# Personal Liability of Corporate Directors for Failure to Remit Source Deductions



Brief your officers and directors on what they must do to meet the standard of due diligence.

‘Trying to get your CEO or CFO to gain a deeper appreciation for your HR and payroll program? Here’s a real-life liability nightmare scenario to run by them, along with a template on how to brief the officers about the significance of the case and its potential impact on their own personal liability for your company’s failure to remit source deductions.

## Scenario

An experienced business professional agrees to join the board of directors of a financially troubled talent agency. During his very first board meeting in November, the director receives a balance statement showing the company has a net operating loss of $132,000 through 3 quarters. What the other directors don’t tell him is that the company hasn’t been remitting source deductions from employee salaries to the government as required by the *Income Tax Act*. The director resigns 3 months later without ever asking or finding out about the remittances. When the government tries to personally assess him for the unpaid remittance, he claims he showed due diligence. The court disagrees and upholds the $13,000 assessment [*Soper v. Canada*, 1997 CanLII 6352 (FCA), [1998] 1 FC 124,

## The Legal Risks

A corporate director can be held personally liable for a corporation’s failure to deduct and remit taxes from employees. Directors can defend themselves against liability by showing that they exercised “due diligence” to prevent the company from committing the violation. But, as the *Soper* case shows, due diligence is a high standard for a director to meet. Even though *Soper* is a 1997 case, it remains the standard of director liability for a corporation’s failure to remit.

## The Due Diligence Defence for Failure to Remit

In the 1980s, the government was having a hard time collecting remittances from financially strapped companies. To prevent companies from using the money they were supposed to remit to pay off creditors, the government added section 227.1(1) to the

*Income Tax Act* in 1982 making corporate directors personally responsible for amounts their companies fail to remit. The new tax laws also included certain defences directors could use to avoid liability. One of them, Sec. 153(1), provides that a director isn't liable "where he exercised the degree of care, diligence and skill to prevent the [failure to remit] that a reasonably prudent person would have exercised in comparable circumstances." This is called the "due diligence" defence.

## Practical Impact: What Corporate Officers & Directors Must Do to Meet Due Diligence

But what does due diligence mean? And what are corporate directors actually supposed to do to meet the standard?

The *Soper* case helps answer this question. Due diligence, the case said, is not a one-size-fits-all standard. It's a combination of objective and subjective factors. The objective part is the "reasonableness" standard; but in determining what's "reasonable" for a director to do, it's necessary to consider the director's circumstances, including their:

**Experience:** The greater a director's experience and knowledge in financial matters, the higher the standard. Thus, the director in *Soper* was found liable because he was an experienced businessman. By contrast, in a case decided one year earlier, a director wasn't liable for his company's failure to remit because he "had no management experience" [*Sanford v. M.N.R.*, [1996] 1 C.T.C. 2016 (T.C.C.)].

**Influence:** The more influence a director has over the company's day-to-day business operations, the higher the standard of due diligence. Thus, more is expected of inside than outside directors—although the director found liable in *Soper* was an outside director.

**Warning Signs:** Directors are expected to be on the lookout for and respond to red flags. The director in *Soper* claimed, accurately, that none of the directors told him that the company wasn't remitting. However, the tax court said that the balance sheet should have tipped the director off and caused him to ask about whether the company was meeting its remittance obligations.

## Takeaway: The 6 Questions Officers & Directors Should Ask

Due diligence isn't just a one-time or sporadic activity; it's something a director must exercise on a regular, ongoing basis. The director also must proactively attempt to head off problems with remittances, not simply respond to them when they arise. How can directors tell if they're doing enough? There's no precise formula. But, based on CRA guidance (CRA Information Circular IC89-2R3 Directors' Liability), there are 6 questions they should ask:

1. Are there accounts for withholdings from employees and remittances of source deductions?
2. Do financial officers provide regular reports on the status of each account?
3. Is regular confirmation being provided that all remittances have been made?
4. Is delegation proper? Directors may, in the words of the *Soper* case "rely on company officials to perform honestly duties that have been properly delegated to them." But they must be on the lookout for and immediately respond to any grounds for suspicion.
5. Are directors aware of their legal obligations?

6. Are they documenting their efforts so they can prove they were duly diligent in case they’re charged with a violation? As the lawyers say, if it isn’t documented, it didn’t happen.