

## Martin v The Queen, 2012 TCC 239

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### Directors' Liability for Unremitted GST/HST and for Payroll Taxes - Due Diligence Defence

*Martin v The Queen*, [2012 TCC 239](#)

At issue was whether the Taxpayer has exercised the of care, diligence and skill to prevent the failure to remit the net tax and payroll deduction amounts that a reasonably prudent person would have exercised in comparable circumstances, and thus whether he was liable under subsection 323(1) of the *Excise Tax Act (ETA)* with respect to one of the corporations' failure to remit net tax and under section 223 of the *Income Tax Act (ITA)* with respect to payroll deductions and employer contributions payable by the corporation he was a director of, plus interest and penalties.

The Court partially allowed the appeal. For the 2001 tax year, the court held that the taxpayer was concerned with remitting the relevant amounts, and

had turned his attention to the required remittances, and did in these circumstances exercise the care, diligence and skill that a reasonably prudent person would have exercised in similar circumstances for the 2001 year. HOWEVER, the court held that for the 2002 tax year, the taxpayer was no longer directing his efforts towards avoidances of failures to remit.

#### FACTS

The Taxpayer was a shareholder and director for the relevant corporations as well as for more than a dozen other related corporations. The corporations ran into financial difficulties, and the taxpayer became concerned with the corporations' ability to pay its GST/HST and payroll taxes. The Taxpayer hired an accountant as CFO, and this CFO consulted with the corporation's solicitors, agreeing to consult a bankruptcy expert. The taxpayer and these experts were in communication with the CRA regarding the difficulties and their concern as to the taxes due.

The internal dealings among the related corporations were subject to GST/HST as the corporations had not elected under section 156 of the *ETA* to have supplies made among them treated as having been made for nil consideration. The corporation was also unable to reduce its GST/HST owing by reducing its invoices amounts by the amounts charged but unpaid, pursuant to subsection 232(2), but found out about this provision outside the 4 year period allowed. If these provisions were properly used, the result would be that the corporation has in fact overpaid payroll taxes and GS/HST by \$160,000.00.

#### ANALYSIS

The Court began by reviewing the liability of directors under ETA s 323 and ITA section 227.1.

With regard to the question of whether the taxpayer 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, the Court referred to two decision of the FCA being *Balthazard v. Canada*, 2011 FCA 331, and *Canada v. Buckingham*, 2011 FCA 142. In *Balthazard* the FCA summarized the legal framework as

- a. The standard of care, skill and diligence required under subsection 323(3) of the Excise Tax Act is an objective standard as set out by the Supreme Court of Canada in *Peoples Department Stores Inc.(Trustee of) v. Wise*, 2004 SCC 68, [2004] 3 S.C.R. 461. This objective standard has set aside the common law principle that a director's management of a corporation is to be judged according to his or her own personal skills, knowledge, abilities and capacities. However, an objective standard does not mean that a director's particular circumstances are to be ignored. These circumstances must be taken into account, but must be considered against an objective "reasonably prudent person" standard.
- b. The assessment of the director's conduct, for the purposes of this objective standard, begins when it becomes apparent to the director, acting reasonably and with due care, diligence and skill, that the corporation is entering a period of financial difficulties.
- c. In circumstances where a corporation is facing financial difficulties, it may be tempting to divert these Crown remittances in order to pay other creditors and thus ensure the continuity of the operations of the corporation. That is precisely the situation which section 323 of the Excise Tax Act seeks to avoid. The defence under subsection 323(3) of the Excise Tax Act must not be used to encourage such failures by allowing a care, diligence and skill defence for directors who finance the activities of their corporation with Crown monies, whether or not they expect to make good on these failures to remit at a later date.
- d. Since the liability of directors in these respects is not absolute, it is possible for a corporation to fail to make remissions [sic] to the Crown without the joint and several, or solidary, liability of its directors being engaged.
- e. What is required is that the directors establish that they were specifically concerned with the tax remittances and that they exercised their duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the amounts at issue.

The court held that the financial difficulties of the corporation were somewhat unforeseeable, and that when difficulties arose the taxpayer was concerned with paying taxes first. He and his experts were of the view that the GST/HST would be a wash but, though not wrong, because

the group of companies were not a closely related group of companies as defined for GST/HST purposes and therefore could not benefit from subsection 231(1) of the *ETA*, and because no bad debt was available between the related companies, and the companies could not benefit from a reduction with respect to unpaid invoiced under subsection 232(2) of the *ETA*, the corporations were left with no recourse.

The Court noted two other things:

- At the time, this was only 10 years after the GST/HST regime was introduced, and it was not surprising that all its details were not known;
- The corporations had good history with the CRA and were in communication with them, but the CRA did not inform them of the relief available under the legislation when the corporations and the CRA met to discuss potential problems.

The Court, after referring to the overpayment if the relief provisions available had been used, partially granted the appeal.

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