

12-2022

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Recommended Citation

Singer, Samuel and Cheng, Monica (2022) "Directors' Liability in Canadian Tax Law: Critically Analyzing the Due Diligence Standard," *UBC Law Review*: Vol. 55: Iss. 3, Article 4.

Available at: <https://commons.allard.ubc.ca/ubclawreview/vol55/iss3/4>

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DIRECTORS' LIABILITY IN CANADIAN TAX LAW:
CRITICALLY ANALYZING THE DUE DILIGENCE STANDARD

SAMUEL SINGER & MONICA CHENG[†]

INTRODUCTION

The Canadian tax system requires corporations to withhold tax and payroll amounts and remit those funds to the government. When corporations do not fulfill these obligations, directors' liability acts as an important backstop to collect amounts owed but unpaid by the corporation.¹ To escape liability, directors can invoke the due diligence defence by demonstrating that they acted with the care, diligence, and skill of a "reasonably prudent person" in similar circumstances.² In 2011, *Canada v Buckingham*

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¹ See *Income Tax Act*, RSC 1985, c 1 (5th Supp), s 227.1(1); *Excise Tax Act*, RSC 1985, c E-15, s 323(1); *Canada Pension Plan*, RSC 1985, c C-8, s 21(2); *Employment Insurance Act*, SC 1996, c 23, s 83(1) (all detailing specific types of tax and payroll amounts for which a director may face personal liability).

² See *Income Tax Act*, *supra* note 1, s 227.1(3); *Excise Tax Act*, *supra* note 1, s 323(3).

established that the due diligence defence in tax law is assessed as an objective standard, based on the Supreme Court of Canada's decision in *Peoples Department Stores Inc (Trustee of) v Wise*.³ In 2020, in *Penate v R*,⁴ the Tax Court of Canada explicitly named the racism and sexism faced by the sole director and owner of a corporation as relevant factors in assessing her due diligence.

This article studies directors' liability cases in Canadian tax law after *Buckingham* and identifies inconsistency and fairness concerns about the treatment of a director's personal and socioeconomic circumstances. The statutory due diligence test requires the consideration of a director's actions in reference to what a reasonable person would do in "comparable circumstances". Drawing from critical legal scholarship about the "reasonable person" and critical tax theory, the article argues that the due diligence inquiry requires a critical and contextual approach that accounts for the director's personal and socioeconomic context, including direct and systemic discrimination.

Critical legal scholars emphasize that the "reasonable person" in legal tests is not a neutral party; they carry race, gender, class, and other assumptions.⁵ Similarly, critical tax scholarship shows that tax law is not neutral; tax policy reflects and even reinforces

³ See *R v Buckingham*, 2011 FCA 142 at para 37 [*Buckingham*] citing *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68 [*Peoples*].

⁴ *Penate v R*, 2020 TCC 63 [General Procedure] [*Penate*].

⁵ See e.g. Mayo Moran, "The Reasonable Person: A Conceptual Biography in Comparative Perspective" (2010) 14 Lewis & Clark L Rev 1233; Richard Mullender, "The Reasonable Person, the Pursuit of Justice, and Negligence Law" (2005) 68:4 Mod L Rev 681; Robyn Martin, "A Feminist View of the Reasonable Man: An Alternative Approach to Liability in Negligence for Personal Injury" (1994) 23:3 Anglo-Am L Rev 334; Juan Pablo Pérez-León Acevedo, "The Inconvenience of the Reasonable Person Standard in Criminal Law" (2014) 73 Derecho PUCP 505; Kerry L Shipman, "The Reasonable Black Person Standard in Criminal Law: Impartiality, Justice and the Social Sciences" (2019) 13 Southern J Policy & Justice 75; Margo Schlanger, "Gender Matters: Teaching a Reasonable Woman Standard in Personal Injury Law" (2001) 45:3 St Louis ULJ 769.

societal inequities.⁶ This article contributes to critical legal scholarship and Canadian tax literature on directors' liability by critically analyzing the due diligence standard in Canadian tax law. Other articles have studied tax case law on the due diligence standard for directors, but this is the first to apply a critical tax lens.⁷ At a time when the Canadian government is increasingly undertaking initiatives to address exclusion, including Gender-based Analysis Plus policy analysis, an anti-racism strategy, and an action plan for Canadians with disabilities,⁸ this article also provides an example of how the application of the law

⁶ See Dorothy A Brown, "Split Personalities: Tax Law and Critical Race Theory" (1997) 19 W New Eng L Rev 89 [Brown, "Split Personalities"]; Paul L Caron, "Tax Myopia, or Mamas Don't Let Your Babies Grow up to Be Tax Lawyers" (1994) 13:3 Va Tax Rev 517.

⁷ See Stéphane Rousseau, Gabriel Faure & Nadia Smaili, "La responsabilité civile des administrateurs pour les retenues à la source : Une étude de la défense de diligence raisonnable en matière fiscale" (2015) 45:3 Ottawa L Rev 441; Wayne D Gray, "Personal Tax Planning: Due Diligence Defence to Liability for Unpaid Statutory Remittances" (2020) 68:1 Can Tax J 281; Bobby B Solhi, "Recent Cases on Directors' Liability" (2014) 14:4 Tax for the Owner-Manager 6; R Lynn Campbell, "The Supreme Court's Decision in Peoples: A New Standard of Directors' Liability?" (2007) 55:3 Can Tax J 465; Martha O'Brien, "The Director's Duty of Care in Tax and Corporate Law" (2003) 36:3 UBC L Rev 673; R Lynn Campbell, "Directors' Diligence under the Income Tax Act" (1990) 16:4 Can Bus LJ 480; Edwin G Kroft, "The Liability of Directors for Unpaid Canadian Taxes" (Report of Proceedings of the Thirty-Seventh Tax Conference delivered at the Quebec Municipal Convention Centre, November 1985), (1986) 30:1 Can Tax Found.

⁸ See e.g. Government of Canada, "Government of Canada's approach on Gender-based Analysis Plus" (16 June 2022), online: *Women and Gender Equality* <women-gender-equality.canada.ca/en/gender-based-analysis-plus/government-approach.html>; Government of Canada, "Building a Foundation for Change: Canada's Anti-Racism Strategy 2019–2022" (23 June 2021), online: *Canadian Heritage* <canada.ca/en/canadian-heritage/campaigns/anti-racism-engagement/anti-racism-strategy.html>; Government of Canada, "Disability Inclusion Action Plan" (2021), online (pdf): *Employment and Social Development Canada* <canada.ca/content/dam/esdc-edsc/documents/programs/accessible-canada/consultation-disability-inclusion-action-plan/2021-survey-disability-inclusion-action-plan.pdf>.

without a critical lens can contribute to social and economic marginalization.

The article begins by outlining the legal sources for directors' liability under tax law in Part 1. In Part 2, it provides the history of the reasonably prudent person standard for directors' liability. In Part 3, the article looks to critical legal scholarship on the reasonable person and critical tax scholarship on the relationship between tax law and inequality. In Part 4, the article reports on a study of case law on directors' liability in tax post-*Buckingham*. It explores three themes: a director's level of knowledge and skills, a director's financial investment in the corporation, and a director's reliance on the actions or information provided by others, such as a business partner, an employee, or a spouse. In Part 5, a discussion of *Penate* supplies lessons on the importance of applying a critical lens when assessing whether a director exercised the care, diligence, and skill of a reasonably prudent person in comparable circumstances. The authors conclude by asserting the need for an equitable and consistent due diligence standard in Canadian tax law.

I. DIRECTORS' LIABILITY UNDER TAX LEGISLATION

Under the *Income Tax Act*, a director of a corporation that failed to deduct, withhold, remit, or pay amounts can be held liable for those debts.⁹ These amounts include taxes on salaries and amounts paid to non-residents of Canada, as well as penalties and interest. Directors can only be assessed after the Canada Revenue Agency has met certain statutory requirements in respect of the corporation's liability.¹⁰ The *Income Tax Act* provides that a director can defend themselves from liability if they demonstrate that they "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have

⁹ See *Income Tax Act*, *supra* note 1, s 227.1(1).

¹⁰ See *ibid*, s 227.1(2).

exercised in comparable circumstances" (the due diligence defence).¹¹

Directors can also be held liable under the *Excise Tax Act*, the *Canada Pension Plan*, and the *Employment Insurance Act*.¹² The same due diligence defence is available to directors under all three statutes. Under the *Excise Tax Act*, a corporation must charge and remit goods and services tax (GST) or harmonized sales tax (HST).¹³ Under the *Canada Pension Plan*, corporate employers must deduct and remit pension amounts from payments to their employees, together with mandatory employer contributions.¹⁴ The *Employment Insurance Act* requires each employer to deduct and remit employee contributions, along with the employer's premium.¹⁵

II. THE EVOLUTION OF THE DUE DILIGENCE STANDARD

Directors serve a primary role in corporate governance as the "directing mind" of the corporation.¹⁶ The obligation of directors to exercise care, diligence, and skill in carrying out their duties has long been recognized under the common law.¹⁷ In *Peoples*

¹¹ *Ibid*, s 227.1(3). Note that individuals who are not legally directors may still be held liable if a court holds that the individual is a *de facto* director; see e.g. *Hartrell v Canada*, 2008 FCA 59; *Snively v R*, 2011 TCC 196 [*Snively*].

¹² See *Excise Tax Act*, *supra* note 1, s 323(1); *Canada Pension Plan*, *supra* note 1, s 21.1; *Employment Insurance Act*, *supra* note 1, s 83(1) (each of which import the application of section 227.1(3) of the *Income Tax Act*, *supra* note 1).

¹³ See *Excise Tax Act*, *supra* note 1, s 225.

¹⁴ See *Canada Pension Plan*, *supra* note 1, s 21.1.

¹⁵ See *Employment Insurance Act*, *supra* note 1, s 82(1).

¹⁶ See *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd*, [1915] AC 705, 3 WLJK 17 (UKHL) at 713; *Canadian Dredge & Dock Co v R*, [1985] 1 SCR 662, 19 DLR (4th) 314 (SCC).

¹⁷ See Ivan R Feltham & William R Rauenbusch, "Directors' and Officers' Liabilities in Canada" (1976) 1:3 Can Bus LJ 321 at 326-28; *Peoples*, *supra* note 3 at para 59, citing: *Dovey and The Metropolitan Bank (of England and Wales), Limited v Cory*, [1901] AC 477, 7 WLJK 98 (UKHL); *In re Brazilian Rubber Plantations and Estates, Ltd*, [1911] 1 Ch 425, 11 WLJK 118 (Eng ChD); *In re City Equitable Fire Insurance Co*, [1925] 1 Ch 407, [1924] All ER Rep 485 (Eng CA).

Department Stores Inc (Trustee of) v Wise, the Supreme Court of Canada reviewed the history of the directors' duty of care.¹⁸ It described the common law standard for a director's duty of care as "a reasonably relaxed, subjective standard" considered an individual's skill, knowledge, and experience and only required directors not to be "grossly negligent."¹⁹

Canadian governments recognized the need for a more stringent duty of care for corporate directors in the late 1960s and early 1970s. In 1968, Ontario proposed corporate legislation that required directors to exercise the duty of care of a "reasonably prudent director."²⁰ Ivan R. Feltham and William R. Rauenbusch note that this proposed phrasing raised a director's duties to a professional director's level of care, skill, and diligence, creating a significantly higher standard.²¹ In 1970, a revised version of the statute modified that language to require the level of care of a "reasonably prudent person", lowering the standard to a reasonably prudent individual rather than a professional director.²²

In 1971, a Federal Task Force recommended raising the duty of care requirements for directors under federal corporate law on the basis that the common law standard was too lenient.²³ It produced

¹⁸ *Peoples*, *supra* note 3 at paras 59–64.

¹⁹ *Ibid* at para 59.

²⁰ See Ontario, Legislative Assembly, Select Committee on Company Law, "1967 Interim Report of the Select Committee on Company Law" (1967) (Chair: Allan F Lawrence); Feltham & Rauenbusch, *supra* note 17 at 321–22, 328–29.

²¹ Feltham & Rauenbusch, *supra* note 17.

²² See *Business Corporations Act*, RSO 1970, c 53, s 144.

²³ See Information Canada, *Proposals for a New Business Corporations Law for Canada: Volume I Commentary* by Robert WV Dickerson, John L Howard & Leon Getz, Monograph (Ottawa: Information Canada, 1971), online (pdf): [Government of Canada <publications.gc.ca/collections/collection_2011/ic/RG35-1-1971-I-eng.pdf>](https://publications.gc.ca/collections/collection_2011/ic/RG35-1-1971-I-eng.pdf) [*Proposals*]; Information Canada, *Proposals for New Business Corporations Law for Canada: Volume II Draft Canada Business Corporations Act*, by Robert WV Dickerson, John L Howard & Leon Getz, Monograph (Ottawa: Information Canada, 1971), online (PDF): [Government of Canada <publications.gc.ca/collections/collection_2011/ic/RG35-1-1971-II-eng.pdf>](https://publications.gc.ca/collections/collection_2011/ic/RG35-1-1971-II-eng.pdf).

the “Dickerson Report”, which advised that the standard should be that directors must exercise the care, diligence, and skill of a “reasonably prudent man.”²⁴ The Dickerson Report asserted that this phrasing raised the standard to the duty of care imposed on professionals, such as lawyers and surgeons.²⁵

Both the Ontario and federal business corporate statutes ultimately included an additional phrase that modified the duty of care required of directors. A director must “exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.”²⁶ Robert Flannigan argued that the phrase “comparable circumstances” was politically artful, as it satisfied both those wanting to raise the standard for directors and those seeking to maintain subjectivity.²⁷ The revised wording produced the political solution of “interpretive ambiguity.”²⁸ Rousseau and colleagues also discuss the varying interpretations of the statutory duty of care because of the inclusion of the expression “comparable circumstances.”²⁹ They note that some commentators argued that the statutory duty of care did not significantly change the common law standard, while others asserted that the statutory duty elevated directors' duty of care by adding an objective component.

The requirement that directors act as a reasonably prudent person in comparable circumstances is now included in tax and corporate statutes across Canada.³⁰ Yet “interpretative ambiguity”

²⁴ *Proposals*, *supra* note 23 at 83.

²⁵ *Ibid* at 83.

²⁶ *Canada Business Corporations Act*, RSC 1985, c C-44, s 122(1); *Business Corporations Act*, RSO 1990, c B16, s 134(1)(b) [*Business Corporations Act* (ON)]; *Peoples*, *supra* note 3 at para 62; Feltham & Rauenbusch, *supra* note 17 at 328.

²⁷ Robert Flannigan, “Reshaping the Duties of Directors” (2005) 84:2 Can Bar Rev 365 at 373–74. Iain Ramsay discusses similar legislative compromises in bankruptcy law: see Iain Ramsay, “Interest Groups and the Politics of Consumer Bankruptcy Reform in Canada” (2003) 53:4 UTLJ 379.

²⁸ See Flannigan, *supra* note 27 at 374.

²⁹ See Rousseau, Faure & Smaïli, *supra* note 7 at 448.

³⁰ See *Canada Business Corporations Act*, *supra* note 26, s 122(1)(b); *Business Corporations Act*, RSA 2000, c B-9, s 122(1)(b) [*Business Corporations Act*

remains as to which comparable circumstances should be considered in applying the due diligence standard.³¹

A. BEFORE *PEOPLES*: AN OBJECTIVE SUBJECTIVE STANDARD

Prior to the *Peoples* decision in 2004, the due diligence defence in tax was generally assessed on an “objective subjective” standard. The Federal Court of Appeal decision in *Soper v Canada* served as the leading decision.³² The Court relied on the common law history of the duty of care and the words “in comparable circumstances” to conclude that directors should be assessed differently depending on their knowledge, skill, and background, and the corporate context.³³

The Federal Court of Appeal in *Soper* stated that directors should not be treated as a “homogeneous group of professionals whose conduct is governed by a single, unchanging standard”.³⁴ Rather, the Court asserted that the standard of care “embraces a subjective element which takes into account the personal knowledge and background of the director, as well as his or her corporate circumstances.”³⁵ In other words, the capacity of the reasonably prudent person shifted based on the director’s “comparable circumstances”.³⁶ A person with greater skills or knowledge was evaluated at a higher level of expectation.

(AB)]; *Business Corporations Act*, SBC 2002, c 57, s 142(1)(b) [*Business Corporations Act* (BC)]; *The Corporations Act*, CCSM c C225, s 117(1)(b); *Business Corporations Act*, SNB 1981, c B-9.1, s 79(1)(b); *Corporations Act*, RSNL 1990, c C-36, s 203(1)(b); *Business Corporations Act*, SNWT 1996, c 19, s 123(1)(b); *Business Corporations Act* (ON), *supra* note 26, s 134(1)(b); *Business Corporations Act*, RSPEI 1988, c B-6.01, s 97(1)(b); *Business Corporations Act*, CQLR c S-31.1, s 119; *The Business Corporations Act*, RSS 1978, c B-10, s 117(1)(b); *Business Corporations Act*, RSY 2002, c 20, s 124(1)(b).

³¹ See Flannigan, *supra* note 27 at 374.

³² [1998] 1 FC 124, 149 DLR (4th) 297 (FCA) [*Soper*].

³³ See *ibid* at para 29.

³⁴ *Ibid* at para 29.

³⁵ *Ibid* at para 29.

³⁶ *Ibid* at para 30.

B. *PEOPLES*: AN OBJECTIVE STANDARD

In *Peoples*, the Supreme Court of Canada interpreted a director's duty of care under the *Canada Business Corporations Act*,³⁷ and described the due diligence standard as objective. It held that the words "in comparable circumstances" do not provide for a subjective component in assessing the director's competence.³⁸ Rather, the Court asserted that the standard allows courts to situate a director's decisions in their socioeconomic context.³⁹

The *Peoples* decision was hailed as a significant shift in directors' duty of care in Canada that would raise expectations for all corporate directors. Catherine Francis described the decision as "a major leap forward in recognizing the rights of creditors".⁴⁰ Lynn Campbell commented that *Peoples* raised the standard for good governance and "would put pressure on corporations to improve the quality of board decisions."⁴¹ After *Peoples*, it was understood that passive directors would not be spared liability due to their inaction and the subjective motivations of directors were not relevant in assessing a director's adherence to the duty of care.

C. *BUCKINGHAM*: THE OBJECTIVE STANDARD IN TAX LAW

In 2004, *Peoples* established that the objective standard applied to all statutes that use language requiring directors to exercise care, diligence, and skill.⁴² Rousseau and colleagues describe the different ways that tax law cases treated the *Peoples* decision in the initial years following the decision.⁴³ This included not

³⁷ RSC 1985, c C-44, *supra* note 26, s 122(1).

³⁸ *Peoples*, *supra* note 3 at para 62.

³⁹ *Ibid* at paras 62, 64.

⁴⁰ Catherine Francis, "*Peoples Department Stores Inc. v Wise*: The Expanded Scope of Directors' and Officers' Fiduciary Duties and Duties of Care" (2004–2005) 41 Can Bus LJ 175 at 183.

⁴¹ Campbell, *supra* note 7 at 467–68.

⁴² *Peoples*, *supra* note 3 at para 63.

⁴³ See Rousseau, Faure & Smaili, *supra* note 7 at 452, citing *Jarrold v Canada*, 2009 TCC 164 [Informal Procedure] at paras 24–26, *aff'd* 2010 FCA 278; *Lau*

acknowledging *Peoples* at all, finding that the Supreme Court of Canada simply renamed the due diligence standard, or concluding that *Peoples* eliminated the consideration of a director's personal characteristics.

Finally, in 2011, the Federal Court of Appeal explicitly addressed *Peoples* and confirmed that the Supreme Court of Canada decision also applied to tax law, making the due diligence defence under tax law an objective standard.⁴⁴ The Federal Court of Appeal found that the duty of care in corporate statutes is comparable to the language found in section 227.1(3) of the *Income Tax Act* and other tax statutes, except that under tax legislation, directors must have exercised the degree of care, diligence, and skill to *prevent the failure* to remit.⁴⁵

In rejecting the objective subjective standard from *Soper*, the Federal Court of Appeal stated that a director was no longer to be judged by the common law standard "according to his own personal skills, knowledge, abilities and capacities"⁴⁶ or subjective motivations, but by "the factual aspects of the circumstances surrounding the actions."⁴⁷ The Federal Court of Appeal went on to state, however, that the "particular circumstances" of a director remain relevant.⁴⁸

v R, 2007 TCC 718 [General Procedure] at para 34; *St-Yves v R*, 2008 TCC 549 [Informal Procedure] at para 16; *Hochhausen v R*, 2008 TCC 299 at para 19 [Informal Procedure]; *Madison v R*, 2011 TCC 201 [Informal Procedure] at para 67; *Elliott v R*, 2011 TCC 59 [Informal Procedure] at paras 40–41; *Nachar v R*, 2011 TCC 36 [General Procedure]; *Snively*, *supra* note 11; *Higgins v R*, 2007 TCC 469 [Informal Procedure] at para 9.

⁴⁴ See *Buckingham*, *supra* note 3 at para 37.

⁴⁵ Note that the legislation setting out the due diligence defence in tax statutes uses the phrase "prevent the failure". See *Income Tax Act*, *supra* note 1, s 227.1(3); *Excise Tax Act*, *supra* note 1, s 323(3); *Canada Pension Plan*, *supra* note 1, s 21.1; *Employment Insurance Act*, *supra* note 1, s 83(2). See Gray, *supra* note 7 at 292 (stating "the proper focus of a director's due diligence efforts must be to prevent the failure to remit. It is impermissible to allow a remittance failure in the hope or expectation that the delinquency can be cured later").

⁴⁶ *Buckingham*, *supra* note 3 at para 38, citing *Peoples*, *supra* note 3 at para 63.

⁴⁷ *Ibid* at para 38.

⁴⁸ *Ibid* at paras 38–39, citing *Peoples*, *supra* note 3 at para 63.

Similarly, *Peoples* asserted that the need to consider “comparable circumstances” in assessing a director’s due diligence was not about a director’s competence, but rather added a “contextual element” to the test. In the words of the Supreme Court of Canada:

the words “in comparable circumstances” . . . modif[y] the statutory standard by requiring the context in which a given decision was made to be taken into account. This is not the introduction of a subjective element relating to the competence of the director, but rather the introduction of a contextual element into the statutory standard of care.⁴⁹

Despite recognizing that the due diligence defence in tax law is an objective standard, questions remain about how the reasonably prudent person standard should be applied. The Courts in *Peoples* and *Buckingham* asserted that directors are no longer judged by their personal abilities and subjective motivations. Yet the Courts also stated that a director’s “particular circumstances”⁵⁰ and “prevailing socio-economic conditions”⁵¹ remain relevant. After *Peoples* and *Buckingham*, which comparable circumstances can a decision maker consider in assessing whether a director exercised the requisite care, diligence, and skill to prevent the corporation’s failure to deduct, remit, or pay? The following section looks to critical legal scholarship for lessons to inform the application of the due diligence defence in tax law.

III. CRITICAL LEGAL SCHOLARSHIP

Case law on the due diligence standard in tax law establishes that the inquiry into a director’s “comparable circumstances” should account for a director’s “particular circumstances” and consider what a reasonably prudent person would do in that context. But who is the reasonably prudent person, and how is their identity shaped by the director’s “particular circumstances” and the perspectives of the judiciary or other decision makers? The first

⁴⁹ *Peoples*, *supra* note 3 at para 62.

⁵⁰ *Buckingham*, *supra* note 3 at para 39.

⁵¹ *Peoples*, *supra* note 3 at para 64.

part of this section takes guidance from critical legal scholarship about the reasonably prudent person. It then looks to critical tax theory for further direction.

A. IDENTIFYING THE REASONABLY PRUDENT PERSON

The “reasonably prudent person” in tax stands alongside their reasonable peers in law, including perhaps their most famous colleague, the reasonable person in tort law.⁵² Decades of critical legal scholarship demonstrate that the reasonable person (and its precursor, the reasonable man) is not a neutral party.⁵³ Mayo Moran describes the reasonable person as “one of the law’s most ubiquitous creatures”.⁵⁴ Margo Schlanger argues that conceptualizing the reasonable person in personal injury law requires making important choices about that person’s characteristics.⁵⁵ The “reasonable person” carries assumptions about that person’s education level, business knowledge, economic background, gender, race, culture, ability, and sexual orientation. Moran asserts that “the rhetorical unity of the reasonable person may be dangerous.”⁵⁶ In tort law, Joanne

⁵² The concept of reasonableness is a recurring theme in tax legislation. Adlington reviewed the *Income Tax Act* for the word reasonable and its derivatives and found 1,219 references, and over 1,700 instances of cases interpreting those words. See Raymond G Adlington, “How Reasonable is Reasonable?” (2017) 14:5 Tax Hyperion 1 at 1–2.

⁵³ See e.g. Marvin Astrada & Scott Astrada, “Law, Continuity and Change: Revisiting the Reasonable Person within the Demographic, Sociocultural and Political Realities of the Twenty-First Century” (2017) 14:2 Rutgers LJ 196 [Astrada & Astrada, “Law”]; Moran, *supra* note 5; Schlanger, *supra* note 5; Joanne Conaghan, “Tort Law and the Feminist Critique of Reason” in Anne Bottomley, *Feminist Perspectives on the Foundational Subjects of Law*, 1st ed (London: Routledge-Cavendish, 1996) at 47; Scott Astrada & Marvin L Astrada, “The Enduring Problem of the Race-Blind Reasonable Person,” American Constitutional Society Expert Forum (11 May 2020), online: *American Constitution Society* <aclaw.org/expertforum/the-enduring-problem-of-the-race-blind-reasonable-person/>.

⁵⁴ Moran, *supra* note 5 at 1283.

⁵⁵ See Schlanger, *supra* note 5 at 769.

⁵⁶ Moran, *supra* note 5 at 1283.

Conaghan asks whether a universal standard is even possible or desirable.⁵⁷ Emily Kidd White discusses how emotions are called upon to guide the judicial application of legal doctrines in constitutional law.⁵⁸ In bankruptcy law, Anna Lund demonstrates how the emotional context can shape which facts a bankruptcy trustee considers when deciding whether to oppose debt relief.⁵⁹

In response to concerns about the false neutrality of the reasonable person, Marvin Astrada and Scott Astrada argue for the revision of the imagined reasonable person to reflect diverse sociocultural realities.⁶⁰ The Tax Court of Canada also acknowledged that the reasonable person standard is not objective, despite efforts to refine the test. In 1993, Chief Justice Bowman stated:

Attempts by courts to conjure up the hypothetical reasonable person have not always been an unqualified success. Tests have been developed, refined and repeated in order to give the process the appearance of rationality and objectivity but ultimately the judge deciding the matter must apply his own concepts of common sense and fairness.⁶¹

Tax case law on the due diligence defence shows judges doing exactly as Chief Justice Bowman described: using their own sense of fairness to assess whether a director acted as a reasonably prudent person. Our case law review below demonstrates that this judicial analysis continues to include reflections on a director's personal attributes and abilities, although to varying effect. Critical legal scholarship about the reasonable person supports the need to judge a director's actions in reference to a similarly situated reasonable person. The identity of that reasonable person must

⁵⁷ See Conaghan, *supra* note 53 at 50.

⁵⁸ See Emily Kidd White, "Replaying the Past: Roles for Emotion in Judicial Invocations of Legislative History, and Precedent" (2019) 9:5 *Oñati Socio-Legal Series* 577.

⁵⁹ See Anna Jane Samis Lund, *Trustees at Work: Financial Pressures, Emotional Labour, and Canadian Bankruptcy Law* (Vancouver, BC: UBC Press, 2019).

⁶⁰ See Astrada & Astrada, "Law", *supra* note 52.

⁶¹ *Cloutier v Minister of National Revenue*, [1993] 2 CTC 2038, 93 DTC 544 (TCC) at para 7.

shift to account for personal circumstances and socioeconomic factors.

B. CRITICAL TAX THEORY

Tax law is often presented as a technical discourse, but critical tax scholarship shows that it is not neutral.⁶² Scholarship helps reveal how tax policy may accidentally or deliberately benefit some people and marginalize or exclude others.⁶³ A critical analysis is necessary to ensure that tax law does not reflect and reinforce inequalities.

Cheyenne Neszo describes how the courts employed colonial stereotypes about Indigenous peoples when applying the “connecting factors test” to assess whether income was sufficiently connected to a reserve to qualify for the tax exemption under the *Indian Act*. As a result, Indigenous people’s access to the exemption has been limited.⁶⁴ Bradley Bryan tells the story of how First Nation governments spent decades navigating advance tax rulings and audits and reassessments by the Canada Revenue Agency as it assessed their eligibility under the “public body tax exemption” in paragraph 149(1)(c) of the *Income Tax Act*.⁶⁵ Bryan emphasizes that the story is not jurisprudential or legislative, but rather about First Nations’ interactions with the tax administrator, illustrating how the tax authorities can play a significant role in creating and maintaining systemic barriers.

⁶² See e.g. Lisa Philipps, “Discursive Deficits: A Feminist Perspective on the Power of Technical Knowledge in Fiscal Law and Policy” (1996) 11:1 CJSLS 141 [Philipps, “Discursive”].

⁶³ See e.g. Anthony C Infanti & Bridget J Crawford, eds, *Critical Tax Theory: An Introduction* (Cambridge: Cambridge University Press, 2009); Kim Brooks, “Critical Tax Theory: An Introduction”, Book Review of *Critical Tax Theory: An Introduction* by Anthony C Infanti & Bridget J Crawford, eds, (2010) 22:1 CJWL 281 at 281–88.

⁶⁴ See Cheyenne Neszo, “The Section 87 Tax Exemption as a Tax Expenditure” (2020) 4:1 Lakehead LJ 50.

⁶⁵ See Bradley Bryan, “Indigenous Peoples, Legal Bodies, and Personhood: Navigating the “Public Body” Exemption with Private Law Hybrid Entities” (2020) 6 CJCL 58.

Feminist scholars highlight how the tax system may contribute to gender inequality, including who gets taxed, what constitutes family income, and how the tax system recognizes unpaid care work.⁶⁶ Rebecca Johnson reveals how the discourse of personal choice around childcare obfuscates how gender, race, and class may limit a taxpayer's options.⁶⁷ Claire Young demonstrates that, even with many women now working outside the home, elderly women have less access to retirement tax subsidies due to ongoing employment barriers for women and the non-recognition of unpaid domestic and care work towards the accumulation of retirement savings.⁶⁸

Dorothy A. Brown shows how the benefits of the American tax system are disproportionately gained by white people, perpetuating the wealth gap between Black and white Americans.⁶⁹ Leo P. Martinez & Jennifer M. Martinez demonstrate that the tax system is not neutral for Latino people and that some of the differential treatment experienced is distinct from other

⁶⁶ See Kim Brooks et al, eds, *Challenging Gender Inequality in Tax Policy Making: Comparative Perspectives* (Oxford: Bloomsbury Publishing, 2011); Claire FL Young, "Child Care—A Taxing Issue?" (1994) 39 McGill LJ 539.

⁶⁷ See Rebecca Johnson, *Taxing Choices: The Intersection of Class, Gender, Parenthood, and the Law* (Vancouver: UBC Press, 2002). See also Lisa Philipps, "Taxing the Market Citizen: Fiscal Policy and Inequality in an Age of Privatization" (2000) 63:4 Law & Contemp Probs 111.

⁶⁸ See Claire Young, "Tax Policy, Theoretical Explorations, and Social Realities" (2003) 51:5 Can Tax J 1922. See also Siobhan Austen, Rhonda Sharp & Helen Hodgson, "Gender Impact Analysis and the Taxation of Retirement Savings in Australia" (2015) 30:4 Austl Tax Forum 763.

⁶⁹ See Dorothy A Brown, *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans and How We Can Fix It* (New York: Random House, 2021). See also Dorothy A Brown, "Race, Class, and Gender Essentialism in Tax Literature: The Joint Return" (1997) 54:4 Wash & Lee L Rev 1469; Beverly I Moran, "Exploring the Mysteries: Can We Ever Know Anything about Race and Tax?" (1998) 76:5 NCL Rev 1629; Dorothy A Brown, "Racial Equality in the Twenty-First Century: What's Tax Policy Got to Do with It" (1999) 21:759 U Ark Little Rock L Rev 759; Beverly Moran & Stephanie M Wildman, "Race and Wealth Disparity: The Role of Law and the Legal System" (2007) 34:4 Fordham Urb LJ 1219; Bekah Mandell, "Race and State-Level Earned Income Tax Credits: Another Case of Welfare Racism?" (2008) 10:1 Rutgers Race & L Rev 1.

racialized groups.⁷⁰ Mylinh Uy discusses the long history of the tax system's use as a tool to subordinate or exclude Asian people.⁷¹ In Canada, levies were imposed on Chinese immigrants and the argument that certain provisions of the Canadian tax system have a discriminatory effect on Chinese people has recently been litigated.⁷²

The tax system has also been a source of discrimination for LGBTQ2 people in Canada. When same-sex marriage was not yet legally recognized, tax scholars like Kathleen Lahey demonstrated how excluding same-sex spouses from the statutory definition of "spouse" limited gay and lesbian people's access to tax benefits.⁷³ Samuel Singer argues that trans medical expenses are held to a higher standard than other medical expenses to be eligible for tax relief.⁷⁴ Tamara Larre shows how the disability tax credit may

⁷⁰ See Leo P Martinez & Jennifer M Martinez, "The Internal Revenue Code and Latino Realities: A Critical Perspective" (2011) 22:3 U Fla JL & Pub Pol'y 377.

⁷¹ See Mylinh Uy, "Tax and Race: The Impact on Asian Americans" (2004) 11:1 Asian LJ 117.

⁷² While commonly referred to as the "Chinese head tax", the *Chinese Immigration Act*, 1885 imposed a levy on Chinese immigrants. See *An Act of Respecting and Regulating Chinese Immigration into Canada*, SC 1885 48-49 c 71 (Ottawa: Statutes of Canada, 1885). See e.g. Beverley Baines, "When is Past Discrimination Un/Constitutional? The Chinese Canadian Redress Case" (2002) 65 Sask L Rev 573; Lily Cho, "Rereading Chinese Head Tax Racism: Redress, Stereotype, and Antiracist Critical Practice" (2002) 75 Essays on Can Writing 62; Constance Backhouse, "Legal Discrimination Against the Chinese in Canada: The Historical Framework" in David Dyzenhaus & Mayo Moran, eds, *Calling Power to Account: Law, Reparations, and the Chinese Canadian Head Tax Case* (Toronto: University of Toronto Press, 2005) 24. See also *Li v British Columbia*, 2021 BCCA 256, where the appellants challenged the constitutionality of transfer taxes on purchasers of residential property who are a "foreign entity".

⁷³ See e.g. Kathleen A Lahey, "Tax Law and 'Equality': The Canadian Charter of Rights, Sex and Sexuality" (2000) 2000:4 Brit Tax Rev 378; Patricia A Cain, "Heterosexual Privilege and the Internal Revenue Code" (1999) 34:3 USF L Rev 465.

⁷⁴ See Samuel Singer, "Marginalizing Trans Medical Expenses: Line-Drawing Exercises in Tax" (2013) 31:2 Windsor YB Access Just 209.

perpetuate stereotypes about disabilities, with decision makers at times importing their assumptions in assessing eligibility.⁷⁵

Critical tax theory provides important lessons for applying the due diligence standard. Dorothy A. Brown asserts that there is a “myth that tax law is neutral and objective.”⁷⁶ To ignore a director’s personal and socioeconomic context is to assume a neutrality of experience between directors. The statutory due diligence test explicitly calls for reference to comparable circumstances. The tax authorities and the courts should apply a critical lens that accounts for differences between directors’ ability to exercise care, diligence, and skill.

Critical tax scholarship also helps shift our perspective when thinking of the government as a creditor. Shu-Yi Oei argues that non-collection or forgiveness of tax debts is a type of social insurance.⁷⁷ Corporations play a crucial role in withholding and remitting tax revenue from their customers, employees, and non-residents to the government. Directors’ liability helps maintain the tax system’s integrity by requiring directors to act to prevent failures to withhold and remit or face personal liability. Unlike other creditors, however, the government acts in the public interest and has broader social and economic goals. By including the statutory requirement to assess due diligence based on “comparable circumstances”, the legislature mandates the consideration of a broad scope of contextual circumstances that led to a failure to pay tax debts.

⁷⁵ See Tamara Larre, “The Disability Tax Credit: Exploring Attitudes, Perceptions, and Beliefs about Disability” (2018) 29 *JL & Soc Pol’y* 92.

⁷⁶ Brown, “Split Personalities”, *supra* note 6 at 91. Brown cites Caron, *supra* note 6, who coined the term “tax myopia”—a perception that tax law is different from other areas of the law and is an isolated and self-contained body of law. See also Paul L Caron, “Tax Myopia Meets Tax Hyperopia: The Unproven Case of Increased Judicial Deference to Revenue Rulings” (1996) 57:2 *Ohio St LJ* 637.

⁷⁷ See Shu-Yi Oei, “Who Wins When Uncle Sam Loses? Social Insurance and the Forgiveness of Tax Debts” (2012) 46:2 *UC Davis L Rev* 421.

IV. LESSONS FROM DIRECTORS' LIABILITY CASE LAW

This section presents the results of a study of directors' liability case law post-*Buckingham* that invoked a due diligence defence. The study reviewed all Tax Court of Canada and Federal Court of Appeal cases post-*Buckingham*, between May 2011 and August 2021. A total of 64 cases were reviewed.⁷⁸

The study adds to the existing literature in Canadian tax scholarship about directors' liability cases in tax law by focusing on cases that provide lessons about the need for a critical lens when assessing a director's due diligence.⁷⁹ The first section discusses cases that address a director's personal circumstances, including their education, prior experience as a director, level of knowledge about the responsibilities of directorship, and medical conditions. The second section addresses cases that consider a director's financial investment in the corporation. The third section considers cases in which a director relied on the actions or information provided by others, such as a business partner, an employee, or a spouse.

A. LEVEL OF KNOWLEDGE, EXPERIENCE, AND OTHER PERSONAL CIRCUMSTANCES

Buckingham held that directors are no longer judged according to their skills, knowledge, abilities, and capacities, based on the Supreme Court of Canada's decision in *Peoples*.⁸⁰ Yet, the case law

⁷⁸ Some decisions released shortly after *Buckingham* still relied on *Soper* and did not form part of our review. In canvassing and coding the case law, the authors used Taxnet Pro, Blue J Legal Predictive Tax and Employment Law Software ("Blue J Legal Tax Foresight"), and CanLII. Of the 64 cases reviewed, 48 addressed amounts under the *Excise Tax Act*, either solely or in addition to amounts under the *Income Tax Act*, *Employment Insurance Act*, and/or the *Canada Pension Plan*. From 2012–2020, the director was held duly diligent in 22% of the cases. The total number of cases and the success rates for these periods were calculated using Blue J Legal Tax Foresight on August 27, 2021. The percentages were rounded to the nearest whole number.

⁷⁹ For an academic article that provides a study of due diligence case law in tax law between 1994 and 2013, see Rousseau, Faure & Smaili, *supra* note 7.

⁸⁰ *Buckingham*, *supra* note 3 at para 38, citing *Peoples*, *supra* note 3 at para 63.

illustrates that courts continue to address these factors as part of their findings of fact. This section provides examples of cases which address personal factors and illustrates how the treatment of these factors is inconsistent.

In *Helgesen v R*,⁸¹ the facts included that the director was an “experienced businessman with a long history of business and property ownership” and that the director owned and operated several other businesses.⁸² Similarly, in *Doncaster v R*,⁸³ the facts included that the director was an intelligent person, had a computer science degree, and worked in the IT industry for many years. In *Whissell v R*,⁸⁴ the director put into evidence that he worked in the family’s business after completing high school. The director was 23 years old and worked as a labourer.⁸⁵ In *McKenzie v R*,⁸⁶ the Tax Court of Canada noted that the director had a high school education and six months of nursing studies. She worked at various administrative jobs, including as an administrative assistant at a bank.⁸⁷

In *Newhook v R*,⁸⁸ the decision began with the “factual context”, which included the director’s age, education level, and that he received a disability pension. It also noted that he had no experience with or knowledge of accounting.⁸⁹ In *Attia v R*,⁹⁰ the director suffered from severe depression, anxiety, and insomnia. Before his health issues, the corporation always met its tax obligations. While the Tax Court of Canada explicitly stated that the mental health of the director was not in itself a defence, the

⁸¹ 2016 TCC 114 [General Procedure], aff’d 2017 FCA 21.

⁸² *Ibid* at para 11.

⁸³ 2015 TCC 127 [Informal Procedure] at para 82.

⁸⁴ 2014 TCC 350 [General Procedure].

⁸⁵ See *ibid* at para 14.

⁸⁶ 2013 TCC 239 [General Procedure] at para 16 [*McKenzie*].

⁸⁷ See *ibid* at para 16.

⁸⁸ 2021 TCC 1 [Informal Procedure].

⁸⁹ See *ibid* at para 2.

⁹⁰ 2014 TCC 46 [General Procedure].

Court identified it as a factor to be considered when assessing the director's actions.⁹¹

Despite the establishment that the due diligence defence is an objective standard, the Tax Court of Canada continues to consider a director's general skill, knowledge, and experience. Kopstein et al discuss the difficulties of removing personal factors from the due diligence analysis, given the legislative text:

On the basis of the statutes' text alone, it would seem to be difficult to entirely strip out all personal factors. The statutes ask whether the director has exercised the degree of care, diligence, and skill to prevent the failure that a reasonably prudent person would have exercised "in comparable circumstances." Care and diligence are descriptions of behaviour; "skill," like knowledge and experience, is a personal attribute.⁹²

The statutory language itself likely drives the ongoing consideration of personal attributes, as it provides that directors will be judged on the care, diligence, and skill that they exercised. The level of skill that a director exercised, for example, is difficult to assess without reflecting on their prior work experience, educational background, or level of business knowledge.

While the courts have stated that a lack of knowledge of the risks or requirements of being a director does not absolve the individual,⁹³ this lack of knowledge may influence the outcome of a due diligence defence in some cases. In *Qian v R*,⁹⁴ the director was employed as an accountant before she was asked to become a director. She had been in Canada for less than four years, never served as a director before, lacked an understanding of what the position entailed, and possessed no previous business or management experience. Her duties at the company were limited to an accounting role. The Tax Court of Canada held that Ms. Qian was not liable. As part of its decision, the Court noted personal

⁹¹ See *ibid* at para 14.

⁹² Robert Kopstein et al, "Current Cases" (2015) 63:3 Can Tax J 751 at 777-78 [emphasis in original, footnotes omitted].

⁹³ *McKenzie*, *supra* note 86 at para 106.

⁹⁴ *Qian v R*, 2013 TCC 386 [General Procedure] [*Qian*].

factors that it considered relevant, including language and cultural barriers that she faced as a recent immigrant to Canada, and the fact that others took advantage of her.

In *Bourabaa v R*, the Tax Court of Canada referred to the statement in *Buckingham* that “contextual factors are part of an analysis of the objective standard.”⁹⁵ In coming to its decision that the director was duly diligent, the Court noted several factors, including that this was Bourabaa’s first experience as a director and officer,⁹⁶ that he was deceived by the other director, and that he lacked business experience.⁹⁷

Qian and *Bourabaa* should be distinguished from *McKenzie*, where notwithstanding that the director was found to be duly diligent, the director was held to a higher standard due to the nature of the business and its tax consequences.⁹⁸ In *McKenzie*, the director was the sole director, officer, employee, and shareholder of a motor vehicle dealership engaged in the business of buying and selling vehicles.¹⁰² The corporation was in an arrangement to sell vehicles to First Nations, which relied on an exemption from GST under the *Indian Act*. The Tax Court of Canada held that McKenzie was duly diligent but hesitated to come to that conclusion. It factored in her compliance with the Canada Revenue Agency’s administrative positions on the First Nations tax exemption but discussed whether reliance on those positions was sufficiently diligent.⁹⁹

The Tax Court of Canada in *McKenzie* appeared to require a heightened level of knowledge of the responsibilities and duties of a director where the underlying business involves more complex tax law—in this case, Indigenous tax issues. Tax law is one of the frontlines in Indigenous legal battles asserting treaty and sovereignty rights. Requiring directors of Indigenous businesses to

⁹⁵ *Bourabaa v R*, 2018 TCC 245 [Informal Procedure] at para 33 [*Bourabaa*].

⁹⁶ See *ibid* at para 36.

⁹⁷ See *ibid* at para 40.

⁹⁸ *McKenzie*, *supra* note 86.

¹⁰² See *ibid*.

⁹⁹ *McKenzie*, *supra* note 86 at paras 121–23.

proceed with added caution due to matters of taxation may create further inequities.

B. FINANCIAL INVESTMENT

A recurring theme in the case law post-*Buckingham* is evidence of a director's financial investment in the corporation, whether to try to cure deficiencies in remittances, or to invest in the corporation more generally.

In *Thistle v R*, the director was not involved in the management of the business and invested almost \$1,000,000 in the corporation.¹⁰⁰ While the contribution of funds was not explicitly stated as a factor, the Tax Court of Canada found that the director was duly diligent. The Court accepted that the director believed that the corporation was "asset rich and not in any financial difficulty" because the director advanced such a large amount of funds to the corporation.¹⁰¹

In *Bourabaa*, the director invested \$25,000 in the corporation, secured the obligations of a lease, and went without a salary for a full year.¹⁰² The director also had to take another job to continue to provide for his family. The Court noted the director's lack of experience as a board member and his financial sacrifices.¹⁰³ After reviewing the body of evidence, the Court concluded that the director was duly diligent.

In *Balthazard*, the Federal Court of Appeal stated that the appellant's "numerous additional capital contributions to support the corporation throughout the period of its financial difficulties" weighed in favour of the appellant.¹⁰⁴ The Federal Court of Appeal emphasized that although the financial contributions were relevant as part of the factual context of that case, personal

¹⁰⁰ See *Thistle v R*, 2015 TCC 149 [General Procedure].

¹⁰¹ *Ibid* at para 90.

¹⁰² See *Bourabaa*, *supra* note 95 at para 36.

¹⁰³ See *ibid*.

¹⁰⁴ *Balthazard v Canada*, 2011 FCA 331 at para 56 [*Balthazard*].

financial contributions to the corporation are not a requirement to establish a due diligence defence.¹⁰⁵

In *Ambs v R*, two directors liquidated their own assets, including vehicles, snowmobiles, boats, and other personal items, to pay creditors.¹⁰⁶ The directors also withdrew money from their registered retirement savings plans. Collectively, the directors contributed over \$300,000.¹⁰⁷ Most of the money raised by selling their personal assets was used to repay creditors other than the tax authorities.¹⁰⁸ The Court held that the directors were not duly diligent. Relying on *Balthazard*, the Court stated that financial contributions must be considered in the context of the due diligence defence.¹⁰⁹ While the Court acknowledged the directors' personal contributions, it found that the directors did not take steps to prevent the failure to remit source deductions and HST.¹¹⁰ The directors' financial investments were not used to cure deficiencies in tax remittances, and there was a pattern of the corporation using employee source deductions to pay other creditors.¹¹¹

While meeting the reasonably prudent person standard does not require financial contributions to the corporation, evidence of financial investment can help build a successful due diligence

¹⁰⁵ See *ibid* at para 59.

¹⁰⁶ See *Ambs v R*, 2020 TCC 62 [Informal Procedure].

¹⁰⁷ See *ibid* at para 18 (Robert Ambs contributed \$121,259.96 and James Ambs contributed \$196,110.47).

¹⁰⁸ See *ibid* at paras 19–24.

¹⁰⁹ See *ibid* at para 37.

¹¹⁰ See *ibid* at paras 44–45 (where the Tax Court of Canada, in acknowledging the significant personal contributions, suggested that costs should be limited to the amounts fixed by the Tariff and recommended that the Minister exercise her discretion in cancelling some or all the interest and penalties for which the directors were vicariously liable).

¹¹¹ See *ibid* at paras 41–43. See also *Ahmar v Canada*, 2020 FCA 65, as an example where the director injected his own money into the company, including maxing out his lines of credit at para 7. The Federal Court of Appeal upheld the Tax Court's decision that the director was not duly diligent, focusing on the fact that company funds were used to continue the company's activities rather than to correct the HST deficiencies.

defence.¹¹² Courts, as well as the decision makers at the Canada Revenue Agency and the public, may sympathize with directors who lose their own money. Yet some directors will not have the financial means to contribute financially to prevent a failure.

Historically marginalized groups have a documented lack of access to capital in Canada. Indigenous businesses face barriers due to institutional bias, a lack of a relationship with traditional banks, the inability to use assets to secure a loan for entrepreneurs living on reserves, and other factors.¹¹³ Female entrepreneurs seeking financing for small- and medium-sized businesses are rejected more frequently and receive less money than their male counterparts.¹¹⁴ A 2021 survey of Black women entrepreneurs in Canada found a lack of access to capital for non-profit and for-profit organizations.¹¹⁵ From an equity perspective, if financial contributions are a consideration in the due diligence defence, then a director's inability to contribute due to a lack of access to capital is also relevant.

C. RELIANCE ON OTHER INDIVIDUALS

The actions of a director generally hinge on their knowledge of corporate and financial circumstances. Under corporate law, directors may rely on information from certain individuals, including employees, officers, external advisors, and other

¹¹² See *Balthazard*, *supra* note 104 at para 59.

¹¹³ See Export Development Canada, "Focus on the Future: Building Trust with Canada's Indigenous Business Community" (19 June 2020), online (blog): *Export Development Canada* <edc.ca/en/blog/edc-indigenous-business-strategy.html>.

¹¹⁴ See Government of Canada, Innovation, Science and Economic Development Canada, News Release, "Increasing Access to Capital" (13 March 2019), online: *Government of Canada* <ised-isde.canada.ca/site/women-entrepreneurship-strategy/en/increasing-access-capital>.

¹¹⁵ Pitch Better Canada, "The First and Largest Market Study of Black Women Founders in Canada" (2021) *FoundHer Canada*, online: <foundhersca.wpcomstaging.com/>. See also Abacus Data, "Pan-Canadian Survey Finds Black Entrepreneurs Face Significant Barriers to Success" (26 May 2021), online: *Abacus Data* <abacusdata.ca/black-entrepreneurs-canada-inclusive-entrepreneurship/>.

directors in meeting their duties.¹¹⁶ There is no similar explicit allowance in tax law, but the Tax Court of Canada has recognized a distinction between access to corporate information for inside and outside directors.¹¹⁷ The need to rely on other individuals is particularly true for outside directors who obtain most information about the financial conditions of the business from inside directors or officers. The following cases demonstrate inconsistency about whether a director can rely on information from other individuals, including business partners, employees, and spouses. They also raise concerns about whether deceived parties should be held liable, particularly if they were more vulnerable due to their gender, culture, and economic position.

In *Bohbot-Gagnon v R*,¹¹⁸ the appellant, Ms. Bohbot-Gagnon, was the sole shareholder and director of a corporation which held a liquor license. She met two individuals, Mr. Descoteaux and his spouse, Ms. Clairoux, and agreed to work for them because she had been working limited hours and wanted to “take on a challenge and hope[d] for a higher salary.”¹¹⁹ Descoteaux and Clairoux asked to use Bohbot-Gagnon’s corporation as a nominee to access her

¹¹⁶ Under corporate law, a director can rely on third parties to meet the due diligence defence. See *Canada Business Corporations Act*, *supra* note 26, ss 123(4)–(5) (regarding financial statements provided by an officer or auditor, and reports by a professional person). See also *Business Corporations Act* (ON), *supra* note 26, s 135(4) (regarding financial statements and other reports); *Business Corporations Act* (BC), *supra* note 30, s 157(1); *Business Corporations Act*, (AB), *supra* note 30, s 123(3).

¹¹⁷ See *Buckingham v R*, 2010 TCC 247 at para 21; *McKenzie*, *supra* note 86; *Fengos v R*, 2014 TCC 253 at para 34 [Informal Procedure], citing *Wightman c Widdrington (Succession de)*, 2013 QCCA 1187 at paras 392–407. An inside director is involved in the day-to-day management of the corporation. An outside director has “superficial knowledge of and involvement in the affairs of the corporation”: see *Smith v Canada*, 2001 FCA 84 at para 12. See also Wayne D Gray, *Ontario Corporate Law and Practice* (Toronto: Thomson Reuters, 2021) (loose leaf updated 2021, release No 1) at 31:25, 31:42. An inside director will hold a management position in the company while an outside director does not. See *Western Potash Corporation v Amarillo Gold Corporation*, 2020 BCSC 17 at paras 8–9.

¹¹⁸ *Bohbot-Gagnon v R*, 2013 TCC 128 [General Procedure] [*Bohbot-Gagnon*].

¹¹⁹ *Ibid* at para 7.

corporation's liquor license. Descoteaux could not obtain a license due to his criminal record. Bohbot-Gagnon agreed after a meeting with Descoteaux's lawyer.¹²⁰

Bohbot-Gagnon's corporation used a management company for payroll connected to Descoteaux and Clairoux. Bohbot-Gagnon also showed the management company contracts to her accountant, "who gave . . . his blessing".¹²¹ Eventually, the corporation began to have remittance issues. In holding that the director was not duly diligent, the Court stated that Bohbot-Gagnon should have been "vigilant" given various red flags, including that one of the individuals had a criminal record.¹²²

In *Roitelman v R*,¹²³ the Tax Court of Canada held that the director was duly diligent. The director hired a bookkeeper, provided training, and supervised her work, including remittance obligations. Once the director became aware of a lapse in remittances, he increased supervision. After the bookkeeper ceased to be employed by the company, the director discovered hidden documents and remittance cheques that should have been forwarded to the Canada Revenue Agency. In its reasoning, the Court referred to *Buckingham* and stated that "although an objective test does not take into account a director's personal skills, experience, education or abilities, it does not mean that the personal circumstances of a director are irrelevant to the analysis."¹²⁴ The Court found that the bookkeeper acted fraudulently to deceive and erase financial information.¹²⁵

In *Constantin v R*, Ms. Constantin, the director, was unaware of the tax debts to the Canada Revenue Agency.¹²⁶ Ms. Constantin's spouse asked her to be the sole shareholder and director of the

¹²⁰ See *ibid* at para 10.

¹²¹ *Ibid* at para 11.

¹²² See *ibid* at para 43-44.

¹²³ 2014 TCC 139 [General Procedure].

¹²⁴ *Ibid* at para 28.

¹²⁵ See *ibid* at paras 15-16.

¹²⁶ See *Constantin v R*, 2012 TCC 425 [Informal Procedure].

company to share the risks and to protect the family's assets.¹²⁷ Evidence was presented that the spouse managed all aspects of the business. The spouse did not inform Constantin about the company's financial situation or that individuals were threatening and harassing him. The spouse also never informed Constantin that he was participating in a fraudulent scheme.

The Tax Court of Canada held that Constantin was not duly diligent, as she presented herself as president and director of the corporation but did not seek out information about the corporation's risks and obligations. It stated that a reasonably prudent person in comparable circumstances would have inquired about potential risks.¹²⁸ On appeal, the Federal Court of Appeal affirmed the decision of the Tax Court of Canada but expressed sympathy for Constantin. It referred to the Tax Court of Canada's statement that "[a] reasonably prudent person, who knew that there were bad debts, would not have asked only general questions."¹²⁹ Constantin had accompanied her spouse to cheque-cashing centres and personally agreed to indemnify one of the centres for cheques returned for insufficient funds. The Court found that Constantin could not have been unaware of the company's financial problems.¹³⁰

The extent to which directors can rely on those whom they believe are the most knowledgeable about the corporation is unclear. In the cases summarized above, the director relied on other individuals, whether a business partner, employee, or spouse. In *Bohbot-Gagnon*, the court found the appellant liable, with a party's criminal record cited as a red flag.¹³¹ Yet the appellant took both precautionary steps, including meeting with the other party's lawyer and having her accountant review the management contract. *Roitelman* and *Constantin* raise questions about which socioeconomic and personal circumstances should be

¹²⁷ *Ibid* at para 5.

¹²⁸ See *ibid* at para 38.

¹²⁹ *Ibid* at para 39.

¹³⁰ *Constantin v Canada*, 2013 FCA 233 at para 5, citing *Constantin v R*, *supra* note 126 at para 39.

¹³¹ See *Bohbot-Gagnon*, *supra* note 118 at para 44.

considered when determining what a director “ought” to have known in relying on another individual. In *Roitelman*, the Court found that the director was duly diligent even though he had warning signs about the bookkeeper sufficient to cause him to increase his supervision. In *Constantin*, the director had some knowledge of minor financial difficulties but did not know the extent of the corporation’s challenges, as her spouse managed all business matters. She was found liable.

In cases like *Constantin* and *Bohbot-Gagnon*, gender, cultural, and other socioeconomic factors may affect the dynamics of a professional or spousal relationship and the level of diligence that a person can exercise. The Tax Court of Canada has recognized that a director who could not act due to “psychological, economic and social control” may obtain relief under the due diligence defence.¹³² In *Labrecque v R*, the director’s business partner borrowed money from Mr. Lacroix, an individual involved in criminal activities.¹³³ The director received threats from Lacroix and his Hell’s Angels associates and had to effectively give up control of the corporation. The Court found him not liable because the intimidation he faced prevented him from acting.

Lynn Campbell expresses concern about the effect of an objective standard in the family context if it fails to consider family dynamics when assessing a director’s actions. Directors may be influenced by “an uncompromising patriarch” or “blind devotion to a son or daughter who controls the financial affairs of a business.”¹³⁴ Campbell asserts that “considerations of compassion, coercion, and the realities of family relations are ‘circumstances’ that could be perceived to affect the actions or lack thereof of the reasonable person.”¹³⁵ The statutory language of “comparable circumstances” allows decision makers to account for contextual factors. The due diligence standard should acknowledge that personal circumstances may limit a director’s ability to act.

¹³² See *Labrecque v R*, 2012 TCC 339 [Informal Procedure] at para 13.

¹³³ See *ibid*.

¹³⁴ Campbell, *supra* note 7 at 477.

¹³⁵ *Ibid* at 477–78.

V. *PENATE V R*: A CRITICAL LENS

After *Buckingham*, directors' liability case law shows how courts grapple with which circumstances should be considered when imagining a reasonably prudent person in comparable circumstances. The case law raises concerns about a shifting due diligence standard applied unevenly, assigning relevance to some personal and socioeconomic factors and not to others, potentially leading to inconsistent or inequitable treatment.

This section discusses *Penate v R*, a case in which the Tax Court of Canada created an important precedent by explicitly naming racism and sexism as relevant factors in assessing a director's due diligence.¹³⁶ *Penate* demonstrates that not only does case law provide for the consideration of socioeconomic circumstances and personal factors, but also that accounting for these contextual factors is imperative for the equitable application of the due diligence standard.

In *Penate*, the director was the sole shareholder of a roofing company. Ms. Penate described the impact of sexual harassment and racism on her business. Contractors refused to make payments for her completed work unless she provided "sexual favours ranging from a kiss, to a date, to a marriage proposal."¹³⁷ Penate described having to hire a white male estimator due to racism.

The Tax Court of Canada held that Penate was duly diligent and found that the corporation's failure to meet its GST/HST obligations resulted from the inability to collect funds due to sexual harassment and racism.¹³⁸ Penate prioritized remittances and directed available funds to remittances rather than into the business.¹³⁹ The Court held that the discrimination she faced constituted the type of "extraordinary circumstances" where a

¹³⁶ See *Penate*, *supra* note 4 (this case carries precedential value as it was heard and decided under the General Procedure of the Tax Court of Canada).

¹³⁷ *Ibid* at para 5.

¹³⁸ See *ibid* at para 20.

¹³⁹ See *ibid*.

director could be held to be duly diligent even when carrying on a business that was unlikely to meet its remittance requirements.¹⁴⁰

Some commentators have criticized *Penate* because the corporation did not employ tax remedies that would allow her to write off bad debts and avoid liability for tax amounts not collected.¹⁴¹ When considering a director's diligence, however, the requirement to consider "comparable circumstances" should include awareness of the challenges many Canadian taxpayers face in accessing affordable tax advice. Access to sophisticated tax advice may be unattainable for businesses already facing financial difficulties.

Alongside the case law reviewed earlier in this article, *Penate* provides another strong example of the need to account for personal circumstances and socioeconomic factors, including discrimination, when considering whether a director was duly diligent. If interpreted differently, the need for *Penate* to show that she acted "to prevent the failure" to remit could arguably require *Penate* to shut down her business earlier because discrimination made the corporation's accounts uncollectable and therefore likely to fail to meet its remittance obligations.¹⁴² This would be a poor result for Canadian society, where the federal government champions small businesses, applies a Gender-based Analysis Plus to policy, and implements an Anti-Racism Action Program to challenge racism and empower communities.¹⁴³

Directors' liability case law also raises concerns about the tax authorities' interpretation of the due diligence standard for

¹⁴⁰ See *ibid* at para 18.

¹⁴¹ See Stuart Clark & Robert G Kreklewetz, "The Extreme Edge: Directors' Due Diligence Under the ETA" (2020) 20:4 Tax for the Owner-Manager 8.

¹⁴² See *Income Tax Act*, *supra* note 1, s 227.1(3).

¹⁴³ See Canadian Heritage, "Building a Foundation for Change: Canada's Anti-Racism Strategy 2019-2022" (23 June 2021), online (pdf): *Government of Canada* <publications.gc.ca/collections/collection_2019/pch/CH37-4-29-2019-eng.pdf>; Employment and Social Development Canada, News Release, "Canadians Invited to Help Shape Canada's First Disability Inclusion Action Plan" (4 June 2021), online: *Government of Canada* <canada.ca/en/employment-social-development/news/2021/06/canadians-invited-to-help-shape-canadas-first-disability-inclusion-action-plan.html>.

directors. The Canada Revenue Agency decides the outcome of most directors' liability assessments, as very few cases are resolved in the courts. Tax authorities should widen their understanding of relevant circumstances so that cases like *Penate* are resolved without the need for appeal to the Tax Court of Canada. A broader understanding of relevant circumstances is essential given ongoing access to justice issues in tax law, with many taxpayers lacking access to legal counsel.¹⁴⁴

Penate conveys a clear message that the courts and the tax authorities cannot apply the law in a vacuum—void of socioeconomic factors and personal circumstances. The case should influence the factors that courts explicitly consider in directors' liability cases. A critical inquiry into a director's "comparable circumstances" should account for the "particular circumstances" of a director, which may include direct and systemic discrimination.

CONCLUSION

This article studied Canadian case law after *Buckingham*. Current jurisprudence demonstrates the importance of a critical analysis in the due diligence standard to ensure that tax law does not reflect, reinforce, or create inequalities. Tax statutes provide that the due diligence standard considers what a reasonably prudent person would do in "comparable circumstances".¹⁴⁵ The Supreme Court of Canada's decision in *Peoples* recognized that the statutory due diligence inquiry requires a "contextual approach".¹⁴⁶ Canadian tax law provides courts and the tax authorities with the ability to consider personal circumstances and socioeconomic factors, including the effects of discrimination.

Canadian society is increasingly recognizing the impact of discrimination and responding with more inclusive

¹⁴⁴ See André Gallant, "The Tax Court's Informal Procedure and Self-Represented Litigants: Problems and Solutions" (2005) 53:2 Can Tax J 333.

¹⁴⁵ See Raymond G Adlington, "How Reasonable is Reasonable" (2017) 14:6 Tax Hyperion 1 at 1–3.

¹⁴⁶ See *Peoples*, *supra* note 3 at para 64.

policymaking.¹⁴⁷ For example, in the corporate and securities context, some Canadian laws now require diversity disclosures on the make-up of their board membership and senior management.¹⁴⁸ In the budgeting context, the federal government requires reports on the gender and diversity impacts of current and proposed government expenditure programs.¹⁴⁹ Tax law must also reflect changing societal values. Critical legal scholarship teaches us that there is not one objective reasonable person, and tax law is not a neutral, technical discourse.¹⁵⁰ As a government policy instrument, tax law requires the tax authorities and the courts to use a critical lens when applying the due diligence standard.

¹⁴⁷ See Canadian Heritage, *supra* note 143; Employment and Social Development Canada, *supra* note 143.

¹⁴⁸ See e.g. *Canada Business Corporations Act*, *supra* note 26, s 172.1; Canadian Securities Administrators, CSA Multilateral Staff Notice 58-314, "Review of Disclosure Regarding Women on Boards and in Executive Officer Positions: Year 8 Report" (October 27, 2022) online (pdf): <securities-administrators.ca/wp-content/uploads/2022/10/sn_20221027_58-314_women-on-boards.pdf>.

¹⁴⁹ *Canadian Gender Budgeting Act*, SC 2018, c 27, s 314.

¹⁵⁰ See Philipps, "Discursive", *supra* note 62.