



NO.: IC89-2R3

DATE: April 10, 2014

SUBJECT: Directors' liability

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This circular cancels and replaces Information Circular IC89-2R2, dated March 24, 2006.

1. This circular outlines the consequences that corporate directors may face when the corporation that they are a director of 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 under sections 227.1 of the *Income Tax Act* (ITA), 323 of the *Excise Tax Act* (ETA), 81 of the *Air Travellers Security Charge Act* (ATSCA), 295 of the *Excise Act, 2001* (EA2001), 95 of the *Softwood Lumber Products Export Charge Act, 2006* (SLPECA) 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 sections 227.1 of the ITA, 323 of the ETA, 81 of the ATSCA, 295 of the EA2001, and section 95 of the SLPECA, 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, the EA2001, and the SLPECA is attached as Appendix A.

3. Corporations (for-profit, non-profit, or not-for-profit) have 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 (SR&ED) 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 the 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;
- (i) the excise duty payable (EA2001); and
- (j) export and refund charges on specified softwood lumber products.

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

5. Corporate directors who are in office when the corporation fails to deduct, withhold, collect, remit, or pay the amounts in (b), (g), (h), (i), and (j) 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, the amount that should have been deducted, plus a penalty of 10% or 20% of the amount that should have been deducted and any related interest;
- (c) in the case of a failure to collect or remit amounts of GST/HST, the amount that should have been remitted, plus penalties and interest;
- (d) in the case of a failure to repay GST/HST refund amounts that the corporation was not entitled to, that were paid to or applied to the liability of the corporation on or after June 29, 2005, the amount of the refund 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;
- (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; or
- (g) in the case of a failure to pay an export or refund charge, the amount that should have been paid, plus interest.

Rules for determining directors' liability

6. The three basic rules of directors' liability are:

- (a) the CRA must demonstrate its inability to recover the amounts directly from the corporation;
- (b) the CRA must issue the assessment against the directors within two years from the time they last ceased to be directors; and
- (c) the directors did not exercise the degree of care, diligence, and skill ("due diligence") required to prevent the failure to deduct, withhold, remit, or pay.

The CRA's obligation

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

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

Limitation

8. The CRA must issue the assessment against the directors within two years from the time they last ceased 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 similar person, acting in a similar capacity, has been appointed to act on behalf of the company.

Types of directors

9. The statutes do not distinguish between directors, whether active, passive, nominee, or outside directors. Therefore, their lack of involvement in the affairs of the company will generally not absolve them from liability. 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 or elected as directors, but who perform the functions that directors would perform, may be liable.

Due diligence

11. Directors should make sure that the corporation is properly withholding deductions. Also, a corporation and its directors must act responsibly. Directors must make every reasonable effort to ensure that source deductions, GST/HST, excise duty, and amounts charged under the ATSCA and the SLPECA are withheld, collected, remitted, and paid.

12. Directors are not liable if they exercise due diligence, that is, the care that a reasonably prudent person would take in similar circumstances to make sure that the corporation deducts, withholds, collects, remits, or pays the amounts due. To do this, directors should use methods such as:

- (a) establishing a separate account for withholdings from employees and remittances of source deductions and for remittances of GST/HST, excise duty, and amounts charged under the ATSCA and the SLPECA;

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

13. If the corporation is in receivership or bankrupt, one of the responsibilities of directors may include advising the receiver and manager or trustee in writing of the banking arrangements in place for paying the source deductions withheld, the GST/HST, excise duty, and charges under the ATSCA and the SLPECA.

14. To demonstrate that they exercised due diligence, directors must show that they took reasonable steps to prevent the failure to deduct, withhold, remit, or pay. In other words, the steps must be taken before the failure has occurred.

15. Directors are obliged to be aware of what is happening in the corporation that they are a director of. They must maintain effective lines of communication between them and the corporation's responsible employees.

16. Directors cannot claim that they were unaware of their obligations or the corporation's obligations under the statutes. A reasonably prudent person who knows that he or she is a director but is uncertain about his or her responsibilities must at least try to find out what is expected of him or her and to carry out that duty.

17. While directors may delegate their statutory responsibilities to other people, they remain responsible for ensuring that payroll deductions, GST/HST, excise duty, and charges under the ATSCA and the SLPECA are remitted.

18. An objective standard is applied when considering a due diligence defence. This does not mean that the director's particular circumstances are to be ignored. The circumstances must be considered against an objective standard of a "reasonably prudent person."

Assessment policy

19. Following an initial investigation, the CRA will inform, in writing, the 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, section 295 of the EA2001, or section 95 of the SLPECA are being considered.

20. It is in the interest of each director to respond to and explain all actions taken to ensure that the corporation deducted, withheld, remitted, or paid the amounts and, where possible, to provide documentation of these actions. The CRA 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 pre-assessment proposal, the CRA may issue an assessment without further notice.

22. Under the directors' liability provisions, each director may be assessed for the full amount of the corporation's liability, but a director who pays an amount toward this liability is entitled to:

- (a) the same preference in liquidation, dissolution, or bankruptcy proceedings as would otherwise have been available to the Crown;
- (b) obtain a certificate registered by the Crown, for the amount due, to the extent of the director's payment; and
- (c) a contribution from all other directors who are liable.

APPENDIX A

Income Tax Act

227.1(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 135.1(7) 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, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.

227.1(2) Limitations on liability

A director is not liable under subsection 227.1(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 bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or bankruptcy order.

227.1(3) Idem

A director is not liable for a failure under subsection 227.1(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

No action or proceedings to recover any amount payable by a director of a corporation under subsection 227.1(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

Where execution referred to in paragraph 227.1(2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

227.1(6) Preference

Where a director pays an amount in respect of a corporation's liability referred to in subsection 227.1(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

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

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) or (7.5) or 237.3(8) 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)**

Where a corporation fails to remit an amount of net tax as required under subsection 228(2) or (2.3), 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)

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

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 bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the date of the assignment or bankruptcy order.

323(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

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

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

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

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

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**

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 on it under this Act.

81(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 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 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 assignment or bankruptcy order.

81(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

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

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

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

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

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**

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

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

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

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

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

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

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

A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

Softwood Lumber Products Export Charge Act, 2006**95(1) Liability of directors**

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

95(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 88 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.

95(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.

95(4) Assessment

The Minister may assess any person for any amount payable by the person under the section and, if the Minister sends a notice of assessment, sections 50 to 63 apply with any modifications that the circumstances require.

95(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.

95(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.

95(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 in right of Canada 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.

95(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.