



NO.: **89-2R2**

DATE: March 24, 2006

SUBJECT: Directors' Liability Section 227.1 of the *Income Tax Act*, Section 323 of the *Excise Tax Act*, Section 81 of the *Air Travellers Security Charge Act*, and subsection 295(1) of the *Excise Act, 2001*

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This Circular cancels and replaces Information Circular IC89-2R, dated June 27, 1997 and IC89-2R-Erratum, dated August 8, 1997.

1. This Circular outlines the consequences which corporate directors may face, when the corporation, of which they are a director, fails to deduct, withhold, remit, or pay certain amounts of money held in trust for the Crown. Under these circumstances, corporate directors may be held personally liable pursuant to section 227.1 of the *Income Tax Act* ("ITA"), section 323 of the *Excise Tax Act* ("ETA"), section 81 of the *Air Travellers Security Charge Act* ("ATSCA"), subsection 295(1) of the *Excise Act, 2001* ("EA2001"), and similar provisions of the *Canada Pension Plan*, and the *Employment Insurance Act*.

2. While the purpose of this Circular is to provide information on section 227.1 of the ITA, section 323 of the ETA, section 81 of the ATSCA, and subsection 295(1) of the EA2001, the Circular itself is not law. The law is set out in the statutes, and a copy of the relevant provisions of the ITA, the ETA, the ATSCA, and the EA2001 is attached as Appendix A.

3. Corporations (for-profit, non-profit, or not-for-profit) are required to deduct, withhold, collect, remit, or pay amounts for

- (a) patronage dividends (subsection 135(3) of the ITA);
- (b) salary, wages, certain benefits, and payments out of various plans (subsection 153(1) of the ITA);
- (c) refundable tax (Part VII of the ITA) for share-purchase tax credits designated by the corporation;
- (d) refundable tax (Part VIII of the ITA) for scientific research and experimental development tax credits designated by the corporation;
- (e) dividends, interest, or proceeds of disposition received on behalf of beneficial owners of shares, if the corporation is a broker or dealer in securities, and if such owners are unknown;
- (f) the payment or crediting of certain amounts to non-residents;
- (g) the goods and services tax/harmonized sales tax ("GST/HST") (Part IX of the ETA);
- (h) the air travellers security charge (ATSCA); and,
- (i) the Excise duty payable (EA2001).

4. This Circular focuses on (b), (g), (h) and (i) in paragraph 3.

5. Corporate directors who are in office when the corporation, of which they are a director, fails to deduct, withhold, collect, remit, or pay the amounts in (b), (g), (h), and (i) of paragraph 3, may be personally liable, together with the corporation, to pay part or all of these amounts:

- (a) in the case of a failure to remit or pay, the unpaid amount, plus any related penalties and interest;
- (b) in the case of a failure to deduct or withhold amounts from any remuneration, a penalty of 10 or 20 per cent (as the case may be) of the amount that should have been deducted, plus any related interest;
- (c) in the case of a failure to collect and/or remit amounts of GST/HST, the amount of that GST/HST that should have been remitted, plus penalties and interest;
- (d) in the case of a failure to repay GST/HST refund amounts, to which the corporation was not entitled, that were paid to, or applied to the liability of the corporation, on or after June 29, 2005, plus penalties and interest;
- (e) in the case of a failure to pay Air Travellers Security Charge amounts that were or should have been collected, the amount that should have been paid, plus interest; and,
- (f) in the case of a failure to pay Excise duty amounts that were or should have been collected, the amount that should have been paid plus interest.

The Rules for Liability

6. There are three basic rules to the general rule of personal liability:

- (a) the Agency must demonstrate its inability to recover the amounts directly from the corporation;
- (b) the Agency must start proceedings to assess directors no later than two years after they have ceased to be directors; and
- (c) directors must be unable to show that they exercised the degree of care, diligence, and skill ("due diligence") required to prevent the failure.

The Agency's Obligation

7. To demonstrate its inability to recover the amounts directly from the corporation, the Agency must:

- (a) show that its execution against the corporation was returned unsatisfied; or
- (b) prove a claim against the corporation in dissolution or liquidation; or
- (c) prove a claim against the corporation in bankruptcy.

Limitation

8. Directors are not liable if the Agency commences proceedings to assess them more than two years after they cease to be directors. Directors cease to be directors by resigning, or by operation of law (e.g., they become personally bankrupt).

Directors continue to be directors, although with reduced rights and powers, after a trustee, receiver, liquidator, or other like person, acting in a similar capacity, has been appointed.

Types of Directors

9. The ITA, the ETA, the ATSCA, and the EA2001 do not distinguish between directors, be they passive, nominee, or outside directors. Consequently, their lack of involvement in the affairs of the company may not absolve them from liability. Further, directors who relinquish their responsibilities to co-directors, officers, or employees may be held liable.

De Facto Directors

10. Officers, employees, and others who are not legally appointed as directors, but who perform the functions that directors would perform, may be liable.

Due Diligence

11. Directors should ensure that the corporation is properly withholding deductions. Moreover, a corporation and its directors must act responsibly. Above all, the directors must make every reasonable effort, while deductions, GST/HST, ATSCA, and Excise duty amounts are withheld and collected, to ensure that those amounts will be remitted and paid.

12. Directors are not liable if they exercise due diligence, that is, the diligence that a reasonably prudent person would exercise in comparable circumstances to ensure that the corporation deducts, withholds, collects, remits, or pays the amounts due. The Agency expects that a director should attempt to take positive action to this end by methods such as:

- (a) establishing an account for withholdings from employees and remittances of source deductions, as well as for remittances of GST/HST and ATSCA net amounts, and Excise duty;

- (b) calling upon financial officers of the corporation to report regularly on the status of the account; and
- (c) obtaining regular confirmation that withholdings and remittances have in fact been made during all relevant periods.

13. As well, if the corporation is experiencing financial difficulties, the responsibilities of directors may include the following:

- (a) obtaining from the financial institution where the line of credit is extended, an enforceable undertaking to pay all amounts due to the Crown when due;
- (b) if the corporation is in receivership or is bankrupt, advising the receiver and manager or trustee in writing of the banking arrangements in place for the payment of the source deductions withheld, net GST/HST and ATSCA, and Excise duty.

14. To demonstrate that they exercised due diligence, directors must show that they took reasonable steps to **prevent** the failure. In other words, the steps must be taken before the failure has occurred, and not after the failure has already occurred.

15. Directors are obliged to be aware of what is happening in the corporation of which he or she is a director. Effective lines of communication between directors and the corporation's responsible employees must be maintained.

16. Directors may not claim that they were uninformed as to the requirements of the applicable statutes. A reasonably prudent person, who is aware that he or she is a director, but who is uncertain as to the extent of the responsibilities as a director, is under a duty to at least attempt to discover what is expected of him or her, and to discharge that duty.

17. While directors may delegate their statutory responsibilities to other directors, they are nonetheless responsible for ensuring that payroll deductions, GST/HST, ATSCA, and Excise duty are remitted.

18. The due diligence test is subjective as well as objective. It is objective in that there has to be a standard against which to judge a director, i.e., a reasonable person; it is subjective in the sense that the director must have done what a reasonably prudent person would have done in the circumstances. What constitutes due diligence, then, would vary with the circumstances of each case.

Assessment Policy

19. Following an initial investigation, the Agency will inform, in writing, directors who may be liable, that one or more assessments under section 227.1 of the ITA, section 323 of the ETA, section 81 of the ATSCA, or subsection 295(1) of the EA2001 are being considered.

20. It is in the interest of each director to respond and to explain all actions taken to ensure that the corporation deducted, withheld, remitted, or paid and, where possible, to provide documentation of these actions. The Agency will consider the merits of every response before deciding to issue an assessment.

21. If a director does not reply within the time set out in the proposal letter, the Agency may issue an assessment without further notice.

22. The provisions of section 227.1 of the ITA, section 323 of the ETA, section 81 of the ATSCA, and subsection 295(1) of the EA2001 are remedial, not penal, and as such are a means of collection. Each director may be assessed for the full amount of its corporation's liability, but a director who pays an amount towards this liability is entitled to:

- (a) the same preference in liquidation, dissolution, or bankruptcy proceedings as would otherwise have been available to the Crown; and,
- (b) a contribution from all other directors who are liable.

APPENDIX A

INCOME TAX ACT

227.1(1) Liability of directors for failure to deduct

(1) **Liability of directors for failure to deduct.** – Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest or penalties relating thereto.

227.1(2) Limitations on liability

- (2) **Limitations on liability.** – A director is not liable under subsection (1), unless
- (a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 223 and execution for that amount has been returned unsatisfied in whole or in part;
 - (b) 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 that subsection has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or
 - (c) the corporation has made an assignment or a receiving 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 that subsection has been proved within six months after the date of the assignment or receiving order.

227.1(3) Idem

(3) **Idem.** – A director is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

227.1(4) Limitation period

(4) **Limitation period.** – No action or proceedings to recover any amount payable by a director of a corporation under subsection (1) shall be commenced more than two years after the director last ceased to be a director of that corporation.

227.1(5) Amount recoverable

(5) **Amount recoverable.** – Where execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

227.1(6) Preference

(6) **Preference.** – Where a director pays an amount in respect of a corporation's liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had that amount not been so paid and, where a certificate that relates to that amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is hereby empowered to make.

227.1(7) Contribution

(7) **Contribution.** – A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim.

227(10) Assessment

(10) **Assessment.** – The Minister may at any time assess any amount payable under

- (a) subsection 227(8), 227(8.1), 227(8.2), 227(8.3) or 227(8.4) or 224(4) or 224(4.1) or section 227.1 or 235 by a person,
 - (b) subsection 237.1(7.4) by a person or partnership,
 - (c) subsection 227(10.2) by a person as a consequence of a failure of a non-resident person to deduct or withhold any amount, or
 - (d) Part XIII by a person resident in Canada,
- and, where the Minister sends a notice of assessment to that person or partnership, Divisions I and J of Part I apply with any modifications that the circumstances require.

EXCISE TAX ACT

323(1) Liability of directors (prior to June 29, 2005)

(1) **Liability of directors.** – Where a corporation fails to remit an amount of net tax as required under subsection 228(2), the directors of the corporation at the time the corporation was required to remit the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest thereon or penalties relating thereto.

323(1) Liability of directors (as at June 29, 2005)

(1) **Liability of Directors.** – If a corporation fails to remit an amount of net tax as required under subsection 228(2) or (2.3) or to pay an amount as required under section 230.1 that was paid to, or was applied to the liability of, the corporation as a net tax refund, the directors of the corporation at the time the corporation was required to remit or pay, as the case may be, the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay the amount and any interest on, or penalties relating to, the amount.

323(2) Limitations

- (2) **Limitations.** – A director of a corporation is not liable under subsection (1) unless
- (a) 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 and execution for that amount has been returned unsatisfied in whole or in part;
 - (b) 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) has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or
 - (c) the corporation has made an assignment or a receiving 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) has been proved within six months after the date of the assignment or receiving order.

323(3) Diligence

- (3) **Diligence.** – A director of a corporation is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

323(4) Assessment

- (4) **Assessment.** – The Minister may assess any person for any amount payable by the person under this section and, where the Minister sends a notice of assessment, sections 296 to 311 apply, with such modifications as the circumstances require.

323(5) Time limit

- (5) **Time limit.** – An assessment under subsection (4) of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person last ceased to be a director of the corporation.

323(6) Amount recoverable

- (6) **Amount recoverable.** – Where execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

323(7) Preference

- (7) **Preference.** – Where a director of a corporation pays an amount in respect of a corporation’s liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had the amount not been so paid and, where a certificate that relates to the amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director’s payment, which assignment the Minister is empowered to make.

323(8) Contribution

- (8) **Contribution.** – A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

AIR TRAVELLERS SECURITY CHARGE ACT**81(1) Liability of Directors**

- (1) **Liability of Directors.** – If a corporation fails to pay an amount as and when required under this Act, the directors of the corporation at the time it was required to pay it are jointly and severally or solidarily liable, together with the corporation, to pay it and any interest that is payable under this Act.

81(2) Limitations

- (2) **Limitations.** – A director of a corporation is not liable unless
- (a) a certificate for the amount of the corporation’s liability has been registered in the Federal Court of Canada under section 74 and execution for that amount has been returned unsatisfied in whole or in part;
 - (b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved, and a claim for the amount of the corporation’s liability has been proved within six months after the earlier of the date of commencement of the proceedings and the date of the dissolution; or
 - (c) the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy and Insolvency Act*, and a claim for the amount of the corporation’s liability has been proved within six months after the date of assignment or receiving order.

81(3) Diligence

- (3) **Diligence.** – A director of a corporation is not liable for a failure under subsection (1) if the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

81(4) Assessment

- (4) **Assessment.** – The Minister may assess any person for any amount payable by the person under this section and, if the Minister sends a notice of assessment, sections 39 to 52 apply with any modifications that the circumstances require.

81(5) Time Limit

- (5) **Time Limit.** – An assessment of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person ceased to be a director of the corporation.

81(6) Amount Recoverable

- (6) **Amount Recoverable.** – If execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

81(7) Preference

(7) **Preference.** – If a director of a corporation pays an amount in respect of the corporation’s liability that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference to which Her Majesty would have been entitled had the amount not been so paid, and if a certificate that relates to the amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director’s payment, which assignment the Minister is empowered to make.

81(8) Contribution

(8) **Contribution.** – A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

EXCISE ACT, 2001**295(1) Liability of directors.**

(1) **Liability of directors.** – If a corporation fails to pay any duty or interest as and when required under this Act, the directors of the corporation at the time it was required to pay the duty or interest are jointly and severally or solidarily liable, together with the corporation, to pay the duty or interest and any interest that is payable on the duty or interest under this Act.

295(2) Limitations

- (2) **Limitations.** – A director of a corporation is not liable unless
- (a) a certificate for the amount of the corporation’s liability has been registered in the Federal Court under section 288 and execution for that amount has been returned unsatisfied in whole or in part;
 - (b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation’s liability has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or
 - (c) 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 has been proved within six months after the date of the assignment or bankruptcy order.

295(3) Diligence

(3) **Diligence.** – A director of a corporation is not liable for a failure under subsection (1) if the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

295(4) Assessment

(4) **Assessment.** – The Minister may assess any person for any amount of duty or interest payable by the person under this section and, if the Minister sends a notice of assessment, sections 188 to 205 apply with any modifications that the circumstances require.

295(5) Time limit

(5) **Time limit.** – An assessment of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person ceased to be a director of the corporation.

295(6) Amount recoverable

(6) **Amount recoverable.** – If execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

295(7) Preference

(7) **Preference.** – If a director of a corporation pays an amount in respect of the corporation’s liability that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference to which Her Majesty would have been entitled had the amount not been so paid, and if a certificate that relates to the amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director’s payment, which assignment the Minister is empowered to make.

295(8) Contribution

(8) **Contribution.** – A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

2002, c. 22, s. 295; 2004, c. 25, s. 198.