Docket: 2018-260(IT)I

BETWEEN:

IMAD HAMAD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

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Appeal heard on January 14, 2018, at Montréal, Quebec.

Before: The Honourable Justice Réal Favreau

Appearances:

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| For the appellant: | The appellant himself |
| Counsel for the respondent: | Marie-Claude Landry |

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**JUDGMENT**

The appeal from the assessment made under section 227.1 of the *Income Tax Act*, dated February 8, 2016, and bearing number 3650448, is allowed, and the assessment is vacated, in accordance with the attached Reasons for Judgment.

Signed at Montréal, Quebec, this 27th day of June 2019.

"Réal Favreau"

Favreau J.

Citation: 2019 TCC 137
Date: 20190627
Docket: 2018-260(IT)I

BETWEEN:

IMAD HAMAD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

**REASONS FOR JUDGMENT**

Favreau J.

[1] This is an appeal from an assessment made under section 227.1 of the *Income Tax Act*, R.S.C., (1985), c. 1 (5th Supp.), as amended, (the Act) by the Minister of National Revenue (the Minister), dated February 8, 2016, and bearing number 3650448 (the assessment).

[2] Under the assessment, the Minister assessed an amount of $15,242.85 from the appellant as director of the corporation RER Hydro Ltd. (the corporation) for source deductions not remitted to the Receiver General of Canada as employer's contributions for employment insurance for the months of June, July and August 2014 ($3,346.68), penalties ($7,313.82) and interest ($4,582.35).

[3] The company was incorporated on August 21, 2008, under the *Canada Business Corporations Act* and specialized in hydrokinetic turbine research and development. The corporation was part of Groupe RER, which consisted of the corporation, its parent company, Gestion RER Inc. (Gestion), and a subsidiary of the corporation called Hydroliennes TRÉC St-Laurent Inc. (HTSL).

[4] The appellant, an engineer by profession, was the Chief Executive Officer and a director of the corporation, which had six directors at the time. Louis Villeneuve was the corporation's Vice-President, Finance, and Jean-

Nicolas Lafortune, a chartered accountant, was the Director of Finance. The firm ADP was hired to manage the payroll.

Background

[5] From 2008 to 2010, the corporation invested $60 million in scientific research and experimental development in a Quebec river-based hydrokinetic turbine technology to meet the need to produce reliable electric power and provide firm energy (not intermittent in areas where other forms of energy production are not an option). Of that $60 million, $28 million came from the federal and Quebec governments.

[6] After two years of work, Groupe RER was able to develop two fully functional turbines of 126 metric tonnes each, and one of the turbines was successfully installed on the bed of the St. Lawrence River in Montréal on August 17, 2010.

[7] Until September 2010, Groupe RER was part of Groupe RSW, a group of companies that had existed for some 40 years and that was financially stable. Upon the sale of Groupe RSW to AECOM in September 2010, Groupe RER became a separate and autonomous group.

[8] Between 2010 and 2013, Groupe RER continued to test its hydrokinetic turbine prototype for energy production.

[9] To proceed to the commercial phase, on May 31, 2012, Groupe RER signed a marketing agreement with the American corporation Boeing, giving Boeing exclusive rights to globally market the TREK turbines made in Quebec by Groupe RER for 25 years.

[10] On November 11, 2013, the Government of Quebec committed to an equity participation in Groupe RER of $10 million and to provide it with a repayable loan of $15 million bearing interest at an annual rate of 10%. In consideration for this financial agreement, Groupe RER agreed to establish a turbine production plant in Bécancour and to manufacture a fleet of 46 new-generation turbines totalling 10 MW. The 46 turbines were to be manufactured in two phases, with six turbines in the first phase and 40 turbines in the second, following confirmation of the results and the parties' satisfaction with the six turbines from the first phase. In addition to this agreement, Groupe RER had to provide a financial commitment of

at least $26 million and no longer request financial assistance from the Quebec government.

[11] Groupe RER opened the Bécancour plant and managed to secure investments of over $50 million, but the terms Hydro-Québec offered for energy (6 cents per Kilowatt hour without adjustment) prevented Groupe RER from closing the financing.

[12] On February 21, 2014, the Government of Quebec and Boeing decided to accelerate the manufacture of the first six turbines and asked Groupe RER to begin placing orders with suppliers. In May 2014, the Government of Quebec hired Deloitte & Touche to oversee the correct execution of the transaction and to assist with Groupe RER's financial planning and cash flow projections to ensure that the six turbines would be installed in the St. Lawrence River by November 2014.

[13] On April 6, 2014, a new Liberal government was elected in Quebec, and on April 12, 2014, the government terminated the agreements the outgoing government had made, thus jeopardizing the positions of 40 senior-level strategic employees, along with their families, and the 30 licensed suppliers. As a result, the production of the six new-generation turbines was halted.

[14] In order to develop a restructuring and refinancing plan, on July 25, 2014, the corporation temporarily laid off its employees for a period of 60 days. Those layoffs subsequently became permanent.

[15] On July 30, 2014, Groupe RER obtained a preliminary tribunal order under the *Companies' Creditors Arrangement Act* (the CCAA).

[16] On October 22, 2015, Groupe RER sold all of its tangible and intangible assets to an entity controlled by Charles Sirois for a total of $1,725,000.

[17] On November 30, 2015, Groupe RER filed an amended proposal under section 50 of the *Bankruptcy and Insolvency Act*, which presented assets of $1,625,000 and a deficit of $27,665,982.24, which the creditors did not approve. For the purposes of the proposal, the Canada Revenue Agency (the CRA) filed a claim as a secured creditor for an amount of $74,000.

[18] On December 11, 2015, all companies in Groupe RER declared bankruptcy. On December 16, 2015, the CRA filed a proof of claim with the bankruptcy trustee in the amount of $59,791.56 for a claim of property (secured claim) and a proof of

claim in the amount of $15,222.30 as an unsecured creditor. In the settlement of the bankruptcy, the CRA received payment for its secured claim but received nothing for its unsecured claim, which resulted in the assessment against the appellant.

Testimonies

[19] The appellant testified at the hearing and explained that, after May 29, 2014, Groupe RER was in a difficult situation and had no other source of revenue or potential financing. Groupe RER lacked the cash flow to fulfill its existing obligations and was in a state of insolvency.

[20] The appellant submitted into evidence the minutes of the extraordinary meeting of the corporation's 44 shareholders, held on July 12, 2014, namely for the purpose of obtaining an additional contribution of $3.125 million to enable the corporation to elect a new board of directors, restructure its debts and pursue financing. The minutes of that meeting indicate that Mr. Hamad informed shareholders that three of the corporation's directors had resigned on June 5, 2014, because of the corporation's precarious financial situation and that they could not be replaced, since any new director would be personally exposed to the amounts owed to the government as source deductions and sales taxes (GST and QST).

[21] The minutes of the extraordinary meeting of the corporation's shareholders also state that the employees' salaries were paid through a payroll service (ADP) but that, for a month, only the salary had been paid to employees and no source deductions had been made and remitted to the tax authorities. In addition, for two weeks, neither salaries nor source deductions had been paid.

[22] During the meeting, the shareholders refused to invest the additional requested sum of $3.125 million and asked Mr. Hamad to provide them with supplementary documents on this subject. The shareholders also refused to cover the pay that was to be provided on July 16, 2014, in the amount of $150,000 to retain the key employees.

[23] Based on those decisions, the corporation laid off its employees and officially placed itself under CCAA protection on July 29, 2014.

[24] The appellant went on to explain that, given the freeze imposed by the Government of Quebec and Hydro-Québec, it was impossible to continue production of the six turbines, which were 75% complete as of September 30,

2015, and to generate interest from investors in relaunching Groupe RER's activities. Under the circumstances, the only option was to sell Groupe RER's tangible and intangible assets to maximize the sales proceeds to be remitted to the creditors. The assets were sold on October 22, 2015, for a total of $1,725,000. This amount was considered sufficient to pay the secured creditors, including the CRA, which had a claim of $74,000.

[25] During his testimony, the appellant also criticized the CRA for failing to file a request for payment for any amount it was owed in a timely manner to the trustee in the proposal and the trustee in the bankruptcy of Gestion RER Inc., RER Hydro Ltd. and Hydroliennes TRÉC Saint-Laurent Inc., when the companies had the funds required to pay all preferred claims.

[26] Stephen Thibault, collections officer for the CRA, testified at the hearing to explain that the CRA had filed its claims in a timely manner with the trustee in the proposal and the trustee in the bankruptcy. He explained that, because the creditors did not approve the proposal and Groupe RER was forced to declare bankruptcy, the CRA's claim became subject to the *Bankruptcy and Insolvency Act*, which does not consider an employer's contributions for employment insurance to be a preferred claim. That is why, on December 16, 2015, the CRA filed with the trustee in bankruptcy a claim of property in the amount of $59,791.56, which was paid by the trustee, and a claim in the amount of $15,222.30 as an unsecured creditor, which was not paid by the trustee and which resulted in the assessment against the appellant.

Relevant statutory provisions

[27] Section 227.1 of the Act provides that directors of a corporation that has failed to withhold and remit to the Receiver General of Canada the source deductions from salaries paid to its employees are solidarily liable with the corporation to pay the amount that should have been withheld and remitted and any interest or penalties relating to it. Subsections 227.1(2) and (3) of the Act provide certain limitations on the liability of directors, permitting a defence based on the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

[28] Subsections 227.1(1), (2) and (3) read as follows:

> 227.1 (1) Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to

> remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.
>
> (2) A director is not liable under subsection 227.1(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 223 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 that subsection has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or
> >
> > (c) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or bankruptcy order.
>
> (3) A director is not liable for a failure under subsection 227.1(1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

## Analysis

[29] In this case, there is no doubt that the appellant was a director of the corporation during the months of June, July and August 2014, since he never resigned from his position as a director of the corporation.

[30] Furthermore, it has been demonstrated that the corporation made an assignment or was subject to a bankruptcy order under the *Bankruptcy and Insolvency Act* and that the CRA's claim was established in the six months following the date of the assignment or bankruptcy order, thus meeting the requirements of paragraph 227.1(2)(c) of the Act and rendering the appellant liable as a director of the corporation.

[31] The liability of directors of corporations that have failed to withhold and remit source deductions under the *Canada Pension Plan* and the *Employment Insurance Act* has been the subject of many decisions of our courts, but one of the

most important is inarguably that of Mr. Justice Mainville for the Federal Court of Appeal in *Canada v. Buckingham*, 2011 FCA 142, which specifically addressed the issue of the appropriate standard of care, diligence and skill required of a director which exonerate a director of liability for failures to withhold and remit source deductions.

[32] The main principles laid down in *Buckingham*, cited above, are as follows:

(a) the burden is on the directors to prove that the conditions required to successfully plead the defence provided in subsection 227.1(3) of the Act have been met (paragraph 33);

(b) the words of legislation are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the legislation, the purpose of the legislation, and the intention of Parliament (paragraph 35);

(c) the standard of care, diligence and skill required under subsection 227.1(3) of the Act is an objective standard as set out by the Supreme Court of Canada in *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461 (paragraph 37);

(d) an objective standard does not, however, entail that the particular circumstances of a director are to be ignored. These circumstances must be taken into account, but must be considered against an objective "reasonably prudent person" standard in which context a given decision was made (paragraph 39);

(e) the objective of the review of the defence provided under subsection 227.1(3) of the Act is to require that the director's duty of care, diligence and skill be exercised to prevent failures to remit. In order to rely on this defence, a director must thus establish that he turned his attention to the required remittances and that he exercised his duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the concerned amounts (paragraph 40);

(f) the assessment of the director's conduct begins when it becomes apparent to the director, acting reasonably and with due care, diligence and skill, that the corporation is entering a period of financial difficulties (paragraph 46).

[33] It is appropriate to note here, for the purposes of this analysis, that the failures to remit source deductions from the salaries originate from the employer's contributions to the employment insurance of employees and not from amounts withheld from employees' pay.

[34] According to the evidence on record, the corporation became technically insolvent at the end of May 2014 after the Government of Quebec abruptly terminated the funding that had previously been established by the accounting firm, Deloitte, on the government's behalf for the period ended July 31, 2014. As of that date, the Quebec government had already invested $9.6 million, and approximately $2.9 million remained to be paid to the corporation in 2014. After May 29, 2014, Groupe RER had no other source of funds or potential financing from external private investors.

[35] In the hopes of financing the continuation of Groupe RER's activities, the directors called the extraordinary meeting of the corporation's shareholders, held on July 12, 2014, at the corporation's headquarters. The majority of the 44 shareholders were present or represented at the meeting. The primary goal of the meeting was to explain Groupe RER's situation and the three potential options. The first option was an additional shareholder contribution of $3,125,000 and forming a new board of directors, restructuring the debt and taking steps with the Government of Quebec and Hydro-Québec to obtain their approval for private investments. The second option was to place the corporation under the protection of the *Companies' Creditors Arrangement Act*, and the third option involved shareholders who did not wish to invest in the corporation selling their shares for $1.

[36] To assist in making a decision, the shareholders asked the appellant to provide the following documents:

- the list of secured and unsecured creditors, including all details;

- the detailed budget for the coming weeks and the actions to be taken to improve the corporation's situation, such as reviewing essential human resources needs and the minimum expenditures required, a schedule and a cash flow statement of transactions; and

- the details (amounts owed to employees for salaries and vacations) and the GST and QST amounts owed to the governments.

[37] The appellant produced the requested information and confirmed that the corporation had hired a restructuring advisor to help improve its financial situation.

[38] During the meeting, the appellant also asked shareholders to support employee pay, due on July 16, 2014, in the amount of $150,000 in order to retain the key employees while management established an operating plan to keep the minimum staff required to deliver the contract with Boeing.

[39] The shareholders refused to inject the $3,125,000 requested, as well as the appellant's recommendation to advance pay in the amount of $150,000.

[40] Following those refusals, the corporation laid off its employees and placed itself under the protection of the *Companies' Creditors Arrangement Act* to protect the entities of Groupe RER and give itself time to restructure its operations.

[41] To safeguard the technology developed by Groupe RER and avoid bankruptcy, the corporation's management was able to sell all of Groupe RER's tangible and intangible assets through a tribunal order on October 20, 2015, to a new buyer for a total of $1,725,000, which was considered sufficient to pay all preferred claims, including the full amount of the CRA's $74,000 claim.

[42] In the report from the management of Groupe RER to the creditors concerning the proposal filed for approval, dated November 25, 2015, the appellant stated that [TRANSLATION] "to develop, protect, defend and prevent the bankruptcy of Groupe RER, my spouse and I have invested over $4 million of our own money to date, with the sole objective of relaunching the Groupe's activities, keeping the technology, jobs and economic benefits in Quebec and preventing Groupe RER's bankruptcy and a never-ending spiral of proceedings."

[43] As mentioned previously, the creditors rejected the proposal, and the companies in Groupe RER declared bankruptcy on December 11, 2015.

[44] Given the context in which the management of Groupe RER decided to continue its activities after May 2014 and considering the steps taken to seek the financing needed to continue those activities from private investors and shareholders in the corporation, I am of the opinion that the appellant fulfilled his duty of care, diligence and skill to prevent failures to remit, as required under subsection 227.1(3) of the Act.

[45] Recall that in May 2014, the technology had proven successful and had definite commercial value, that the corporation had agreed to produce six additional turbines and that an international corporation had signed an exclusive agreement to distribute the turbines around the world after conducting exhaustive due diligence.

[46] The evidence on record clearly demonstrates that the management of Groupe RER was attentive to the remittance of source deductions, taxes and dues by providing shareholders with information in this regard during the extraordinary shareholder meeting and had fulfilled its duty of care, diligence and skill to prevent the corporation's failure to remit the required amounts by requesting the additional contribution of $3,125,000 and the amount of $150,000 for the employees' next pay. It was after the shareholders refused that the corporation decided to lay off its employees.

[47] Not only did management take concrete steps to prevent the failure to remit, but it also did everything possible to correct the failure by making every effort to maximize the sale price of its assets. The amount obtained was sufficient to pay the full amount of the CRA's claim, and it was only because of a technicality in the *Bankruptcy and Insolvency Act* that the CRA's claim could not be paid in full (part of the CRA's claim was not considered a claim of property belonging to the Receiver General of Canada).

[48] As indicated in management's report to the creditors concerning the proposal, the appellant and his spouse invested over $4 million of their own money to continue Groupe RER's activities and prevent its bankruptcy. Although the details of those investments were not provided at the hearing, these are nevertheless concrete actions intended to improve the corporation's financial situation.

[49] In my view, the appellant has discharged his burden of proof because he exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

[50] For all of these reasons, the appeal is allowed and the assessment is quashed.

Signed at Montréal, Quebec, this 27th day of June 2019.

"Réal Favreau"

Favreau J.

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| CITATION: | 2019 TCC 137 |
| COURT FILE NO.: | 2018-260(IT)I |
| STYLE OF CAUSE: | IMAD HAMAD AND HER MAJESTY THE QUEEN |
| PLACE OF HEARING: | Montréal, Quebec |
| DATE OF HEARING: | January 14, 2018 |
| REASONS FOR JUDGMENT BY: | The Honourable Justice Réal Favreau |
| DATE OF JUDGMENT: | June 27, 2019 |

APPEARANCES:

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| For the appellant: | The appellant himself |
| Counsel for the respondent: | Marie-Claude Landry |

COUNSEL OF RECORD:

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|---|---|
| For the appellant: | |
| Name: | |
| Firm: | |
| For the respondent: | Nathalie G. Drouin<br>Deputy Attorney General of Canada<br>Ottawa, Canada |