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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 and amendments to Chapter 1 General Principles; Chapter 2 (Deemed Statutory Trusts in Non-Bankruptcy Realizations); Chapter 3 (Statutory Liens and Enhanced Garnishment Orders in Non-Bankruptcy Realizations); Chapter 4 (Priority Disputes in Bankruptcy and Under the Company Creditors' Arrangement Act); Chapter 6 (Summary of Priority Findings and Considerations for Law Reform) and, Words and Phrases.

Highlights

Deemed Trust Provisions – ITA ss. 222 and 227 - Application to Unsecured Creditor - *Bona fide* Purchaser for Value Defence - The debtor operated a restaurant between June 2000 and October 2015, when it ceased operating and was sold as an unrelated third party for $100,000.00, During 2013, 2014 and 2015 the debtor withheld but failed to remit $74,518.17 in prescribed amounts under Income Tax Act (ITA), Canada Pension Plan Act, Employment Insurance Act to Canada Revenue Agency, $36,250.86 of which were subject to a deemed trust in favour of Crown pursuant to ss. 222 and 227 of ITA. The Bank provided banking services to debtor and its Director, and debtor incurred overdrafts on corporate account until account was closed, making the bank an unsecured creditor of the debtor. The CRA notified bank of its claim to $36,250.86 on January 8, 2018 and the bank did not pay Crown. The Crown brought an action against the bank relating to proceeds the bank had received from the debtor after the debtor failed to remit payroll deductions to the Crown. The parties proposed two questions to be determined under R. 220 of Federal Court Rules relating to deemed trust provisions in s. 227. The first question was whether deemed trust provisions applied to unsecured creditors, and the second question was whether unsecured creditors could rely on the bona fide purchaser for value defence to defend against a deemed trust claim. The court's answer to the first question was yes and its answer to second question was no. The court observed that if an unsecured creditor and the Crown were both claimants against a debtor that continued to hold particular property, the Crown would prevail in a priorities dispute and, in that sense, the deemed trust provisions apply to unsecured creditors. In the scenario where a tax debtor voluntarily sells its property that was subject to the deemed trust and pays the proceeds of that sale to an unsecured creditor, the deemed trust provisions apply to the unsecured creditor, as the statutory obligation requires it to pay those proceeds to the Crown. The court's conclusion on second question as to whether the availability of the bona fide purchaser for value defence when defending against a deemed trust claim was inconsistent with the legislative intent. It found that it was, saying at para 88:

> 88 As noted above . . . TD Bank FCA [Toronto-Dominion Bank v. Canada 2020 CAF 80, 2020 FCA 80, 2020 CarswellNat 1443, 2020 CarswellNat 2345, [2020] G.S.T.C. 16, 12 P.P.S.A.C. (4th) 27, 2020 D.T.C. 5042, 317 A.C.W.S. (3d) 698, 4 B.L.R. (6th) 1, 78 C.B.R. (6th) 104] at paragraph 40 describes the purpose of the deemed trust provision as the collection of unremitted tax. The Federal Court of Appeal states that this purpose is effected by granting priority to the deemed trust in respect of property that is also subject to a security interest. That purposive analysis recognizes Parliament's intention to afford the Crown priority access to the value of the tax debtor's assets, notwithstanding the existence of a security interest. However, the analysis is not dependent on the existence of the security

> interest. Rather, it applies despite the existence of a security interest. Applied now to the second Rule 220 question, it would be inconsistent with Parliament's intent in enacting the deemed trust provisions to afford unsecured creditors recourse to the bona fide purchaser defence.

The Court acknowledged that this conclusion was inconsistent with the observations made with respect to unsecured creditors in *Canada v. Toronto-Dominion Bank* 2018 FC 538, 2018 CF 538, 2018 CarswellNat 2787, 2018 CarswellNat 3406, [2018] G.S.T.C. 54, 293 A.C.W.S. (3d) 433, 60 C.B.R. (6th) 173, 8 P.P.S.A.C. (4th) 26, where, after concluding that the bona fide purchaser for value defence was not available to secured creditors, Justice Grammond added at paragraph 47 that the defence remained available to unsecured creditors, such as suppliers, landlords or public utilities, who receive payments from a tax debtor, as denying the defence in those cases would have a general chilling effect on commercial transactions of the sort described in *First Vancouver Finance v. Minister of National Revenue* 2002 SCC 49, 2002 CarswellSask 317, 2002 CarswellSask 318, [2002] 2 S.C.R. 720, [2002] 3 C.T.C. 285, [2002] G.S.T.C. 23, [2003] 1 W.W.R. 1, 2002 D.T.C. 6998 (Eng.), 2002 D.T.C. 7007 (Fr.), 212 D.L.R. (4th) 615, 288 N.R. 347, 45 C.B.R. (4th) 213, J.E. 2002-960, REJB 2002-28499 (at para 44) . Justice Grammond also queried however, (at para 51) why Parliament would single out secured creditors in the deemed trust provisions. Although expressing that it might appear absurd to allow unsecured creditors to claim the *bona fide* purchaser defence, when secured creditors could not, Justice Grammond reasoned that this may have been a rational decision for Parliament to make, as security interests by their nature provide debtors with a very strong inducement to pay their secured creditors (at para 52). In the court's view these observations were clearly *obiter*, as the factual matrix of that case involved a secured creditor only, and the comments related to the position of unsecured creditors did not form part of the critical path to the decision the Court was required to make: *Canada v. The Toronto-Dominion Bank (TD Canada Trust)* 2024 FC 441, 2024 CarswellNat 882

Environmental Remediation Claims – Private Dispute - Application of Orphan Well - The Alberta Court of Appeal overturned the attempt of a lower court to extend the reasoning in *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 *(Redwater)* to a private dispute between neighboring landowners outside of formal insolvency proceedings. A chambers judge had found that a common law super-priority right, capable of subordinating rights of pre-existing secured lenders, can exist in favor of a private party in respect of environmental obligations. The Court of Appeal did not agree and found that the priority declaration sought exceeded the limits on power of the judiciary to change the law. There was no statutory authority that supported the plaintiff obtaining any elevated priority. The Court of Appealed observed that disrupting legislated priority schemes and the commercial certainty they provided by granting common law "super priorities" to private litigants for environmental remediation claims brought no assurance that money recovered would be used other than to serve the litigant's interests: *Qualex-Landmark Towers Inc v. 12-10 Capital Corp* 2024 ABCA 115, 2024 CarswellAlta 768

RVO – Availability in Receivership Proceedings – This case involved a contested application for a reverse vesting order or RVO in a receivership proceeding. The RVO was supported by the principal secured creditor on the basis that it would minimize its expected losses. It was opposed by the Government of Canada, described by the court as "a creditor with nothing to gain if the order is refused" (para. 1). The RVO was proposed to give effect to a transaction under which a purchaser would acquire the debtor's business for

$670,000. The principal secured creditor was owed in excess of $4 million. Canada was a modest creditor, both in respect of statutory deemed trust claims totalling approximately $70,000, and in respect of unsecured claims for payroll source deductions and taxes totalling approximately $107,000. There was not enough money to satisfy all the secured claims, and the unsecured creditors would receive nothing. Further, there was no prospect of an offer that would generate funds for the unsecured creditors. Canada's principal objection was that the court had no power to order an RVO in a receivership proceeding. The converse had been decided in *Peakhill Capital Inc. v. Southview Gardens Limited Partnership*, 2023 BCSC 1476, 2023 CarswellBC 2506, 2023 A.C.W.S. 4242, 9 C.B.R. (7th) 119, paras. 21 to 22 and *Peakhill* was under appeal. The court found that absent appellate authority calling *Peakhill* into question, of which there was none at the time, the court was bound to follow it and reject Canada's argument. Canada submitted in the alternative that an RVO was inappropriate in the case before the court. The court did not agree. It acknowledged that an RVO was an unusual or extraordinary measure but found on the uncommon facts of this case, that there were compelling and exceptional circumstances that justified the order sought. The court went on to say at para. 41 that it did not accept the premise of Canada's argument that an RVO was, in substance, a species of proposal, that, in fact, "[a]n RVO is, as the name indicates, a kind of vesting order. It is inherent in vesting orders that liabilities attached to the property in question are released in order that the property may be conveyed to a third party, free and clear of encumbrances. The question is not whether the court can make such an order, it is whether the release of the liabilities in question is justified in the circumstances. The point is that an RVO is not a misnamed form of proposal subject to the exigencies of Part III of the BIA. It is something different."

Royal Bank of Canada v. Canwest Aerospace Inc. 2024 BCSC 585, 2024 CarswellBC 975