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Business Law
Directors' and Officers' Liability in the Current Marketplace

Liabilities under Taxation Statutes

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DIRECTOR'S AND OFFICER'S LIABILITY IN THE CURRENT MARKETPLACE

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FEDERAL STATUTES

Note that this section summarizes only the liability of directors and officers under the *Income Tax Act* (Canada) and the *Excise Tax Act* (Canada). Liability of directors and officers for unpaid amounts may also exist under the *Air Travellers Security Charge Act*, the *Excise Act, 2001*, the *Canada Pension Plan*, and the *Employment Insurance Act*.

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.) (“ITA”)

Director's Liability

- A director is jointly and severally liable with the Corporation for failing to deduct or withhold taxes, unless he or she can prove that one of the limitations is unsatisfied, the due diligence defence applies, or the limitation period has passed
- Section 227.1(1) (summary of section) – Where a corporation has failed to deduct or withhold an amount, has failed to remit such an amount or has failed to pay an amount of tax as required by the ITA, the directors of the Corporation are jointly and severally liable, together with the corporation, to pay that amount and any interest or penalties relating to it
- Defences
 - Section 227.1(2) (modified extract from the ITA) – Limitations:
 - (i) Certificate must be registered in the Federal Court and execution returned unsatisfied;
 - (ii) Corporation commenced a liquidation or dissolution proceeding or has been dissolved and a claim for the liability has been proved; or
 - (iii) Corporation has made an assignment or receiving order has been made against it under the *Bankruptcy and Insolvency Act* (Canada) and a claim for the amount of the corporation's liability has been proved.
 - Section 227.1(3) (referenced and summarized at the end of this paper) – Due Diligence defence
 - Section 227.1(4) (summary of section) – Limitation Period is two years after Director last ceased to be a director of the Corporation

General Liability applicable to Directors and Officers

- A director or officer can be personally liable for the offences listed under section 239(1)(a)-(e), but only if the specific requirements of each subsection are met

- Section 239(1) (modified extract from the ITA) – Every person who has
 - (a) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements,
 - (b) evaded payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,
 - (c) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,
 - (d) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act, or
 - (e) conspired with any person to commit any of the above offencesis guilty of an offence and is liable on summary conviction to
 - (f) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or
 - (g) both the fine described in paragraph 239(1)(f) and imprisonment for a term not exceeding 2 years.

Excise Tax Act, R.S.C. 1985, c. E-15 (“ETA”)

Director’s Liability

- A director is jointly and severally liable with the Corporation for failing to remit or pay tax or interest and penalties relating to the tax, unless he or she can prove that one of the limitations is unsatisfied, the due diligence defence applies, or the limitation period has passed
- Section 323(1) (summary of section) – If a corporation fails to remit or pay an amount of net tax required under the ETA, the directors of the Corporation are jointly and severally, or solidarily, liable together with the Corporation, to pay the amount and any interest or penalties relating to the amount
- Defences
 - Section 323(2) (modified extract from the ETA) – Limitations:
 - (i) Certificate must be registered in the Federal Court and execution returned unsatisfied;
 - (ii) Corporation commenced a liquidation or dissolution proceeding or has been dissolved and a claim for the liability has been proved; or
 - (iii) Corporation has made an assignment or receiving order has been made against it under the *Bankruptcy and Insolvency Act* (Canada) and a claim for the amount of the corporation’s liability has been proved.

- Section 323(3) (referenced and summarized at the end of this paper) – Due Diligence defence
- Section 323(5) (summary of section) – Limitation Period is two years after Director last ceased to be a director of the Corporation

General Liability applicable to Directors and Officers

- A director or officer can be personally liable for the offences listed in sections 326, 327, 329, and 330, but only if the specific requirements of each section are met
- Section 330(1) (summary of section) – Every officer, director or agent of a corporation who directed, authorized, assented, acquiesced in or participated in wilfully failing to pay, collect or remit tax or net tax is guilty of the offence and liable on conviction to the punishment provided for the offence
- Section 329(1) (summary of section) – Every person who wilfully fails to pay, collect, or remit tax or net tax is guilty of an offence punishable on summary conviction and liable to a fine not exceeding the aggregate of \$1,000 and an amount equal to 20% of the amount of tax or net tax that should have been paid, collected or remitted or both a fine and imprisonment for up to six months
- Section 326 (summary of section) – Every person who fails to file a return is guilty of an offence and liable to a fine of not less than \$1,000 and not more than \$25,000, or, both a fine and imprisonment for a term not exceeding twelve months
- Section 327(1) (modified extract from the ETA) – Every person who has
 - (a) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements,
 - (b) evaded payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,
 - (c) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,
 - (d) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act, or
 - (e) conspired with any person to commit any of the above offencesis guilty of an offence and is liable on summary conviction to
 - (f) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or
 - (g) both the fine described in paragraph 327(1)(f) and imprisonment for a term not exceeding 2 years.
- Case Law specific to ETA
 - *R. v. J.I.L.M. Enterprises & Investments Ltd.*, [2005] G.S.T.C. 117 – Manager of taxpayer Corporation found personally responsible under section 327 of the ETA and sentenced to

six months of imprisonment and a fine of \$20,543, for making a deceptive statement on the Corporation's GST return

- *R. v. Onkar Travels Inc.*, [2003] G.S.T.C. 129 (Ont. S.C.J.) – President and sole Director of taxpayer Corporation found guilty under section 327 of ETA for making false entries in the books and records filed to Revenue Canada, and therefore had to make restitution in the amount of \$105,000, pay a fine of \$200,000, and serve a term of imprisonment of two years less one day

PROVINCIAL STATUTES

Income Tax Act, R.S.O. 1990, c. I.2 (“OITA”)

Director's Liability

- A director is jointly and severally liable with the Corporation for failing to withhold or remit source deductions, unless he can prove that one of the limitations is unsatisfied, the due diligence defence applies, or the limitation period has passed
- Section 38(1) (summary of section) – Directors are personally liable on a joint and several basis and together with the corporation, for two years after ceasing to be a director for a corporation's failure to withhold and remit source deductions
- Defences
 - Section 38(2) (modified extract from the OITA) – Limitations:
 - (i) Certificate must be registered in the Federal Court and execution returned unsatisfied;
 - (ii) Corporation commenced a liquidation or dissolution proceeding or has been dissolved and a claim for the liability has been proved; or
 - (iii) Corporation has made an assignment or receiving order has been made against it under the *Bankruptcy and Insolvency Act* (Canada) and a claim for the amount of the corporation's liability has been proved.
 - Section 38(3) (referenced and summarized at the end of this paper) – Due Diligence defence
 - Section 38(4) (summary of section) – Limitation Period is two years after Director last ceased to be a director of the Corporation

General Liability applicable to Directors and Officers

- Section 46 (summary of section) – When a Corporation is guilty of an offence under the OITA, an officer, director or agent of the Corporation who directed, authorized, assented to, acquiesced in, or participated in, the commission of the offence is a party to and guilty of the offence

- Section 18(5) (summary of section) – Every person who fails to make an information return or comply with a duty imposed as required by the OITA is liable to a penalty equal to the greater of \$100 and the product obtained when \$25 is multiplied by the number of days, not exceeding 100, during which the failure continues
- Section 19(1) (summary of section) – Penalty for repeated failure to report an amount is liable to a penalty equal to 10% of the total amount
- Section 19(2) (summary of section) – Every person who knowingly makes, participates in, assents to or acquiesces in the making of a false statement or omission is liable to a penalty of the greater of \$100 and 50% of the amount

Retail Sales Tax Act, R.S.O. 1990, c. R.31 (“RSTA”)

Director’s Liability

- A director is jointly and severally liable with the Corporation for failing to collect or remit tax, or pay interest or penalties relating to that tax, unless he can prove that one of the limitations is unsatisfied, the due diligence defence applies, or the limitation period has passed
- Section 43(1) (summary of section) – Where a Corporation has failed to collect tax or remit tax, or failed to pay any interest or penalty relating to that tax, the directors of the corporation are jointly and severally liable, together with the Corporation
- Defences
 - Section 43(2) (modified extract from the RSTA) – Limitations:
 - (i) A warrant of execution issued and the warrant returned unsatisfied;
 - (ii) Corporation subject to a proceeding to which section 22 applies and a claim has been made under that section; or
 - (iii) Corporation has become bankrupt or has filed a Notice of Intention to file a proposal under the *Bankruptcy and Insolvency Act* (Canada), and a claim for the Corporation’s liability has been proved.
 - Section 43(3) (referenced and summarized at the end of this paper) – Due Diligence defence
 - Section 43(5) (summary of section) – Limitation Period is two years after Director last ceased to be a director of the Corporation

General Liability applicable to Directors and Officers

- Section 42 (summary of section) – Any officer, director or agent of a Corporation, or any other person who directed, authorized, assented to, acquiesced in or participated in the commission of any act by the Corporation which is an offence under the RSTA, is guilty

of an offence and on conviction is liable to the punishment for this offence whether or not the Corporation has been convicted under the RSTA

- Section 44(1) (summary of section) – Any person who contravenes the RSTA is guilty of an offence and is liable to a fine of not less than \$50 and not more than \$5,000
- Section 44(2) (summary of section) – Every person who fails to collect the tax under the RSTA is guilty of an offence and is liable to a fine equal to the amount of the tax that should have been collected and an amount not less than \$50 and not more than \$2,000

DUE DILIGENCE DEFENCE

- Due Diligence defence available under all four statutes mentioned above
- Directors are not liable if they exercise due diligence – diligence that a reasonably prudent person would exercise in comparable circumstances to ensure that the corporation deductions, withholds, collects, remits or pays the amounts due
- Directors must show that they took reasonable steps to *prevent* the failure of the Corporation to deduction, withhold, collect, remit or pay taxes
- If Corporation in financial difficulties, Directors may have to obtain an enforceable undertaking to pay all amounts due to the Crown, or if the Corporation is in receivership or bankrupt, advise the receiver and manager or trustee of the banking arrangements in place for the payment of taxes withheld
- Directors obliged to be aware of what is happening in the Corporation and effective lines of communication must be maintained
- Directors may not claim they were uninformed as to the requirements of applicable statutes
- Due Diligence test is subjective and objective – Director must have done what a reasonably prudent person would have done in the circumstances, but there must also be a consistent standard to judge that Director against
- *Soper v. Canada* (CA) (1997), 149 D.L.R. (4th) 297 (“*Soper*”) – An experienced Director who was aware the company was struggling financially, but not aware of the company’s failure to remit taxes, was found liable under subsection 227.1 of the ITA. Director could not rely on the due diligence defence because he failed to make an inquiry into the remittance issue, when clearly he should have, given what a reasonably prudent person in his position would have done in the circumstances.
- *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461 (“*Peoples*”) – A contextual objective approach must be used in analyzing whether the due diligence defence applies, such that it is clear that the factual aspects of the circumstances surrounding the actions of the director or officer are examined, as opposed to just the subjective motivation of the director or officer.

- *Hartrell v. Canada*, [2008] 3 C.T.C. 24 (F.C.A.) – A director was charged under section 227.1(1) of the ITA and could not rely on the due diligence defence enumerated in *Soper* and *Peoples* because as a chartered accountant, he did not make reasonable efforts to prevent deficient remittances that arose. The director could have caused the company to pay the arrears out of the funding that was subsequently provided to it, but chose not to.
- *Stafford v. The Queen*, 2009 T.C.C. 247 (CanLII) – A director charged under section 323(1) of the ETA, was not found to be in breach of his duty of care under subsection 323(3) of the ETA simply because he delegated the responsibility to ensure that tax was collected and remitted, as stated in *Soper*. The due diligence defence does not require a director who has delegated managerial functions to a family member to be obliged, in the absence of suspicious circumstances, to commission periodic forensic audits. It is a question of fact that must be decided in each case, whether a director is justified in relying upon an employee of a company, regardless of whether he is a relative or not.
- *Danso-Coffey v. Ontario*, [2009] 3 C.T.C. 127 (O.S.C.J.) – A director charged under section 43 of the RSTA cannot rely on the due diligence defence where she also seeks a declaration from the Court that she was never a director of the company, and therefore not liable to the Minister for any amounts owed to it by the company. The due diligence defence is available only to individuals lawfully assessed as directors under section 43 of the RSTA.

CASE LAW ON DIRECTOR AND OFFICER LIABILITY

- *R. v. Wheeliker* (1999), 172 D.L.R. (4th) 708 (F.C.A.) – Liability does not depend on whether a Director is being paid for being a director, as volunteer directors of a non-profit Corporation were found guilty of failing to remit required employee source deductions amounting to \$17,866.91 under the ITA, after the Corporation became bankrupt.
- *Scavuzzo v. R.*, [2005] G.S.T.C. 199 – Even if a Director has not been legally appointed as a director, he may be deemed to be a director (*de facto* director) depending on the particular circumstances and actions of the individual. It does not cover everyone who exercises authority in the Corporation, but it may cover persons who hold themselves as directors such that third parties rely upon their authority, or persons who may not actually be directors because of some technical requirement.
- *Grigg v. R.*, [1998] 4 C.T.C. 2758 (T.C.C.) – Corporation did not make employee payroll remittances because its Bank was struggling with financial difficulties and there were issues as to which creditors would be paid. When Bank did not release funds to Revenue Canada, director of the Corporation assessed for unpaid remittances under Section 38(1), and other relevant federal tax statutes, on the basis that he did nothing to prevent the Corporation's failure to remit. Director should have ensured there was a system in place by which remittances could be made in a timely manner.