Docket: 2006-516(GST)G

BETWEEN:

DANIEL SAVARD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 26, 2007, at Québec, Quebec

Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant: Robert Marcotte

Counsel for the Respondent: Philippe Morin

JUDGMENT

The appeal from the assessment made under the *Excise Tax Act*, notice of which is dated April 30, 2004, and bears the number PQ-2004-7597, is allowed with costs and the assessment is vacated.

Signed at Fredericton, New Brunswick, this 13th day of June 2008.

"François Angers"

Angers J.

Translation certified true
on this 5th day of November 2008.

Brian McCordick, Translator

Citation: 2008TCC309
Date: 20080613
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DANIEL SAVARD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Angers J.

[1] In 2002 and 2003, the Appellant was the sole director of Industries F.D.S. inc. ("F.D.S."). F.D.S. was registered for the purposes of the *Excise Tax Act* ("the Act"). F.D.S. filed net tax returns and an audit was conducted, with the result that it was determined that F.D.S. had collected goods and services tax (GST) but failed to remit the tax collected for the period from February 1, 2002, to July 31, 2003.

[2] On January 25, 2002, F.D.S. filed a notice of intent to file a proposal under the *Bankruptcy and Insolvency Act* ("the BIA"). The proposal was filed on March 1, 2002, and a meeting of creditors was held on March 21. The creditors accepted the proposal, which was then approved by the Quebec Superior Court on April 19, 2002. Groupe Thibault Van Houtte et associés ltée ("the trustee") was appointed as trustee for the proposal.

[3] The trustee made a motion in the Quebec Superior Court on September 15, 2003, asking that the proposal made by F.D.S. be set aside and seeking an order declaring F.D.S. to be bankrupt on the ground that there were still large sums unpaid,

since the National Bank of Canada, the main short-term lender to F.D.S., was continually reducing F.D.S.'s authorized credit, thus reducing the amounts available to it to repay the unpaid sums and pay suppliers. The trustee also added the ground that it had learned that the National Bank of Canada was having F.D.S. pay the security it had given for Autocars Champlain inc., and so F.D.S.'s self-managed funds during the course of the proposal were used to pay the security given by F.D.S. to the bank for amounts potentially owed by Autocars Champlain inc., thus causing injustice to the creditors of F.D.S. and making it impossible to carry out the proposal. The Quebec Superior Court allowed the motion, and on September 17, 2003, the proposal was set aside and F.D.S. was declared bankrupt.

[4] On October 16, 2003, the Respondent filed a proof of claim, which was amended on March 22, 2004. However, the Appellant is contesting the amount of the assessment, arguing that it is larger than F.D.S.'s actual tax debt, because the amount should be reduced by the amount of the refunds owed to F.D.S. by the Canada Revenue Agency for scientific research and experimental development (SR&ED) tax credits for the 2002 and 2003 fiscal years. The Appellant also argues 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.

[5] F.D.S. carries on a business providing repair, towing and similar services for heavy and high-end vehicles. In the Appellant's submission, the company generated very good revenue and profits of $200,000 to $1,000,000 per year. Because of purchases by certain of F.D.S.'s corporate customers and the events of September 11, 2001, F.D.S., according to the Appellant, lost 80% of its reservations. F.D.S. then found itself in a situation in which its bank, the National Bank of Canada, called in F.D.S.'s loans, thus reducing the funds available to it to carry on its business. In the Appellant's submission, this situation could not continue, and the result was the proposal made in January 2002.

[6] At the same time as the proposal was filed and approved by the Court, in March and April 2002, and a trustee was appointed, the National Bank required that an accounting firm prepare cash flow forecasts and provide weekly oversight of F.D.S. This cost the Appellant $86,159 for the period from March 15, 2002, to January 18, 2003. The Appellant asserts that the accounting firm's representative handled everything. He decided what purchases F.D.S. would make; in other words, he decided what the expenses would be. On the other hand, expenses had to be reduced, and so the only expenses permitted where those that would produce

revenue, and wages. The representative sent the bank the details of the expenses, and the Appellant asserts that it was the representative who decided who would be paid.

[7] F.D.S's returns and net tax calculations under the Act were done each month. According to the Appellant, the GST returns were always done on time and the company owed no net tax before the notice of intention to file a proposal was filed at the end of January 2002. F.D.S. had a vice-president of finance and an entire management team that handled the returns and remittances, and it was their responsibility to ensure that everything was done. The Appellant testified that after the notice of intention was filed, the rules changed and the staff responsible for that task were replaced by the representative of the accounting firm retained by the National Bank, and so after the notice of intention he no longer was in full control of the management of his business. According to him, the accounting firm's representative had instructions to ensure that the bank was repaid. He argued that even if F.D.S. had written a cheque to pay its taxes, it would have been declined by the bank, just as in the case of other suppliers that F.D.S. could not pay because it could not earn income. In fact, the only creditors that were paid were the ones that the representative of the accounting firm, or the bank, allowed.

[8] The details of the assessment are set out in Exhibit I-3, which reads as follows:

[TRANSLATION]

GST								
Period	**Statutory filing date**	**Actual filing date**	**Type of assessment**	**Amount owing**	**Actual filing date**	**Type of assessment**	**Amount**	**Total**
Feb-02	2002-04-02	2003-09-07	audit	$86.57				$86.57
Mar-02	2002-04-30	2003-09-17	audit	$86.57				$86.57
May-02	2002-07-02	2002-07-10	original	$573.58	2003-09-17	audit	$86.57	$660.15
Jul-02	2002-09-03	2002-11-18	original	$2,707.96	2003-09-17	audit	$86.57	$2,794.53
Aug-02	2002-09-30	2002-11-22	original	$1,323.26	2003-09-17	audit	$86.57	$1,409.83
Sep-02	2002-10-31	2003-09-17	audit	$119.02				$119.02
Oct-02	2002-12-02	2002-12-02	original	$2,698.42	2003-09-17	audit	$86.57	$2,784.99
Nov-02	2003-01-03	2003-04-16	credit balance chq	$4,841.03	2003-09-17	audit	$86.57	$4,927.60
Dec-02	2003-01-31	2003-01-31	original	$2,403.82	2003-09-17	audit	$86.57	$2,490.39
Feb-03	2003-03-31	2003-04-01	original	$15.05	2003-09-17	audit	$404.28	$419.33
Mar-03	2003-04-30	2003-09-17	audit	$20,865.81				$20,865.81
Apr-03	2003-06-02	2003-09-17	audit	$155.87				$155.87
May-03	2003-06-30	2003-07-31	original	$2,141.04	2003-09-17	audit	$2,373.75	$4,514.79
Jun-03	2003-07-31	2003-09-17	audit	$2,170.90				$2,170.90
Jul-03	2003-09-02	2003-09-17	audit	$17,750.29				$17,750.29
								$61,236.64

[9] With respect to the amount of tax under the Act for which F.D.S. was assessed, the evidence presented by the Appellant shows that the amount changed several times over the course of the consideration of F.D.S.'s case. At the time the proof of claim was filed, on October 16, 2003, the amount claimed for GST was $476,133. A few months later, on March 22, 2003, the amount had been reduced to $459,889. On January 14, 2004, the director of audits at Revenu Québec sent the trustee in bankruptcy a draft GST assessment in the amount of $154,511.16. On February 17, 2004, the amount for which F.D.S. was assessed for GST was $150,755. F.D.S. itself had estimated that it owed the Canada Revenue Agency $100,000 for GST.

[10] The Appellant's arguments and questions regarding the amount owing are based on the fact that he asked the trustee in bankruptcy to claim a scientific research and experimental development (SR&ED) tax credit on behalf of F.D.S. The tax credit claimed was for the amount of $215,980. The trustee in bankruptcy made the claim, but it was too late, and so a second claim was needed; according to the Appellant, the mistake caused significant harm and resulted in the trustee in bankruptcy settling the tax credit claim for half of the value sought. The decision to settle the claim for half its value was within the sole authority of the trustee in bankruptcy. In the Appellant's submission, this was a blatant error and was very harmful to F.D.S., which could have applied the credit to F.D.S.'s debt to the Agency.

[11] According to the tax collection officer, the discrepancies in the amounts depend on the periods for which the claims are made and the fact that certain periods were withdrawn, including one going back to August 31, 2003, which was for $104,886. Those amounts were therefore not claimed since they were outside the period in issue, she said. She also acknowledged that an amount from the SR&ED tax credit, $46,906, was received in February 2006, but was applied to August 2003, therefore outside the period covered by the assessment of the Appellant in his capacity as director. On cross-examination she admitted that ordinarily a payment of that nature would be applied to the earliest period. According to Exhibit I-2, the balance owing on February 28, 2002, the beginning of the period in issue, was $86.57.

[12] The question is therefore whether the Appellant acted with the degree of care, diligence and skill to prevent the failure by F.D.S. to remit the net tax payable that a reasonably prudent person would have exercised in comparable circumstances. The second question, in the event that the answer to the first question is that the Appellant did not act in accordance with the standard established, is whether the amount shown in the assessment by the Minister exceeded F.D.S.'s true tax debt, because the true

amount of that debt should be reduced by the amount of the refunds owed by the Canada Revenue Agency to F.D.S.

[13] The statutory provisions that are relevant in this case are subsections 323(1) and (3) of the Act:

> **323(1) Liability of directors** — Where a corporation fails to remit an amount of net tax as required under subsection 228(2) or (2.3), the directors of the corporation at the time the corporation was required to remit the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest thereon or penalties relating thereto.
>
> …
>
> **(3) Diligence** — A director of a corporation is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

[14] In *Soper v. R.*, [1998] 1 F.C. 124, the Federal Court of Appeal did a detailed analysis of the defence of reasonable diligence as set out in subsection 227.1(3) of the *Income Tax Act*, which is worded identically to subsection 323(3) of the Act. *Soper* provides an "objective subjective" test for applying the reasonable diligence standard. However, in *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004], 3 S.C.R. 461, the Supreme Court of Canada changed that test and adopted an objective standard for applying paragraph 122(1)(*b*) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44), and thus subsection 323(3) of the Act, which is worded identically. At paragraph 63 of that decision, the Court stated:

> 63 . . . To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director or officer are important in the case of the s. 122(1)(*b*) duty of care, as opposed to the subjective motivation of the director or officer, which is the central focus of the statutory fiduciary duty of s. 122(1)(*a*) of the CBCA.

[15] At paragraph 67 of the decision, the Court added that the duty of care may be met if the directors acted prudently and based their decisions on the information available to them. They need not make the best decision; rather, they must make a business decision that is reasonable in the circumstances. As well, it must be noted that in applying the test of prudence, the business decision should not be analyzed in light of subsequent facts, but only by taking into account the information available to the directors at the time the decision was made.

> 67 Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(*b*) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.

[16] Is it possible that when a third party takes over, a director is not liable, particularly if the third party interferes in the administration and management of the company when the company is in financial difficulty, or when a trustee is appointed after a proposal is made under the BIA? In *Robitaille v. Canada*, [1990] 1 F.C. 310, Mr. Justice Addy of the Federal Court, discussing a director's liability, said that a director will not be liable if the director cannot act freely in his or her capacity as a director. He wrote, at page 318:

> 29 Furthermore, where the effective control of the corporation has been taken over by a bank such as in the case under appeal, without the bank being requested or invited to do so by the directors, and where the decisions as to what cheques will or will not be issued without consultation with the Board of Directors, are exclusively those of the bank, then from that time the actions of the corporation regarding the payment or withholding of monies are essentially those of the bank and I would be prepared to hold that, even without considering section 227.1(3), there would be no liability on the directors under section 227.1(1) because the latter obviously contemplates that the corporation is freely acting through its Board of Directors. The exercise of freedom of choice on the part of the director is essential in order to establish personal liability.

[17] In *Canada v. McKinnon*, [2001] 2 F.C. 203, the Federal Court of Appeal reviewed a number of decisions in which directors were not held liable under subsection 227.1(1) of the *Income Tax Act* on the ground, *inter alia*, that they had lost the ability to remit source deductions or net tax because the bank was managing the company's finances.

[18] In *McKinnon*, *supra*, the Federal Court of Appeal considered the question of whether control is a requirement in order for subsection 227.1(1) of the *Income Tax*

Act to apply. The answer may be seen in paragraphs 58 to 60 of the decision, which I reproduce below:

> [58] With all respect to those who have taken a different view, in my opinion it is inappropriate to import into subsection 227.1(1) a requirement that it is only engaged if the directors have *de facto* control over the financial operation of the company, particularly the payment of its bills.
>
> [59] First, these words are not contained in the statute, and courts should normally not add words to those in the statutory text approved by Parliament.
>
> [60] Second, the due diligence exemption in subsection 227.1(3) will prove broad enough to provide a defence to directors who have acted with propriety in attempting to prevent defaults by their company. It is therefore unnecessary to read the notion of control into subsection (1) in order to ensure that directors are not saddled with liability when their conduct to prevent the company's failure to remit satisfied the standard of the care that a reasonable person would have exercised in comparable circumstances to prevent the defaults.
>
> [61] Moreover, "control" is not a monolithic concept and it will inevitably be difficult to determine whether, in a given case, the directors retained sufficient "control" to trigger subsection (1). The situation is different on the appointment of a receiver whose legal powers supercede those of the directors who, in a functional sense, cease to be directors and thus fall outside the ambit of subsection 227.1(1): see, for example, *Drover v. Canada* (1998), 161 D.L.R. (4th) 518 (F.C.A), at paragraph 4.
>
> [62] Third, if the concept of "control" extends to a *de facto* inability to take measures to ensure that remittances are paid when they fall due because the company's bank will not honour cheques in favour of Revenue Canada, then a director would not become liable under subsection 227.1(1), regardless of whether it was reasonable to keep the business going, and of the length of time that it was operated without making remittances when legally due. The reasonableness of a director's conduct is only relevant as a defence under subsection 227.1(3) once liability under subsection (1) has been engaged.

[19] In this case, a receiver was not appointed until the proposal was set aside by the Quebec Superior Court, on September 17, 2003, that is, on a date subsequent to the period in issue. On the question of objections by a trustee appointed under a proposal, the BIA gives the trustee no powers of management. The trustee's role is defined in subsections 50(5), (9) and (10) of the BIA. A trustee makes an appraisal and investigation of the company and reports the results to the creditors. According to Paul-Émile Bilodeau in *Précis de la faillite et de l'insolvabilité*, 2nd edition, 2004, p. 237, a trustee [TRANSLATION] "has only the powers that the proposal grants".

The parties may agree between themselves that the trustee under the proposal will be responsible for directing the company, but no evidence was introduced in this case from which it could be concluded that the trustee under the proposal assumed a managerial office or function or took control of the company to the detriment of its director.

[20] The Appellant in this case did not legally lose control of F.D.S. Accordingly, and pursuant to *McKinnon*, *supra*, I cannot find that the Appellant may not be held liable for the debts of F.D.S. because he lost legal control during the period in issue. There is no absence of liability in this case. We must therefore come back to the first question: whether the Appellant acted with the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

[21] The unique circumstances in this case involve the role played by the representative of the National Bank in the day-to-day management of F.D.S. and the authority the representative may have exercised over payment of debts owed by F.D.S. I would note straight away that the Appellant's testimony seemed to me to be forthright and candid; his main concern was that the Bank was reducing F.D.S.'s credit, both before and after the proposal, and this concern was borne out by the trustee's affidavit in his motion to terminate the proposal, in which he stated that the Bank was in fact reducing F.D.S.'s authorized credit and it was having F.D.S. pay the security it had given the Bank for Autocars Champlain inc., thereby causing an injustice to F.D.S.'s creditors.

[22] There is no doubt in my mind that when the National Bank required that a representative of an accounting firm be retained, its sole objective was to protect its interests. All of the arrangements put in place by the Appellant in relation to the management of F.D.S., such as its vice-president of finance and the entire management team, which handled tax returns and remittances, were replaced by that representative, and it was that representative who decided, with the Bank's involvement, which creditors were going to be paid. According to the Appellant, priority was given to expenditures that might bring in revenue.

[23] The Appellant could have acted more speedily and required that F.D.S. declare bankruptcy sooner. In addition to having injected funds himself amounting to some $200,000, it was entirely reasonable, in my opinion, for him to believe that the situation could be salvaged. The trustee surely must have believed this too, since he also took some time before applying to have F.D.S. declared bankrupt.

[24] I am therefore of the opinion that in the circumstances, the Appellant had lost *de facto* control and that the fate of F.D.S. lay in the hands of the representative of the National Bank and of the Bank itself, whether it was justified in what it did or not. The Appellant therefore acted to the best of his ability to avoid the failure. Even the trustee under the proposal, who was to oversee the activities and finances of the insolvent person (F.D.S.), was unable to do anything about what the Bank was doing. I therefore believe the Appellant when he says that even if he had required that the tax owing be paid, the Bank would not have honoured the cheque.

[25] The appeal is allowed and the assessment made against the Appellant is vacated. Although it is not necessary for me to address the second question, I would note that there is nothing that would justify the failure to follow the Agency's usual practice of applying payments to the oldest debts in this case. The fact that the payments were applied to debts that came immediately after the period in issue leaves an impression of bad faith on the part of the Agency, which thought it would undoubtedly be possible for it to take action against the Appellant personally. The payment should therefore have been deducted from the assessment in issue or other debts during the period in issue.

[26] The appeal is allowed with costs and the assessment is vacated.

Signed at Ottawa, Canada, this 13th day of June 2008.

"François Angers"

Angers J.

Translation certified true
on this 5th day of November 2008.

Brian McCordick, Translator

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APPEARANCES:

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