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Directors: Don't get left on the hook!

Corporate directors (including directors of not-for-profit corporations) can be held liable for payroll withholdings and other taxes that the corporation should have collected or remitted to federal or provincial tax authorities. Knowing your obligations as a director and how to protect yourself can reduce the chance that you will be left holding the bag or putting your personal assets at risk.

The directors of a corporation in distress have a lot to worry about, as typically money is flowing out of the corporation faster than it is flowing in. Being tempted to use any available cash to pay current liabilities is understandable, but there can be severe consequences if the cash comes from taxes withheld from employees' wages or collected from customers. This is because, adding to the directors' woes, a number of federal and provincial tax statutes can make directors personally responsible for amounts collected or withheld by the corporation but not properly remitted to the appropriate taxing authority.

Under the *Income Tax Act* (Canada), for example, a director can be found personally liable if the corporation fails to withhold or remit taxes as required from employees' wages and benefits. The director may be jointly liable with the corporation (and its other directors, if any) for the full amount that should have been withheld or remitted, plus a 10% penalty (20% in some circumstances) and interest. In order to assess a director under these circumstances, however, the taxation authority must show that it cannot directly recover the amounts owed from the corporation by, for example, proving a claim against the corporation in bankruptcy proceedings.

The federal *Excise Tax Act*, the *Employment Insurance Act* and the *Canada Pension Plan* and provincial tax legislation all contain similar provisions imposing liability on directors for the corporation's failure to collect, withhold and remit tax as required. It should be noted that the directors of a non-profit corporation that pays salaries and wages or collects HST or GST from customers may also be held liable under all of these provisions.

The Accidental Director

Becoming a corporate director is not usually an accident as, generally, a director gives his or her express consent to being appointed. In certain circumstances, however, an individual can be considered a *de facto* director without a legally valid appointment. A person may start acting as the corporation's director without going through the necessary formalities, may wish to step down as a director (particularly if the corporation is not doing well) but fail to make sure these events are properly documented.

If individuals appear to be acting like directors to those outside the corporation by, for example, signing resolutions or attending directors' meetings, they may be considered *de facto* directors and be held responsible for the corporation's tax liabilities without being validly appointed or even after resigning from the board of directors.

What's a Director to Do?

Be diligent: Directors who can show that they exercised the degree of care, diligence and skill to prevent a corporation's failure to withhold or remit tax as required may escape liability through what is known as a due diligence defence. Directors will have to show that, considering their personal knowledge, experience and background and the corporation's organization and resources, they acted appropriately under the circumstances.

The courts have held that directors have a duty to *prevent* a failure to withhold or remit as required, not a duty to fix the failure once it is obvious that the corporation is in distress. To support a due diligence defence, directors should try to document their efforts to make sure the corporation correctly calculated the taxes and other amounts to be collected or withheld, and that the amounts withheld or collected were kept in a separate account. Once there are indications that things are not going well, the directors must take steps to ensure that remittances are being made as required.

Responsibility for withholding and collecting tax and for making remittances can be delegated but directors should ensure that staff have the necessary training and experience to carry out these duties. Directors should also communicate regularly with officers and staff and should obtain regular

reports confirming that taxes are being remitted to the proper authorities in full and on time.

Resign like you mean it: Directors can be assessed for the corporation's tax liabilities even after they resign but only in respect of amounts collected or withheld (or amounts that should have been collected or withheld) while they were still directors. Generally, however, the taxation authority cannot proceed against the director for unremitted taxes more than two years after the resignation. To start the two-year clock running, therefore, it is very important for the resigning director to insist that the resignation is promptly and properly documented, both in the corporation's minute book, and in the appropriate federal or provincial corporate registry. For corporations formed under the Ontario *Business Corporations Act*, this means filing a notice of change with the Ontario Ministry of Government Services.

A taxation authority may argue that the director's resignation was not legally effective on the date specified in a letter of resignation if the corporate registry is not notified at the same time. If the corporation is in receivership or bankruptcy proceedings, the receiver or trustee in bankruptcy should also be advised in writing of the director's resignation.

After resigning, the former director should take care to avoid being considered a *de facto* director by not doing anything to suggest he or she is still involved in the corporation's affairs, particularly if all the other directors have also resigned. This means the former director should avoid corresponding with creditors or taxation authorities on behalf of the corporation or trying to recover amounts owing by the corporation's customers.

Get help: If you need help understanding your responsibilities as a corporate director or assistance in resolving a dispute with taxation authorities, please contact a member of our Insolvency & Corporate Restructuring Practice.

Wojtek Jaskiewicz focuses his practice in the area of bankruptcy and insolvency.

Helen Ferrigan is the firm's Director of Knowledge Management and has experience resolving tax disputes.

Pallett Valo LLP Insolvency & Corporate Restructuring Practice

Businesses transform. Partnerships change. At every step, Pallett Valo has proven to be adept at providing critical advice, strong representation and timely resolution when it matters most. We offer legal advice to directors, debtors, secured and unsecured creditors, trustees and receivers in the context of proceedings under the *Bankruptcy & Insolvency Act (BIA)* and the *Companies Creditors Arrangement Act (CCAA)*.

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