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# NEWSLETTER

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## THE DIRECTOR'S PERSONAL LIABILITY FOR A COMPANY'S FAILURE TO PAY TAXES

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In this harsh economic climate, it is possible that the level of tax compliance by companies may fall below average. Some companies may find it easier to keep tax dollars in their possession longer than usual as they contend with financial problems, such as difficulties with cash flow, low levels of sales and income, alongside increasing cost of operations and the unavailability of affordable credit.

Many persons would readily appreciate that a company found guilty of non-payment of taxes will be liable for the crime. Not as many persons appreciate that the directors of the company at the time (when the taxes were due but not paid) may also be personally liable. The penalties that delinquent directors may face include imprisonment and payment of a fine (which is sometimes double or treble the amount of taxes owing). Convicted directors may also be barred from holding the position of director or manager of regulated institutions on the basis that they do not meet the "fit and proper" person criteria.

Legislation governing payment of income tax, National Insurance Fund contributions, National Housing Trust contributions, Education tax and H.E.A.R.T. contributions all require that the company appoint a responsible officer for the purpose of ensuring that the company's obligations under the law are carried out. If no appointment is made, the managing director or person in charge of the company's affairs shall be deemed to be the responsible officer. The responsible officer should also ensure that payments are made within the deadlines stipulated by the law. The responsible officer shall be personally liable (along with the company) for any failure or neglect to carry out his or her duties.

If, however, the responsible offer is able to prove that he was prevented from carrying out his duty because of being overruled or otherwise prevented by the board of directors, the directors shall be personally liable (jointly and separately) for the unpaid taxes or contributions and any penalties due. Directors may defend themselves against a claim of this nature by proving that "there were *bona fide* reasons for overruling the responsible officer or preventing payment and that the payment could not have been made in the circumstances; or that the particular director was neither a party to the decision of the board to overrule the responsible officer nor a party to any action by the board or any other director to prevent payment."

The legislations governing National Insurance Fund contributions, National Housing Trust contributions and H.E.A.R.T. contributions generally provide that directors are personally liable (jointly and separately) if the directors knew or ought to have known of the failure to pay over the outstanding contributions. The responsibility imposed by these provisions are more far reaching than the liability created where a responsible officer is prevented by directors from making the payment. A director may be liable if he is simply aware of the failure or neglect or did not exercise all due diligence to prevent the commission of the offence, whether or not he took any active steps in preventing the payment.

*The General Consumption Tax Act* imposes liability for failure to collect and pay over GCT on directors involved in the management of the business, as well as other managers (who are not directors). Therefore, non-executive directors are not liable for non-payment of GCT. This is to be contrasted with the other laws (discussed above) which impose liability on all directors, both executive and non-executive. Where a company fails to pay over GCT collected or fails to collect GCT as it ought, the managing director, manager or other officer concerned in the management of the company shall be deemed liable. The defences available to these managers are that the offence was committed without his knowledge, consent or connivance, or that he exercised all due diligence to prevent the commission of the offence.

While directors may try to ensure that they are indemnified by their companies for liabilities which the directors may face for their struggling companies' failure to pay taxes in a timely manner, in some cases this remedy will not be adequate because of the long term effect it may have on directors' reputations and professional careers.

# Due Diligence Prior to the Purchase of a Business

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In deciding whether to purchase a business, and before signing the purchase agreement, the buyer should get as much detailed information as he possibly can about the business. This information gathering exercise is commonly referred to as "due diligence". In the limited situations where there is insufficient time to undertake the due diligence before signing the contract, the buyer will need to make sure that the representations given by the seller concerning the business are comprehensive. Further, he should ensure that the relevant acquisition agreements allow him to either terminate the arrangement or adjust the purchase price proportionately in the event that the subsequent due diligence unveils an unsatisfactory situation.

The stage at which a purchaser decides to involve attorneys will depend on the acquisition in question, and will usually be influenced by factors such as size, value, timing, complexity and perceived importance of the transaction. Regardless of when this happens, the need to align the objectives of the client and his attorneys (and other professionals as appropriate) is sometimes underestimated. The client and his attorneys should work closely together throughout the transaction, with the client ensuring that he understands and is satisfied with the deal he is about to make, and the attorneys doing their best to ensure that the client gets precisely what he has bargained for.

Conducting detailed due diligence will assist the buyer to avoid the following problems:

- paying a price in excess of the real worth of the business;
- bad financial decisions;
- bad management decisions; and
- pending law suits and contingent liabilities.

A thorough due diligence exercise should generally involve an examination by the buyer of the following areas of the business being purchased;

- **Corporate Standing** Conducting a comprehensive search at the Companies Office to ascertain matters such as the shareholders, directors and whether there are outstanding charges on the company's assets.
- **Personnel** Reviewing employees' skills, experience, wages and benefits, payroll procedures, terms of contracts, and other relevant human resource issues.
- **Financial Operations** Examining company's books and records, as well as accounting and bookkeeping methods. Analysis of cash flows, both present and projected, as well as detailed review of accounts receivables. Consideration of debt and bank or other lender relations.
- **Marketing** Examining the advertising campaigns and public relations programmes (if any) and analysing of marketing and sales strategies and compare with how competitors market and advertise their products.
- **Property and Equipment** Review all appropriate documents of title, leases and/or deeds, encumbrances and liens over property, and other restrictions. Conduct appraisals for all equipment and assets. Consider depreciation in property and equipment values.
- **Intellectual Property** Investigate the ownership of trade marks, brands and trade secrets used in the business, strategies for protecting brands and trade secrets from infringement, the value of goodwill associated with the business, and the value of any research and development.
- **Business Operations** Consider location, inventories, vendors, suppliers, management, customer relations, insurance policies, and any other topics specifically related to the business you are considering buying.

Attorneys acting for purchasers often specifically require that the sellers provide information to confirm, among other things, ownership of assets, compliance with legal obligations and regulations, taxation obligations or liabilities relevant to the business. The information gleaned from this "legal due diligence" enables the attorneys to decide what, if any protections must be built into the purchase agreement, and ultimately whether the buyer should proceed with the acquisition.

It is good practice to use a due diligence checklist to help focus the information gathering exercise. Although some checklists may be tailored or more suitable to particular businesses, all checklists are designed with the same intention, namely, obtaining for the proposed buyer the information necessary to make a prudent business decision.

## RESOLVING YOUR TRADE DISPUTES WITHIN CARICOM

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The Revised Treaty of Chaguaramas ("the Treaty") enhances trade within the Caribbean Community through the lessening of intra regional trade barriers. However, concerns regarding the entry of goods into other Caribbean states have made it clear that manufacturers need to be knowledgeable of the dispute resolution mechanisms available and how to implement them. The Treaty emphasises alternative dispute resolution methods such as good offices (the use of a third party state to resolve disputes between contracting states), consultation, mediation, negotiation, conciliation and arbitration. In addition, the CARICOM Competition Commission may be called upon to investigate anti-competitive business conduct. However, the Treaty contemplates that these mechanisms will be used by states. Therefore, private entities must first complain to their state and request that a dispute resolution mechanism be undertaken.

While it is not surprising that a legal system requiring multilateral cooperation would desire the use of alternative methods to resolve trade disputes, private entities may require direct redress. Such direct redress is available to CARICOM nationals, including Jamaicans, from the Caribbean Court of Justice ("CCJ") acting in its original jurisdiction (that is adjudicating matters pertaining to the Treaty) notwithstanding that the CCJ is not Jamaica's final appellate court.

This avenue was used by a private entity in the recent case of *Trinidad Cement Limited ("TCL") and TCL Guyana Limited ("TGI") v. the Cooperative Republic of the State of Guyana ("Guyana")* before the CCJ. In this case, an action was brought against the state regarding the suspension of the Common External Tariff ("CET") on non-regional cement without an application for a waiver to the Council for Trade and Economic Development ("COTED"). Before hearing the substantive matter, the CCJ had to determine whether the applicants had satisfied the requirements entitling them to special leave to bring the action.

Article 222 of the Treaty stipulates that individuals or companies may bring an action before the Court (in its original jurisdiction) where:

a. *"The Court has determined…that a right or benefit conferred by or under this Treaty on a State shall enure to the benefit of such persons directly; and*

b. *The persons concerned have established that such persons have been prejudiced in the enjoyment of the right or benefit mentioned in paragraph (a) of this Article; and*

c. *The State entitled to espouse the claim in proceedings before the Court has:*

   i. *omitted or declined to espouse the claim; or*

   ii. *expressly agreed that the persons concerned may espouse the claim instead of the State so entitled; and*

d. *The Court has found that the interest of justice requires that the persons be allowed to espouse the claim."*

The CCJ noted that a company incorporated or registered in a state fell within the category of *"persons, natural or juridical, of a State"*. Therefore, even a non-CARICOM company which is registered as an overseas company within a state may approach the CCJ. In this case, one applicant was incorporated in Trinidad and Tobago and registered in Guyana while the other was incorporated in Guyana.

The Court further found that the obligation of states, in respect of the CET, enured to the benefit of individuals and that a failure to fulfil obligation under the CET is of potential prejudice to all.

The CCJ decided that where a private entity wishes to bring an action against its own state, it need not show that this state has declined or omitted to bring the action on its behalf since a state would not bring an action against itself. In such circumstances, the question to be answered is whether or not the applicant can bring proceedings against its own state. However, the Court found that it would be discriminatory, on the grounds of nationality, if a private entity could not bring an action against his own state. Ultimately, the Court in *TCL v Guyana* granted the applicants special leave to make the claim.

This case underscores the threshold which must be reached for private entities to access the CCJ but also illustrates that direct action is a viable avenue for manufacturers. Indeed, the appropriate use of the dispute resolution mechanisms under the Treaty may lead to better trade alliances within CARICOM.

## NEGOTIATING OUT OF A BY-ELECTION?

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There has been much talk by commentators in the news recently that our two main political parties should sit at the bargaining table and spare the country the cost of holding by elections. The basic gist of this argument is that it is up to the political parties to decide whether they can prevent the constituents of the vacated seats from having to go back to the polls. The question therefore is: Can the two main political parties 'negotiate' out of the holding of a poll?

In Jamaica, persons may be elected as Members of the House of Representatives of Parliament ('MPs') in one of two ways:

- Election via the holding of a poll of registered electors (voters) where more than one candidate has been duly nominated to run for the seat; or
- Election by acclamation where only one candidate has been duly nominated in a constituency.

The issue of which of these two modes should be used has become a very live issue for the Jamaican people given the recent decisions of the Courts which have held that at least three sitting MPs (Daryl Vaz, Gregory Mair and Michael Stern) were not qualified to be elected. The Courts found that these persons had sworn an oath or were under an allegiance to a non-Commonwealth country in violation of the Constitution. The courts, after holding the MPs to be unqualified by the terms of the Constitution, ruled that vacancies had arisen in each of the seats which must be filled constitutionally by the holding of a by-election.

It was argued before the court in the case of *Dabdoub v Vaz* by counsel for the unsuccessful candidate (Mr. Dabdoub) in the 2007 General Elections, that Mr. Dabdoub should be returned by acclamation. The reason for this argument was based on the principle enunciated in *Drinkwater v Deakin*, in which it was held that where registered voters were notified that a candidate was not qualified on Nomination Day and nevertheless voted for him, those voters were held to have thrown away their votes. The local courts recognised this principle but found on the particular facts of *Dabdoub v Vaz* that sufficient notice was not given. This finding was largely based on the part that the then Director of Elections certified the candidates as duly nominated.

However, any discussion on whether or not to hold a poll must consider that a party cannot legally deter any duly qualified person from offering himself as a candidate. The discussions and the "agreement" may, therefore, be futile.

It is, however, conceivable that the two main political parties, being the only parties currently represented in the Parliament, may also lawfully agree to amend the Constitution to allow for forfeiture of a by-election and return by acclamation.

## TAXES GENERALLY PAYABLE BY COMPANIES

Companies doing business in Jamaica are generally required to pay the following taxes and contributions to various government agencies:

(i) Income tax at the rate of 33 1/3% on business profits;

(ii) Income tax withheld from payments made to persons liable to pay income tax in Jamaica and for which the law requires that the payer withhold the tax. Tax is usually withheld from employees, customers of banks and financial institutions that make interest payments, companies paying over income earned in Jamaica by overseas individuals and corporations, and local companies making dividend payments to overseas individuals and corporations.

(iii) General Consumption Tax ("GCT") at the rate of 16.5% for most businesses with sales in excess of three million dollars ($3,000,000) per annum. (There are special rates for specified business activities, such as hotel services, telecommunications services and importation of motor vehicles).

(iv) National Insurance Fund contributions at the rate of 2 ½% to be withheld from the salaries of employees. (National Insurance contributions are payable on salary not exceeding $500,000 per annum for most employees). The employer is required to pay a matching 2 ½% contribution. Therefore, companies who are employers are required to remit to the National Insurance Fund a total of 5% of the salary (up to $500,000 per annum) of each employee.

(v) Education Tax at the rate of 2% to be withheld from the salary of employees. The employer is required to pay a tax of 3% of the salary of each employee.

(vi) National Housing Trust contributions at the same rates as the Education Tax.

(vii) Contributions to the Human Resource and Employment Training (H.E.A.R.T.) Fund at the rate of 3% of the emoluments paid to employees. No deduction is to be made from employees' salaries for this contribution.

Returns in respect of all these taxes (excepting income tax, as stated at (i) above) are to be filed on a monthly basis and the payments due are to be remitted to the government. Income tax returns are generally filed annually. Failure to file tax returns and pay the taxes due are generally criminal offences, and expose the company to liability or suit for the debt.

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