Citation: 2008 TCC 363
Date: 20080623
Docket: 2005-3085(IT)G

BETWEEN:

ALLAN WARRING,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

ORAL REASONS FOR JUDGMENT
(Delivered from the Bench on June 1, 2007
at Hamilton, Ontario)

Campbell J

[1] This is an appeal from an assessment made pursuant to section 227 and subsection 227.1(1) of the *Income Tax Act* (the "*Act*"). The Appellant was assessed for the failure by the Appellant's corporation to remit source deductions for the period ended September 7, 2000 in the amount of $57,042.55 together with interest in the amount of $4,253.42.

[2] The Appellant testified that he has been in business since 1980. He and his brother operated D.A. Warring & Sons Foods Ltd., which was involved in the business of poultry wholesale and sales to independent grocers.

[3] As I understood the Appellant's evidence, this company successfully supplied the National Grocers Group throughout Ontario and Québec with frozen poultry. When National Grocers changed its marketing and distribution techniques, D.A. Warring & Sons Foods Ltd. lost Loblaws as a customer and, with this loss, the business floundered over the next few years.

[4] Eventually the business shut down and a decision was made to purchase a shelf company, 1312662 Ontario Inc., operating as Warring Transport. It was incorporated on September 11, 1998, although actual operations did not commence, according to the evidence, until April 1999. Its focus was in the transport area. This company was plagued with problems from the very outset. The bank would not

provide a line of credit so the Appellant and his brother invested the sum of $50,000.00 from available cash balances on their credit cards. Almost immediately a complaint was lodged against the company alleging that it was not sufficiently separated from the former company, D.A. Warring & Sons Foods Ltd. The Appellant represented the company in this complaint and did not engage legal counsel. While the Appellant was dealing with this legal issue, he had his licence revoked for failure to pay child support amounts. The Appellant stated that he worked long hours and tried to cut costs but nothing worked for him and the company continued to under-perform and lose money.

[5] In the midst of these problems, his brother left the company in February 2000. Initially he engaged an outside bookkeeping service to pay staff and remit deductions. He thought that it was probably January 2000 that the company stopped using this outside service.

[6] The Appellant acknowledges that he was a director and officer throughout 1999 and 2000. He also admitted on cross-examination that he was primarily responsible to pay fuel charges and staff expenses in the year 2000. He did not believe that he made any payments to the Receiver General in respect to employee source deductions in 2000. He felt that one of his primary responsibilities was to his staff and their families and to ensure he could keep employing and paying them. During all this time he testified that his primary purpose was to make the company profitable so that it could get out of debt. With the advantage of hindsight he stated that he should have shut the company down long before he did. Eventually in June 2000, approximately one year after it started operating, he approached a trustee in bankruptcy to close the business. He stated that when he completed the assignment to the trustee, he thought he was relieved from his responsibilities as a director.

[7] The issue is whether the Appellant as director of the numbered company is jointly and severally liable with the company for payment of the amounts of federal income tax as required to be remitted by section 153 of the *Act*, together with interest. In deciding this issue, I must determine whether the Appellant acted with the same care, diligence and skill, to prevent the company's failure to pay these amounts, that a reasonably prudent person would exercise in comparable circumstances.

[8] Justice Robertson in the case of *Soper v. Canada*, [1997] F.C.J. No. 881, reviewed the historical significance and origins of section 227.1. Prior to its enactment, directors generally gave preference to those creditors and suppliers that supplied goods and services essential to the sustenance of the corporate activities instead of amounts owed to the Minister of National Revenue (the “Minister”). It was to address this potential abuse that led to the enactment of section 227.1. It is not an

absolute liability provision, however, and a director may, under subsection 227.1(3) be relieved of personal liability for amounts owed by the corporation to the Minister by showing that he acted with the requisite care and diligence required of a reasonably prudent person in similar circumstances.

[9] There is a great deal of caselaw in this area but each case turns on its own facts. The caselaw makes it clear that directors will be under a duty to anticipate and to take steps to prevent a failure to remit sums owing (*Veilleux v. Canada,* [2001] F.C.J. No. 547*; Worrell v. Canada,* [2000] F.C.J. No. 1730; *Ruffo v. Canada,* [2000] F.C.J. No. 551; and *Wheeliker v. Canada,* [1999] F.C.J. No.401). It is also a generally accepted principle that directors should not use funds, which a company otherwise owes as remittance to the Minister, to finance its current operations. This translates to a duty upon directors to prevent failure to remit amounts owing and not to cure defaults after the fact. While Justice Robertson in *Soper*, applied an objective/subjective standard in determining if directors have acted prudently and reasonably in the circumstances, the Supreme Court of Canada in Peoples Department Stores appeared at first glance to reject Robertson's test in favour of an objective standard. Although there may not be consensus in this Court as to which test applies, I do not feel that I need to resolve that issue here in order to dispense with this appeal. Some of the questions which the cases have directed us to answer are:

> 1. Did the director make reasonable business decisions under the circumstances?
>
> 2. Were the actions taken by a director to prevent the failure, those of a reasonable prudent person in similar circumstances?
>
> 3. What positive steps were taken to prevent the failure to remit and what steps were ignored or not taken? and
>
> 4. As Justice Bowman stated in *McKinnon v. Canada,* [2003] T.C.J. No 715, due to unforeseen events, was there anything more the director could have done?

[10] In *Mosier v. Canada,* [2001] T.C.J. No 692, Justice Bowman, in addressing the standard of care to which a director will be held accountable under section 227.1, stated the following:

> …one must ask whether, in light of the facts that existed at the time that were known or ought to have been known by the director, and in light of the alternatives

> that were open to that director, did he or she choose an alternative that a reasonably prudent person would, in the circumstances, have chosen and which it was reasonable to expect would have resulted in the satisfaction of the tax liability. That the alternative chosen was the wrong one is not determinative.

[11] Turning now to the facts before me, Mr. Warring was in effect an inside director. He was actively involved in the daily operation of the company and he had in excess of 20 years of prior experience in the poultry and transport business. He acknowledged that he was aware that source remittances, in respect to wages, were not being paid. He testified that he made a conscious decision in early 2000 not to remit them to the Minister because he wanted to ensure that his staff were paid. Suppliers of fuel were also given preference over the payment of remittances. Mr. Warring appears to be an honest individual and he testified he has always paid his taxes up to this point. I believe he always intended to "catch up" with these payments at some future date when his company would start to turn a profit. The problem here is that Mr. Warring, despite his lengthy experience in this industry and his past exposure with the loss of his first company, commenced this second corporate operation with full knowledge that financially it was already "behind the 8 ball". Most businesses in the beginning phases encounter difficult and prolonged periods of financial stress. However, I believe the reasonable and prudent individual, with the facts I have before me, would and should have measures in place to deal with its finances.

[12] In this appeal, the Appellant could not obtain any assistance from the banks or from outside investors and therefore the documentation shows that the business was undercapitalized from the very outset. There was no indication that some unforeseen circumstances arose which threw "a monkey wrench" into the Appellant's plans. Certainly his first company, D.A. Warring & Sons Foods Ltd., that was forced to shut down when it lost Loblaws as a customer, had a number of unforeseen events that affected its financial picture but the evidence does not suggest anything akin to this occurred in the brief one year period in which this second company operated. In fact the Appellant's statement of earnings shows that just a few months into the operations, there were large cash flow problems. I believe Mr. Warring when he told me he tried his best to make the company work. He was also involved in ongoing family problems but, as I understood his evidence, these problems had commenced prior to the start up of this company which was facing insurmountable financial woes right from the outset. I do not believe that it was realistic in these circumstances to commence a transport company without some kind of financial backing and a plan in place to satisfy the future corporation's obligations. When his brother left the business in February 2000, this event may have been unforeseen but all of the financial problems existed long before this occurrence. While I do not believe it is

my job to second guess business decisions of a taxpayer, I must review Mr. Warring's actions against the backdrop of the prudent, reasonable person with the Appellant's lengthy history in the industry. I am sympathetic with Mr. Warring and would like to assist him. However, he took absolutely no positive steps to deal with these remittances. There is no evidence that he was in regular communication with Canada Revenue Agency (the "CRA") about these remittances or that he tried to distribute the money amongst all the creditors or that he considered closing down the business at an earlier date to halt the losses.

[13] I am fully cognizant that staff and suppliers must be paid or a business will close. However, all of these financial obligations existed from the outset, as well as, a host of others, including remittances. The intent to pay at some point in the future if the company becomes successful is not the equivalent of concrete positive action taken in the present in order to prevent a default. It is simply not the actions of a prudent and reasonable person to forge blindly ahead when, from day one, the company clearly had major financial problems for which it had no banking assistance or other investment support and there was no back up plan in place to deal with these issues.

[14] Consequently, I have no choice but to dismiss this appeal but without costs to the Respondent.

Signed at Ottawa, Canada, this 23rd day of June 2008.

"Diane Campbell"

Campbell J.

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APPEARANCES:

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