot be dismissed without proper notice. This would mean that the obligation to pay salaries (or compensation for proper notice) will continue after any decision is made to dismiss employees and such costs (which will give rise to requirements to remit amounts under the applicable legislation) will be incurred regardless of whether the company has sufficient revenue to cover such costs. No third party is necessarily providing the funds to the company to cover such costs.
>
> [72] As well since Maxim was acquiring a division it seems reasonable that the employees of that division would be retained until the sale was completed and it seems to me that the Appellant would have had a reasonable expectation that the deal with Maxim would close.

[16] The trial judge nevertheless reached a different conclusion concerning the failure to remit GST/HST. He rejected the defence of the respondent, which had been essentially the same as that submitted for the failure to remit employee source deductions, and explained his decision to do so in the following terms (Reasons at para. 82):

> The liquidation of assets was not undertaken to prevent failures to remit GST/HST. As noted by the Appellant, the decision to sell assets was made to realize cash so that the company could pay its bills. This would be done to cure defaults in

> remittances, not prevent failures to remit. As a result, it does not seem to me that the Appellant has satisfied the standard of care imposed on him pursuant to subsection 323(3) of the *Excise Tax Act* to prevent the failure to remit the net tax that was payable on April 30, 2003 and July 30, 2003.

The position of the Crown

[17] The Crown argues that the trial judge committed an error in law by incorporating a cash-flow analysis into the duty of care, diligence and skill defence under subsection 227.1(3) of the *Income Tax Act*. This, in the Crown's view, significantly expands the defence available under that subsection and, if accepted, would pass to the Crown part of the risk associated with continuing a business which is facing financial difficulties. This is particularly offensive for the Crown in light of the trial judge's finding at paragraph 33 of his Reasons that the respondent "had admitted that the amounts that had been deducted from the payroll payments were being used to pay other bills."

[18] By using amounts withheld on employee source deductions to pay third party creditors, the respondent tried to refinance his business in an effort to save it. Preferential payments were made to creditors other than the Crown purely for the purpose of continuing and preserving the continued operation of the business in order to attempt to salvage the respondent's investment. For the Crown, this is exactly the mischief which section 227.1 of the *Income Tax Act* was intended to avoid.

[19] The Crown asserts that the trial judge failed to draw the distinction made in *Worrell* between actions which might be reasonable from a business point of view, and actions which would have prevented the failure to remit employee source deductions, and he thus erred in equating a general

business intent with the more specific requirements of section 227.1 of the *Income Tax Act* which are directed to preventing the failure to remit.

The position of the respondent

[20] In the respondent's view, *Worrell* stands for the proposition that insofar as the directors can demonstrate that they have made serious and reasonable efforts to resolve the financial difficulties faced by their corporation, they have met the standard of care, diligence and skill required to sustain a defence under either subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act*.

[21] In this case, the trial judge recognized that the respondent had made serious and reasonable efforts to resolve the financial difficulties of Mosaic and of its subsidiaries, and applied the principles set out in *Worrell* to find that the respondent had successfully established a defence under subsection 227.1(3) of the *Income Tax Act*.

[22] The respondent adds that the trial judge erred in law by failing to follow *Worrell* with respect to the GST/HST remittances. Rather, the trial judge carried out a separate and distinct analysis of these remittances based on his concern that GST/HST funds are received from third parties, while source deductions are funded from the general revenues of the business. For the respondent, the trial judge erred in drawing this sharp contrast between GST/HST and source deduction remittances. Treating the GST/HST remittances separately from the source deduction remittances also resulted in the trial judge reaching contradictory findings of fact.

The issues

[23] These consolidated appeals raise three principal issues:

a. Is the applicable standard of care, diligence and skill under subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* an objective standard?

b. Does the standard under subsection 227.1(3) of the *Income Tax Act* apply differently than under subsection 323(3) of the *Excise Tax Act*?

c. Can a successful defence under subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act* be sustained where the efforts of the directors are focussed on curing failures to remit rather than towards preventing such failures?

Standard of review

[24] The decision of *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, sets out the applicable standard of appellate review in an appeal from a judgment of the Tax Court of Canada. The standard of review on a question of law is correctness, while findings of fact are not to be disturbed unless it can be established that the trial judge made a palpable and overriding error. The application of a legal standard to a set of facts is a question of mixed fact and law which is also subject to deference unless an extricable question of law can be identified.

[25] Whether a defence under subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act* has been established requires the application of a legal standard to a set of facts.

Accordingly, these determinations generally constitute questions of mixed fact and law that are reviewable on a standard of palpable and overriding error: *Hartrell v. Canada*, 2008 FCA 59, 2008 D.T.C. 6173 at para. 3. However, the three issues raised by these consolidated appeals also raise extricable questions of law to which a standard of correctness applies.

The pertinent legislative provisions

[26] Paragraph 153(1)(*a*) of the *Income Tax Act* provides for income tax withholdings from employee wages, and for the remittance of these withholdings to the Receiver General. Subsection 227.1(1) of the *Income Tax Act* sets out that the directors of a corporation which has failed to so withhold and remit are jointly and severally, or solidarily, liable together with the corporation to pay the concerned amount and any related interest or penalties. Subsections 227.1(2) and (3) of the *Income Tax Act* provide for certain limitations on this liability of directors, notably by allowing a defence of care, diligence and skill:

153. (1) Every person paying at any time in a taxation year	**153.** (1) Toute personne qui verse au cours d'une année d'imposition l'un des montants suivants :
(*a*) salary, wages or other remuneration, other than amounts described in subsection 115(2.3) or 212(5.1),	*a*) un traitement, un salaire ou autre rémunération, à l'exception des sommes visées aux paragraphes 115(2.3) ou 212(5.1);
…	[…]
shall deduct or withhold from the payment the amount determined in accordance with prescribed rules and shall, at the prescribed time, remit that amount to the Receiver General on account of the payee's tax for the year	doit en déduire ou en retenir la somme fixée selon les modalités réglementaires et doit, au moment fixé par règlement, remettre cette somme au receveur général au titre de l'impôt du bénéficiaire ou du dépositaire pour

under this Part or Part XI.3, as the case may be, and, where at that prescribed time the person is a prescribed person, the remittance shall be made to the account of the Receiver General at a designated financial institution.

l'année en vertu de la présente partie ou de la partie XI.3. Toutefois, lorsque la personne est visée par règlement à ce moment, la somme est versée au compte du receveur général dans une institution financière désignée.

227.1 (1) Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.

227.1 (1) Lorsqu'une société a omis de déduire ou de retenir une somme, tel que prévu aux paragraphes 135(3) ou 135.1(7) ou aux articles 153 ou 215, ou a omis de verser cette somme ou a omis de payer un montant d'impôt en vertu de la partie VII ou VIII pour une année d'imposition, les administrateurs de la société, au moment où celle-ci était tenue de déduire, de retenir, de verser ou de payer la somme, sont solidairement responsables, avec la société, du paiement de cette somme, y compris les intérêts et les pénalités s'y rapportant.

(2) A director is not liable under subsection 227.1(1), unless

(2) Un administrateur n'encourt la responsabilité prévue au paragraphe (1) que dans l'un ou l'autre des cas suivants :

(*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 223 and execution for that amount has been returned unsatisfied in whole or in part;

a) un certificat précisant la somme pour laquelle la société est responsable selon ce paragraphe a été enregistré à la Cour fédérale en application de l'article 223 et il y a eu défaut d'exécution totale ou partielle à l'égard de cette somme;

(*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 that subsection has been proved within

b) la société a engagé des procédures de liquidation ou de dissolution ou elle a fait l'objet d'une dissolution et l'existence de la créance à l'égard de laquelle elle encourt la responsabilité en vertu de ce paragraphe a été

six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

établie dans les six mois suivant le premier en date du jour où les procédures ont été engagées et du jour de la dissolution;

(*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 that subsection has been proved within six months after the date of the assignment or bankruptcy order.

c) la société a fait une cession ou une ordonnance de faillite a été rendue contre elle en vertu de la *Loi sur la faillite et l'insolvabilité* et l'existence de la créance à l'égard de laquelle elle encourt la responsabilité en vertu de ce paragraphe a été établie dans les six mois suivant la date de la cession ou de l'ordonnance de faillite.

(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

(3) Un administrateur n'est pas responsable de l'omission visée au paragraphe (1) lorsqu'il a agi avec le degré de soin, de diligence et d'habileté pour prévenir le manquement qu'une personne raisonnablement prudente aurait exercé dans des circonstances comparables.

[27] Subsections 21(1) and 21.1(1) and (2) of the *Canada Pension Plan* set out similar withholding and remittance obligations in relation to contributions to the Canada Pension Plan:

21. (1) Every employer paying remuneration to an employee employed by the employer at any time in pensionable employment shall deduct from that remuneration as or on account of the employee's contribution for the year in which the remuneration for the pensionable employment is paid to the employee

21. (1) Tout employeur payant une rémunération à un employé à son service, à une date quelconque, dans un emploi ouvrant droit à pension est tenu d'en déduire, à titre de cotisation de l'employé ou au titre de la cotisation pour l'année au cours de laquelle la rémunération au titre de l'emploi ouvrant droit à pension est

such amount as is determined in accordance with prescribed rules and shall remit that amount, together with such amount as is prescribed with respect to the contribution required to be made by the employer under this Act, to the Receiver General at such time as is prescribed and, where at that prescribed time the employer is a prescribed person, the remittance shall be made to the account of the Receiver General at a financial institution (within the meaning that would be assigned by the definition "financial institution" in subsection 190(1) of the *Income Tax Act* if that definition were read without reference to paragraphs (*d*) and (*e*) thereof).	payée à cet employé, le montant déterminé conformément à des règles prescrites; l'employeur remet au receveur général, à la date prescrite, ce montant ainsi que le montant qui est prescrit à l'égard de la cotisation qu'il est tenu de verser selon la présente loi. De plus, lorsque l'employeur est une personne prescrite à la date prescrite, le montant est versé au compte du receveur général dans une institution financière (au sens du paragraphe 190(1) de la *Loi de l'impôt sur le revenu*, compte non tenu des alinéas *d*) et *e*) de la définition de cette expression).
21.1 (1) If an employer who fails to deduct or remit an amount as and when required under subsection 21(1) is a corporation, the persons who were the directors of the corporation at the time when the failure occurred are jointly and severally or solidarily liable, together with the corporation, to pay to Her Majesty that amount and any interest or penalties relating to it.	**21.1** (1) En cas d'omission par un employeur personne morale de verser ou de déduire un montant de la manière et au moment prévus au paragraphe 21(1), les personnes qui en étaient les administrateurs à la date de l'omission sont solidairement responsables envers Sa Majesté du paiement de ce montant ainsi que des intérêts et pénalités qui s'y rapportent.
(2) Subsections 227.1(2) to (7) of the *Income Tax Act* apply, with such modifications as the circumstances require, in respect of a director of a corporation referred to in subsection (1).	(2) Les paragraphes 227.1(2) à (7) de la *Loi de l'impôt sur le revenu* s'appliquent, compte tenu des adaptations de circonstance, à l'administrateur d'une personne morale visée au paragraphe (1).

[28] Similar provisions are also found in subsections 82(1) and 83(1) and (2) of the *Employment Insurance Act*:

82. (1) Every employer paying remuneration to a person they employ in insurable employment shall (*a*) deduct the prescribed amount from the remuneration as or on account of the employee's premium payable by that insured person under section 67 for any period for which the remuneration is paid; and (*b*) remit the amount, together with the employer's premium payable by the employer under section 68 for that period, to the Receiver General at the prescribed time and in the prescribed manner.	**82.** (1) L'employeur qui paie une rétribution à une personne exerçant à son service un emploi assurable est tenu de retenir sur cette rétribution, au titre de la cotisation ouvrière payable par cet assuré en vertu de l'article 67 pour toute période à l'égard de laquelle cette rétribution est payée, un montant déterminé conformément à une mesure d'ordre réglementaire et de le verser au receveur général avec la cotisation patronale correspondante payable en vertu de l'article 68, au moment et de la manière prévus par règlement.
83. (1) If an employer who fails to deduct or remit an amount as and when required under subsection 82(1) is a corporation, the persons who were the directors of the corporation at the time when the failure occurred are jointly and severally, or solidarily, liable, together with the corporation, to pay Her Majesty that amount and any related interest or penalties.	**83.** (1) Dans les cas où un employeur qui est une personne morale omet de verser ou de déduire un montant de la manière et au moment prévus au paragraphe 82(1), les administrateurs de la personne morale au moment de l'omission et la personne morale sont solidairement responsables envers Sa Majesté de ce montant ainsi que des intérêts et pénalités qui s'y rapportent.
(2) Subsections 227.1(2) to (7) of the *Income Tax Act* apply, with such modifications as the circumstances require, to a director of the corporation.	(2) Les paragraphes 227.1(2) à (7) de la *Loi de l'impôt sur le revenu* s'appliquent, avec les adaptations nécessaires, à l'administrateur de la personne morale.

[29] Paragraphs 228(1) and (2) of the *Excise Tax Act* require the filing of returns and the payment of remittances for the net tax owed in relation to goods and services, while subsection 323(1) provides that the directors of a corporation which has failed to so remit are jointly and severally, or solidarily, liable together with the corporation to pay the concerned amounts and any related interest

or penalties. Subsections 323(2) and (3) provide for certain limitations on the liability of directors which are similar to those set out in the *Income Tax Act* for employee source deductions:

228. (1) Every person who is required to file a return under this Division shall, in the return, calculate the net tax of the person for the reporting period for which the return is required to be filed, except where subsection (2.1) or (2.3) applies in respect of the reporting period.	**228.** (1) La personne tenue de produire une déclaration en application de la présente section doit y calculer sa taxe nette pour la période de déclaration qui y est visée, sauf si les paragraphes (2.1) ou (2.3) s'appliquent à la période de déclaration.
(2) 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,	(2) La personne est tenue de verser au receveur général le montant positif de sa taxe nette pour une période de déclaration dans le délai suivant, sauf les paragraphes (2.1) ou (2.3) s'appliquent à la période de déclaration :
(*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 (*b*) in any other case, on or before the day on or before which the return for that period is required to be filed.	*a*) si elle est un particulier auquel le sous alinéa 238(1)*a*)(ii) s'applique pour la période, au plus tard le 30 avril de l'année suivant la fin de la période; *b*) dans les autres cas, au plus tard le jour où la déclaration visant la période est à produire.
323. (1) 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	**323.** (1) Les administrateurs d'une personne morale au moment où elle était tenue de verser, comme l'exigent les paragraphes 228(2) ou (2.3), un montant de taxe nette ou, comme l'exige l'article 230.1, un montant au titre d'un remboursement de taxe nette qui lui a été payé ou qui a été déduit d'une somme dont elle est redevable, sont, en cas de défaut par la personne morale, solidairement tenus, avec cette dernière, de payer le montant

the amount and any interest on, or penalties relating to, the amount.

(2) 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) 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.

ainsi que les intérêts et pénalités afférents.

(2) L'administrateur n'encourt de responsabilité selon le paragraphe (1) que si :
a) un certificat précisant la somme pour laquelle la personne morale est responsable a été enregistré à la Cour fédérale en application de l'article 316 et il y a eu défaut d'exécution totale ou partielle à l'égard de cette somme;
b) la personne morale a entrepris des procédures de liquidation ou de dissolution, ou elle a fait l'objet d'une dissolution, et une réclamation de la somme pour laquelle elle est responsable a été établie dans les six mois suivant le premier en date du début des procédures et de la dissolution;
c) la personne morale a fait une cession, ou une ordonnance de faillite a été rendue contre elle en application de la *Loi sur la faillite et l'insolvabilité*, et une réclamation de la somme pour laquelle elle est responsable a été établie dans les six mois suivant la cession ou l'ordonnance.

(3) L'administrateur n'encourt pas de responsabilité s'il a agi avec autant de soin, de diligence et de compétence pour prévenir le manquement visé au paragraphe (1) que ne l'aurait fait une personne raisonnablement prudente dans les mêmes circonstances.

Analysis

The standard of care, diligence and skill

[30] There has been some debate in recent years as to whether the objective standard of care, diligence and skill developed by the Supreme Court of Canada in *Peoples Department Stores* in relation to paragraph 122(1)(*b*) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("CBCA") can extend to subsection 227.1(3) of the *Income Tax Act* and to subsection 323(3) of the *Excise Tax Act* which use almost identical language in their English versions and similar language in their French versions: *Hartrell v. Canada*, above at para.12; compare *Higgins v. Canada*, above at paras. 6 to 11, with *Liddle v. Canada*, 2009 TCC 451, 2009 D.T.C. 1296 at paras. 33 to 35. Paragraph 122(1)(*b*) of the CBCA reads as follows:

122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall	**122.** (1) Les administrateurs et les dirigeants doivent, dans l'exercice de leurs fonctions, agir :
(*b*) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.	*b*) avec le soin, la diligence et la compétence dont ferait preuve, en pareilles circonstances, une personne prudente.

[31] Though similar, the provisions of paragraph 122(1)(*b*) of the CBCA and of subsections 227.1(3) of the *Income Tax Act* and 323(3) of the *Excise Tax Act* have fundamentally different purposes. The different purposes to which these various provisions relate must inform the application of the standard of care, diligence and skill in each case.

[32] The duty of care in paragraph 122(1)(*b*) of the CBCA does not refer to an identifiable party as the beneficiary of the duty: *Peoples Department Stores* at para. 57. Thus, the identity of the beneficiaries of the duty of care under paragraph 122(1)(*b*) of the CBCA is open-ended and includes all creditors. This provision sets out a standard of behaviour that should reasonably be expected, though it does not provide an independent foundation for claims: *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, [2008] 3 S.C.R. 560 at para. 44.

[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.

[34] This *caveat* being stated, I agree with the trial judge that the "objective subjective" standard set out in *Soper* has been replaced by the objective standard laid down by the Supreme Court of Canada in *Peoples Department Stores*. I come to this conclusion in light of the language used in subsection 227.1(3) of the *Income Tax Act* and in subsection 323(3) of the *Excise Tax Act*, and also by applying the principle of the presumption of coherence between statutes.

[35] The words of legislation are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the legislation, the purpose of the legislation, and the intention of Parliament: *Bell ExpressVu Limited Partnership v. Rex*, [2002] 2 S.C.R. 559 at para. 26. Both subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* refer to the degree of care, diligence and skill "that a reasonably prudent person would have exercised in comparable circumstances." The reference to a reasonably prudent person is a clear indication that the test is objective rather than subjective.

[36] Moreover, the language used in paragraph 122(1)(*b*) of the CBCA is similar to that used in both subsections 227.1(3) of the *Income Tax Act* and 323(3) of the *Excise Tax Act*. This is not a mere coincidence, but rather a further indication that the standard of care, diligence and skill required by all these provisions is similar. Similar legislative language dealing with similar matters should be given a similar interpretation unless the legislative context indicates otherwise: *Pointe-Claire (City) v Quebec (Labour Court)*, [1997] 1 S.C.R. 1015 at para. 61; *R. v. Ulybel Enterprises Ltd.*, [2001] 2 S.C.R. 867, 2001 SCC 56 at para. 52; *Bell ExpressVu Limited Partnership v. Rex*,

above at para. 27; Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Markham, Ontario: LexisNexis Canada 2008) at pp. 223 to 225.

[37] Consequently, I conclude that the standard of care, skill and diligence required under subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* is an objective standard as set out by the Supreme Court of Canada in *Peoples Department Stores*.

[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.

[39] An objective standard does not however entail that the particular circumstances of a director are to be ignored. These circumstances must be taken into account, but must be considered against an objective "reasonably prudent person" standard. As noted in *Peoples Department Stores* at paragraph 62:

> The statutory duty of care in s. 122(1)(*b*) of the CBCA emulates but does not replicate the language proposed by the Dickerson Report. The main difference is that the enacted version includes the words "in comparable circumstances", which modifies the statutory standard by requiring the context in which a given decision was made to be taken into account. This is not the introduction of a subjective element relating to the competence of the director, but rather the introduction of a contextual element into the statutory standard of care. It is clear that s. 122(1)(*b*) requires more of directors and officers than the traditional common law duty of care outlined in, for example, *Re City Equitable Fire Insurance, supra* [[1925] 1 Ch. 407].

[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.

Does the standard under subsection 323(3) of the Excise Tax Act *apply differently than under subsection 227.1(3) of the* Income Tax Act*?*

[41] Since GST/HST is paid by third parties, while employee source deductions are funded by general business revenues which may be insufficient to allow their payment, the trial judge was of the view that an analysis under subsection 227.1(3) of the *Income Tax Act* must be carried out

separately from an analysis under subsection 323(3) of the *Excise Tax Act*. This distinction resulted in two different applications of the standard of care, diligence and skill defence.

[42] However, employee source deductions are also paid by third parties, the employees, and there is therefore no fundamental conceptual difference between employee source deductions remittances and GST/HST remittances which justify a separate analysis of the duty of care, diligence and skill defence on the sole basis of the origin of the funds. This notably flows from subsection 153(3) of the *Income Tax Act* which states that any amount withheld from employee remuneration "shall, for the purposes of this Act, be deemed to have been received at that time by the person to whom the remuneration, benefit, payment, fees, commissions or other amounts were paid." Similar provisions are found in subsection 21(5) of the *Canada Pension Plan* and in subsection 82(7) of the *Employment Insurance Act*.

[43] Consequently, the amounts withheld from employee remuneration for income tax, Canada Pension Plan and Employment Insurance purposes are deemed to have been paid by the employee for all purposes associated with these Acts, including for the purposes of assessing the liability of directors for the failure of their corporation to remit the amounts so withheld.

[44] In addition, subsection 227(4) of the *Income Tax Act* provides that those who deduct or withhold an amount under this Act are deemed to hold the amount separate and apart in trust for Her Majesty and for payment in the manner and at the time provided under the Act.

[45] The cash-flow analysis proposed by the trial judge is thus incompatible with the applicable provisions of the *Income Tax Act*. The liability of the directors under subsection 227.1(1) is not conditional on the existence of sufficient cash in the corporation to pay the remittances of employee source deductions, quite the contrary.

[46] The cash-flow analysis proposed by the trial judge also assumes that the time frame in which to assess the director's conduct begins when the corporation runs out of cash. The assessment of the director's conduct rather begins when it becomes apparent to the director, acting reasonably and with due care, diligence and skill, that the corporation is entering a period of financial difficulties: *Soper* at para. 50.

[47] The distinction proposed by the trial judge would also convert the liability of directors under section 323 of the *Excise Tax Act* into an absolute liability, which is clearly not the intention of Parliament in light of subsection 323(3) of that Act. The distinction would also result in directors having a lesser responsibility in relation to employee source deductions remittances than in relation to GST/HST remittances, a distinction which is not supported by the words of either section 227.1 of the *Income Tax Act* or section 323 of the *Excise Tax Act*. Since both these legislative provisions are drafted in similar terms, they should consequently be applied in a similar fashion. The introduction of a distinction which is not set out in the legislation should be avoided.

Can a defence under subsection 227.1(3) of the Income Tax Act *or under subsection 323(3) of the* Excise Tax Act *be sustained where the efforts of the directors are focussed on curing failures to remit rather than preventing such failures?*

[48] An important question arising from this appeal is whether a successful defence under subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act* can be sustained where the directors continue to operate the business of the corporation knowing that this could lead to and has in fact resulted in failures to remit in circumstances where they have a reasonable expectation that the failures could be cured, notably through asset sales or through the sale of part or all of the business. The trial judge took two apparently contradictory positions in this matter, accepting such a defence in regard to the employee source deductions remittances (Reasons at paras. 69 to 72) but rejecting it in regard to the GST/HST remittances (Reasons at para. 82).

[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.

[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]

[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.

[53] In this case, the trial judge found that until February 2003, the respondent had a reasonable expectation that the efforts being made would succeed in avoiding the failures to remit taxes, but that subsequent to that time, the efforts were rather aimed at curing defaults in remittances (Reasons at para. 69, reproduced above). This finding of fact has not been challenged before us. Thus, by the

end of February 2003 the respondent no longer had any reasonable expectation of preventing the failures of employee source deductions remittances and of GST/HST remittances.

[54] However, the trial judge further found that it was reasonable for the respondent to believe that the sale of the online course development division for $1.6 million could provide funds for the payment of arrears on remittances. Was this sufficient to dispel the respondent's liability for the remittances for the period after February 2003? The trial judge found that it was in relation to the employee source deduction remittances, but not in relation to GST/HST remittances.

[55] The trial judge justified his approach based on the reasoning that even if all the employees had been laid-off shortly after February 2003, reasonable notice would have been required giving rise to related source deductions remittances regardless of whether the company had sufficient revenues to cover such costs. He further found that in light of the contemplated sale of the online course development division for $1.6 million, it was reasonable that the employees of that division be retained until the sale was completed. I find neither of these arguments persuasive.

[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.

[58] The trial judge was consequently correct in concluding that a defence under subsection 323(3) of the *Excise Tax Act* was not available after February 2003 in light of his finding that the respondent's focus had shifted away from avoiding failures to remit the taxes owed. The trial judge however erred in not applying the same reasoning to the defence under subsection 227.1(3) of the *Income Tax Act* concerning the failures to remit employee source deductions after February 2003.

Conclusion

[59] I would grant the appeal in file A-224-10, set aside the judgment of the Tax Court of Canada in Docket 2008-2817(IT)G and, giving the judgment which should have been rendered, refer the matter back to the Minister of National Revenue for reconsideration and reassessment on the basis that the respondent is liable under section 227.1 of the *Income Tax Act*, section 21.1 of the *Canada Pension Plan* and section 83 of the *Employment Insurance Act* as a director of Mosaic Technologies Corporation, Multimedia Ventures (Alberta) Inc., Multimedia Ventures Inc. and 6678

British Columbia Ltd. for the amounts these corporations failed to remit under these Acts for the period subsequent to February 2003 as well as for any interest or penalties relating to these amounts.

[60] I would also dismiss the appeal in file A-225-10. I would order only one set of costs in favour of the Crown in file A-224-10.

"Robert M. Mainville"
J.A.

"I agree
M. Nadon J.A."

"I agree
J.D. Denis Pelletier J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-224-10
APPEAL FROM A JUDGMENT OF THE TAX COURT DATED MAY 6, 2010, NO. 2008-2817(IT)G	
STYLE OF CAUSE:	Her Majesty the Queen v. Kevin Richard Buckingham
PLACE OF HEARING:	Fredericton, New Brunswick
DATE OF HEARING:	April 6, 2011
REASONS FOR JUDGMENT BY:	Mainville J.A.
CONCURRED IN BY:	Nadon J.A. Pelletier J.A.
DATED:	April 21, 2011

APPEARANCES:

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D. Andrew Rouse	FOR THE RESPONDENT

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