

Directors and Officers Beware: The Taxman may come calling...

New Legislation Increases the Risk of Personal Liability

by Kerri Rance

The Bermuda Government is currently owed more than \$27 million in unpaid taxes and a further \$2 million in outstanding pension payments. In an effort to recoup these taxes and to crack down on employers who fail to pay taxes and pension contributions the Government has proposed amendments to legislation which will make directors and officers of companies liable for outstanding sums of tax owed.

The following three Bills have been tabled to enforce these changes:

- Taxes Management Amendment Bill 2006;
- National Pensions Scheme (Occupational Pensions) Amendment Bill 2006; and
- Contributory Pensions Amendment Bill 2006.

The changes are particularly severe as they not only affect current directors and officers but have retroactive effect meaning that court proceedings may be taken against directors and officers for outstanding taxes owed while they were a director or officer, even if they no longer hold that position. The Limitation Act 1984 will however limit the retroactivity of proceedings to 20 years.

These changes make directors and officers jointly and severally liable which means that a single director or officer may be targeted to pay the outstanding taxes or pension contributions owed. In such case, he or she would then have a right of contribution against his or her fellow directors and officers of the company.

The Government has found it difficult to recover taxes owed in the past from limited liability companies that are liquidated before settling outstanding tax bills. These bold amendments will significantly strengthen

the Government's power to bring proceedings against debtors. No doubt, some will view these amendments as an infringement on the principle of limited liability and fear that people will now think twice before serving on a board of directors.

Of course, liability for directors is not a new issue. A director has always been subject to personal liability for his acts or those of the company where there has been a breach of his duties, in particular where he has:

- not acted honestly and in good faith with a view to the best interests of the company;
- used his power for the benefit of a third party or himself;
- not disclosed to the company his own interests in a material contract or a material interest in a person that is a party to a material contract;
- made a personal profit as a result of his position as a director;
- failed to exhibit a degree of care, diligence and skill that a reasonable prudent person would exercise in comparable circumstances; or
- entered into transaction beyond the company's powers, and a director has always been open to criminal liability under the general laws of theft and fraud.

However, directors and officers have generally been able to rely upon the company indemnifying them, in its bye-laws or by contract, in respect of any negligence, default, breach of duty or breach of trust by them in relation to the company (although not in the case where the director has acted dishonestly or has engaged in fraudulent activity). In reality, it is questionable in the case of liability for unpaid taxes and pension contributions whether such an indemnity

will have any real value as, in many cases, the likely reason why the company is in default of paying taxes or pension contributions is because it is in financial difficulty and is not able to do so.

It is questionable whether directors and officers will be able to challenge the retroactivity clause of these new laws in Court. Unlike the protection in respect of criminal liability afforded under the Bermuda Constitution Order 1968, where no person may be charged for a criminal offence that was not criminal at the time they committed the offence, there does not appear to be any such protection against civil liability.

These legislative changes mean that, going forward, it is imperative that directors and officers ensure that they avail themselves of all necessary financial information to ensure that the company is meeting its tax and pensions liabilities.

Notes

1. In this case, an officer does not mean a secretary of a company, but does mean a president and a vice-president or a chairman and a deputy chairman and such other officers who may or may not be directors.
2. This note is intended to provide general information about some recent and anticipated developments which may be of interest. It is not intended to be comprehensive nor to provide any specific legal advice and should not be acted or relied upon as doing so. Professional advice appropriate to the specific situation should always be obtained.