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Insolvency Law

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FRASER MILNER CASGRAIN LLP

DUE DILIGENCE DEFENCE FOR DIRECTOR LIABILITY FOR UNREMITTED TAX, EI PREMIUMS AND CPP CONTRIBUTIONS

Intracoastal Systems Engineering Corporation ("Intracoastal") failed to remit tax, employment insurance premiums and Canadian Pension Plan contributions deducted from employees' paycheques in the amount of \$166,314.89. Intracoastal was deemed to have made an assignment in bankruptcy in April, 2003.

Sean Carroll was an engineer that became an employee of Intracoastal in the 1990s. He remained an employee until 1996 when he became a consultant. He became a director of Intracoastal from May, 1996 to February, 2003 and also held a very minor shareholding in the company.

Mr. Carroll was appointed to the board because of his technical experience and claimed no aptitude or expertise in accounting. In reviewing Mr. Carroll's due diligence defence, the Tax Court of Canada commented that the defence is factually driven and, accordingly, reviewed the history of Mr. Carroll's relationship with the company, including the various roles he occupied, as well as the circumstances that surrounded his tenure as a member of the company's board of directors. The Court's summary of its findings in this regard is useful, providing:

[5] As in most director's liability and due diligence cases, the defence is fact driven. It is somewhat unusual in that the Appellant sought legal advice before accepting his directorship, and was warned about personal liability for unremitted employee tax deductions. He was advised to question from time to time those responsible in finance, with respect to remittances, which he did. He relied on the chief financial officer, Mr. Ho, or Mr. Wadhvani, who he questioned on a regular basis. The issue of

remittances was raised in the quarterly directors meetings and confirmations that there were current is recorded in three or four minutes contained in the Appellant's book of documents. Over the six years of his tenure, there had been no previous remittance problems.

[6] The accounting firm of Ellis Foster prepared audited financial statements, Intracoastal being a public companies. In September 2002, the Appellant received assurances from trusted fellow board members that investments were forthcoming and remittances would be reinstated. With hindsight, he admits he should have resigned when he learned of the default in September 2002, but I believe he felt his expertise was need in assisting those who were arranging financing. It appeared to him that Intracoastal's product was going to take off.

[7] Obviously, the Appellant had no aptitude or expertise in accounting. He had to rely on those more qualified than he was. As stated, he was an electrical engineer, although he had signing authority for about a year and did sign payroll cheques. He reasonably relied on others to assure source deductions and remittances were made.

After a review of the applicable case law the Court concluded that Mr. Carroll's proactive questioning about the status of remittances, particularly given that his role on the board was to provide engineering expertise, not financial or accounting guidance, was sufficient to establish the due diligence defence in this case. Accordingly, the appeal was granted and the ruling that assessed director's liability was set aside.

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