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Tax

Director liability for corporate tax debts depends on facts, geography

By AdvocateDaily.com Staff

Because the rules regarding when and how an individual ceases to be a corporate director vary by jurisdiction, those who rely on the two-year rule to escape personal liability for corporate tax debts may experience dramatically different outcomes depending on the applicable law, Toronto tax litigator Adrienne Woodyard writes in *The Lawyer's Daily*.

Woodyard, a partner with DLA Piper (Canada) LLP, says the Canada Revenue Agency may look to the directors to collect a corporation's unpaid GST/HST or payroll taxes. Consequently, the issue of director liability has been heavily litigated, as the question of whether a particular director is liable for a corporation's debt depends largely on the facts.

"Many former directors rely on the 'two-year rule' contained in the *Income Tax Act* and the *Excise Tax Act*, which provides that a person cannot be assessed for a corporation's taxes more than two years after ceasing to be a director," writes Woodyard.

In Ontario and most other provinces, she explains, a director ceases to hold office when she resigns, dies, is removed or becomes disqualified from acting as a director.

However, Woodyard adds, a founding director of an Ontario corporation may be at a particular disadvantage if she wishes to resign but there is no one willing to take her place, as ss. 119(2) of Ontario's *Business Corporations Act* (OBCA) provides that, until the first meeting of shareholders, the resignation of a director named in articles of incorporation is not effective unless a successor has been elected or appointed.

"The OBCA thus operates to ensure no 'orphan' corporations — except, potentially, where a sole director has died or has been automatically disqualified. Even in those cases, ss. 115(4) of the OBCA may 'fill the gap' by deeming any person who manages or supervises the management of the corporation's business and affairs to be a director," writes Woodyard.

Although there is no precise counterpart to ss. 119(2) in other corporate legislation, Woodyard says other provisions, read together, may operate to the same effect.

"For example, under the *Canada Business Corporations Act* (CBCA), corporations must have at least one director, and if replacement directors are not elected at a shareholders' meeting, the incumbent directors continue in office until their successors are elected."

Ontario also differs in its technical requirements for resignations, adds Woodyard, as ss. 121(2) of the OBCA says that a written resignation is effective only at the later of (a) the time when it is "received by the corporation" and (b) the time specified in the resignation.

"Where a notice of resignation is filed with the Ontario corporate registry, the Ontario *Corporations Information Act* requires this filing to be verified by an officer, director, or 'other individual having knowledge of the affairs of the corporation," she writes.

"The Tax Court has held resignations to be invalid where a resignation could not be shown to be 'received' or where the notice was not filed. But in practice, these requirements may be impossible to fulfil: If the business is no longer operating by the time the resignation is tendered, there may be no one available either to 'receive' the resignation on the corporation's behalf or to file the required notice," says Woodyard.

In comparison, she says, other jurisdictions are not as stringent — in British Columbia, for example, a written resignation may be considered effective if sent to the lawyer for the corporation.

One 2016 case did offer the prospect of relief for Ontario directors for a brief time, says Woodyard, as the Tax Court accepted that a resignation letter delivered to the corporation's lawyer was "received by the corporation," as prescribed by ss. 121(2) of the OBCA, as the

corporation's affairs were in disarray and delivery to the lawyer was the best available option in the circumstances.

However, she adds, this hope soon vanished, as eight months later, the Federal Court of Appeal in another case refused to accept the validity of resignations which were prepared in draft but not signed.

“The Tax Court, noting that the resignations had been communicated verbally, held that they were effective because they were ‘understood and accepted by the corporation.’ The FCA overturned, holding that the resignations failed to meet the requirements of ss. 121(2) of the OBCA; the court went on to say, at para. 14, that ‘the dangers associated with allowing anything less than delivery of an executed and dated written resignation are unacceptable,’” says Woodyard.

In the face of mounting debt arising from unpaid GST/HST and source deductions, Woodyard acknowledges that directors may be understandably eager to jump ship before personal liability becomes a risk, but cautions that they can easily fall afoul of the technical requirements of the corporate legislation when delivering their resignations.