

# Ceasing to be a Director – Directors’ Liability for Tax – Toronto Tax Lawyer Analysis



By David J Rotfleisch, CPA, JD

## Introduction – Directors’ Liability for Tax

Directors are jointly and severally liable for some of the tax debts of the corporation of which they are a director. The *Canadian Excise Tax Act* makes the directors of a corporation liable for the GST/HST remittance arrears of that corporation. Similarly, the *Canadian Income Tax Act* makes the directors of a corporation liable for the payroll remittance and the part XIII withholding tax arrears of the Corporation. Notably, the *Canadian Income Tax Act* does not make directors liable for the corporate income tax debts of their corporation. Directors’ liability is a formidable tool in the Canada Revenue Agency’s arsenal, but it is subject to several important restrictions. One is that the CRA cannot collect from directors without first assessing them for the relevant remittance arrears and both the *Canadian Excise Tax Act* and the *Canadian Income Tax Act* require several procedural steps to be satisfied before a director can be validly assessed. For example, the Canada Revenue Agency needs to unsuccessfully attempt to collect from the corporation before it can assess the corporation’s directors. Most importantly, the CRA cannot assess an individual for director’s liability if that person last ceased to be a director more than two years ago. Directors are also able to avoid liability for remittance arrears if they are able to demonstrate that they exercised the degree of care, diligence and skill necessary to prevent the failure by the corporation to remit tax that a reasonably prudent person would have exercised in comparable circumstances.

## Resignation – Ceasing to be A Director

One way to cease to be a director of a corporation is to resign. The *Canadian Income Tax Act* and the *Canadian Excise Tax Act* do not explicitly impose any requirements on how a resignation is to be accomplished, so the question of how to resign effectively is determined by reference to corporate law and the relevant incorporating statute. For corporations incorporated under Ontario’s *Business Corporations Act*, a resignation becomes effective at the time a written resignation is received by the corporation, or at the time specified in the resignation, whichever is later. Many of Canada’s other incorporating statutes have similar requirements. In *Canada v. Chriss*, the Federal Court of Appeal determined that written resignations prepared for the directors by their lawyers but that were never executed were not effective. It is not necessary for the written resignation to be stored in the minute book of the corporation for the resignation to be effective.

Corporations are required to provide information to various provincial corporate registries depending on where they operate and what statute they were incorporated under. The information in the provincial corporate registry is available to the public. Normally, when a director resigns, the corporation should update the appropriate provincial corporate registry so that the former director is no longer listed as a director. Some but not all court decisions have found that a resignation is still effective for the purposes of the time limit even if the provincial registry was not updated.

## Dissolution – Ceasing to be A Director

The process by which a corporation ceases to exist as a legal entity is called dissolution. If a corporation is dissolved, the individuals who were directors of the corporation cease to be directors at the time of the dissolution. The Tax Court of Canada and the Federal Court of Appeal have repeatedly found that this is sufficient to start the clock for the two year director’s liability limitation period. The most common causes of a corporation being dissolved are when the corporation is involuntary dissolved because it hasn’t kept up with its corporate filings or when the corporation is dissolved voluntarily. Either type of dissolution is sufficient for the purposes of the limitation period. If the corporation is later revived, it does not mean that the limitation period clock has been reset for individuals who ceased to be a director by virtue of the corporation being dissolved. Former directors will only be restored to director status for the purposes of director’s liability if the corporation is revived by a court order which specifically reinstates the directors. So far, the courts have proven reluctant to grant such orders to the CRA. Note that dissolution is not the same as bankruptcy or insolvency. An insolvent corporation is a corporation which cannot continue to meet its financial obligations. Bankruptcy is a process that can be applied to insolvent corporations whereby all legal action by creditors of the corporation is ceased and the corporation’s property is assumed by a trustee on behalf of the corporation’s creditors. Neither bankruptcy nor insolvency automatically causes the corporation to be dissolved or means that an individual ceases to be a director of the corporation. However, the director of a corporation which has gone bankrupt is not liable for the corporation’s remittance arrears if the Canada Revenue Agency fails to prove a claim for the corporation’s remittance liability within six months of the corporation’s assignment in bankruptcy or bankruptcy order.

### De Facto Directorship – Ceasing to be a Director

Individuals who have not been validly appointed a director of a corporation may still be subject to directors liability under the *Canadian Excise Tax Act* or the *Canadian Income Tax Act* by virtue of being a *de facto* director. An individual is a *de facto* director if they have not been validly appointed as a director, but still act as a director and hold themselves out as a director to third parties. There is no cut and dried legal test to determine if an individual is a *de facto* director, instead, the court considers a large number of different non-determinative factors to make a decision about each particular individual. Examples of factors considered by the court include whether the individual attends directors' meetings, signs documents as a director, plays a significant role in supervising the management of the corporation, and introduces himself to third parties as a director of the corporation. This means that directors who cease to be a director by resigning but continue their role with the corporation may not have started the director's liability limitation period running by virtue of being a *de facto* director. Individuals can cease to be a *de facto* director by ceasing to act as a director and by making it clear within the corporation and to third parties that they are not a director.

### Ceasing to be a Director - Tax Tips

Individuals who are a director of a corporation that is in financial difficulty or that is known to have remittance arrears should consider resigning to start the two-year limitation period running as soon as possible. If the individual resigns, they should keep a copy of the resignation and proof that it was delivered to the corporation at a specific time. This will make it more likely that the limitation period will have run by the time the Canada Revenue Agency attempts to assess the individual and that the individual will be able to persuade CRA or the courts that they did resign. It is also worthwhile to seek advice from an experienced Toronto tax lawyer when you resign to ensure that you meet all the formal requirements for resignation and to ensure you do not become a *de facto* director. If the Canada Revenue Agency has approached you regarding director's liability and you have not resigned, it is also worth checking if the corporation was ever dissolved, as this will mean that the limitation period has already started running.

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*David J Rotfleisch, CPA, JD is the founding tax lawyer of Rotfleisch & Samulovitch P.C., a Toronto-based boutique tax law firm. He appears regularly in print, radio and TV. With over 30 years of experience as both a lawyer and chartered professional accountant, he has helped start-up businesses, resident and non-resident business owners and corporations with their tax planning, with will and estate planning, voluntary disclosures and tax dispute resolution including tax litigation. [www.Taxpage.com](http://www.Taxpage.com) and [david@taxpage.com](mailto:david@taxpage.com)*

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