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DIRECTORS' LIABILITY FOR TAX - PART I

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on the potential liability of a corporation's directors under the Income Tax Act (Canada) and other taxation statutes.

Alpert Law Firm is experienced in providing legal services to its clients in tax dispute resolution and tax litigation, tax and estate planning matters, corporate-commercial transactions and estate administration. Howard Alpert has been certified by the Law Society as a Specialist in Estates and Trusts Law, and also as a Specialist in Corporate and Commercial Law.

A. DIRECTORS' LIABILITY FOR UNPAID TAXES

(i) SECTION 227.1 OF THE INCOME TAX ACT

Section 227.1 of the *Income Tax Act* (the "Act") renders a director jointly and severally liable with his corporation for failure to deduct, withhold or remit amounts required, together with any interest or penalty in relation thereto, pursuant to the following sections of the Act:

(i) subsection 135(3), which imposes withholding obligations upon cooperative corporations that pay amounts to their resident customers as patronage dividends;

(ii) subsection 135.1(7), which imposes an obligation on an agricultural cooperative corporation to withhold taxes when a tax deferred share is redeemed, acquired or cancelled by the corporation or by a person or partnership with whom the corporation does not deal at arm's length;

(iii) section 153, which imposes an obligation to deduct or withhold from a payment of salary, wages and other amounts, an amount determined in accordance with the regulations under the Act and to remit that amount within the time limits prescribed by the said regulations (i.e. source deductions);

(iv) section 215, which relates to the obligation imposed upon a person resident in Canada to withhold and remit taxes for payments or credit in the form of dividends, interest or royalties made to a non-resident person; and

(v) for failure to pay tax under Part VII (section 192) or VIII (section 194) of the Act.

The potential liability does not include the corporation's regular Part I tax liability. Liability under section 227.1 of the Act only arises in the event that one of the following three conditions is satisfied:

(i) a certificate for the amount of the corporation's liability has been registered in the Federal Court of Canada and an execution for the amount in question has been returned unsatisfied in whole or in part;

(ii) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability under subsection 227.1(1) has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

(iii) the corporation has made an assignment, or a receiving order has been made against the corporation, under the *Bankruptcy and Insolvency Act*, and a claim for the amount of the corporation's liability under subsection 227.1(1) has been proved within six months after the date of the assignment or receiving order.

Pursuant to subsection 227.1(4), proceedings to recover any amount from a director may not be commenced more than two years after the individual ceased to be a director. Subsection 227.1(5) provides that the amount recoverable from a director is only the amount remaining unsatisfied after execution.

Under subsection 227.1(6), if a director pays an amount that is proved in dissolution or bankruptcy proceedings in respect of the liability of a corporation under subsection 227.1(1), the director is given the same preference as a creditor of the corporation. The director would also be entitled to contribution from the other directors of the corporation who were liable for the claim.

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(ii) SECTION 323 OF THE EXCISE TAX ACT

Section 323 of the *Excise Tax Act* (the "ETA") provides that a director may be personally liable if the corporation failed to remit taxes, payments, interests or penalties as required under subsection 228(2) or (2.3), or under section 230.1.

As is the case in the Act, director liability in respect of the ETA arises only if one of the three conditions are satisfied:

(i) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 316 of the ETA and execution for that amount has been returned unsatisfied in whole or in part;

(ii) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in subsection (1) of the ETA has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

(iii) 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 subsection (1) of the ETA has been proved within six months after the date of the assignment or bankruptcy order.

Subsection 323(3) of the ETA provides that a director is not liable if he or she has exercised the degree of care, diligence and skill to prevent the failure under subsection (1) that a reasonable person in the same circumstances would have exercised.

Furthermore, section 330 of the ETA provides that where a director acquiesces or participates in the commission of an offence as set out in the GST legislation, he is considered a party to and guilty of the offence and will be, whether the corporation itself has been prosecuted or convicted.

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B. DUE DILIGENCE DEFENCE

Until recently, the standard applicable to a director in determining whether he had been duly diligent was the objective-subjective test set forth in ***Soper v. the Queen***, 1997 D.T.C. 5407. The test was partly objective, in that one had to assess what a reasonably prudent person would have done to be duly diligent, and partly subjective, in that the circumstances of each case must have also been considered. Pursuant to the test set forth in ***Soper***, a passive director was not required to exhibit the same degree of care, diligence and skill as an active director.

In ***The Queen v. Buckingham****,* 2011 GTC 2024, the Federal Court of Appeal developed a different approach to the application of the due diligence test holding that the objective-subjective test in ***Soper*** had been replaced by a purely objective test as a result of the decision of the Supreme Court of Canada in ***Peoples Department Stores Inc. (Trustee of) v. Wise***, [2004] S.C.J., No. 64. The objective test 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. It created a stricter standard on which a director is to be judged and seeks to 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.

While the law in this area of the due diligence defence is still developing, other principles which can be gleaned from the case law are as follows:

(i) Positive steps that should be taken by a director to ensure that such taxes are paid include: (i) requesting information regarding the procedures in place with respect to withholding, and if such procedures are not in place or appear to be inadequate, establishing such procedures and ensuring that a competent person is in charge to see that these procedures are instituted and followed; (ii) calling upon financial officers of the corporation to report regularly on the continued implementation of these procedures; (iii) informing the CRA expeditiously if there is a withholding problem; (iv) obtaining regular confirmation that withholdings and remittances have in fact been made during all relevant periods; and (v) obtaining an opinion, where required, from a qualified tax advisor if it is believed that withholding is not required at law;

(ii) Where a director cannot insist upon the implementation of the foregoing steps because he is the minority, he should nevertheless recommend those steps at a directors' meeting and ensure that the minutes of the meeting duly record this recommendation;

(iii) Where a company is in financial difficulty, the directors have special responsibilities in addition to those outlined above. These special responsibilities could include obtaining a reliable undertaking from a financial institution to pay all related deductions or, failing that, establishing a separate payroll trust account into which gross payroll would be deposited for subsequent disbursement to employees with the difference to be remitted to the CRA when due;

(iv) The company's historical pattern of remittances, both before and after default, may be considered in determining due diligence. In addition, in certain circumstances, the remittance pattern of other companies of which the person is a director may also be examined;

(v) In determining whether a director has been duly diligent, he will not be held responsible for the acts of other directors;

(vi) Where a receiver-manager is appointed or a bank, either directly or through an agent, takes control of the company's operations, a director may consider resigning in order to minimize the likelihood that he will be a director at the time that a failure to remit arises, thereby avoiding the need to establish a due diligence defence; and

(vii) A director is not liable for defaults occurring after he ceases to be a director. In addition, no action may be commenced against a director under subsection 227.1 more than two years after the director last ceased to be a director.

C. PRE-*BUCKINGHAM* CASE LAW RELATING TO DUE DILIGENCE DEFENCE

1. *Soper v. The Queen*, 1997 D.T.C. 5407

The taxpayer, who was an experienced businessman, became a director of RBI in October, 1987 and resigned as a director effective February 10, 1988. At the time he joined the Board of Directors, he knew that the corporation was experiencing financial difficulties. At the November 1987 Board meeting, the taxpayer was given a copy of the balance sheet of RBI which revealed the corporation's serious financial problems. While RBI's failure to remit source deductions was never raised at any Board meeting, the taxpayer did not at any time inquire as to whether the corporation was complying with its remittance obligations under the Act. As a result, the Minister assessed the taxpayer personally for RBI's unremitted source deductions for the period from October, 1987 to

January, 1988. The Tax Court of Canada dismissed the taxpayer's appeal when it rejected the taxpayer's due diligence defence, stating that he knew of the corporation's financial difficulties when he accepted the directorship, and citing his failure to take steps to ensure remittance of source deductions. The taxpayer appealed to the Federal Court of Appeal.

In dismissing the taxpayer's appeal, the Federal Court of Appeal analyzed in detail the standard of care, diligence and skill to be exercised by a corporate director in the performance of his or her duties. As a starting point, the Court referred to the judgment in ***Re City Equitable Fire Insurance Co. Ltd.***, a 1925 Court of Appeal decision which summarized a director's duties. In particular, this case held that, at common law, a director must act honestly, but with some degree of skill and diligence. However, he does not need to exercise a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. Furthermore he is not required to give continuous attention to the corporation's affairs and, in the absence of grounds for suspicion, he may trust the corporation's officials to perform their duties honestly.

The Federal Court of Appeal then analyzed the legislated duties of care imposed upon directors in the *Ontario Business Corporations Act* ("OBCA"), the *Canada Business Corporations Act* ("CBCA") and subsection 227.1(3) of the Act. Mr. Justice Robertson concluded that the common law standard of care outlined in ***City Equitable***, while altered slightly, has not been significantly "upgraded" by statute. Furthermore, the standard of care laid down in subsection 227.1(3) of the Act is "inherently flexible". Specifically, instead of treating directors as a homogeneous group of professionals whose conduct is governed by a single, unchanging standard, that provision of the Act also contains a subjective element which takes into account the personal knowledge and background of the director as well as his or her corporate circumstances in connection with the company's organization, resources, customs and conduct. Therefore, the Court concluded that individuals with superior qualifications such as experienced business persons would be held to a higher standard of care under subsection 227.1(3) of the Act. Describing the standard as "objective-subjective", the Court warned that honesty and doing one's best are not enough to establish due diligence, although the standard is not a professional one, nor is it one governed by the law of negligence.

The Federal Court of Appeal then reviewed the case law regarding section 227.1 of the Act by distinguishing between cases involving inside directors, meaning those involved in the day-to-day management of the company and who influence the conduct of its affairs, and outside directors, meaning those not involved in the day-to-day running of the company. The Court concluded that inside directors will have the most

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difficulty in establishing the due diligence defence. For outside directors, the positive duty to act arises where a director obtains information or becomes aware of facts, which might lead one to conclude that there is, or could reasonably be, a potential problem with remittances. In other words, it is incumbent upon an outside director to take positive steps if he or she knew, or ought to have known, that the corporation could be experiencing a remittance problem.

Applying the law to the facts of ***Soper***, the Federal Court of Appeal found that the taxpayer was under a positive duty to act which arose, at the latest, in November of 1987 when he received the balance sheet of RBI revealing that the company was experiencing extremely serious financial problems. Given the taxpayer's experience in the field of business, this balance sheet should have alerted him to the existence of a possible problem with remittances. The fact that the taxpayer then took no positive steps to ensure remittance of employee withholdings, despite the fact that he should have been alerted to a potential problem in this regard, led the Court to conclude that the taxpayer did not exercise the degree of care, skill and diligence required by the Act. As a result, the taxpayer's appeal was dismissed.

2. ***Blanchard v. The Queen*, 2000 DTC 2255**

The Minister assessed two taxpayers personally as directors of a corporation for its unremitted source deductions. The Tax Court of Canada dismissed the taxpayers' appeals. The Tax Court found that: (i) the taxpayers knew that they were directors of the corporation; (ii) the taxpayers were actively involved in its daily operations; (iii) the corporation was undercapitalized from the beginning and suffered ongoing cash flow problems; (iv) the corporation had a history of non-remittances with respect to which discussions with the CRA had taken place; and (v) both taxpayers viewed their duty to remit source deductions as a substantial duty which could entail personal liability.

Therefore, the taxpayers were "inside directors", with a high standard of care. Notwithstanding that, they continued to pay other suppliers and the corporation's employees, in order to facilitate the finishing of a certain job. They did not take the positive steps contemplated by ***Soper*** regarding the payment of source deductions. It was not enough for the taxpayers to claim that they believed that everything would be satisfactory if they continued on as they had done, allowing the source deduction arrears to accumulate in the hope of finding new investors, and meanwhile using whatever cash they themselves had available. The taxpayers deserved sympathy for having spent considerable sums of their own funds to keep the corporation in business. However, they did not act as reasonable directors would have acted under the

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circumstances. The defence of due diligence, therefore, was denied, and they were personally liable as assessed.

3. ***Ciriello v. The Queen*, [2000] T.C.J. No. 829**

The taxpayers, a husband and wife, were directors of a corporation, which failed to remit GST for the periods from May 1, 1991, to October 31, 1991, and from February 1, 1992, to April 30, 1994. On June 25, 1994, the corporation made an assignment in bankruptcy and the Minister proved his claim for GST. The taxpayers were vicariously assessed as directors of the corporation for unremitted GST.

The taxpayers' appeals to the Tax Court of Canada were allowed in part. The wife lacked the skill and experience to recognize any default by the corporation in remitting its GST. Any individual with her lack of skill, experience and qualifications would have acted in the same way that she did. The Court allowed her appeal.

Although, the husband, like his wife, had only a public school education, he had gained experience by managing the corporation's business. Prior to 1991, the corporation had remitted source deductions and the husband was aware that, with the coming into force of the GST in 1991, the corporation had to remit GST as well. The husband was also aware that the corporation was in financial difficulty, but he appeared not to have done much to solve the GST remission problem. The husband was absorbed in trying to satisfy the corporation's creditors and he failed to show the requisite degree of due diligence. The Tax Court disallowed the husband's claim that he had ceased to be a director when the corporation made an assignment in bankruptcy on June 25, 1994. The Tax Court held that a corporation continues to exist when it makes an assignment in bankruptcy or is petitioned into bankruptcy. The directors may no longer be operating the bankrupt corporation, but they remain directors.

Therefore, the husband was personally liable as assessed. However, the Minister was ordered to re-examine the assessment in order to determine if the corporation's trustee in bankruptcy had made any GST payments on its behalf, in which case, the amount of the husband's assessment was to be reduced accordingly.

4. ***Dirienzo v. The Queen*, 2000 DTC 2230**

The taxpayer's uncle was the beneficial owner of the shares of a corporation. The uncle was also a *de facto* director. The Minister assessed the taxpayer personally in his capacity as a director for the corporation's unremitted source deductions.

The taxpayer's appeal to the Tax Court of Canada was allowed. The taxpayer was a puppet in the hands of his uncle. The taxpayer was a mere nominal director of the corporation with no powers, responsibilities, or control over how it was being operated. The taxpayer had ingenuous blind faith in his uncle, who was the family patriarch. The Minister, therefore, would have been entitled to assess the uncle as a *de facto* director of the corporation. However, the Court's duty in this case was to decide the facts in a "highly imperfect world where malleable young family members are bullied by domineering patriarchs". In this context, the taxpayer was powerless to do anything since his uncle dominated the family and all aspects of the business.

5. ***Facchini v. The Queen*, 2004 DTC 3677**

In this Tax Court of Canada case, the taxpayer, who was represented by Alpert Law Firm, was assessed as a director of a corporation for the corporation's failure to remit employee source deductions and goods and services tax. Specifically, the Minister asserted that the taxpayer did not exercise the degree of care, diligence, and skill to prevent the failure of the construction business to remit $38,000 in GST and $92,000 in income tax a reasonably prudent person would have exercised in comparable circumstances.

In his defence the taxpayer asserted that he used the necessary skill and due diligence required of him, considering (i) his lack of education; (ii) his minimal involvement in the business operations of the office; and (iii) his resulting reliance on the office experience of another director. While the taxpayer was a skilled carpenter, he demonstrated that he had extremely limited reading and writing abilities since he had emigrated from Italy at the age of 13 and his education was limited to grade 3 in Italy and a mere 8 months in Canada. Due to this lack of education and general lack of sophistication, the taxpayer argued that he was required to adhere to a lower standard of due diligence.

The taxpayer also indicated that his role as a director of the corporation did not consist of any significant involvement in the "paper end" of the business. Rather, his principal duty was as a foreman, for the completion of subcontracts for various construction projects outside of Toronto. He very rarely went to head office and when he did, it was usually only to deliver time sheets and pick up pay checks for his employees. The taxpayer's lack of involvement was corroborated by the corporation's former bookkeeper, accountant and secretary to the other director, who was explicitly responsible for the office and management of financial matters.

The taxpayer argued that given his lack of education and sophistication in business matters, he had no other choice but to rely absolutely on the expertise of the other director, who had office management skills and was responsible for filing the corporation's tax returns. The taxpayer contended that while he took no active steps to ensure that the corporation would make its required remittance, but relied on the other director to remit what had to be remitted, he did so because he not have the expertise, ability, or know-how to do anything else.

The court held that the taxpayer exercised the degree of care, diligence and skill to prevent the failure of the corporation to remit that a reasonably prudent person would have exercised in comparable circumstances, namely none. While the court stated that the taxpayer was indeed an "inside" director, the court put considerable weight on the evidence which indicated that the taxpayer was also an uneducated, unsophisticated individual who reasonably relied on the experience of another director, who was responsible for managing the office and filing the corporation's tax returns.

In coming to this conclusion, the court was of the view that the taxpayer was not personally liable for the corporation's failure to remit income tax since the taxpayer had very little education, no accounting or business experience, nothing to do with business matters of the corporation, and left all the decision-making to another director. The court found that given the taxpayer's limited education and skill it was appropriate for the taxpayer to rely on expertise of the other director, expanding on the finding in ***A.G. Can. v. Dilorenzo****,* 2003 GTC 1538, where the court found it was reasonable for the taxpayer to rely on the expertise of the corporation's accountant.

6. *Lau et al. v. The Queen*, 2002 D.T.C. 2212

In this Tax Court of Canada case, two taxpayers, husband and wife, were personally assessed as directors of a corporation for its unremitted GST payments. In the early 1990's, the husband incorporated a restaurant business and his wife agreed to do the bookkeeping. As the wife did not have any bookkeeping experience she regularly consulted with a national accounting firm and used their accounting system. Several years later, the corporation was not able to meet its GST obligations and the Minister sought payment from the taxpayers as directors. In their defence, the taxpayers argued that neither was liable for the unremitted GST. The wife claimed that she was simply not a director and the husband argued that while he was a director, he exercised due diligence which negated his liability. The Court held that both taxpayers were not liable.

In finding the wife not liable, the Court considered the evidence produced by both the wife and the lawyer who acted on the initial incorporation of the business. The corroborated evidence indicated that while the wife was listed as a director she did not actually sign a consent form to act as a director. Instead, the lawyer signed the form. The Court found that as the wife never consented to act as a director, she was not a director. Thus, the wife could not be held vicariously liable.

In deciding that the husband was not liable the Court considered the testimony of both the husband and the accounting firm which instructed and guided his wife with respect to bookkeeping and accounting. The evidence indicated that the husband had no reason to believe that his wife was making any bookkeeping mistakes as all revenues were fully disclosed to the accounting firm and his wife was carrying out the accounting firm's instructions with respect to the GST. In light of the husband's expectations that the accounting firm was monitoring his wife's work, the Court found that the husband was acting reasonably with respect to the corporation's GST obligations. As such, the Court found that the husband exercised due diligence and could not be found liable for the outstanding GST payments of the Corporation. This judgment was affirmed by the Federal Court of Appeal.

7. *McKinnon v. The Queen*, 2004 DTC 2049

In this Tax Court of Canada case, the taxpayer was personally assessed as a director for approximately $25,000 of unremitted source deductions of a company. The taxpayer was the president, sole shareholder, and sole director of the company, which operated a window installation business. The business was performing well until a cash-flow shortfall made it impossible for the company to remit source deductions. This cash-flow shortfall came about largely because a contractor, for which the company was a subcontractor, arbitrarily and improperly withheld $58,000 owed to the company for work performed. The Minister assessed the taxpayer personally for the unremitted source deductions.

The taxpayer appealed to the Tax Court, arguing that he exercised due diligence and as such was not liable. The Court held that the taxpayer was not personally liable as the taxpayer exercised due diligence. The Court found that there was nothing that the taxpayer could have reasonably done to prevent the company from being unable to remit its source deductions, as the taxpayer could not have known the contractor would not pay them for the work done as: (i) the contractor had paid them for similar projects in the past; (ii) the project for which the company did not receive payment for was a low risk project; and (iii) any attempt by the taxpayer to obtain the money owed, even through legal means, was met with stonewalling by the contractor's lawyers.

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It is interesting to note that the Court clearly rejected the Minister's argument that the taxpayer was not exercising due diligence in that either: (i) he should not have gone into the business to begin with; or (ii) he should have pulled out of the business sooner than he did. The Court dismissed these arguments, stating that neither were viable choices for a taxpayer who had invested all that he owned into a business and did not want to leave his employees in the lurch by walking away from it.

8. ***Cameron v. The Queen*, 2001 DTC 5405**

In this Federal Court of Appeal case, the taxpayer was a lawyer and a director of a private family-held corporation. The Minister assessed the taxpayer personally for unremitted source deductions. The taxpayer appealed, stating he was not liable as he had exercised due diligence. He produced uncontested evidence that he frequently asked management about the status of the tax remittances and once it became apparent that the company was not meeting its tax obligations, he attempted to handle the problem by appointing an accountant to do a report about the company's financial status and paying the arrears of source deductions to Revenue Canada.

In addition, the taxpayer argued that he had a less rigorous duty of due diligence because he was an "outside director". He was not involved in the day-to-day operations of the corporation, but was rather concerned with raising money for the public offering and general policy, and he was not a director with signing powers. The taxpayer argued that, given his limited responsibilities, his conduct constituted due diligence. In finding the taxpayer not liable, the Court relied upon: (i) evidence which indicated that the taxpayer had limited responsibilities as an outside director; and (ii) the uncontested evidence that the taxpayer was not passive but did as much as could reasonably be expected of an outside director to protect the interests of Revenue Canada.

9. ***Charette v. The Queen*, [2001] T.C.J. No. 10**

In this Tax Court of Canada case, the taxpayer was a shareholder and director who was assessed in his capacity as a director for a corporation's unremitted GST. The taxpayer appealed the assessment, arguing that prior to the period in question there had been an acrimonious shareholder split in which he had essentially lost control and had become a "outside director" of the company, with a less rigorous duty of due diligence than that of an "inside director".

The taxpayer provided uncontested evidence indicating that after the shareholder split he had become an outside director as he had lost access to the company's

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financial records and his cheque-signing authority. The taxpayer claimed that since he effectively lost control of the company at the time of the split, he was unable to do anything at all to protect the interests of Revenue Canada and thus could claim the defence of due diligence. The Court held that the taxpayer was not liable. The taxpayer was found to be an "outside director" with no control over the company's day-to-day activities. As such, he had satisfied his obligation to be duly diligent.

10. *Weyand v. The Queen*, 2004 TCC 355

In this Tax Court of Canada case, the taxpayer was a director of a corporation that was engaged in the construction and sale of a condominium. In the later part of May 2000 the only other director, the taxpayer's husband, resigned, making the taxpayer the sole director. In 2002, the taxpayer was assessed personally as a director for the corporation's failure to remit GST on May 1, 2000.

The taxpayer appealed the assessment, arguing that she satisfied her duty of due diligence in the filing of taxes and that she had a less rigorous duty given that she was an "outside director" as she played a passive role in all the endeavours of the corporation. The taxpayer presented evidence indicating that she was not involved in the day-to-day operations of the corporation, such as financing the operation or choosing a real estate agency to find tenants.

The Court found that the taxpayer did not demonstrate due diligence and was thus personally liable. The Court found that given the taxpayer's passive role in the corporation's affairs, the taxpayer was initially an "outside director" since her husband was managing the corporation's day-to-day business affairs. However, after her husband resigned and the taxpayer was the only director, she could no longer be considered an "outside director". Where there is only one director of a corporation, and the person knows that he or she is the only director, that person is implicitly an "inside director" because that person knows that he or she cannot rely on any other individual to bear the responsibility. The Court also pointed to evidence that suggested that the taxpayer, after her husband's resignation, played a more important role in the company, such as signing important documents, further suggesting her role as "inside director".

Thus, as an inside director, the taxpayer should have exercised a high level of diligence. The Court found that the taxpayer need only have asked simple questions to find out that the corporation had GST remittance problems, but failed to ask these questions and thus was not duly diligent and was personally liable as assessed.

11. ***Polsinelli v. The Queen*, 2004 TCC 186**

In this Tax Court of Canada case, two taxpayers, father and son, were personally assessed as directors of a certain corporation for its unremitted GST payments during a three-year tax period. The corporation was a family business engaged primarily in constructing roads and laying water mains throughout Ontario. Neither director had completed high school and as such relied heavily on (i) a bookkeeper, who paid the bills and was responsible for the day-to-day financial matters of the corporation; and (ii) a chartered accountant, who had looked after the family business for over twenty years and was responsible for preparing the corporation's yearly financial statements and tax returns. Throughout the period from 1992 and 1995, the corporation did not meet its GST obligations and the Minister sought payment from the taxpayers as directors.

In their defence, the taxpayers argued that neither was liable for the unremitted GST as they had demonstrated due diligence when they justifiably relied on the chartered accountant and the bookkeeper (who had been trained by the chartered accountant on GST matters). They argued that: (i) the taxpayers were not actively involved with the administrative side of the business; (ii) the taxpayers did not have the skills or training to make the GST calculations themselves; and (iii) calculating GST is inherently difficult for even experienced GST officials, and thus it was extremely difficult for the taxpayers to identify the problem at all.

The Court held that the taxpayers were not liable. The Court found that since the taxpayers, having recognized their own shortcomings in this area and having delegated this task to competent administrative staff and an accountant, it was entirely reasonable for the taxpayers to rely on them to ensure that proper GST remittances were being made. In addition, the Court weighed the following factors: (i) that a clerical error, and not declining revenues, caused the corporation's failure to remit, noting that the major clerical errors resulted around the time their were staffing changes with the bookkeeper; and (ii) when the taxpayers became aware of the problem, they made every effort to comply with the Minister and to aid in his assessment.

12. ***Campbell v. The Queen*, 2010 DTC 1090**

In this Tax Court of Canada case, the taxpayer was the sole director of a corporation that failed to remit source deductions. When the Minister assessed the taxpayer for the corporation's unremitted source deductions pursuant to subsection 227.1(1) of the Act, the taxpayer appealed to the Tax Court of Canada. The taxpayer argued that because he had resigned as a director, he was not liable, as proceedings were commenced against him more than two years following his resignation, pursuant

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to subsection 227.1(4). However, the Minister claimed that the letter of resignation was invalid, and even if the letter was valid, the taxpayer continued to be a *de facto* director.

The Tax Court of Canada allowed the taxpayer's appeal, but held that the taxpayer did not adduce evidence in support of the authenticity of the letter of resignation, and as such, he remained a *de facto* director. However, the Tax Court held that the taxpayer had acted with the required due diligence to prevent the remittance failures by involving himself directly with a proactive approach in attempts to secure payment of the remittances. In particular, the taxpayer (i) invested over $140,000 of his personal savings into the corporation to meet CRA remittances and loan payments; (ii) made attempts to obtain funding from other sources; (iii) voluntarily did not take a salary so that priority could be given to the CRA remittances; and (iv) scaled back on internal corporate expenses. Thus, the Tax Court found that the taxpayer acted as a prudent and reasonable person would have done in similar circumstances.

Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.