Docket: 2008-280(GST)G

BETWEEN:

SALEM NACHAR,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 27, 2010, at Vancouver, British Columbia.

Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the Appellant:	Ronald G. Pederson
Counsel for the Respondent:	Elizabeth (Lisa) McDonald

JUDGMENT

The appeal from the assessment dated November 29, 2006, made by the Minister of National Revenue (**Minister**) under section 323 of the *Excise Tax Act*, is allowed, with costs, and the assessment is vacated.

Signed at Ottawa, Canada, this 21st day of January 2011.

"Lucie Lamarre"

Lamarre J.

Citation: 2011 TCC 36
Date: 20110121
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REASONS FOR JUDGMENT

Lamarre J.

[1] This is an appeal from an assessment dated November 29, 2006, made by the Minister of National Revenue (**Minister**) under section 323 of the *Excise Tax Act* (**ETA**). The appellant was assessed an amount of $67,143 (including net tax, penalties and interest) for the failure by Naza Tri-Pac Auto Repairs Ltd. (**Naza**), of which the appellant was the sole director, to collect and remit net goods and services tax (**GST**) for the period from July 1, 2000 to December 31, 2003.

[2] Section 323 of the ETA read as follows during the period at issue:

> *Liability of directors*
>
> 323. (1) Where a corporation fails to remit an amount of net tax as required under subsection 228(2), 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.

Limitations

(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 receiving 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.

Diligence

(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.

Assessment

(4) The Minister may assess any person for any amount payable by the person under this section and, where the Minister sends a notice of assessment, sections 296 to 311 apply, with such modifications as the circumstances require.

Time limit

(5) An assessment under subsection (4) of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person last ceased to be a director of the corporation.

Amount recoverable

(6) Where execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

Preference

(7) Where a director of a corporation pays an amount in respect of a corporation's liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had the amount not been so paid and, where a certificate that relates to the amount has been registered, the director is

> entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is empowered to make.
>
> *Contribution*
>
> (8) A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

[3] The appellant raises three arguments in his defence. First, he argues that at all relevant times he exercised all reasonable due diligence in remitting GST on sales made in the course of Naza's business and therefore, pursuant to subsection 323(3) of the ETA, is not jointly and severally liable as a director for any shortfall in the GST remitted to the Canada Revenue Agency (**CRA**). Second, he submits that he is entitled to challenge the underlying assessment of Naza notwithstanding the fact that, in his capacity as sole director of Naza, he did not challenge that assessment at the time as required by the ETA. Third, the amount of the underlying assessment made against Naza, which relates specifically to GST on propane sales at the service station, was not properly calculated in that the procedure adopted by the CRA's auditor in arriving at the amount of the shortfall in remittances of the GST collected by Naza was unreliable. The respondent takes issue with all three arguments.

Facts

[4] The parties filed a Statement of Agreed Facts (Partial), which is reproduced hereunder.

> 1. The appellant was the sole officer and director of Naza Tri-Pac Auto Repairs Ltd. (the "corporation").
> 2. The corporation was a GST registrant with GST registration number 131216665RT.
> 3. The corporation was required to report GST on a quarterly basis.
> 4. At all material times, the corporation operated a Mohawk service station in Surrey, British Columbia as a franchisee;
> 5. The corporation sold fuel, including propane, at the service station.
> 6. The corporation was invoiced for the propane it purchased from Superior Propane as follows:

TOTAL LITRES VOLUME (YR.)	**COST**	**INCL. GST**	**JUST GST**
Volume 2000 – 535,827	183,504.16	196,349.45	12,845.29
Volume 2001 – 599,457.90	213,049.14	227,962.58	14,913.44

Volume 2002 – 600,753.90	164,192.51	175,685.99	11,493.48
Volume 2003 – 579,533.80	250,708.23	268,257.81	17,549.58

7. The appellant worked at the service station on a daily basis and was involved in all aspects of the business including: preparing all documents and office work; keeping the inventory up to date and purchasing; preparing daily sales reports; calculation of GST on commissions earned from gasoline sales, and; recording of sales information in synoptic ledger book for the corporation.

8. The corporation's financial statements were prepared for it by an accountant, Mr. Nizar Mawani, based on information which the appellant supplied.

9. The appellant, on behalf of the corporation, established an account for GST remittances during the periods, calculated the GST, filed GST returns and made GST remittances to the Minister of National Revenue.

10. The corporation was audited in 2004 and the auditor concluded there was a daily GST shortfall of $40 to $62 throughout the audit period through sampling seven daily cash register tapes of the corporation and extrapolating those results to the entire audit period. The auditor traced the shortfall to the corporation's propane sales. The auditor calculated the unremitted GST of the corporation by multiplying the net cost (exclusive of GST) of the propane purchased from Superior Propane during the audit period, as set out in paragraph 6 above, by 7%. The auditor concluded that expenses and ITCs were properly claimed and reported for the corporation and no adjustments were made in respect of expenses and ITCs.

11. The corporation was assessed on May 15, 2004 by the Minister of National Revenue for failure to remit GST in the amount of $50,379.08 for the following periods:

    (a) July 1, 2000 to Dec. 31, 2000;

    (b) Jan. 1, 2001 to Dec. 31, 2001;

    (c) Jan. 1, 2002 to Dec. 31, 2002; and

    (d) Jan. 1, 2003 to Dec. 31, 2003.

12. The corporation was also assessed for penalties of $4,842.16, and interest of $2,210.45, in addition to the $50,379.08 of GST described in paragraph 14 [*sic*] above.

13. The corporation ceased operating the service station by March 15, 2004.

14. On December 6, 2005, the Federal Court of Canada issued a Certificate under Court No. GST-6408-05 against the corporation for $61,048.54 and a Writ of Seizure of [*sic*] Sale for $61,048.54.

15. The Writ of Seizure and Sale was returned to the Minister of National Revenue by West Coast Bailiffs on July 4, 2006 marked “unable to locate exigible assets”.

16. On November 29, 2006, the appellant was assessed by the Minister of National Revenue pursuant to s. 323(1) of the *Excise Tax Act* as a director of the corporation for the amount of $67,143.26, which amount included net tax of $46,379.08, penalties of $14,267.97 and interest of $6,496.21.

[5] In the years at issue, Naza operated, pursuant to a Marketing Outlet Lease (**Lease**) that was renewed annually (Exhibit R-1, Tabs 15, 16 and 17), a retail petroleum facility and a convenience store under the trade name of Avalon Mohawk (and under the name of Naza Tri-Pac Auto Repairs Ltd. as of 2001, as per Exhibit R-1, Tabs 15 and 16, article 8.4) on premises owned by Mohawk Canada Limited (**Mohawk**) and, starting in 2001, by Husky Oil Marketing Company (**Husky**) (hereinafter referred to as **Mohawk/Husky**). Articles 1.3, 2.2 and Schedule H of the Lease indicated that the retailer (Naza) was operating the Mohawk/Husky facility as a commission sales site, meaning that Mohawk/Husky owned and retained title to the Mohawk/Husky fuels at all times, and that it paid the retailer a commission on a per-litre basis. The parties to the lease agreed that the proceeds from the sale of Mohawk/Husky fuels were held by the retailer as trustee for Mohawk/Husky and were to be deposited daily in an account of Mohawk/Husky without any deduction, abatement or set-off. The retailer was required to provide daily sales reports by product. The retailer was paid a commission daily at a predetermined rate for Mohawk/Husky fuels supplied by Mohawk/Husky and sold through the retail pumps located at the Mohawk/Husky facility. Mohawk/Husky determined the retail price of all Mohawk/Husky fuels, and the sales commissions were deducted from the sale proceeds as calculated in the daily sales reports. “Mohawk Fuels” or "Husky Fuels", as the case may be, is defined in article 6.3 of the Lease as meaning gasoline, diesel, propane and liquid fuels marketed, distributed or sold by Mohawk/Husky. The retailer had to pay Mohawk/Husky an annual fixed rent for the use of the Mohawk/Husky premises (article 4 and Schedule B-1 of the Lease). The retailer was also responsible for paying when due all taxes, rates, levies, assessments and penalties imposed, levied or charged upon the premises, except for real property taxes, and all pump insurance fees, licence fees, business or income taxes of the retailer, and any other taxes, rates, levies or assessments imposed, levied or charged

upon the retailer, the Mohawk/Husky facility or the business of the retailer conducted on the premises (article 12 of the Lease).

[6] The appellant testified that he had operated the service station for 14 years. His understanding was that he operated a franchise, with respect to which he received all instructions from the franchisor (Mohawk/Husky). He reported to the franchisor daily on the volume of fuel sold, on which Naza was paid commissions. The appellant explained that Naza was selling gasoline and propane for vehicles at the pumps. It was also selling propane for barbecue cylinders. The propane for vehicles and the propane for cylinders came from one tank, which was filled by a company approved by Mohawk/Husky, namely Superior Propane.

[7] The appellant explained that while Naza charged GST to clients buying propane for cylinders, none was charged specifically on propane sold for vehicles. He said that propane sales for vehicles were handled the same way as gasoline sales. Mohawk/Husky indicated the retail sales price at the pump, which was the exact price charged to the clients, and the total sales were registered in the daily sales report for the purposes of calculating sales commissions. According to the appellant, that sales price fluctuated regularly and could fall below the purchase price charged by Superior Propane (Transcript, pp. 32-34). The appellant's understanding, after talking with people from Mohawk/Husky, was that GST on propane for vehicles was included in the sales price determined by Mohawk-Husky and that it was remitted to the government by Mohawk/Husky in the same way that the remittances were made for gasoline. For all other products sold by Naza, including the sale of propane for cylinders, the sales were registered in the computer which was programmed to calculate the GST to be added and to be charged to customers. The appellant said he also kept a separate book to record on a daily basis written summaries of all the sales on which GST was charged. This was used to complete the quarterly GST returns.

[8] The appellant never thought that he was doing anything wrong. He explained that Mohawk/Husky representatives came regularly to the premises to verify how Naza handled the sales and how GST was recorded, and they never advised him that GST should be added on the sale of propane for vehicles. No one from Mohawk/Husky was present in court to corroborate this. The appellant said that he tried to get someone from Mohawk/Husky to testify at the hearing, but since the events in question happened a long time ago, all the managers present at the time had left. The appellant never thought to verify with the CRA either since the procedure followed with Mohawk/Husky had always been the same from the beginning, and it was never questioned.

[9] The agreement between Husky and the appellant was cancelled effective March 21, 2004 (Exhibit R-1, Tab 20). The audit of Naza was done shortly after that, but the appellant did not think it necessary at the time to call someone from Husky to verify whether GST had been remitted on the propane sold for vehicles. The appellant said that he was under the impression at the time that there was a misunderstanding between Naza and the auditor for the CRA. The appellant did not remember at the hearing whether the auditor had told him at the time of the audit that there was a shortfall in the GST remittances on propane sales. Furthermore, he acknowledged that he did not verify with Husky whether there was a mistake, as he said that, if there was a mistake, it would be corrected, but he did not think the matter would end up in court (Transcript, pp. 132-133).

[10] Although somewhat confused in this regard, the appellant acknowledged that Naza claimed the input tax credits (ITCs) on the purchase of propane from Superior Propane. Asked what made him believe that GST would be remitted by Mohawk/Husky, he answered that the commission guaranteed in the agreement was on the retail sales price fixed by Mohawk/Husky. If GST had been added to the retail sales price at his level, the sales price would not have matched the sales price at the pump (Transcript, pp. 45-46, and 166).

[11] The appellant called Mr. Zouheir Abou El Houda to testify. He worked for Naza during the years at issue. He just confirmed that GST was charged on the sale of propane for cylinders and that on the sale of propane for vehicles the customer was charged the price fixed at the pump. He said that he observed that sales of propane for cylinders and of propane for vehicles were roughly equal. He also said that the equipment was old and that there was a lot of leakage. He mentioned as well that the price charged to customers for propane fluctuated frequently, on a weekly basis.

[12] Ms. Rav Sandhu, an appeals officer with the CRA was called by the respondent. Ms. Sandhu said that in reviewing the documentation provided by the appellant she did not find any indication that Mohawk/Husky was remitting the GST on propane. In cross-examination, she conceded she was satisfied that the appellant had in fact taken steps with respect to his business to ensure compliance with the tax regulations and was satisfied as well that he was diligent in ensuring that the business's GST returns were filed in a timely fashion (Transcript, pp. 194-195).

[13] Finally, Ms. Cathy Wu, who conducted the CRA's audit of Naza, testified at the request of the respondent. In a nutshell, Ms. Wu determined that the GST on propane was not being remitted. She was provided with cash register tapes, some summary sheets, and a handwritten synoptic book prepared by the appellant showing

sales, provincial sales tax (PST) and GST (a photocopy of the information provided by the appellant to Ms. Wu as an example of what would have been recorded in the synoptic book was filed as Exhibit A-2; see also Transcript, pp. 72-76). What she remembered was that the records were not very well organized. As a matter of fact, Exhibit R-2 shows not-very-clearly scribbled figures. The appellant testified that all this was handed to his accountant for him to put in order.

[14] Ms. Wu prepared working papers on which she copied the net sales amounts shown on the cash register tapes or sales reports. Because the records were not very well organized, she picked randomly seven daily cash register tapes or sales reports. She recalculated the GST that should have been collected on the sales amounts, compared the results with the amounts reported, and found a variance for each day. She was able to verify that the variance came from the propane sales. In 2003, the business's system was changed to a computerized one, which produced daily sales reports. At the time of the audit, the appellant did not mention that he made a distinction between the propane sold for cylinders and that sold for vehicles. She was confident that the variance identified existed for the whole period, even though the cash register tapes and sales reports she looked at covered only seven days, because the variance was consistent in each sample, although there were months between the dates of some of the samples. She said in cross-examination that the random check was only performed to test whether something was wrong and that she then assumed that the situation was the same throughout the relevant period because she assumed that there would have been no change in the cash register program that would have produced a different variance (Transcript, pp. 243-244).

[15] Ms. Wu then asked the appellant to provide her with monthly propane sales figures, which he did not have. She did not want to go through the daily sales for a three-year audit period, as this would have meant examining over 1,000 samples, which, realistically, was not feasible. She therefore decided to assess GST on the total cost of the propane purchased in a year without considering any profit on sales. This, according to her, resulted in the most conservative assessment. As a matter of fact, the appellant had told her that the profit was "not much". The purchase cost figures were provided by Superior Propane at the request of the appellant, and were filed as Exhibit A-1, Tab 1. At the time, the appellant did not mention that he was losing money on propane. Ms. Wu said, however, that he was very cooperative, and that is why she did not assess a gross negligence penalty.

[16] In cross-examination, Ms. Wu admitted that the appellant had asserted that sometimes he barely made any profit due to the competitive market (Exhibit R-1, Tab 27, page 7 of 12, note 3). She did not consider that there could have been losses

because, from the samples she used, she noted that Naza purchased frequently from Superior Propane, which meant that it kept a low inventory. Furthermore, the appellant made no mention of Naza having suffered losses. Ms. Wu also said that even if GST were considered to have been included in the sales price of propane, there would still be a variance between the GST collected and the amount remitted.

Appellant's argument

[17] The appellant argued that he made an honest mistake. He mistakenly believed that GST on sales of propane for vehicles would be remitted by the franchisor (Mohawk/Husky) in the same manner as it was for gasoline sales. He had developed a long-standing relationship with the franchisor, and he trusted them. After all, they were the experts in that very specialized industry.

[18] The appellant stated that, as a director of Naza, he established an account for GST remittances, kept records on a daily basis, and submitted all of his financial information on sales and expenses to the franchisor and to his accountant. Neither the franchisor nor the accountant identified any irregularities. The appellant remitted correctly the GST on all other products that were sold in the business. He always filed the GST returns on time and correctly claimed the ITCs. The appellant did not simply turn his back on his responsibilities in relation to the business. He honestly attempted to comply with the statutory requirements to the best of his ability, using the information, facilities and resources available to him. In his view, he exercised the care that a reasonably prudent person would have in comparable circumstances.

[19] With respect to the audit itself, the appellant asserted that he had the right to challenge the original assessment against Naza even though it was not contested by the company itself. He specifically requested permission before this court to amend his notice of appeal on this particular point, which was granted. The appellant is of the view that, since the amendment was allowed, the respondent may not argue now that the appellant is estopped from contesting the original assessment.

[20] As regards the assessment itself, the appellant's view is that Ms. Wu did not consider in her approach the fact that half of the propane sales were for cylinders and that GST was charged on those sales. Using the cost of all propane purchased to calculate the amount with respect to which there was a failure to remit is therefore flawed. The resulting assessment is twice as much as the actual shortfall. Further, Ms. Wu examined only seven samples, meaning that sales for seven days only out of a period of three and a half years were considered in establishing a variance. This does not seem very accurate. Her assumptions were also inaccurate. She assumed that the

propane was never sold at loss. It was established, however, that the price at the pump fluctuated frequently, often falling below cost price. Furthermore, Ms. Wu did not take into account loss of propane by leakage and theft.

[21] The appellant suggested, in an alternative argument, that the amount of the assessment be reduced by 5% to take into account leakage and theft, then divided by 2 to take into account the fact that GST was in fact remitted on the sale of propane for cylinders, and finally reduced by the amount of $4,000 already paid by the appellant. This would lower the assessment from $50,379 to $19,930.

Respondent's submissions

[22] The respondent argued that the appellant, being involved in the day-to-day operation of the service station, including keeping the financial records, did not exercise due diligence to ensure that Naza deducted and remitted the GST on its propane sales. There is, the respondent argued, a higher threshold for inside directors who invoke the due diligence defence.

[23] The respondent relied on the case of *Drover v. Canada*, 1998 CanLII 7889, in which the Federal Court of Appeal stated that the obligation imposed on directors is not limited to that of exercising the requisite standard of care in ensuring that GST was remitted. There is also an obligation to exercise the same standard with respect to ensuring that GST is properly calculated.

[24] The respondent is of the view that there is no reasonable explanation as to why the appellant would have thought that the GST on the propane for vehicles would be remitted differently than the GST on the rest of the propane. Nothing in the documentation shows that there were any specific instructions about Mohawk/Husky remitting the GST on propane sales. Naza purchased the propane from Superior Propane, paid GST on that propane, and claimed ITCs. It is not clear why, when Naza was claiming ITCs on the propane, the appellant would have assumed that the franchisor was responsible for the calculation and remittance of the GST on any of the propane sold by Naza.

[25] Naza remitted PST on the propane sales but no GST. The appellant was negligent for not enquiring why there would be a difference with regard to the two types of propane sales.

[26] The respondent also argued that under the agreements with the franchisor, Naza earned commissions from the franchisor on the fuels that it sold, except

propane. She stated that for propane Naza received a discount on the posted sale price upon its purchase from Superior Propane. She then argued that there was no explanation why, when the appellant realized that propane was being treated differently for commission purposes by the franchisor, he did not question the status of the propane. On this point, it is my understanding that the respondent relied on the 1991 agreement signed by the appellant with Mohawk, which is found in Exhibit R-1, Tab 14. Article 6.6 of that agreement was indeed a specific provision concerning the purchase of propane, which stated that the lessee (Naza) would receive a propane margin of four cents per litre off the posted retail price at the time of delivery. In the years at issue, the lease signed was drafted differently, and no distinction was made regarding propane, which was included in the Mohawk/Husky fuels. Naza was referred to as the retailer in the leases for those years and was paid sales commissions daily by means of deduction from the sale proceeds from Mohawk/Husky fuels sold at the Mohawk/Husky facility at a retail price determined by Mohawk/Husky. Although it is true that the propane was supplied by Superior Propane, the appellant testified that this was a requirement of Mohawk/Husky. In my view, a reading of the provisions of the leases for the years at issue does not lead to the conclusion drawn by the respondent that the appellant should have known that, for the purposes of the GST remittances, there was a difference in the way sales of gasoline and sales of propane were to be treated.

[27] With respect to the appellant's ability to challenge the corporation's liability, the respondent argued that a textual, contextual and purposive analysis confirms that section 323 of the ETA ought to be interpreted as providing for no challenge by directors with regard to the underlying corporate liability. Section 323 is a collection provision. The starting point of the analysis in relation thereto is the corporate assessment, which fixes the net tax owing. Pursuant to subsections 299(3) and (4), the corporate assessment is deemed to be valid and binding subject only to its being varied or vacated on objection or appeal. The respondent stated that an assessment that is not challenged has the same force and effect as an assessment that is unsuccessfully challenged. When a certificate in respect of a corporate debt relating to an unpaid assessment is registered in the Federal Court, that certificate has the same effect as if it were a judgment obtained in that court for a debt (section 316 of ETA). A director cannot be assessed until a certificate for the assessment amount has been registered in the Federal Court and execution for that amount has been returned unsatisfied. A director's challenge of the amount assessed against the corporation would, in essence, be a challenge of the Federal Court certificate. In the respondent's view, the statutory language of section 323 does not permit a collateral attack of the underlying corporate assessment. The word "amount" must be given a consistent interpretation. Subsection 323(2) specifically equates the amount of the corporation's

liability referred to in subsection 323(1) with the amount of the corporation's liability that has been registered in the Federal Court, which is the amount of the director's liability. Section 323 serves as a means of collecting the corporate debt arising during the period of a director's stewardship. Parliament views the role performed by a registrant on behalf of the government with regard to the collection of GST as reflecting a trust relationship (subsection 222(1)). Directors are held accountable; they are the directing mind; they have legal authority; and they have the power to direct the corporation in its operations. They act as agents and quasi trustees of the corporation. They have a full opportunity to challenge the corporate assessment in the name of the corporation within the time limit set for doing so, and that constitutes an incentive for them to use that opportunity rather than sitting back while the passage of time erodes memories and reduces the likelihood of documentary evidence being located. Thus the integrity of the assessment in the adjudicative process is preserved.

[28] The respondent distinguished the decision in *Gaucher v. Canada*, [2000] F.C.J. No. 1869 (QL) (C.A.), which permitted the beneficiary of a transfer who had been assessed under section 160 of the *Income Tax Act* (**ITA**) to challenge the primary debtor's tax liability. Contrary to the beneficiary of a transfer who is assessed pursuant to section 160 of the ITA, a director generally has the power and authority to cause a corporation to challenge the assessment issued against it. As a matter of fact, a person assessed under section 160 may not even know of the existence of the underlying tax debt at the time the property is transferred.

[29] For these reasons, the respondent concluded that the text, context and purpose of section 323 of the ETA reveal that Parliament intended directors to be jointly and severally liable for the payment of a corporation's liability resulting from its failure to remit, as determined first by an assessment respecting the corporation and then eventually crystallized through the registration of a certificate in the Federal Court.

[30] In the event that the Court should consider it necessary to determine whether the underlying assessment is correct, the respondent's position is that there is no basis for disturbing that assessment. Essentially, the appellant takes issue with the methodology used by the auditor to establish the amount assessed, but he has not provided any evidence to contradict the calculation of the shortfall either on the days selected by the auditor or at any time over the entire audit period. The appellant has not shown that, during the period at issue, Naza actually sold propane at a price less than the cost price. He failed to provide any alternative method or any data demonstrably more accurate than the method which was actually employed. The respondent referred to the decision of this court in *Ruest v. The Queen*, 1998 CanLII

649, in which Judge Tardif held that the taxpayer did not discharge her burden of showing that the assessment was ill-founded as, instead of bringing forward arguments to support her position, she chose to focus on discrediting the respondent's work.

[31] In the present case, the respondent submitted that the auditor used a fair, rational and acceptable process, which led to plausible results that are certainly more reliable, (in the respondent's view) than those suggested by the appellant. The respondent relied on the decision of this court in *Telus Communications (Edmonton) Inc. v. The Queen*, 2008 TCC 5, in which Hershfield J. analyzed the adequacy of sampling methods used during the audit. The Court drew a negative inference from the fact that the taxpayer called no evidence to rebut the testimony of the auditor. In the present case, the respondent submitted that there was a total absence of evidence suggesting that the methodology used by the auditor was inaccurate. The onus is on the appellant to prove that the methodology used was unsound. Yet he did not adduce any evidence of the sales price fluctuations, or evidence showing that the propane was sold at loss or that there were claims regarding business losses due to leakage or theft. There is no evidence substantiating any of those things, according to the respondent.

Analysis

[32] With respect to the respondent's first argument, which relates to the due diligence defence, I agree with counsel for the respondent that reference must be made to the Federal Court of Appeal decision in *Drover, supra*. Relying in part on the previous decision of the same court in *Soper v. Canada*, [1998] 1 F.C. 124, dealing with the due diligence of a director in income tax matters, Robertson J. A. stated the following at paragraph 6 and following in *Drover*:

> 6 In *Soper*, the issue was whether the director had exercised the required degree of care to prevent the failure by his corporation to remit income tax and other source deductions from employees' salaries. The following passages from *Soper* are particularly relevant (at pages 155, 156, 157 and 160):
>
> > The standard of care laid down in subsection 227.1(3) of the Act is inherently flexible. Rather than treating directors as a homogenous group of professionals whose conduct is governed by a single, unchanging standard, that provision embraces a subjective element which takes into account the personal knowledge and background of the director, as well as his or her corporate circumstances in the form of, *inter alia*, the company's organization, resources, customs and conduct. Thus, for example, more is

expected of individuals with superior qualifications (e.g. experienced business-persons).

The standard of care set out in subsection 227.1(3) of the Act is, therefore, not purely objective. Nor is it purely subjective. It is not enough for a director to say he or she did his or her best, for that is an invocation of the purely subjective standard. Equally clear is that honesty is not enough. However, the standard is not a professional one. Nor is it the negligence law standard that governs these cases. Rather, the Act contains both objective elements - embodied in the reasonable person language - and subjective elements - inherent in individual considerations like "skill" and the idea of "comparable circumstances". Accordingly, the standard can be properly described as "objective subjective".

. . . I am not suggesting that liability is dependent simply upon whether a person is classified as an inside as opposed to an outside director. Rather, that characterization is simply the starting point of my analysis. At the same time, however, it is difficult to deny that inside directors, meaning those involved in the day-to-day management of the company and who influence the conduct of its business affairs, will have the most difficulty in establishing the due diligence defence. For such individuals, it will be a challenge to argue convincingly that, despite their daily role in corporate management, they lacked business acumen to the extent that this factor should overtake the assumption that they did know, or ought to have known, of both remittance requirements and any problem in this regard. In short, inside directors will face a significant hurdle when arguing that the subjective element of the standard of care should predominate over its objective aspect.

. . .

Of course, not all inside directors have been held liable. The Tax Court has refused to impose liability on an inside director in cases where he or she is an innocent party who has been misled or deceived by co-directors: see *Bianco v. Minister of National Revenue* (1991), 2 B.L.R. (2d) 255 (T.C.C.); *Edmondson (S.G.) v. M.N.R.*, [1988] 2 C.T.C. 2185 (T.C.C.); *Shindle (B.) v. Canada*, [1995] 2 C.T.C. 227 (F.C.T.D.); and *Snow v. Minister of National Revenue* (1991), 38 C.C.E.L. 70 (T.C.C.). There are also other examples of an inside director being exonerated: see *Fitzgerald (G.) v. M.N.R.*, [1991] 2 C.T.C. 2595 (T.C.C.).

. . .

In my view, the positive duty to act arises where a director obtains information, or becomes aware of facts, which might lead one to conclude that there is, or could reasonably be, a potential problem with remittance of GST.

[emphasis mine]

> 7 It could not be expected that *Soper* would provide a ready answer to all questions dealing with directors' liability. At the same time, it did attempt to provide some general principles in order to fill the analytical void that existed. The "objective subjective" standard of care outlined above focuses on whether the surrounding circumstances are such that a person of the director's ability and business experience was under a positive duty to act [so] as to ensure that the corporation's obligation to remit withholding taxes was fulfilled. Certainly, such a duty exists if a director is aware or should have been aware of a remittance problem, and is breached if no steps are taken to ensure compliance with the legislation. As the taxpayer in *Soper* was held to be under a positive duty to act and had done nothing to fulfill that obligation, the due diligence defence was not available. In these circumstances, it was unnecessary for this Court to consider what steps the director in that case should have taken once the positive duty to act arose.
>
> 8 The present case adds a further dimension to the principles set out in *Soper*. The obligation imposed on directors is not limited to that of exercising the requisite standard of care in ensuring that GST as calculated was remitted. There is also an obligation to exercise the same standard with respect to ensuring that GST is properly calculated. To interpret s. 321(1) of the *Excise Tax Act*, (or for that matter s. 227.1(1) of the *Income Tax Act*) in a contrary manner would undermine the purpose of that section. Carelessness in calculation is as unacceptable as carelessness in remittance. The obligation to properly calculate GST flows from ss. 228(1) of the *Excise Tax Act* which reads as follows:
>
> > 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.
>
> 9 Utilizing the language adopted in *Soper*, the issue in the present case may be recast as follows: Did the taxpayer exercise the required standard of care [so] as to ensure that Conestoga did not fail in its obligation to properly calculate and remit GST to the Receiver General? Having regard to the surrounding circumstances and the taxpayer's business experience and acumen should she have been aware that there was a problem with respect to the proper calculation of GST? Correlatively, if the taxpayer knew or ought to have known that there was a problem with respect to its proper calculation, did she exercise the requisite standard of care in ensuring that the problem was resolved. Though the taxpayer was an "inside director" (involved in the day to day operation of the business) it is evident that other persons, including an accountant, were responsible for calculating and remitting all taxes. I should add that no evidence was drawn to this Court's attention in support of the understanding that the taxpayer was actually aware of a problem with respect to the proper calculation of GST.

[33] Therefore, the question to be answered first is whether, having regard to the surrounding circumstances and the appellant’s business experience and acumen, he

should have been aware that there was a problem with respect to the proper calculation of GST on propane. Second, if the appellant knew or ought to have known that there was a problem with respect to its proper calculation, did he exercise the requisite standard of care to ensure that the problem was resolved?

[34] Here, the evidence revealed that the appellant had operated the service station for 14 years as a franchisee of Mohawk/Husky. The original contract signed in 1991 was renewed annually. In the years at issue, the contract between the parties was drafted differently. As I said in paragraph 26 above, there was no distinction made between the commission income from gasoline sales and that from propane sales. The original contract and the subsequent ones all stated that the lessee or the retailer was responsible for the payment of taxes imposed upon its business conducted on Mohawk/Husky's premises. Except for sales of gasoline and of propane for vehicles, the appellant did collect and remit GST on all products sold. With respect to fuels sold at the pumps, the appellant testified that he had always believed that the GST was taken care of by Mohawk/Husky. As a matter of fact, he was not made aware of the discrepancy in the GST remittances with respect to propane until the audit in 2004, after the cessation of Naza's operations. The appellant testified that, when he started operating the service station, he complied with the rules laid down by the franchisor. For 14 years, the franchisor never mentioned any problem with GST remittances. It is true that no one from Mohawk/Husky was in court to corroborate this, but the appellant explained that when preparing for this trial he attempted unsuccessfully to reach someone at Husky who had knowledge of the situation that existed at the time at issue.

[35] The respondent brought up the fact that it was not clear why GST was remitted on propane for cylinders while it was not on propane for vehicles. In my view, the explanation given by the appellant is plausible. He did not make any differentiation between gasoline and propane for vehicles. The price at the pump was fixed by the franchisor, and it did not cross his mind that a higher amount should be charged to customers for propane, as such was not the case for gasoline.

[36] The respondent also mentioned that Naza remitted PST, on propane sales, but not GST. It is not clear to me whether PST was remitted on propane sold for vehicles. However, it is my understanding that there was confusion regarding PST remittances, a matter which was addressed on the appellant's own initiative when he was made aware of a potential problem by the provincial authorities.

[37] The respondent also raised the fact that Naza claimed ITCs on the purchase of propane, and stated that this should perhaps have suggested to the appellant that Naza

had an obligation to remit GST on propane sold. This might be true, but I noticed in court that the appellant was confused when asked whether Naza claimed ITCs on propane. The appellant did not appear to me to be a sophisticated, knowledgeable person in that field. He complied with the tax regulations to the best of his knowledge, remitting GST on all products sold that were entered in his computer system as being subject to GST. It is my understanding that the computer was programmed by someone sent by the franchisor, who regularly verified that everything was being done correctly.

[38] In addition, Ms. Sandhu, the appeals officer, conceded both that the appellant had taken steps with respect to his business to ensure compliance with the tax regulations and that he was diligent in ensuring that GST returns were filed on time.

[39] Having regard to the surrounding circumstances and the appellant's business experience and acumen, I am satisfied that he did not have any reason to believe that there was a problem with the GST remittances for propane. As was said in *Drover, supra* (quoting *Soper, supra*), a positive duty to act arises where a director obtains information, or becomes aware of facts, which might lead one to conclude that there is, or could reasonably be, a potential problem with the remittance of GST. I am satisfied that here the appellant did not obtain information, or become aware of facts, which could have led him to conclude that there was a potential problem with the remittance of GST on propane while Naza was still in operation. In fact, he learned of the problem only after the cessation of Naza's operations, at the time of the audit in 2004. I therefore conclude that the appellant has met the conditions required in order to fit within the exception stated in subsection 323(3) of the ETA, as he has satisfied that the due diligence defence applied in his case.

[40] This conclusion dispenses me from answering the two other arguments raised by the respondent. I would like to say, however, that in my view the decision of the Federal Court of Appeal in *Gaucher, supra*, applies equally to cases of director's liability for non-remitted net tax.

[41] In *Gaucher*, it was stated at paragraph 6:

> 6 I am of the respectful view that the Tax Court Judge was in error in coming to this conclusion. It is a basic rule of natural justice that, barring a statutory provision to the contrary, a person who is not a party to litigation cannot be bound by a judgment between other parties. The appellant was not a party to the reassessment proceedings between the Minister and her former husband. Those proceedings did not purport to impose any liability on her. While she may have been a witness in

> those proceedings, she was not a party, and hence could not in those proceedings raise defences to her former husband's assessment.

[42] In my view, whether the word "amount" in subsection 323(1) refers to the amount shown on the Federal Court certificate or merely to the amount of net tax that the corporation was legally obligated to remit (as suggested by C. Miller J. of this Court in *Kern v. The Queen.*, 2005 TCC 314), one cannot escape the fundamental principle of Canadian law, reiterated in *Gaucher*, that it is a basic rule of natural justice that a person who is not a party to litigation cannot be bound by a judgment between other parties, unless there exists a statutory provision to the contrary.

[43] I further do not agree with the respondent that the context and purpose of section 323 of the ETA suggest that a challenge by a director of an underlying assessment should not be permitted. In *Scavuzzo v. The Queen*, 2005 TCC 772 (General Procedure), Bowman C.J. rejected the idea that *Gaucher* can be distinguished and that the reasoning therein does not apply to situations governed by section 323 of the ETA and section 227.1 of the *Income Tax Act*, which is also found in a part dealing with collection matters. Bowman C.J. wrote:

> 10 With respect, I think that what was stated in *Gaucher* is a principle of broad application and ordinary fairness and it applies equally to assessments of director's liability under section 227.1 of the *ITA* and section 323 of the *ETA*.
>
> 11 The distinction drawn in *Schuster* and *Maillé*, *supra*, between section 160 of the *ITA* assessment [*sic*] and section 227.1 of the *ITA* or section 323 of the *ETA* assessments does not, in my view, withstand scrutiny. It is based on the argument that a director who does not cause the company to file an objection cannot subsequently contest the corporate assessment when he or she is assessed as a director. This is in my view an erroneous rationalization of a refusal to follow the Federal Court of Appeal's judgment in *Gaucher*.
>
> 12 There are, as Mr. Sherman notes in his editorial comment, many reasons why the company might not have filed an objection — lack of funds, insolvency or disagreement among the directors come to mind. Also, the directors may not have been permitted to object if the company was bankrupt. I note for example that Garon C.J. (as he then was) in *Schuster* relied on a transfer of property case, *Schafer v. The Queen*, [1998] G.S.T.C. 7. *Schafer* had been explicitly overruled by *Gaucher*. More recently, Miller J. held that a director who was assessed derivatively under section 323 of the *ETA* could challenge the underlying corporate assessment in *Kern v. R.*, [2005] G.S.T.C. 101. As Miller J. noted in *Kern*, a company headed for bankruptcy or insolvency is not likely to object to an assessment.

> 13 It is also noteworthy that Justice Bowie in *Zaborniak* did not base his conclusion on the distinction drawn in *Schuster* and *Maillé*. He based it solely on his interpretation of the words in section 323 of the *ETA*.
>
> 14 I do not think that the reasoning in *Gaucher* can be distinguished in a director's liability case. The principle established in *Gaucher* is that a person who is not a party to an assessment and who is derivatively assessed is not bound by the failure of the primary obligor to contest its assessment. This principle is consistent with common sense and ordinary fairness. I do not think that the salutary rule stated in *Gaucher* should be eroded or whittled away by flawed distinctions. To extrapolate into the *Gaucher* principle a requirement that in every case we enquire into why the primary assessment was not challenged, or whether the derivatively assessed directors should have or could have influenced the primary taxpayer to contest its assessment would so dilute the principle as to make it meaningless and unworkable. Once we eliminate the fallacious distinction drawn in *Schuster* and *Maillé* between directors' liability cases and property transfer cases we are left with the full force of the *Gaucher* authority applying to all derivative assessment cases.

[44] This reasoning was recently approved by Rip C.J. in *Barry v. The Queen*, 2009 TCC 508. Further, although it was not specifically addressed in its reasons for judgment, the Federal Court of Appeal, in the recent case of *Abrametz v. The Queen*, 2009 FCA 70, agreed to hear the argument challenging the underlying corporate assessment put forward by a sole director of a company who had been assessed pursuant to section 323 of the ETA.

[45] As I have concluded that the appellant has escaped liability by virtue of subsection 323(3) of the ETA, it is not necessary for me to analyze whether the assessment against Naza was valid or not.

[46] The appeal is allowed, with costs, and the assessment under appeal is vacated.

Signed at Ottawa, Canada, this 21st day of January 2011.

"Lucie Lamarre"

Lamarre J.

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