Docket: 2019-1573(IT)G

BETWEEN:

ABBAS AJ JAFARNIA,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeals heard on January 25, 2023, at Windsor, Ontario and
July 6, 2023, at Ottawa, Canada

Before: The Honourable Justice Jean Marc Gagnon

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Grace Jothiraj

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeals made in respect of the Notices of assessment dated December 6, 2017, and bearing reference numbers 4716867 and 4716870, are hereby dismissed, with costs in accordance with Tariff B of Schedule II of the *Tax Court of Canada Rules (General Procedure)*.

Signed at Ottawa, Canada, this 29th day of December 2023.

"J.M. Gagnon"

Gagnon J.

Citation: 2023 TCC 171
Date: 20231229
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BETWEEN:

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REASONS FOR JUDGMENT

Gagnon J.

I. Introduction

[1] These are appeals by Mr. Abbas AJ Jafarnia, the Appellant, from two assessments made by the Minister of National Revenue (**Minister**) under section 227.1 of the *Income Tax Act* [1]. The Minister held the Appellant liable as a director for the amounts owed by Maritime Steel Foundry Limited (**Corporation**) following the failure to deduct, withhold or remit amounts as required under the ITA, the *Canada Pension Plan* [2], the *Employment Insurance Act* [3] and the *Nova Scotia's Income Tax Act* [4].

[2] Two notices of assessment dated December 6, 2017, and bearing reference numbers 4716867 and 4716870 were issued against the Appellant for the amounts of $162,179.65 and $223,365.29, respectively (**Assessments**). The Assessments pertain to payroll source deductions unremitted by the Corporation during the monthly periods of 2011 and 2012, during which the Appellant was a director at all relevant times.

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[1] RSC 1985, c 1 (5th Supp) [ITA].
[2] RSC 1985, c C-8.
[3] SC 1996, c 23.
[4] RSNS 1989, c 217.

[3] The Corporation is a corporation incorporated in April 2011 under the laws of Nova Scotia, Canada.

II. Issue in dispute

[4] The sole issue under appeal is whether the Appellant is entitled to the benefit of a due diligence defence provided under subsection 227.1(3) ITA. In summary, that defence excuses from subsection 227.1(1) liability a director who exercised the degree of care, diligence and skill to prevent the failure to remit that a reasonably prudent person would have exercised in comparable circumstances. The parties admit that all conditions to trigger section 227.1 ITA against the Appellant are satisfied, subject to the due diligence defence.

III. Evidence

[5] The Appellant was the sole witness. The Appellant did not call any other witness to testify and support his position. The Respondent had no witnesses.

[6] He began with a quote that he ascribed to Franklin D. Roosevelt: "… in politics nothing happened by accident. If it happens, you can bet that it was planned." He then addressed his education (engineering, graduated from University of Isfahan, Iran), his previous and subsequent employers or occupations, and his new life when he emigrated in 2001 from Iran to Canada.

[7] The Appellant was an employee of the corporate group that previously owned the foundry plant that the Corporation eventually acquired (**Plant**) from the receivership. The Plant is a 22 acres of land next to the river in downtown of Town of New Glasgow, Nova Scotia. The Plant has been in place for more than 100 years before the Corporation bought it.

[8] The Appellant joined the former employer's foundry in 2004. He showed willingness in the future of the foundry, and proposed in the very first weeks of his new employment to increase production provided additional investment from the former owner. He was confident to recover that investment in a 3-month period. The owner accepted the proposal, not without some disruptions with the actual management team, including the president then. The Appellant mentioned that his relationship with the owner was not particularly well regarded by the executives.

[9] The Appellant moved quickly from Production Manager to Production Manager and Quality Assurance Manager.

[10] The Appellant will say that when he joined the former owner's foundry they were about 25 employees. By 2008, they were 180 employees. He left his employment in 2008-2009 and returned to Iran for family reasons.

[11] When he came back more than a year later, the foundry was in bad shape according to him. The production dropped dramatically. The situation was different and the leadership was different. The Appellant did not stay long this time and left presumably the same year. Late in 2010, the Appellant receives a call from the former owner to announce him that the foundry would be soon under a receivership control.

[12] In January 2011, the receiver contacted the Appellant. The discussions among the receiver and the Appellant included details of financial arrangements that would need to be resolved in order to conclude the sale of the assets to the Appellant, if successful.

[13] At the time, the Appellant had a conversation with the former president of the foundry about the opportunity to purchase the Plant's assets from the receivership. His recommendation was not favorable and suggested the Appellant not to proceed with the acquisition. The Appellant decided otherwise.

[14] With the assistance of private foreign investors from Iran, the Appellant incorporated the Corporation and the Corporation bought the Plant's assets in July 2011, conditional upon, *inter alia*, obtaining the operational permit from the competent authorities.

[15] This is when the difficulties began and escalated. The Appellant, being the sole senior officer and director of the Corporation in Nova Scotia, had to face the following challenges:

i. economic sanctions against Iran introduced in 2011 (including financial, exportation and importation sanctions), the residence country of foreign investors behind the Corporation;
ii. unfavorable position of the Nova Scotia provincial government on loans requested by the Corporation early in the acquisition process, and officially rejected in 2015;
iii. employment insurance coverage denied for employees;
iv. various solutions were proposed but all doors remained closed;
v. increasingly strained interpersonal and family relationships;

vi. late 2012 particularly difficult for the Appellant considering the Corporation's situation, the employees, the social and economic impact for the community and the employees. Approximately $3 million in less than a year lost in operations.

[16] Early February 2011, difficulties persisted in reaching key agreements to complete the transaction. The Appellant was involved in negotiations and discussions with local groups who are also showing an interest in the Plant's assets.

[17] As part of these talks, the Appellant was informed of a letter from the Town of New Glasgow to the Department of Environment of Nova Scotia where The Town of New Glasgow strongly urges that the Department of Environment consider any operation permit request carefully and in consideration of the community surrounding the current location. The Town of New Glasgow confirms its long-term intention to explore development opportunities and usage of this riverfront property.

[18] At that point, in such a small community, the Appellant was also made aware of opposing groups and people who prefer another purchaser for the Plant's assets.

[19] The authorities were not responding within the delay and this impact on the possibility for certain bidders not to extend their offer. The authorities raised issues relating to the financial aspect of the previous corporate owner and how the next operator may handle such liabilities. In short, the support from some local officials was not positive for the Corporation to purchase the Plant's assets.

[20] During the negotiations, the Appellant confirmed that the authorities and the receivership learned that the investors proposed by him are from Iran, the funds are from Iran and the investors are planning to immigrate to Canada. He describes them as being highly educated in the steel manufacturing field.

[21] On April 18, 2011, the Appellant arranged for the Corporation to issue the shares to the investors. Although he was a shareholder at the beginning, on April 18, 2011, the investors replaced him as shareholders except for 10%. Bank transfers were arranged between Iran and Canada to receive the funds, and the Appellant kept a 10% interest in the Corporation.

[22] The Court did not get the complete list of directors of the Corporation. However, the evidence supports that the Appellant was, and remained, a director of the Corporation at all relevant times.

[23] Following all negotiations, talks, positions adopted by the different actors, on July 29, 2011, the Corporation acquired the Plant's assets from the receivership. The Corporation was still waiting for authorizations before the Plant operations can begin.

[24] Tests and authorizations took about three months for the Corporation to complete. Employees of the Corporation were working during that period. In fact, to the extent that the Corporation was responsible for the Plant, employees of the Corporation were working on site. The production officially started on December 28, 2011.

[25] However, the total period covered by the Assessments is for withholdings unremitted for the period of September 2011 to October 2012. With or without production, there were a maximum of approximately 20 employees on site employed by the Corporation and salaries were paid to them.

[26] The payroll arrangement were done by a human resources employee (**Ms. Lee**). Ms. Lee did not testify before the Court. She was an employee of the former owner and now under employment with the Corporation. Part of her work included making the payroll deductions on salaries. A portion of the money received from the investors was devoted to pay the net salaries to the employees. The rest of the investors' money was for completion of the transaction. From the Appellant's testimony, the money available at the beginning for paying salaries and some maintenance costs is estimated to be a maximum of $250,000. The Appellant admitted that the money available for salaries was not enough.

[27] By letter dated August 31, 2011, the Corporation's Canadian bank announced to the Appellant as president of the Corporation that for a number of years there have been U.S. laws in place that restrict the ability of financial institutions from engaging in specified transactions with certain countries, individuals and entities. The bank has implemented additional compliance policies and procedures for USD products to comply with U.S. laws, and advised the Corporation that it cannot facilitate commercial transactions in USD directly or indirectly with companies that have significant Iranian ownership such as the Corporation. In addition, the bank informed the Corporation that the Canadian economic sanctions against Iran preclude the bank from authorizing any transactions in any currency related directly or indirectly to Iran's oil and gas sector or Iran's nuclear enrichment program.

[28] From the bank's correspondence, it became clear that transactions with the US would be compromised. 90% of the Corporation's clients were US based. The

Appellant confirmed that they could not bring any money from Iran due to sanctions. As they thought this would be a temporary situation, they decided to borrow from the private sector until they figure out a solution. However, the private sector was mainly from Iran.

[29] The Appellant was of the view that, as for the economic sanctions, it is not something that a businessperson would normally know. Transfer funds from Iran to Canada was not easy. They eventually lost $350,000 in one transaction using other alternatives such as exchange offices.

[30] The Corporation's financing structure remained unresolved. The provincial government and banks were ultimately not willing to finance the Corporation.

[31] In 2012, the Appellant's focus was on getting financing support for the operations. Money cannot leave Iran to come to Canada and no help is offered in Canada. Early in 2012, the Appellant was aware that news are not good about resolving the financial situation. However, he remained optimistic in saving the situation and finding a sustainable solution for the Corporation.

[32] The Court asked him about the payroll deductions during that difficult period. At all times, money was an issue. Prior to start production, the Corporation received funds but not enough. The decision was made to pay only net salaries. The payroll deductions were not remitted to the tax authorities on the basis that the difficulties would be temporary and could be dealt with later, and for the time being the objective is to save funds, as much as possible, in order to be able to pay the employees. Once the production started, the financial situation became worst, and although net salaries are still paid, the decision is to maintain the same position vis-à-vis payroll deductions and not remit them.

[33] The Appellant is aware that if he pays the payroll deductions at source to the tax authorities the Corporation will not be able to pay the employees as long as he would like.

[34] Ultimately, early in July 2012, additional liabilities became due. Money from a $425,000 secured loan obtained from a Canadian friend of the Appellant (Mr. Harris) was used by the Corporation to pay the debts due then (including net salaries) but not the tax authorities. The Appellant testified that a shareholder and director in Montréal, Canada (Mr. Borazghi) took over to authorize payments to be made by the Corporation using its available funds. The Appellant did not oppose to this approach or raise any concern, and let the shareholder/director authorized each

Corporation's payment once information requiring the payment is sent to him by the Appellant. With respect to net salaries that became payable, Ms. Lee was still involved, and a list of employees and the amounts to appear on the cheques were sent to the shareholder/director in Montréal for approval. The Appellant confirms that the tax authorities were still not paid through this process, and he was aware of that.

[35] End of July 2012, the decision is made to cease the operations completely. The Appellant was not pleased with that decision, and he explained to the investors that his working capital was in place, he can easily generate money and pay all the debt. Notwithstanding the explanation, the decision was maintained. The Appellant did not resign as a director.

[36] All employees were laid off, except for the Appellant and another person. The payroll was managed the same way as before and the tax authorities were not paid. The Appellant was still of the same view as for the absence of payments of the withholdings.

[37] Later, the last two employees were laid off. However, the Appellant provided no specific termination date.

[38] The Appellant confirmed not having put in place any plan to pay the tax authorities as he felt that the money was not available for that.

[39] The Appellant added that operating the Plant was not a business case, it was a political case. The local officials and leaders did not want them to succeed and created an environment for them not to be able to continue. The reason is that they wanted the land. The Appellant found the context unfair and some parties disloyal. He believes he did not have control over it and there was no way to prevent it.

[40] On July 30, 2013, the Appellant announced his resignation as president. He remained a director of the Corporation, although his implication was nominal like others under the limited circumstances.

[41] In cross-examination, counsel for the Respondent wanted to confirm the time that the $425,000 loan came in. The documents in support of the loan indicate April 13, 2012, not July 2012 as previously announced.

[42] Counsel asked whether the Appellant advised Mr. Borazghi to put the money towards the tax authorities. The Appellant said that Mr. Borazghi was already aware

of it. The Appellant was confronted with his examination for discovery done in February 2021 about his interaction with Mr. Borazghi for signing cheques. The Court understands that the Appellant did not give instructions to him about amounts payable to the tax authorities; only the amount payable to each employee was provided. The Appellant said that he thought that Borazghi was taking care of it, although the Appellant provided no information about remittances to Mr. Borazghi. Ultimately, he did not know if Mr. Borazghi did it or not.

[43] The answers given by the Appellant in cross-examination about his role do not coincide with his testimony given during the examination for discovery in February 2021. He has a tendency to minimize his role. The Court believes that the evidence supports that the Appellant was the sole central voice and public face of the Corporation in Canada.

[44] From the exchange during the cross-examination about the withholdings and payroll responsibility, it is clear that the Appellant was aware of the situation, he had many opportunities to discuss with the investors and we have to assume that it was agreed among the Appellant and the investors not to remit because no money was available for that. This is the Court's understanding following his testimony. In addition, at that all relevant times, the Appellant is the president of the Corporation, the sole officer identified at the hearing and the director of the Corporation involved in all discussions and decisions regarding plans, solutions, employees, issues, clients regarding the Plant and the Corporation.

[45] Regarding the $425,000 loan from Mr. Harris, the Appellant was asked during the examination for discovery in February 2021:

> Q. And this money was used to pay creditors?
>
> A. Yes.
>
> Q. And this money was used to get the corporation up and running?
>
> A. Yes.
>
> Q. And you knew that the money would be spent in this way?
>
> A. I was not in control of the mortgage or loan when we took it immediately. It was Mr. Borazghi who had it.
>
> Q. But you knew that Mr. Borazghi would be spending the money in this fashion?

> A. He got the control, so I don't know.
>
> Q. You'd agree that at no point you advised Mr. Borazghi to put the money towards the CRA?
>
> A. He was aware of it, and we sent the list of workers to him and he was arranging for the payment himself. He had a company, so I didn't question or, you know, ask for his judgment, no.
>
> Q. You didn't question him?
>
> A. No, I didn't.

[46] In respect of responsibilities assumed with payroll deductions, the Appellant was exposed at the hearing with his answers given at the examination for discovery in February 2021:

> Q. And I'm just going to start reading from line 20. The question states: "So you were in charge of wages and salaries, right? You were the one giving them your paycheque? ANSWER: Yes." Line 24: "And who was in charge of the withholdings? So when I say withholdings, I are mean source deductions that you remitted to the government so the payroll deductions, you have the employment insurance deductions, the Canada Pension Plan deductions."
>
> A. Mmhmm.
>
> Q. And I'll just go to your answer here: "If you remember, I said from the first week the place we were in a deep hole."
>
> Q. So I'll give you a moment to go through that, Mr. Jafarnia, but returning back to that original question at line 20, would you adopt your statement from that time: "So you were in charge of wages and salaries, right? You were the one giving them your paycheque? Yes." (As read)
>
> A. I don't want to respond before I read this, but I was the one who submit the cheque to them. Meaning they wrote the cheque, sent it to us, and I was submitted it. So giving the cheque, that wasn't me, not the one who actually signed, write, and order to pay. That was not me. The cheques was going to Montreal, prepared, coming back to my office, and they were coming to my office to receive the cheque.

[47] In respect of the interaction between the Appellant and Mr. Borazghi about the net payments made to the employees:

Q. So at the time that you provided this information [the information for payment to the workers] with respect to the cheques, you did not ask Mr. Borazghi about source deductions?

A. I was actually thinking that he's the one who is taking care of the things, because it's not only the amount of money that he has to pay to the labourer or the workers, he has to pay to the government, too. I was not aware if he's paying that or not, because for that he doesn't need my arrangement. He was doing it himself. The cheques that I supposed to submit to the workers comes to me.

Q. I'm going to move to a different topic but before I do so, during your testimony you stated that the workers were being paid net amounts, correct?

A. I believe so, correct.

Q. So in paying those workers net amounts, you knew that those amounts did not include source deductions?

A. You're not paying the workers the taxes and the other stuff.

Q. You knew that those source deductions were not going towards the government?

A. I didn't know, no. I was not aware of it. I was the production guy from the beginning, and as soon as we had financial issue, I mentioned to my shareholders, and they said, Mr. Borazghi is going to take care of it. That's why we gave him actually the responsibility about payment. I was only taking care of the operations.

Q. You knew what source deductions were?

A. Yeah, I knew that.

Q. And you had, in fact, spoken to a CRA trust examiner in 2012 about source deductions?

A. Yeah.

Q. And during that conversation with the trust examiner, he had talked to you about the source deductions?

A. Mmhmm.

Q. And he explained that he was concerned about the money that you were supposed to pay for these payments?

A. Yeah.

> Q. And you explained that this is our case, there is no money, and we're trying to resolve the issue with government somehow, and as soon as we have any availability towards paying you guys, we will do it?
>
> A. Mmhmm.
>
> Q. So you knew that this money needed to be paid towards government?
>
> A. Yeah.
>
> Q. It was a decision to hold off on paying the government until the corporation was in a better place financially?
>
> A. Sure, not by me. I'm not the one who actually takes care of these stuff. I was the operation manager for -- let's say I was taking care of only the operation. Financial stuff was from Mr. Borazghi.

[48] The Appellant confirmed that the Corporation spent approximately $600,000 in 2012 in repairs and maintenance for the Plant.

[49] The cross-examination at the hearing allowed the Court to understand that the Appellant had the same approach with funds received from clients or owed to suppliers. From the moment funds are available, the Corporation has at all times preferred to meet its needs in relation to operations rather than pay the payroll deductions to the tax authorities. There were just not enough money to pay everyone. The Appellant said that he could not take any action to advise the other directors. He had only a 10% participation in the Corporation. Therefore, for him, he was not in a position to intervene. However, there is even emails discussing purchase orders back in October 2011 where the Corporation through the Appellant buying equipment. The Appellant confirmed these actions on the basis that they need it to produce the goods.

IV. <u>Position of the parties</u>

[50] The Appellant submits that he should not be held liable for the Corporation's failure to remit source deductions. He knew about the Corporation's remittance obligations, but could not control how the funds were used. The Corporation faced financial difficulties due to the government's own sanctions and had no cash to pay the source deductions. He argued having repeatedly informed the shareholders about the situations and resigned as president of the Corporation in June 2013.

[51] The Respondent submits that the Appellant is jointly and severally liable with the Corporation for its unremitted source deductions. The Appellant was aware of the Corporation's remittance obligations, but chose to redirect the funds to other purposes in an effort to improve the Corporation's financial situation. The Corporation's financial difficulties do not alleviate the Appellant of his responsibility to remit source deductions to the tax authorities. The Appellant did not take steps to prevent the Corporation's failure to remit, and was not duly diligent within the meaning of subsection 227.1(3) ITA.

V. <u>Analysis</u>

- *the law and the applicable due diligence defence test*

[52] Considering the issue in dispute, the sole relevant provision is subsection 227.1(3) ITA:

> Liability of directors for failure to deduct
>
> 227.1 (1) […]
>
> Limitations on liability
>
> (2) […]
>
> Idem
>
> (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.
>
> [...]

[53] In accordance with this subsection, a director is not personally liable where the director "exercises the degree of care, diligence and skill to prevent the failure [to deduct, withhold or remit tax] that a reasonably prudent person would have exercised in comparable circumstances." This is a question of fact and the burden of establishing the criteria of the due diligence defence rests with the director. [5]

[54] Since the Supreme Court of Canada decision in *Peoples* [6], the Federal Court of Appeal in *Buckingham* concluded that the "objective-subjective" standard set out

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[5] *Buckingham v The Queen*, 2011 FCA 142 [*Buckingham*].

[6] *Peoples Department Stores Inc. (Trustee of) v Wise*, 2004 SCC 68 [*Peoples*].

in *Soper* [7] was replaced by the objective standard set out in *Peoples*. The references to a "reasonably prudent person" in subsection 227.1(3) ITA were found to be a clear indication that the test is purely objective rather than partly subjective.

[55] An objective standard does not, however, entail that the particular circumstances of a director are to be ignored. In *Buckingham*, the Federal Court of Appeal added that these circumstances must be taken into account, but must be considered against an objective, "reasonably prudent person standard."

[56] The Federal Court of Appeal in the *Buckingham* decision clarified that, in order to rely on the due diligence defence, a director must have taken active steps to prevent the failure to remit, rather than simply having taken steps after the fact to remedy the failure to remit. The focus of the due diligence defence is therefore on the degree of care, diligence and skill exercised by the director to prevent failures to remit. In order to benefit from a due diligence defence, the Federal Court of Appeal states that:

> [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.

[57] The Federal Court of Appeal was more specific about the scope of the test a director must satisfy and the active role a director must adopt:

> This objective standard has set aside the common law principle that a director's management of a corporation is to be judged according to his own personal skills, knowledge, abilities and capacities: Peoples Department Stores, at paragraphs 59 to 62. To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director are important as opposed to the subjective motivations of the director: Peoples Department Stores, at paragraph 63. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions through the establishment of good corporate governance rules: Peoples Department Stores, at paragraph 64. <u>Stricter standards also discourage the appointment of inactive directors chosen for show or who fail to discharge their duties as director by leaving decisions to the active directors. Consequently, a person who is appointed as a director must carry out the duties of that function on an active basis and will not be allowed to defend a claim for malfeasance in the discharge of his or her duties by relying on his or her own inaction</u>: Kevin P. McGuinness, Canadian Business Corporations Law, 2nd ed. (Markham, Ontario: LexisNexis Canada, 2007), at § 11.9.

[7] *Soper v The Queen*, 97 DTC 5407 (FCA) [*Soper*].

[underlining added]

[58] About the period the due diligence defence must cover, the *Buckingham* decision mentions that the assessment of the director's conduct begins when it becomes apparent to the director, acting reasonably with due care and diligence, that the corporation is entering a period of financial difficulties.

[59] A director cannot merely rely on his own inaction as a defence against liability. As Justice Hogan addressed in *Kaur* [8], a director's oversight duties cannot be delegated in their entirety to a subordinate. Similarly, in *Constantin* [9], the Federal Court of Appeal dismissed the appeal of a director who claimed that she had relied exclusively on her spouse to manage the corporation, and had been misled regarding its financial difficulties.

- *the present case*

[60] Only the Appellant testified. He did not call any other witnesses. Therefore, no one corroborated the Appellant's testimony. More specifically, the Court did not hear from Ms. Lee or Mr. Borazghi.

[61] The payroll deductions in the present case cover the period from September 2011 to October 2012. Up until July 2012, the Corporation employed a maximum of approximately 20 employees, after having started production in late December 2011. The number of employees then started to come down in July 2012, ultimately to two employees and none around October 2012.

[62] Most employees were working on production. The evidence does not support many employees within the management team, except for the Appellant and Ms. Lee as a part-time employee. Considering the recurring difficult financial position of the Corporation, the workforce was essentially at a minimum.

[63] On site, the Appellant was not able to rely on the other shareholders/investors or even other directors of the Corporation as none were physically in Canada or if so, were living outside Nova Scotia. Although one director was at some point involved with specific tasks regarding the control of available cash flow, the Appellant was really the sole senior officer and director on site dealing with all sorts of issues, challenges, crisis, negotiations, solicitations, meetings, orders, customers

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[8] *Kaur v R*, 2013 TCC 227 [*Kaur*].

[9] *Constantin v R*, 2013 FCA 233 [*Constantin*].

purchase orders, supplies purchases, daily employees management regarding the Corporation's affair, to name a few.

[64] With respect to the employees, the evidence presents the Appellant as the main contact and senior representative of the Corporation. As part of Ms. Lee's work, she prepared the pay for the employees. The Appellant did not abdicate his authority over her, and for that reason, the Court infers that she was working under the Appellant's instructions and supervision at all relevant times.

[65] Based on the description obtained from the Appellant, it would be fair to describe two periods regarding the management of the payroll functions: prior and past April 2012. April 2012 is the time the evidence was confirmed to be the last sequence the Corporation received funding (**Pre-Loan/Post-Loan**). This was the time the loan from Mr. Harris was signed. The Appellant was certainly involved in this financing arrangement. In particular, he received Pre-Loan approval from his investors/shareholders to find funds in Canada, he knew personally Mr. Harris and he signed the loan documents on behalf of the Corporation.

[66] The Appellant also testified that this loan corresponds to the moment the investors/shareholders have agreed to have Mr. Borazghi a director of the Corporation to supervise/authorize the spending of the loan in a way that would maintain the Corporation's operations. The Appellant explained having agreed with that decision, as he only owns 10% of the Corporation's equity.

[67] Pre-Loan period, the Appellant was the only one to supervise and control the management of the Corporation's payroll functions. This is clearly not a surprise as the evidence identified the Appellant as the sole senior officer and director that the evidence involved in all aspects of the Corporation's operations.

[68] Therefore, the Appellant had all opportunities to assume his responsibilities as director of the Corporation and in particular in respect of payroll remittances to the tax authorities. This conclusion does not mean that the Appellant needed to succeed in convincing the others. However, this is clearly a period where he must actively assume his role as director and the related responsibilities, particularly under the ITA.

[69] The Appellant has been affirmative and forthcoming during the examination-in-chief about his awareness of payroll deductions, responsibilities that arise from it under the law and more specifically on the reasons why the Corporation remitted nothing to the tax authorities. The Appellant is an educated person and aware of the

governance that generally concerns employees and employers. He asked that Ms. Lee determined the net salary to the employees, and this is the amount that was paid by the Corporation. But no such instruction was given in respect of the payroll deductions to the tax authorities. For the Court, this is clear that the Appellant did not turn his attention to the required remittances nor did he exercise his duty of care, diligence and skill with a view to preventing a failure by the Corporation to remit the applicable withholdings. The sole objective was to maintain the employees in place as long as possible, even if it meant non-payment of withholdings to the tax authorities.

[70] For the Court, the due diligence defence cannot save the Appellant for the Pre-Loan period. The evidence supports clearly, that all along the Pre-Loan period, the Appellant will be a key director of the Corporation aware of the whole situation and who will not take, on purpose, tangible or concrete measures to correct or stop the unremitted payroll deductions default.

[71] There is no doubt that the Appellant's desire and intention were to make the Corporation's operation a financial success. However, financial decisions were made to conduct the project in a particular way, and choices were made, but without complying with legal obligations to which the Corporation and the directors were liable. The position of the Appellant is to say that the money was supposed to come from the investors and without money it became difficult. The Appellant was faced with a long series of challenges and difficulties. The Appellant said that originally it was supposed to be temporary. All the decisions pointed in the same direction: getting the Plant in a state capable of ensuring production. However, the absence of payroll remittances payments quickly became a source of financing of the Corporation. The Appellant was clear that funds were not coming as planned and not enough money meant that the tax authorities would need to wait.

[72] The Appellant's decisions were made in good faith. However, one fact remains, a decision was made not to remit the payroll deductions to the tax authorities as required by law, and the Appellant is personally aware and is not taken any action to address or change the situation regarding not remitting the payroll deductions. The Appellant's efforts and objectives were elsewhere. The Appellant might have thought that the cash flow situation would be resolved in the near future. However, such position cannot support the Appellant's due diligence defence.

[73] As for the Post-Loan period, the difference with the Pre-Loan period is the role assumed by another director of the Corporation Mr. Borazghi to supervise/authorize the spending of the loan. The evidence is not entirely clear about

what was exactly the authority of Mr. Borazghi. Does he write the cheques or sign the cheques to the employees? What is clear is that the list of employees with the amount payable to each of them was remitted to him by the Appellant and Ms. Lee. The Appellant did not confirm that more information was provided to Mr. Borazghi about the employees or what would happen to the payroll deductions deducted from the gross salary of the employees. Although the Appellant did not have the same authority for signing cheques as during the Pre-Loan period, the Appellant confirmed not having discussed with Mr. Borazghi the remittance of payroll deductions to the tax authorities. The Appellant confirmed that Mr. Borazghi knew and he did not question him about that responsibility. For the Appellant, Mr. Borazghi was the one who is taking care of this, because he is signing the cheques. The Appellant said he was not aware if Mr. Borazghi is paying the tax authorities or not, because for that he does not need the Appellant.

[74] For the Court, two options exist to explain the Appellant’s position: either he deferred to Mr. Borazghi without talking to him directly because the matter was financial, or the Appellant was free to take the necessary steps.

[75] The Court does not believe that the evidence established so clearly a limited role of the Appellant Post-Loan period with respect to the obligation to remit the payroll deduction. The Appellant’s role with the Corporation was far more than just operation manager. The Court does not deny that Mr. Borazghi assumed a role at some point in April 2012. Nevertheless, the Appellant was not excluded from all financial operations. He continued to assume a role on the daily operation and provide all information to ensure that his decisions be submitted and hopefully endorsed by Mr. Borazghi. To let us believe that Mr. Borazghi was responsible for paying the payroll deductions to the tax authorities in the context as described is not reasonable and does not stand before the entire role and responsibilities assumed by the Appellant in running the Corporation’s affairs from New Glasgow. The Court did not hear any testimony to corroborate the Appellant’s position as he described it.

[76] The Court believes more likely that the Appellant simply tried to hide himself behind another director for decisions that he was aware of and knew from the beginning. This explains why he did not insist on asking Mr. Borazghi about the status of payroll deductions. Moreover, the evidence did not confirm that the Appellant directly, or indirectly through Ms. Lee, provided to Mr. Borazghi the details for the payroll deductions to be remitted to the tax authorities, or that he requested evidence of such payment. In addition, the Court has no evidence that the Appellant provided the director with any information or forms to ensure that payroll

deductions were paid. In fact, this is consistent with the Pre-Loan period where cheques were prepared and signed by the Appellant and no payroll deductions were ever remitted to the tax authorities.

[77] Even if both options are still possible, the Court does not believe that either option would establish a valid defence under subsection 227.1(3) ITA. The Appellant, acting Pre-Loan period, did not take tangible or concrete measures to correct or stop the unremitted payroll deductions default. Moreover, this approach did not change Post-Loan period. As mentioned above, a person who is appointed as a director must carry out the duties of that function on an active basis and will not be allowed to defend a claim for malfeasance in the discharge of his or her duties by relying on his or her own inaction. A director must be active to rely on a due diligence defence. By not addressing the question directly with Mr. Borazghi, he voluntarily abdicated his responsibility as a director. A director cannot just want to rely on another director and support that this is a valid due diligence defence. More must be done to support measures to correct or stop the unremitted payroll deductions default.

[78] The Appellant cannot hide himself behind the role played by another director. Even that part is ambiguous. Not having Borazghi as a witness, the Court does not know the exact role and authority Mr. Borazghi had. The Court understands that he seems to sign the cheques, although he may not prepare them. The Court also understands that the decision to incur an expense originates from the Appellant and the cheque signed to cover such expense is based on information sent to Mr. Borazghi by the Appellant. The Appellant said in cross-examination that “The decision-maker was somebody else. I was just giving him the list of costs and the list of materials that we need.”

[79] Explicitly and intentionally not making remittances in the hopes of eventually being able to make them, as the Appellant did in this Appeal, has been considered by the jurisprudence. In these instances, the director has not met the standard of care required by subsection 227.1(3) ITA.

[80] In *Buckingham*, the Federal Court of Appeal provided that “[…] a director’s duty is to prevent the failure to remit, not to condone it in the hope that matters can be rectified subsequently”. This duty is based on the principle that the “Crown is an involuntary creditor” and:

> […] The level of the Crown’s exposure to the corporation can thus increase if the corporation continues its operations by paying the net salaries of the employees

> without affecting employee source deductions remittances, or if the corporation decides to collect GST/HST from customers without reporting and remitting these amounts in a timely fashion. In circumstances where a corporation is facing financial difficulties, it may be tempting to divert these Crown remittances in order to pay other creditors and thus ensure the continuation of the operations of the corporation. It is precisely such a situation which both section 227.1 of the Income Tax Act and section 323 of the Excise Tax Act seeks to avoid. The defence under subsection 227.1(3) of the Income Tax Act and under subsection 323(3) of the Excise Tax Act should not be used to encourage such failures by allowing a due diligence defence for directors who finance the activities of their corporation with Crown monies on the expectation that the failures to remit could eventually be cured.

[81] The Appellant's actions are the exact ones which the FCA in *Buckingham* provided should not be condoned by the availability of the due diligence defence.

[82] More recently, in *Hall* [10], Justice Campbell Miller found that the directors had condoned the continued operation for that company by diverting source deduction to other purposes and that, for this reason, the due diligence defence was unavailable:

> While the Federal Court of Appeal has stated in Buckingham that "Parliament did not require that directors be subject to an absolute liability," if a director is the very person who ultimately makes the decision to not make remittances to the Government, in favour of paying other creditors, it is difficult to perceive of an available due diligence defence. Such a director is assuming a personal liability.

[83] The Respondent cited *Maxwell* [11] in support of his position that the due diligence defence is unavailable to the Appellant. In that decision, Justice D'Arcy accepted that the Appellants believed that they would collect the monies owing to them from third parties and eventually be able to make the remittances. However, Justice D'Arcy found that the failure to make the remittances in the belief that this failure could be corrected in the future did not constitute a defence under subsection 227.1(3) ITA.

[84] Applying the Court's decision in *Maxwell* to the Appellant's circumstances, even if the Appellant sincerely believed that he would be eventually able to make the remittances, this belief is insufficient to avail himself of the defence under subsection 227.1(3) ITA which specifically requires the director to "prevent the failure" to make the remittances.

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[10] *Hall v The Queen*, 2015 TCC 240 [*Hall*].
[11] *Maxwell v The Queen*, 2015 TCC 74 [*Maxwell*].

[85] Unfortunately for the Appellant, the Court cannot consider the disappointments, challenges and frustrations that he encountered in trying to complete his project. The Court must act and decide in accordance with the provisions of the law. And such a situation has its limits. In addition, the Court is not an equity court and therefore fairness cannot justify a valid reason before the Court.

VI. <u>Conclusion</u>

[86] Based on the foregoing, the appeals made in respect of the Notices of assessment dated December 6, 2017, and bearing reference numbers 4716867 and 4716870, are hereby dismissed, with costs.

Signed at Ottawa, Canada, this 29th day of December 2023.

"J.M. Gagnon"

Gagnon J.

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