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## PRIORITY OF CROWN CLAIMS IN INSOLVENCY

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### Introduction

This text is designed to aid the practitioner in remaining current with the nature of the law of Crown Claims in the various processes of insolvency. Resolving priorities between contractual personal property security transactions and statutory Crown security interests means navigating numerous legislative provisions, wrestling with conflicting case law, and balancing bankruptcy and insolvency law, *Bank Act* security, the *Income Tax Act*, the *Excise Tax Act* and federal/provincial jurisdictions. This text provides: a thorough overview of the general principles applicable to the priority of statutory Crown claims; the constantly evolving rules governing statutory priorities including those resulting from interplay of the *Bankruptcy and Insolvency Act*, the *Bank Act*, the *Income Tax Act* and the *Excise Tax Act*; an in-depth analysis of Crown security interests, such as deemed statutory trusts, statutory liens, super priority and enhanced garnishment orders and an examination of the impact of the *Companies' Creditors Arrangement Act* (CCAA) on the other legislative regimes.

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This release includes updates to Appendix IF. Issues in Focus.

## Highlights

• **Does an assignment secure payment or performance of an obligation (thus falling within the definition of “security interest” under s. 224(1.3) of the Income Tax Act)?** Section 224(1.2) of the federal *Income Tax Act* (ITA) is a garnishment provision which enables the government to recover monies from those who ought to have remitted income tax deductions and GST collections. It allows the government to intercept monies owed to tax debtors. “Security interest” is defined under s. 224(1.3) of the *ITA* as:

any interest in, or for civil law any right in, property that secures payment or performance of an obligation and includes an interest, or for civil law a right, created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for;

Cory J., writing for the majority of the Supreme Court of Canada (SCC) in *Canada Trustco Mortgage Corp. v. Port O’Call Hotel Inc.*, held that a general assignment of book debts (GABD) was a security interest within the meaning of the *ITA* because it was a form of security for a loan which was subject to the redemption right of a debtor. This was contrasted with an absolute assignment, which transfers ownership of the property without condition or encumbrance. Cory J. made it clear that was impossible for the same instrument to be both a security interest and an absolute assignment, as these are conflicting concepts. If an instrument is an absolute assignment, it falls outside the scope of s. 224 of the *ITA*. Whether an assignment is absolute or a security interest is a question of fact.

• **Does the right to retain payment of an obligation under section 2123 of the *Civil Code of Québec* constitute a “security interest” as defined in section 123 of the *Excise Tax Act* (which is identical in wording to the same definition in section 224(1.3) of the *Income Tax Act*)?** “Security interest” is defined broadly under s. 224(1.3) of the *Income Tax Act* (ITA) and s. 123(1) of the *Excise Tax Act* (ETA) to include any interest in property which is created with the purpose of securing payment or performance of an obligation. Section 2123 of the *Civil Code of Québec* (CCQ) provides a right to retain payment of an obligation. The right of retention, which has been defined as “an interest in property granted by statute to secure the performance of an obligation”, clearly falls within the scope of a security interest.

• **Does the bankruptcy of a tax debtor, render the deemed trust pursuant to s. 222 (1) (3) of the *Excise Tax Act* ineffective as against a secured creditor who received proceeds from assets of the tax debtor prior to bankruptcy, which assets were deemed to be held in trust for the Crown?** Pursuant to the Supreme Court of Canada’s decision in *Callidus Capital Corp. v. Canada*, 2018 SCC 47 (*Callidus SCC*), the bankruptcy of a tax debtor following payment of proceeds of the sale of property to a secured creditor extinguishes the deemed trust created by s. 222(1)(3) of the *Excise Tax Act*, R.S.C. 1985, c.E-15 (ETA). The secured creditor is not obligated to remit the amounts deemed to be held in trust for the Crown by the tax debtor, which were not remitted by the tax debtor to the Crown and which were paid to the secured creditor, out of priority, prior to the tax debtor’s assignment in bankruptcy.