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DIRECTORS' LIABILITY FOR TAX - PART II

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. *BUCKINGHAM* AND SUBSEQUENT CASE LAW

1. *Peoples Department Stores Inc. (Trustee of) v. Wise,* [2004] S.C.J., No. 64

This Supreme Court of Canada case involved an action by the trustee in bankruptcy of two related corporations, both of which were managed and owned by the Wise brothers. The bankruptcy trustee of Peoples Department Stores claimed that the brothers had favored the interests of Wise stores (the other related corporation) over Peoples Stores to the detriment of Peoples' creditors. This would have been a breach of their duties as directors of both companies under the CBCA.

Although the Supreme Court was dealing specifically with the requirements of due diligence under section 122(1) of the CBCA, its analysis could be applied to the Act, as the wording of this CBCA section is identical to section 227.1 of the Act which states that a director can avoid liability if he can demonstrate that he exercised the degree or care, diligence and skill necessary to prevent the failure to deduct, withhold or remit that a reasonably prudent person would have exercised in comparable circumstances.

The Supreme Court of Canada interpreted the words "comparable circumstances" as requiring the court to take into account the context of the case. It does not, however, indicate employing a subjective test when determining the merits of the due diligence defence based purely on the facts and circumstances of the case, as ***Soper*** concluded. Rather, the Supreme Court of Canada in ***Peoples*** stated that courts will use an objective standard but are allowed to take into consideration relevant subjective factors. An objective standard should be utilized, while still keeping in mind the contextual factors involved on a case-by-case basis.

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2. *The Queen v. Buckingham*, 2011 DTC 5078

In this Federal Court of Appeal case, the taxpayer was the chairman of the Board and largest shareholder in a public corporation whose stock traded on the TSX. The taxpayer was involved and played a significant role in the day-to-day operations of the Corporation. During 2001 and 2002, the Corporation incurred serious losses and attempted unsuccessfully to obtain financing and secure additional capital in 2002 and again in 2003. In 2003, the Corporation unsuccessfully attempted to sell its assets and part of its business for $1,600,000 in order to pay its creditors but was only able to collect $600,000 from the purchaser. Finally, in September 2003 the Corporation ceased operations.

The taxpayer was subsequently assessed: (i) pursuant to section 227.1 of the Act for the Corporation's failure to remit employee source deductions for the period from October 2002 to August 2003, as well as associated penalties and interest; and (ii) pursuant to section 323 of the ETA for GST/HST remittances which the Corporation had failed to make in March and June of 2003, as well as for associated penalties and interest. The taxpayer appealed all of the assessments to the Tax Court of Canada on the basis of the due diligence defence claiming that he "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances." The taxpayer argued that he had made serious and reasonable efforts to resolve the financial difficulties faced by the Corporation and as a result this satisfied the due diligence defence under both the Act and the ETA.

The Tax Court of Canada allowed the taxpayer's appeal in part, accepting the taxpayer's due diligence defence with respect to the employee source deductions but reached a different conclusion concerning the failure to remit GST/HST and rejected the taxpayer's due diligence in this regard. The Tax Court began by concluding that the "objective/subjective" test set out in ***Soper*** regarding the standard of care, diligence and skill required under each of the Acts had been modified by the Supreme Court of Canada's decision in ***Peoples Department Stores,*** and held that the objective standard should thus be used for the purposes of applying both subsection 227.1 of the Act and subsection 323(3) of the ETA. The Tax Court was of the view that the analysis required in relation to remittances of employee source deductions should be dealt with separately from the analysis required in relation to remittances of GST/HST due to the fact that unlike GST/HST amounts, the amounts for payroll deductions are not funded by a third party but are paid from whatever resources the company might have available to it.

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In accepting the taxpayer's due diligence defence regarding the employee source deductions, the Tax Court was of the view that reasonable business measures were taken in 2002 and in early 2003 to address the financial difficulties of the Corporation and to avoid failure to remit source deductions, including work on a proposed equity issue, attempts to secure a line of credit, reductions in expenditures, and attempts to merge with another company. The trial judge further noted that following the failure to secure new funding, the Corporation had attempted to sell its assets in order to pay its creditors. The Tax Court of Canada concluded that the taxpayer had done all he could in the circumstances to secure additional financing for the Corporation through various means and consequently he had met the standard of care required of him under subsection 227.1(3) of the Act. The Tax Court of Canada reached a different conclusion concerning the failure to remit GST/HST rejecting the due diligence defence of the taxpayer holding that the liquidation of assets was not undertaken to prevent failures to remit GST/HST but was done to pay its bills. The Crown argued that the trial judge committed an error of law by incorporating cash flow analysis into the due diligence defence and appealed the decision to the Federal Court of Appeal.

In allowing the Crown's appeal, The Federal Court of Appeal began by affirming that the "objective/subjective" standard set out in ***Soper*** has been replaced by the objective standard laid down by the Supreme Court of Canada in ***Peoples Department Stores***. The Federal Court of Appeal then concluded that the cash-flow analysis proposed by the Tax Court was incompatible with the applicable provisions of the Act because the liability of the directors under subsection 227.1(1) is not conditional on the existence of sufficient cash in the Corporation to pay the remittances of employee source deductions. The Federal Court of Appeal also held that the cash-flow analysis was flawed because it assumed that the time frame in which to assess the director's conduct began when the Corporation runs out of cash whereas it should begin when it becomes apparent to the director, acting reasonably, that the Corporation is entering a period of financial difficulties. In considering the merits of the taxpayer's defence, the Federal Court of Appeal held that a director of a corporation cannot justify a due diligence defence where he condones the continued operation of the corporation by diverting employee source deductions to other purposes. The Federal Court of Appeal concluded that although the taxpayer had a reasonable expectation that the sale of the business assets could result in a large payment which could be used to satisfy creditors, he consciously transferred part of the risk associated with this transaction to the Crown by continuing operations knowing that employee source deductions would not be remitted and as a result, no successful due diligence defence could be sustained.

3. ***Heaney, Chasse, and Gilbert v. The Queen*, 2011 DTC 1333**

In this Tax Court of Canada case, the taxpayers, as directors of DSL Communications Inc. ("DSL"), were assessed under section 227.1 of the Act and section 323 of the ETA for DSL's failure to remit the source deductions and GST it had collected in the 2000, 2001 and 2002 taxation years. The taxpayers appealed the assessment, contending that their efforts to prevent DSL's failure to remit the source deductions and GST, although unsuccessful, entitled them to a due diligence defence.

The Tax Court allowed the taxpayers' appeals in part. Through an application of the objective standard set out in ***Buckingham***, the Court found that, until the end of 2000, the taxpayers exercised due care and diligence with a view to preventing DSL's failure to remit the source deductions. The taxpayers (i) took positive action based on a reasonable belief that they could prevent DSL's failure to remit; and (ii) pursued measures, such as changing product offerings, laying off employees, reducing customer hours and searching for financing sources, to deal with DSL's remittances. However, the Court found that, after 2000, the conduct of the taxpayers no longer met the standard required by subsection 227.1(3) of the Act and subsection 323(3) of the ETA. When the taxpayers made the decision to pay Bell instead of meeting the remittance obligations at the end of 2000, they lost the benefit of the due diligence defence. Consequently, the taxpayers were held liable for the payroll source deductions and GST amounts which ought to have been remitted under the Act and the ETA for the relevant periods after the end of 2000.

4. ***Babakaiff v. The Queen*, 2012 TCC 22**

In this Tax Court of Canada decision, the taxpayer was the sole director of a corporation that was in the business of buying and selling residential properties. The taxpayer was personally assessed for the corporation's unremitted GST pursuant to subsection 323(1) of the ETA. The taxpayer argued that the failure to remit was due to the negligence of two lawyers retained to close the corporation's real estate sales who neglected to complete the closing documentation in a timely fashion. He claimed that without the closing documents specifying the amounts of GST owed, the corporation could not properly calculate the GST remittances. The taxpayer and the corporation's accountant felt that they could not swear to the truth of the content of the returns without the missing information. The taxpayer testified that he had believed that the corporation would be able to meet any GST liability by selling a particular property it owned. There was a decline in the real estate market, and when the GST was finally calculated, the corporation was experiencing financial difficulties and was unable to remit the GST owed. The taxpayer argued that he had been duly diligent and should therefore not be

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held liable in accordance with the due diligence defence in subsection 323(3) of the ETA.

The Tax Court dismissed the taxpayer's appeal, finding that he had not exercised the care, diligence and skill a reasonably prudent person would have exercised to prevent the failure to remit. Applying the objective standard in ***Buckingham***, the Tax Court noted that the economic conditions of the real estate market and the corporation's experience with the negligent lawyers must be taken into account when considering the reasonably prudent person in comparable circumstances. However, the Tax Court held that a "director cannot... claim due diligence on the basis of having another asset on hand that could serve as insurance to pay off debts to the Crown." The Tax Court also determined that the taxpayer did not need the closing documents to calculate the GST owed, but that a statement of disbursements that was prepared prior to each sale contained all of the information necessary to make the calculations. A reasonably prudent person in the taxpayer's circumstances would have used these documents to calculate the GST and remitted the amounts owed. Finally, the Tax Court noted that the taxpayer was an experienced businessperson with a great deal of knowledge about the housing industry, and could have segregated GST funds when the corporation's financial difficulties became apparent. Therefore, the taxpayer did not fulfill the requirements of the due diligence defence and was properly liable for the corporation's unremitted GST.

5. *Martin v. The Queen*, 2012 TCC 239

In this Tax Court of Canada case, the taxpayer was the shareholder and director of Codiac Boring and Drilling Ltd. ("Codiac"). He was also the shareholder and director of Robinson Construction Company ("Robinson") and more than a dozen related corporations. The corporations were used by Robinson to perform construction and drilling contracts. As a result of delays by the other party to a large contract, both Codiac and Robinson suffered considerable upfront losses. The other party eventually ceased paying Robinson and Codiac, and the taxpayer recognized the corporations' shaky financial positions and hired a chartered accountant as chief financial officer in December 2000. The accountant was able to negotiate some payments to Codiac, but the situation continued to deteriorate. The taxpayer kept the CRA apprised of the situation and continued to make remittances until early 2001. The taxpayer and his advisers erroneously believed they would be able to claim a bad debt credit, which they were unable to claim because the corporations were related. Subsequently, Codiac failed to remit GST and source deductions and the taxpayer was assessed personally for those amounts. The taxpayer claimed the due diligence defence in subsection 323(3) of the ETA.

The Tax Court allowed the taxpayer's appeal in part, noting that the events that led to the corporations' financial difficulties were somewhat unforeseeable. The Court found that the taxpayer's actions in hiring a chief financial officer, consulting a lawyer, and communicating with the CRA met the requirements of the due diligence defence. Furthermore, since the GST had only been recently introduced, it was unsurprising that the taxpayers' advisors made an error with regards to the corporations' eligibility to claim the bad debt credit. The corporations could have reduced the GST owing in accordance with subsection 232(2) of the ETA, but were unaware of these provisions until after the four-year limitation period applicable to that subsection had elapsed. The Court noted that given the taxpayer's rapport with CRA officials, it was surprising that the CRA did not inform the taxpayer that this relief was available. Had the corporations been able to claim this in time, they would have had sufficient funds to remit source deductions.

Given the steps the taxpayer took to prevent a failure to remit, the taxpayer was not liable for the unremitted GST amounts for the periods ending March 31, June 30, and September 30, 2001, as well as the source deductions for the 2001 taxation year.

6. ***Priftis v. The Queen*, 2012 TCC 414**

In this Tax Court of Canada case, the taxpayer was the director and president of Acrontech (the "Corporation"), which had failed to remit CPP deductions in 2001, 2002 and 2003. The Corporation had paid the taxpayer amounts that the taxpayer believed to be repayments of his shareholder's loan account rather than salary. Thus, the Corporation did not withhold CPP, believing there was no need to remit any. The Minister reassessed the Corporation for unremitted CPP, and the Corporation appealed. The appeal was settled and a consent judgment entered. The Minister was unable to collect from the Corporation, and a certificate for the amount of the corporation's liability was registered in the Federal Court of Canada. The Minister then assessed the taxpayer for director's liability with respect to the unremitted CPP. The taxpayer raised two defences, arguing that the assessment was statute-barred under subsection 227.1(4) of the Act and that he exercised due diligence.

The Tax Court ruled in favour of the taxpayer, holding that he had exercised the degree of care, diligence and skill to prevent the failure to remit the CPP deductions that a reasonably prudent person would have exercised in comparable circumstances. With regards to the two-year time limitation in subsection 227.1(4) of the Act, the Tax Court cited ***Larocque (R.L.) v. MNR***, [1991] 2 C.T.C. 2151, for the proposition that the two-year limitation period includes the day on which the director resigns. Since the taxpayer effectively resigned on July 15, 2008, when the Corporation was dissolved, the Minister had until July 15, 2010 to assess the taxpayer. The Minister had assessed the taxpayer on July 15, 2010, and therefore the assessment was not statute-barred.

With regards to the due diligence defence, the Tax Court noted that the settlement between the Corporation and the Minister was not an admission of any failure to remit amounts. The Tax Court held that if the Corporation and its director believed that no salary was paid, there was no failure to remit and therefore no reason to exercise due diligence to prevent a failure to remit, as required by subsection 227.1(4). Thus, since the taxpayer believed the amounts he received were shareholder's loan repayments rather than salary, and that the Corporation therefore had no reason to withhold CPP, the taxpayer, as director, had no reason to exercise the required degree of care.

7. ***Constantin v. The Queen*, 2012 TCC 425**

In this Tax Court of Canada decision, the taxpayer was the sole shareholder and sole director of a corporation that specialized in sign installation and lighting services. The taxpayer's spouse had purchased the corporation and took care of all aspects of management. The taxpayer had no involvement with the business. The taxpayer's spouse became indebted to a group of criminals, and when he failed to pay the amounts he owed them, he caused the corporation to become involved in a fraudulent scheme planned by one of the criminals. The corporation failed to make GST payments from late 2003 until it was audited in June 2007. The taxpayer was unaware of the audit. However, she signed a power of attorney giving her spouse the authority to communicate with Revenu Québec on her behalf.

The taxpayer's spouse had never informed the taxpayer about the fraudulent scheme, and the taxpayer had never asked him any questions about her responsibilities as a director. The taxpayer signed documents from time to time and saw the corporation's financial statements. She also accompanied her spouse to cheque cashing facilities when the corporation was experiencing what he characterized as "minor" financial difficulties. At these facilities, the taxpayer personally undertook as a surety to cover any cheques given to the cheque cashing facility by the corporation. The Minister subsequently assessed the taxpayer personally for the unremitted GST under subsection 323(1) of the ETA. The taxpayer argued that she met the due diligence defence set out in subsection 323(3) of the ETA.

The Tax Court dismissed the taxpayer's appeal, holding that her actions did not constitute due diligence. Although the taxpayer was the sole shareholder and director of the corporation, she took no steps to determine the risks or obligations of such roles.

According to the Tax Court, despite the taxpayer's statement that she had no knowledge of the corporation's affairs and merely followed her spouse's instructions, she was nevertheless involved in the corporation's affairs. The taxpayer's abdication of her responsibilities and obligations by entrusting all of the corporation's business to her spouse did not relieve her of liability. On the contrary, there were clear indications that the corporation was experiencing financial difficulties, which would have prompted a reasonable person to make inquiries. The Tax Court held that "a director of a corporation cannot avoid his or her responsibilities and obligations simply by casting off the director's powers". In conclusion, the Tax Court noted that although the taxpayer's spouse lied to her and misled her, a reasonably prudent person would not have acted as she did. Therefore, she did not exercise the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances, and the due diligence defence was unavailable to her.

This decision was upheld at the Federal Court of Appeal, who found that the Tax Court had properly applied the test laid out in ***Buckingham***.

8. *Hartrell v. R,* 2006 TCC 480

In this Tax Court of Canada case, the taxpayer, an investor in a corporation set up to manage a minor league soccer team, took on a central role in managing and directing the business of the corporation, despite never being named a director. The corporation failed to remit a substantial amount of income tax for both the 1998 and 1999 tax years. The CRA assessed the taxpayer as a de facto director pursuant to s.227.1 of the *Income Tax Act*. The taxpayer appealed this decision, arguing that he was not a director, and that if he was considered to be a director, he exercised due diligence. The taxpayer's due diligence defence was based upon letters from his co-investor refusing to put forward more capital to meet the team's remittance obligations.

The Tax Court of Canada held that the taxpayer was a de facto director of the corporation because he had "ultimate decision making authority" over the corporation from the date of incorporation until 1999. With regards to the taxpayer's due diligence defence, the Tax Court held that he was responsible for the failures to remit income tax in 1998, but not in 1999 when his co-investor suddenly refused to pay his share of the corporate expenses. The Court held that, from that point forward, the taxpayer did everything within his limited power to attempt to have the remittances made by the corporation, and thereby satisfied the requirements of the due diligence defence.

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9. *Qian v. R*, 2013 TCC 386

In this Tax Court of Canada case, the taxpayer was drawn into making an investment and becoming a director of a company as a condition of continued employment as an accountant for the company. The corporation failed to remit a substantial amount of income tax. The CRA assessed the taxpayer as a director of the corporation pursuant to s.227.1 of the *Income Tax Act*. The taxpayer appealed this decision, arguing that she had exercised the required degree of due diligence, but was prevented from making the remittances by overbearing conduct by the majority shareholder.

The Tax Court of Canada held that the taxpayer had exercised the required degree of due diligence because she repeatedly brought up the remittance issues, and make several proposals designed to allow the corporation to make the required remittances. When it became clear that the majority shareholder would not follow any of the taxpayer's suggestions, she resigned her position. According to the Tax Court the taxpayer did not have the necessary authority to make the payments, and thereby could not be held responsible for the failures of the corporation to remit their required taxes.

10. *Attia v. R*, 2014 TCC 46

In this Tax Court of Canada case, the taxpayer, a director of a corporation, fell into a major depressive episode as a result of his father passing away and the removal of the franchise to his business. As a result, the taxpayer was unable to properly manage the financials of his business, and delegated the task to a hired manager. The corporation, under the delegate manager failed to remit a substantial amount of GST. The CRA assessed the taxpayer as a director of the corporation pursuant to s. 323 of the *Excise Tax Act*. The taxpayer appealed this decision, arguing that he had exercised the required degree of due diligence given his disabling depression.

The Tax Court of Canada held that the taxpayer had exercised the required degree of due diligence because he had taken concrete steps to ensure that his corporation would be properly managed in his absence. They gave a great degree of weight to the evidence of the taxpayer's psychiatrists, who testified to the severity of the taxpayer's depression and the disabling effect it had on the taxpayer. According to the Tax Court of Canada, Parliament could not have intended to "penalize an ill person simply because that person did not adequately supervise the person whom he or she appointed to replace him or her". Instead, the Court stated that the focus of the due diligence defence was intended to target managers who were “careless and neglected their role as agents of the Crown (with regards to GST remittances)”.

11. *Thistle v. R,* 2015 TCC 149

In this Tax Court of Canada case, the taxpayer, a lawyer, heavily invested in one of his client’s corporations, and became a director as a result. The corporation had secured a contract to build houses in Nunavut, and the taxpayer had very little to do with the day to day operation of the business. The other director of the company, the client of the taxpayer, managed the corporation and, unbeknownst to the taxpayer, had intentionally failed to remit GST or payroll deductions to the CRA. The CRA assessed the taxpayer as a director of the corporation pursuant to s.227.1 of the *Income Tax Act* and 323(1) of the *Excise Tax Act* with regards to unpaid tax remittances. The taxpayer appealed this decision, arguing that he had demonstrated the required degree of due diligence in trusting the other director to adequately manage the business.

The Tax Court of Canada held that the taxpayer was not liable, and that he had exercised the proper degree of due diligence. The Court gave great weight to the fact that the taxpayer had checked in frequently with the other director, and had been repeatedly intentionally mislead. The Tax Court also noted that the taxpayer had made attempts to move payroll organization and remittances to an outside service, and had been deceived by the other manager into believing this had taken place. The Tax Court found that all of these actions illustrated that the taxpayer had exercised the required degree of due diligence. This is an encouraging result for outside investors who lack the ability to closely manage distant interests in which they may have become directors.

B. RESIGNATION BY A DIRECTOR

Care should be taken to ensure that all proper corporate proceedings are taken regarding the resignation of a director. Pursuant to the provisions of section 121 of the *Ontario Business Corporations Act* (“OBCA”), a director of a corporation ceases to hold office when the director (i) dies; (ii) subject to section 119 (2) of the OBCA, resigns; (iii) is removed from office by a resolution of the shareholders of the corporation at an annual or special meeting of the shareholders pursuant to section 122 of the OBCA; or (iv) becomes disqualified from being a director under section 118 of the OBCA.

A resignation of a director becomes effective at the time a written resignation is received by the corporation or at the time specified in the resignation, whichever is later. It is advisable for the director to file a notice confirming the director’s resignation with the Ministry of Consumer and Commercial Relations. Pursuant to the provisions of

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section 119 of the OBCA, a resignation of any of the first directors of the corporation who are named in the Articles of Incorporation does not become effective until a successor is elected or appointed.

Pursuant to the provisions of section 118 of the OBCA, a person is disqualified from being a director of a corporation if the person (i) a person who is found to be incapable of managing property under the *Substitute Decisions Act*, *Mental Health Act* or by a court in Canada or elsewhere; or (ii) becomes personally bankrupt. An individual continues to be a director of a corporation, although with reduced rights and powers, after the appointment of a trustee, receiver or liquidator of the corporation.

Pursuant to subsection 227.1(4) of the *Income Tax Act*, (the "Act"), proceedings to recover any amount from a director may not be commenced more than two years after the individual ceased to be a director. According to ***Larocque v M.N.R.***, [1991] 2 C.T.C. 2151, the two-year limitation period includes the day on which the director resigns. Therefore, if a director were to resign on January 1, 2013, he or she could be assessed under subsection 227.1(1) of the Act on any day up to and including January 1, 2015, but an assessment would be statute-barred on January 2, 2015 and on any day thereafter.

C. CASE LAW RELATING TO RESIGNATION BY A DIRECTOR

1. *Zwierschke v. M.N.R.*, 92 DTC 1003

In this Tax Court of Canada decision, a receiver was appointed to manage the affairs of a corporation. Subsequently, the taxpayer delivered a written notice to the corporation of his resignation as president of the corporation. It was held that this resignation was ineffective since the individual was a first director of the corporation and there was no evidence that any other person was elected or appointed as a director of the corporation as successor to the individual to comply with requirements of section 119(2) of the OBCA. Therefore, the Minister was successful in assessing the taxpayer personally in his capacity as the sole director of the corporation for unremitted source deductions. The appointment of the receiver did not terminate the taxpayer's directorship and at all material times the taxpayer remained a director and could not mount a defence based on the two-year limitation period contained in the Act.

2. *Doncaster v. R,* 2015 TCC 127

In this Tax Court of Canada case, the taxpayer, the sole director of a corporation, resigned his position by way of an email to the corporate secretary. This occurred more than two years before the CRA assessed the taxpayer as a director of the corporation pursuant to s.323(1) of the *Excise Tax Act* with regards to unpaid GST remittances. The taxpayer appealed this decision, arguing that he was not a director of the corporation as a result of his resignation letter. The Minister disputed the validity of the resignation, both on the grounds that the resignation was not sincere (the taxpayer had subsequently held himself out as a director), and not legally valid under the *Ontario Business Corporations Act*.

The Tax Court of Canada held that the taxpayer was a director of the corporation. With regards to the legal validity of the resignation, the Court held that the taxpayer was not permitted to resign as a result of 119(2) of the *Ontario Business Corporations Act* which requires a successor to be appointed before a resignation can be legally effective under the *OBCA*. The Tax Court made no determination with regards to the subsequent representations of the taxpayer, as the statutory disposition was enough to show that the taxpayer was a director of the corporation. The taxpayer was ultimately held liable, and the Court also upheld the novel accounting method used to calculate the unpaid GST remittances of the corporation. That determination, however, does not bear on the relevance of the case to the subject of director's liability.

3. *Bekesinski v. R,* 2014 TCC 245

In this Tax Court of Canada case, the taxpayer, a director of a corporation, resigned his position. This occurred more than two years before the CRA assessed the taxpayer as a director of the corporation pursuant to s.227.1 of the *Income Tax Act* with regards to unpaid income tax remittances. The taxpayer appealed this decision, arguing that he was not a director of the corporation as a result of his resignation. The Minister disputed the validity of the resignation on the grounds that it may have not been genuine (it was argued that the resignation was backdated).

The Tax Court of Canada held that the taxpayer was not a director of the corporation, and upheld the resignation. The Tax Court had serious doubts about the validity of the resignation, but they found that the production of the document was enough to shift the burden of proof to the Minister to disprove the validity of the document. The Minister failed to bring any expert evidence to contradict the submissions of the taxpayer, and therefore failed to dislodge their onus. The Tax Court held that they were therefore bound to find the resignation was valid.

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4. *Gariepy v. R*, 2014 TCC 254

In this Tax Court of Canada case, the taxpayers, two directors of a corporation, intended to resign their positions but failed to sign the resignations personally. This occurred more than two years before the CRA assessed the taxpayers as directors of the corporation pursuant to s.227.1 of the *Income Tax Act* with regards to unpaid income tax remittances. The taxpayers appealed this decision, arguing that the resignations should be accepted as valid, despite the lack of signatures. The Minister disputed the validity of the resignation.

The Tax Court of Canada held that the taxpayers were not directors of the corporation, and upheld the resignations. The Tax Court held that the lack of a signature is relevant to the continuing and final intention of the individual to resign their position, however in this case the continuing actions of the two directors (taking no further action with regards to the management of the corporation) indicated that this was not a concern in the given case. In this situation, the fact that the two directors had contacted their corporate counsel to draft a resignation and communicated their intention to the corporation to resign was enough to affect the resignation.

5. *Marra v. R*, 2016 TCC 24

In this Tax Court of Canada case, the taxpayer, a director of a corporation, resigned her position by way of a letter to the corporation's lawyer, on advice that this would be sufficient to affect a resignation. This occurred more than two years before the CRA assessed the taxpayer as a director of the corporation pursuant to s.227.1 of the *Income Tax Act* and 323(1) of the *Excise Tax Act* with regards to unpaid tax remittances. The taxpayer appealed this decision, arguing that she was not a director of the corporation as a result of the resignation letter. The Minister disputed the resignation, claiming that the failure of the corporation to disclose the change in directorship meant that the resignation was not effective..

The Tax Court of Canada held that the taxpayer was not a director of the corporation. With regards to the legal validity of the resignation, the Court held that the taxpayer was not required to cause the corporation to inform the provincial government of the change in directors (and noted that, in any case, she lacked the ability to do so upon resignation). The Tax Court held that a resignation is effective on the date that the letter is sent to the company headquarters, and that the CRA had missed their limitation period as a result.

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6. ***The Queen v. Kalef*, 96 DTC 6132**

In this Federal Court of Appeal decision (for which leave to appeal to the Supreme Court of Canada was refused), the taxpayer was a director of a corporation which became bankrupt. The Minister assessed the taxpayer for the corporation's unremitted payroll deductions and the taxpayer who was not one of the first directors of the corporation, argued that these assessments were made by the Minister more than two years after the taxpayer had ceased to be a director. The taxpayer contended that he had ceased to be a director of the company when the trustee in bankruptcy assumed control of the bankrupt corporation, since this was the moment at which the taxpayer lost actual control over the corporation. However, under the OBCA, the taxpayer remained a director of the corporation, notwithstanding the appointment of the trustee in bankruptcy. Therefore, the Minister's assessment against the director was not statute-barred and was upheld by the Court. The Court found that the taxpayer did not resign, although he could have done so, and he was neither removed nor disqualified from being a director.

7. ***Brakop v. Canada*, [1996] T.C.J. No. 393**

In this Tax Court of Canada decision, a bank appointed a receiver to manage the affairs of a corporation that was in financial difficulty. Subsequently, the receiver was appointed the trustee in bankruptcy for the corporation. The directors claimed they had ceased to be directors by virtue of a letter of resignation as well as through a loss of control of the corporation as a result of the actions of the bank. However, the Court found that the directors did not effectively resign from their positions with the corporation since the letter of resignation was not delivered to the corporation's registered office and could not be found in the business and corporation records in the trustee in bankruptcy's possession. In addition, provincial corporate registries did not reflect the resignations. The Court held that the directors had never lost control of the corporation and that the financial difficulty of the corporation did not mean that they ceased to be directors. Therefore the Court upheld an assessment by the Canada Revenue Agency ("CRA") against the directors in respect of unremitted employee deductions.

8. ***Alfano v. The Queen*, 2000 DTC 1962**

The Minister assessed the taxpayer as a director of the corporation for the latter's unremitted source deductions on October 28, 1996. The taxpayer appealed to the Tax Court of Canada, claiming that he had resigned as a director of the corporation on February 3, 1993, or within 30 days thereafter. The taxpayer alleged that the Minister's

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assessment was statute-barred, having been made beyond the two-year period contemplated in subsection 227.1(4) of the Act.

The Tax Court allowed the taxpayer's appeal. Based on the credibility of the testimony offered by the taxpayer's witnesses, the Tax Court held that the taxpayer's resignation as a director of the corporation took effect in February 1993, or very shortly thereafter. The solicitor for the corporation testified that the taxpayer was the incorporator and sole director of the corporation, which was incorporated on February 3, 1993. The taxpayer had never intended to remain as a director of the corporation, but became the incorporator out of a favour to his father and brothers, who were experiencing personal financial difficulties at the time.

The taxpayer resigned as a director in writing on February 3, 1993. The solicitor for the corporation prepared and sent to the corporation for filing with the Ontario Ministry of Consumer and Commercial Relations a notice of change in February 1993, showing the resignation and that his father had become the new director of the corporation. However, due to inadvertence this notice was not filed until May 1995. After February 3, 1993 the taxpayer believed that he was no longer a director of the corporation. Alternatively, even if the resignation did not take effect the taxpayer actually believed that he was not a director of the corporation from and after 1993. Therefore the taxpayer could rely on the decisions in ***Cybulski v. M.N.R.***, 88 DTC 1531, and ***Sheremeta v. M.N.R.***, 91 DTC 867. These decisions appear to stand for the proposition that if a person actually believes he is not a director, he escapes liability under section 227.1 of the Act. Therefore, the Minister's assessment was statute-barred, and was vacated by the Tax Court of Canada.

9. *Whybrow v. The Queen*, 2000 3 CTC 2492

From inception of the corporation, the taxpayer was a 25% shareholder and a director. The Minister assessed the taxpayer personally for the corporation's unremitted source deductions, and imposed penalties. The taxpayer appealed to the Tax Court of Canada claiming that he had resigned as a director more than two years before the assessment, and alternatively that he had demonstrated due diligence .

The Tax Court dismissed the taxpayer's appeal, holding that: (i) there was no corroborating evidence of the authenticity of the taxpayer's resignation as a director, since it was unsigned and no original had been produced; (ii) there was no confirmation that it was ever sent or acted upon; (iii) the resignation was not authentic and a fabrication, as the Minister had alleged; and (iv) the taxpayer failed to demonstrate due diligence as an inside director, knowing of the corporation's financial difficulties and of its source deduction arrears, but failing to take meaningful steps to insure the remission thereof until too late.

10. *Perricelli v. The Queen*, 2002 GTC 244

In this Tax Court of Canada case, the taxpayer owned and operated a corporation which carried on a small cleaning business with two friends. The taxpayer also acted as a director of the company. In 1990 the taxpayer verbally advised the other two shareholder/directors that he was leaving as the business could not economically support all three shareholders, and all agreed. However, the taxpayer did not tender a written resignation as a director. Several years later, the company was unable to meet its Goods and Services Tax ("GST") obligations and the Minister sought payment from the taxpayer as a director of the company.

The taxpayer raised two defences against the imposition of liability: (i) that he had resigned as a director before the corporation was faced with GST problems, and, in the alternative (ii) that he had demonstrated due diligence so he would not be liable in any event. In regards to the first defence, the taxpayer gave testimony, which was corroborated by the other two shareholder-directors, that in 1990 it was clearly determined that the taxpayer would no longer continue to be a director of the corporation. The testimonial evidence also indicated that after this point the taxpayer ceased to supervise the business affairs or to play an active role in the business, only infrequently fixing the cleaning equipment or occasionally signing a cheque.

The Court found the taxpayer could not be held liable. Specifically, the Court found that the taxpayer was neither a *de jure* nor a *de facto* director when the GST problems surfaced, weighing the corroborated verbal testimony quite heavily. The Court stated that "if you do not believe you are a director and there are reasonable grounds for accepting that belief, then you should be relieved from the liability by subsection 323(3) of the Act". The Court also stated that had the taxpayer been found to be a director, then he would have been able to rely on the defence of due diligence as the taxpayer acted as a reasonably prudent person, believing himself not to be a director would have acted and did nothing.

11. *Bonch v. The Queen*, 2003 GTC 589

In this Tax Court of Canada case, the Minister assessed the taxpayer, who was the sole director of a corporation, for the corporation's unremitted source deductions and GST payments for the years spanning 1991 to 1995. The taxpayer appealed arguing that he had ceased to be a director of the corporation in 1995 and, since the

Minister's assessment was dated 1999, the assessment was statute-barred, having been made beyond the two-year limitation period contemplated in subsection 227.1(4) of the Act. Specifically, the taxpayer argued that in 1999 the business itself was terminated as the company was in default of the *Travel Industry Act*, which made it impossible for the travel business to continue. The taxpayer argued that since the business was terminated at that time, he must be considered to have ceased to be a director thereafter and the limitation period began at this time. The Court accepted the taxpayer's argument and found the taxpayer not liable. The Court stated that the limitation period runs for a time when an individual ceases to be in a position in law and in fact to exercise the powers of a director to rectify the failure of a corporation to deduct or remit or both.

12. *Irvine v. The M.N.R.*, 91 DTC 91

In this Tax Court of Canada case, the taxpayer, who was a shareholder and a director of a corporation, was assessed to be personally liable for the corporation's failure to remit source deductions. The taxpayer appealed, arguing that he had resigned as a director of the corporation more than two years prior to the Minister's assessment and as such the assessment was statute-barred, having been made beyond the limitation period contemplated in subsection 227.1(4) of the Act. The taxpayer produced documentary evidence that indicated that he purported to resign in an unsigned letter in 1985, more two years before the Minister's assessment. Documentary evidence was also presented that indicated that the corporation itself perceived the taxpayer as merely a shareholder after this time, and not a director. The Court agreed with the taxpayer's argument and found that the taxpayer did indeed resign as director more than two years prior to the Minister's assessment and as such the assessment was statute-barred.

13. *Tucker v. The Queen*, 2007 TCC 298

In this Tax Court of Canada case, the taxpayer appealed a vicarious liability assessment issued pursuant to subsection 227.1(1) of the Act. The taxpayer had been the corporate director of a company that had failed to remit source deductions from June 2000 to January 2003.

The Tax Court allowed the appeal in part. The taxpayer was an inside director of the company. Although the taxpayer was actively involved in the finances of the company, he did not examine the books and records and did not make further inquiries when he knew there was a dispute with the CRA. Therefore, he did not demonstrate the due diligence that a reasonably prudent person would have in the circumstances.

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However, the taxpayer resigned from his position as director in December 2001, when he sold his shares of the company. The new administrators of the company did not register the change in directors, but the Tax Court found that the documentary evidence proved that the resignation did in fact occur. Therefore the taxpayer was not liable for unremitted source deductions after that time.

14. *Ustel v. The Queen,* 2010 TCC 444

In this Tax Court of Canada case, the taxpayer was a director of a corporation. The Minister assessed the taxpayer under section 323 of the *Excise Tax Act* ("ETA") for GST plus interest and penalties. The GST assessment was made on the basis that the taxpayer was either a *de jure* or a *de facto* director of the corporation at the time of the assessment or at some point during the 24 month period preceding the assessment, dated February 22, 2008. The taxpayer appealed this assessment, claiming that he had tendered his resignation as director on May 30, 2002, and thus was neither *de jure* or *de facto* director of the corporation in the relevant period.

The Tax Court dismissed the taxpayer's appeal. Because the ETA does not define when a person ceases to be a director, the Tax Court looked to subsection 121(2) of the OBCA. This provision provides that a resignation of a director becomes effective at the time a written resignation is received by the corporation or at the time specified in the resignation, whichever is later. In this case, the taxpayer had formally resigned and ceased to be a *de jure* director of the corporation on May 30, 2002. However, the taxpayer also remained active in the actual operation of the business after he had resigned. For example, he signed the 2002 and 2003 tax returns of the corporation, and next to his signature, he was described as a director. Furthermore, the taxpayer never took any steps to advise the CRA that he had ceased to be a director of the corporation. Thus, the Tax Court dismissed the taxpayer's appeal against the GST assessment. To allow the taxpayer to escape liability on these facts would have offended the indoor management rule, as the CRA had reasonable grounds to believe that the taxpayer continued to serve as a director.

15. *Létourneau v. The Queen*, 2011 FCA 354

In this Federal Court of Appeal case, the taxpayer was a director of 9034-1751 Quebec Inc (the "company"). In March 2002, the Minister assessed the company for unremitted source deductions in the amount of $70,023 and $824 for the years 2001 and 2002 respectively. On May 4, 2002, the taxpayer was vicariously assessed for $70,848 pursuant to section 227.1 of the Act. The taxpayer challenged the assessment, claiming that (i) she had resigned as a director on December 9, 1999; and (ii) the

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assessment made by the Minister was statute-barred, having been made more than two years after the date she ceased to be a director of the company.

The Tax Court of Canada concluded that the taxpayer remained a director of the company until May 7, 2004, when the company was officially struck off the enterprise register. The Tax Court judge was of the opinion that unexplained corrections had been made to the register of directors, which made the taxpayer's true date of resignation from her directorship unknown. As such, the Minister's assessment was not statute-barred, and the taxpayer should be held solidarily liable for the company's debts. The taxpayer appealed.

The Federal Court of Appeal allowed the taxpayer's appeal, finding that the taxpayer had resigned on December 9, 1999. Based on the evidence, there was no question that Jean Fontaine was appointed director on December 9, 1999 to replace the taxpayer, and was the only person who acted on behalf of the company until the company was dissolved on May 7, 2004. Even if the Tax Court judge was correct in finding that Jean Fontaine was merely used as a proxy for the taxpayer, this factor is irrelevant with respect to the taxpayer's resignation date. Despite the fact that the taxpayer was not a credible witness, the Court held that the correction made to the register of directors was not fraudulent, as all of the documentary evidence corroborated the testimonies of the taxpayer and Jean Fontaine, according to which there was a change in director on December 9, 1999. Consequently, the Federal Court of Canada held that the taxpayer was not a director in 2001 and 2002. As such, the taxpayer was not held liable for the company's tax debt for unremitted source deductions in 2001 and 2002.

16. *Butterfield v. The Queen*, 2010 FCA 330

In this Federal Court of Appeal case, the taxpayer was the sole director of a company that was assigned into bankruptcy on December 1, 2003. In February 2006, the taxpayer was assessed pursuant to subsection 227.1(1) of the Act and subsection 323(1) of the ETA for the balance of the company's unremitted source deductions and GST left owing after the discharge of the bankruptcy trustee. The taxpayer appealed to the Tax Court of Canada, arguing that, on December 12, 2003, he was rudely removed from the affairs of the company by the trustees and, therefore, was constructively dismissed as a director of the company.

The Tax Court of Canada held that, since the taxpayer had never tendered his resignation, he remained a director until the company was struck from the British Columbia Corporate and Personal Property Registries on July 4, 2005. As such, the Minister's assessments were not statute-barred, and the taxpayer was held to be jointly and severally liable, with the corporation, for the unpaid amounts and any interest or penalties relating to them. The taxpayer appealed.

The Federal Court of Appeal affirmed the decision of the Tax Court of Canada, holding that the taxpayer cannot simultaneously claim that the December 1 bankruptcy did not result in him ceasing to be a director, but that the perceived constructive dismissal during his last visit to the office on December 12 did, in the absence of any statutory power by the trustee to remove him as a director.

17. *Madison v. The Queen*, 2012 FCA 80

In this Federal Court of Appeal decision, the taxpayer was a director of Canfleur Mining (the "Corporation") from the date of its incorporation until it was dissolved on May 2, 2007. The Federal Court issued a certificate for the Corporation's unremitted source deductions and accrued interest, but the liability was unsatisfied because the Corporation had no assets. The taxpayer was assessed personally on April 30, 2009, pursuant to subsection 227.1(1) of the Act. The taxpayer argued that she was never permitted to exercise the powers of a director, and had no control or signing authority. In addition, she argued that she had ceased to be a director more than two years before the date of the assessment, and that the precondition to liability in paragraph 227.1(2)(b) was not met.

The Federal Court of Appeal set aside the judgment of the Tax Court and returned the matter to the Tax Court for a new hearing by a different judge. The Federal Court found that the Tax Court judge's refusal to admit the taxpayer's file notes, which recorded a conversation with another director indicating that the taxpayer had been voted out as a director in September 2006, constituted an error of law. The Tax Court judge excluded the evidence as hearsay without first considering whether it was necessary and reliable, as required by ***R. v. Khan***, [1990] 2 S.C.R. 531.

With regards to the taxpayer's argument that the precondition to liability in paragraph 227.1(2)(b) was not met, the court relied on the decision in ***Kennedy v. Canada***, 92 DTC 6380. In that case, the Federal Court of Appeal upheld the Tax Court's determination that only one of the three requirements in 227.1(2) must be met as a precondition for liability. The taxpayer argued that liability could not be imposed under paragraph 227.1(2)(b) because the claim had not been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution. However, the Federal Court of Appeal determined that the requirements of paragraph 227.1(2)(a) had been met, since a Federal Court certificate was issued for the Corporation's liability for unpaid source deductions, and execution for that amount was returned unsatisfied because the Corporation had no assets.

18. *Chell v. The Queen*, 2013 TCC 29

In this Tax Court of Canada case, the taxpayer was a director of two corporations, cDemo Inc. ("cDemo") and Global Autolink Corp. ("Global"). cDemo was assessed for failure to remit payroll source deductions in 2003, 2004 and 2005 and for failure to remit GST in 2005. Global was assessed for failure to remit payroll source deductions. The taxpayer, a consultant in the automobile industry, became a director of Global in 2000 and a director of cDemo in 2001. The corporations became insolvent, and all other directors resigned, leaving the taxpayer as the sole director of both corporations. In January 2006, the taxpayer sent a letter indicating his intention to resign as director, and delivered a copy of the letter to the lawyer who had been acting for the corporations six weeks later. Because of unpaid bills, the lawyer took no action with respect to the letter. Despite his resignation, the taxpayer remained actively involved with cDemo and Global. He met with the CRA to discuss outstanding liabilities, negotiated with third parties for the sale of some of the corporations' assets, and pursued business development activities. In his discussions with the CRA, he never mentioned that he was no longer a director of cDemo or Global.

The Tax Court dismissed the taxpayer's appeal on the bases that he was a *de facto* director of cDemo and Global despite his resignation and that he failed to meet the requirements of the due diligence defence. The Tax Court noted that under both the Act and the ETA, the minister may not assess an individual for director's liability more than two years after that individual ceases to be a director, and cited ***Mosier*** for the proposition that a director may be a *de jure* director or a *de facto* director for the purpose of director's liability under the Act and under the ETA. The Tax Court held that the taxpayer ceased to be a *de jure* director when he resigned in January 2006, but that his active involvement with the corporations subsequent to his resignation indicated that he continued to be a *de facto* director. In addition, the Tax Court noted that the taxpayer's cooperation with the CRA created the impression that he was still an active director of both corporations.

With regards to the due diligence defence in subsection 227.1(3) of the Act and subsection 323(3) of the ETA, the Tax Court applied the objective standard in ***Buckingham***. According to the Tax Court, a reasonably prudent director with the taxpayer's level of familiarity with the businesses of cDemo and Global would have been aware of the corporations' financial difficulties, despite his assertions that he had never reviewed the corporations' books and was unaware of the remittance patterns.

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The Tax Court held that the taxpayer took no positive steps to ensure that the corporations met their remittance obligations, and that delegating the responsibility of handling the remittances to an employee without any oversight on the taxpayer's part did not discharge his statutory obligation as a director. Therefore, the taxpayer did not exercise the duty of care, diligence and skill to prevent the failure to remit and was liable for the amounts in question.

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