

DIRECTORS' AND OFFICERS' LIABILITY UPDATE

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FEDERAL COURT OF APPEAL CLARIFIES DIRECTOR'S DUE DILIGENCE DEFENCE TO AVOID LIABILITY FOR A CORPORATION'S FAILURE TO REMIT TAXES AND SOURCE DEDUCTIONS

In *Her Majesty the Queen v. Buckingham*, the Federal Court of Appeal clarified the standard of care, diligence and skill required of a director to establish a due diligence defence under subsection 227.1(3) of the *Income Tax Act* and similar provisions of the *Canada Pension Plan*, the *Employment Insurance Act* and the *Excise Tax Act* (collectively the "Acts"). Each of those Acts require a corporation to remit certain specified amounts to the government (such as HST or income tax deductions) and provide that a director of a corporation is jointly and severally liable (with the corporation) for any failures to remit the statutorily required amounts (collectively the "Joint and Several Provisions"). Each of the Acts, however, provide a due diligence defence whereby a director will not be liable where he or she "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."

In *Her Majesty the Queen v. Buckingham*, the Respondent, Kevin Buckingham ("Buckingham"), was a director of Mosaic Technologies Corporation ("Mosaic"). Mosaic faced financial difficulties and in 2002 and 2003 failed to remit employee source deductions and GST/HST in accordance with the Acts. Buckingham was assessed (the "Assessments") for the amounts that Mosaic failed to remit pursuant to the Joint and Several Liability Provisions in the Acts.

Buckingham opposed the Assessments on the basis that, among other things, he exercised due care and diligence by attempting to obtain financing to allow (i) Mosaic to continue operating, and (ii) to cure any of its defaults under the Acts.

Accordingly, the primary issue before the Court was whether Buckingham had established a due diligence defence by taking these steps to put Mosaic in a position to cure its defaults under the Acts?

In addressing this issue, the Federal Court of Appeal recognized that "there has been some debate in recent years as to whether the objective standard of care, diligence and skill developed by the Supreme Court of Canada in *Peoples Department Stores [Inc.] v. Wise* in relation to paragraph 122(1)(b) of the *Canada Business Corporations Act*" is the appropriate standard to apply to the due diligence defences set out in the *Income Tax Act*, the *Excise Tax Act*, the *Canada Pension Plan* and the *Employment Insurance Act*. This debate primarily focused on whether the "objective subjective" test set out in *Soper v. Canada* [1998] 1 F.C. 124 (C.A.) had been replaced by the purely objective standard for care, diligence and skill as set out by the Supreme Court of Canada in *Peoples Department Stores*.

The Court resolved this debate and held that the due diligence defence under the *Income Tax Act*, *Excise Tax Act*, *Canada*

Pension Plan and Employment Insurance Act is to be measured by the purely objective standard in accordance with the Supreme Court of Canada's decision in *Peoples Department Stores*.

The Court then focused on the specific issue of whether a director can establish a due diligence defence where his or her efforts are focused on curing the failures to remit rather than preventing these failures. The Court explained that the "traditional approach has been that a director's duty is to prevent the failure to remit not to condone it in the hope that

matters can be rectified subsequently." The Court reaffirmed this approach and held that the focus of any inquiry into whether a director exercised due diligence under these Acts must be on whether the director attempted to prevent failures to remit. Indeed, the Court specifically stated that "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

concerned amounts... a director of a corporation cannot justify a defence... where he condones the continued operation of the corporation by diverting employee source deductions to other purposes."

This holding has clarified the law in this area. There had been some uncertainty as to whether the "objective subjective" standard for directors remained in place, but this decision continued the recent trend of courts measuring a director's conduct solely on an objective basis.

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