

1999-2041(GST)I

BETWEEN:

741521 ONTARIO INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on March 6, 2000 at Toronto, Ontario by
the Honourable Judge Gerald J. Rip

Appearances

Agent for the Appellant: Stan Swartz

Counsel for the Respondent: Steve D. Leckie

JUDGMENT

The appeals from the assessments made under Part IX of the *Excise Tax Act*, notices of which are dated July 21, 1997 and bear numbers 986981, 986982 and 986983 are dismissed.

Signed at Ottawa, Canada, this 28th day of March 2000.

"Gerald J. Rip"

J.T.C.C.

Date: 20000328
Docket: 1999-2041(GST)I

BETWEEN:

741521 ONTARIO INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Rip, J.T.C.C.

[1] 741521 Ontario Inc., carrying on business as "Metro Printing and Litho" ("Metro"), has appealed assessments of tax issued under Part IX (Goods and Services Tax) of the *Excise Tax Act* ("Act") for the periods August 1, 1995 to October 31, 1995, November 1, 1995 to January 31, 1996 and February 1, 1996 to April 30, 1996.

[2] The issue before me is whether consideration and Goods and Services Tax ("GST") payable in respect of taxable supplies the appellant made to several recipients were in whole or in part a bad debt within the meaning of subsection 231(1) of the *Act* and if the appellant is entitled to input tax credits in the amount of \$21,515.46 which the Minister of National Revenue ("Minister") denied for the period from August 1, 1995 to October 31, 1995. Adjustments made by the Minister for the subsequent periods were \$2,821.06 and \$158.43 respectively.

[3] The circumstances surrounding these appeals are distressing.

[4] The appellant carries on the printing business in the Toronto area. The shareholders of the appellant are Tom Pateras and Mrs. Pateras. Mr. Pateras is president.

[5] In about 1987 the appellant began a relationship with one Joseph Cheng, a printing broker. Apparently printers are rather specialized and Mr. Cheng would put people requiring specific printing services together with a particular printer whose specialty the person (customer) requires. Mr. Pateras determined whether a customer brought to him by Cheng was credit worthy or not. Metro set the prices and delivery schedules. Metro invoiced the customer and paid Mr. Cheng a commission.

[6] Mr. Pateras did not deal with the customers; this was Mr. Cheng's job. Mr. Pateras believed that as long as the customer was being serviced by Mr. Cheng and was paying on time there was no need to have contacts with the customer. If Mr. Pateras had a problem with a customer he would deal directly with Mr. Cheng. Mr. Cheng was the person who met the customers, determined their needs, provided Metro's price quotations and scheduled production and delivery; all this was done in consultation with Mr. Pateras.

[7] Mr. Pateras had great faith in Mr. Cheng. As the years progressed their relationship grew and Mr. Pateras depended more and more on Mr. Cheng. Mr. Pateras gave him authority to deliver invoices to customers, collect the invoiced amounts and to make deposits of these amounts into the appellant's bank account.

[8] In fact, Cheng took over the administration of the appellant. Mr. Cheng wanted more control over invoices and "we let him have that control" said Mr. Pateras. Mr. Pateras indicated that there were so many codes with respect to printing jobs and since Mr. Cheng knew the codes, it was easier for Mr. Cheng to take care of the administration. He also needed Mr. Cheng to help service the accounts.

[9] It appears that Cheng felt at home at Metro. His customers would frequently telephone him at the appellant's office. Mr. Pateras would take messages for Mr. Cheng or direct the call to Mr. Cheng's cell phone.

[10] Mr. Cheng was not an employee of the appellant. He was not paid anything to collect and deposit funds.

[11] In the second half of 1989 Mr. Cheng caused a corporation, 857411 Ontario Inc. ("Ontario") to be incorporated and on September 11, 1989 he caused that corporation to register the name "Metro Printing and Litho Consulting". Mr. Cheng

appears to have been the sole director of Ontario. He also caused Ontario to open a bank account with the Royal Bank of Canada.

[12] During the preparation of the appellant's financial statements for the year ended October 31, 1995 the appellant's accountants were unable to reconcile the accounts. They determined that approximately \$100,000.00 was missing from the appellant's income. Mr. Pateras was advised of the discrepancies and he mentioned this to Mr. Cheng. In the meantime the appellant's accountants began their investigation. They eventually concluded that Mr. Cheng was collecting money from customers on the basis of the appellant's invoices and depositing the money into Ontario's bank account at the Royal Bank of Canada. Apparently the customers would issue a cheque payable to Metro Printing and/or Metro Printing and Litho and this would be sufficient for Ontario's banker to accept these cheques for the benefit of Ontario.

[13] During the time Mr. Cheng was collecting cheques for Metro Mr. Pateras never actually checked his bank account. Since Metro's bills were being paid, he assumed the money was going into its own bank account. If a bill had not been paid then Mr. Pateras complained to Mr. Cheng, Mr. Cheng would withdraw funds from Ontario's bank account for deposit to Metro's account.

[14] Mr. Cheng, if anything, was not meek. Once he was advised that \$100,000.00 was missing from the appellant's bank account, he caused the appellant to bill over \$200,000.00 over the next two months, which amounts he collected and deposited into Ontario's bank account.

[15] In all, according to Mr. Pateras, Mr. Cheng absconded with approximately \$500,000. Eventually Mr. Cheng was found out and prosecuted. He was sentenced to nine months in prison.

[16] The appellant's position is that since Cheng received payment from the customers, the appellant was unable to collect the amounts it ought to have received and therefore the debts were bad debts. The appellant says it did not deal with the customers, that the customers were Mr. Cheng's. The appellant says that it made taxable supplies in the normal course of business to Ontario and it was Ontario that supplied goods to the customers. Therefore there was a debtor-creditor relationship between the appellant and Ontario and since Ontario was unable to make payment for the supplies, the debt from Ontario to the appellant is bad and the collection of the GST with respect to the bad debts is also bad and therefore not payable.

[17] While I have utmost sympathy for the situation the appellant and its shareholders find themselves in I cannot accept the fiction that either Mr. Cheng or Ontario were recipients of the supplies from the appellant. The appellant made out invoices to various customers. The appellant permitted Mr. Cheng to deliver the invoices and to collect the amounts invoiced. The appellant authorized Mr. Cheng to make deposits to its bank account. The appellant empowered Mr. Cheng to deal with customers.

[18] Professor Fridman describes agency as a relationship that exists between two persons when one, called the *agent*, is considered in law to represent the other, called the *principal*, in such a way as to be able to affect a principal's legal position in respect of strangers to the relationship by the making of contracts or the disposition of property.¹

[19] An agent may act gratuitously and even in the absence of contract, because there is no consideration, the agent is still obliged to exercise care in the handling of his principal's affairs.² Professor Fridman cites Scrutton, L.J. in *Lloyds Bank Ltd. v. Chartered Bank of India, Australia & China* to the effect that:³

A third party dealing in good faith with an agent within his ostensible authority is not prejudiced by the fact that as between the principal and his agent, the agent is using his authority for his own benefit and not for that of the principal.

[20] The fact, therefore, that an agent violates the authority given to him by the principal and acts in a manner detrimental to the interests of the principal does not affect the right of a third party acting in good faith who has dealt with the agent. The principal cannot repudiate the agency if it causes injury to third parties.⁴

[21] Mr. Cheng was agent of the appellant in dealing with the customers in the normal course of the appellant's business. Mr. Cheng misappropriated or embezzled money from the appellant. When he collected money from the

¹ Fridman, G.H.L., The Law of Agency, 7th ed. , Butterworths, Toronto, 1996, p. 11.

² *ibid* at 16.

³ Cited at p. 113: [1929] 1 K.B. 40 at 56.

⁴ *Ibid.* at pp. 111-112.

customers, the customers were paying him on the basis that he was a representative or agent of the appellant. These customers paid the appellant for goods provided, and services rendered, by the appellant. The debts could not be said to be bad because the debtors paid them in good faith to the person who was the appellant's representative. The money was collected by Metro. Metro's inability to secure the amounts collected on its behalf by its agent is not, as far as I am aware, a bad debt.

[22] The appeals are dismissed.

Signed at Ottawa, Canada, this 28th day of March 2000.

"Gerald J. Rip"

J.T.C.C.

COURT FILE NO.: 1999-2041(GST)I

STYLE OF CAUSE: 741521 Ontario Inc. and
Her Majesty the Queen

PLACE OF HEARING: Toronto, Ontario

DATE OF HEARING: March 6, 2000

REASONS FOR JUDGMENT BY: The Honourable Judge Gerald J. Rip

DATE OF JUDGMENT: March 28, 2000

APPEARANCES:

Agent for the appellant: Stan Swartz

Counsel for the respondent: Steve D. Leckie

COUNSEL OF RECORD:

For the appellant:

Name:

Firm:

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