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#### PADGETT BUSINESS SERVICES®

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### This Month:

- GST/HST on settling a business dispute
  - Corporate Directors' Liability

## GST/HST on settling a business dispute

If you own or manage a business, you occasionally end up in disputes with customers or suppliers over the terms of a contract or payment. Sometimes these disputes are referred to lawyers, and sometimes they end up in court.

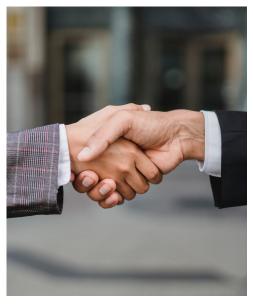
Regardless of how far the dispute goes until it's settled, you should know about the GST or HST consequences of any settlement or damage award.

A settlement or award for breach of contract will normally be considered tax-included if the following conditions are met:

- The payment is made by the "recipient" to the "supplier". That is, it is the purchaser, lessee or customer who is making the payment, and the vendor, lessor or supplier who is receiving it. (In other words, money is flowing in the same direction as it would have flowed under the contract.)
- The payment is for breach, termination or modification of a contract or agreement. (It need not be a written contract; an oral agreement is still a contract.)
- GST or HST was payable, or would have been payable, under the contract, if it had been fulfilled as planned.

In these circumstances, any settlement amount is normally deemed by the Excise Tax Act to be a total that already includes GST or HST.

The supplier (vendor, lessor) must carve out a fraction of the total and remit it to the Canada Revenue Agency as GST or HST. The fraction depends on the province. If your customer is in Ontario, for example, where the HST rate is 13%, the fraction is 13/113ths, or just over 11.5%. In the western provinces and the territories, where the GST rate is 5%, the fraction is 5/105ths.



The recipient (purchaser, lessee) can claim an input tax credit and recover the same amount from the CRA, provided the recipient would have been able to claim the credit if the amount had been paid under the contract.

The same rule applies to an amount that is kept as a forfeited deposit.

So, whenever you settle a commercial dispute, whether by litigation or otherwise, make sure to increase the settlement amount by the appropriate GST, HST and/or QST, so that the tax is available to be remitted to the government without carving into the settlement you are expecting as compensation.

Note that these rules do not apply to payments by a supplier — e.g. payment by a landlord to cancel a tenant's lease early. They also do not apply to payments that are not related to a contract — for example, payments for damage caused by negligence, such as

where someone with whom you have no contractual relationship damages your business's property.

If your dispute is being handled by a lawyer, do not assume that your lawyer is taking care of this issue. Civil litigation lawyers are usually not tax experts, and many of them are not aware of this rule.

## Corporate Directors' Liability

If a corporation (including a for-profit or non-profit corporation) fails to deduct, withhold, remit or pay amounts held in trust for the Receiver General for Canada (CPP, EI and GST/HST), the directors of the corporation at the time may be held personally liable along with the corporation to pay the amount due. This amount includes penalties and interest.

Where the directors take appropriate steps to ensure the corporation makes the necessary deductions or remittances, Canada Revenue Agency will not hold the directors personally responsible.



# PADGETT BUSINESS SERVICES WHERE YOUR SUCCESS TAKES ROOT



Padgett Business Services is dedicated to meeting the tax, government compliance, profit & financial reporting and payroll needs of businesses with fewer than 20 employees in the retail and service sector of the economy. This publication suggests general business planning concepts that may be appropriate in certain situations. It is designed to provide complete and accurate information to the reader. However, because of the complexities of the tax law and the necessity of determining whether the material discussed herein is appropriate to your business, it is important you seek advice from your Padgett office before implementing any of the concepts suggested in this newsletter.