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THIS ISSUE:

DIRECTOR'S LIABILITY – ANOTHER POINT OF VIEW FROM THE TAX COURT

Wendy Brousseau and Rob Kreklewetz examine the result of the Zaborniak decision on the ever changing landscape of director's liability with respect to GST/HST reporting.

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ZABORNIAK - DERIVATIVE ASSESSMENTS; MORE UNCERTAINTY

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In *Zaborniak v. Her Majesty the Queen*,¹ the Tax Court has thrown more uncertainty into the issue of whether or not a director can defend a director's liability assessment by arguing the substantive merits of the corporation's underlying GST case.

This is often a key issue for outside directors, who while assessed under the director's liability provisions, and having at least some involvement in the company's affairs, may not have been able to influence – through voting power or otherwise – the company's course of action in defending against any initial GST assessment.

The Facts

A brother and sister were assessed as directors under section 323 of the ETA, and along with another (third) sibling, were the sole directors of a corporation.

The corporation had failed to file GST returns and failed to remit GST.

The issue before the Tax Court was whether the directors could challenge the underlying assessment of the corporation – i.e., whether a valid defence to the director's liability assessment was that the corporation's assessment was wrong.

The Tax Court's Decision

¹ *Zaborniak v. Her Majesty the Queen*, 2004 CarswellNat 2730; [2004] T.C.J. No. 412 (T.C.C) (GST)I.

In a nutshell, the Tax Court found that the directors could *not* challenge the substantive merits of the corporation's case.

The Court found that the assessment against the corporation, pursuant to subsection 299(4) of the ETA was valid and binding, subject to being vacated on objection or appeal, which could only be done by the person who had been assessed (which in this case was the corporation). In this instance, the Court found that the statutory language in section 323 was clear and did not allow a director to challenge the corporation's assessment (which pursuant to paragraph 323(2)(a) was deemed a judgment debt).

The Court did, however, acknowledge that based on the decision of the Federal Court of Appeal ("FCA") in *Gaucher*,² there have been conflicting decisions of the Tax Court on this issue.

Commentary – What is the Right Answer?

The Tax Court's acknowledgement of the *Gaucher* case is telling, at least in terms of the complexity of the case law in this area.

In *Gaucher*, the FCA appeared to have found that derivative assessments – albeit in the context of section 160 of the *Income Tax Act* ("ITA") – could be defeated by challenging the primary taxpayer's assessment, and many have since suggested (including Associate Chief Justice Bowman of the Tax Court) that it is therefore open to a taxpayer who has been assessed derivatively under section 323 of the ETA to challenge the underlying assessment against the corporation, even if the corporation has failed to do so.³

Specifically, in *Gaucher* the FCA held that persons faced with a derivative assessment under section 160 of the *ITA* could challenge the primary assessment.⁴ The FCA indicated as follows:

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.

...

It seems to me that this approach fails to appreciate that what is at issue are two separate assessments between the Minister and two different taxpayers. Once the assessment against the primary taxpayer is finalized, either because the primary taxpayer does not appeal the assessment, or the assessment is confirmed by the Tax Court (or a higher court if further appealed), that assessment is final and binding between the primary taxpayer and the Minister. An assessment issued under subsection 160(1) against a secondary taxpayer cannot affect the assessment between the Minister and the primary taxpayer.

² *Gaucher v. Her Majesty the Queen*, 2000 CarswellNat 2656; [2000] F.C.J. No. 1869 (F.C.A.).

³ *Wiens v. Her Majesty the Queen*, 2003 CarswellNat 2148 (TCC Informal Procedure); [2003] G.S.T.C. 121 at par. 5 (T.C.C.) (GST)I. See also, *Lau v. Her Majesty the Queen*, 2002 CarswellNat 3312 (TCC General Procedure); [2003] G.S.T.C. 1, *Elias v. Her Majesty the Queen*, 2002 CarswellNat 29 (TCC General Procedure); 2002 D.T.C. 1293 (T.C.C.) (IT)G; *Marceau v. Her Majesty the Queen*, 2000 CarswellNat 3724 (TCC Informal Procedure); [2003] G.S.T.C. 51 (T.C.C.) (GST)I., and *Cochran v. Her Majesty the Queen*, 2001 CarswellNat 2970 (TCC General Procedure); (2002) G.S.T.C. 2 (T.C.C.) (GST)G.

⁴ The purpose of section 160 of the ITA is to prevent taxpayers from attempting to avoid their tax liability by transferring assets to certain non-arm's length transferees for consideration less than fair market value. Section 160 sets out rules imposing joint and several liability on the transferee for the transferor's tax liability, at the time of the transfer, thus allowing the Minister to seek payment from a taxpayer who is not the original tax debtor.

By the same token, since the secondary taxpayer was not a party in the proceedings between the Minister and the primary taxpayer, she is not bound by the assessment against the primary taxpayer. The secondary taxpayer is entitled to raise any defence that the primary taxpayer could have raised against the primary assessment.

Some Tax Court decisions that have since found that notwithstanding *Gaucher*, a director *cannot* challenge the corporation's underlying assessment, relying on the proposition that unlike the situation to which section 160 is directed, a director will normally be in a position to influence the corporation's decision to appeal a tax assessment.⁵

With respect, however, such may not always be the case, especially where a director is marginalized or out-voted. Other situations also complicate matters, as for instance, where a trustee or receiver is appointed, and the director essentially denuded of power.

Accordingly, and given the FCA's reasoning in *Gaucher* (and our view that the deeming provision in subsection 299(4) – which deems an assessment to be valid and binding – only deems the assessment to be binding *between the Minister and the person actually assessed*), we believe that it is still reasonable to assert that a director is capable of challenging the underlying assessment against the corporation.

That would also appear to be the fair and fundamentally just result – which is often overlooked in Tax Court cases (the Tax Court not being a court of equity).

Unfortunately, and until the issue is further resolved by the FCA, there remains some serious doubt on the issue, particularly since the Tax Court seems to have some judges of differing views.

⁵ For instance in *Maillé c R*, 2003 CarswellNat 1707 (CCI Informal), the director was the sole director of the corporation. In *Zaborniak* the Court stated that the directors assessed “had the opportunity to influence the corporation's decision whether to appeal”.