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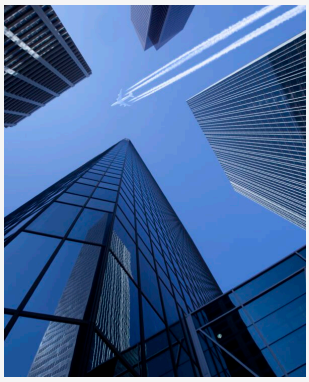
Deemed trusts and priming charges: The Alberta Court of Appeal affirms the priority of CCAA charges over Crown deemed trusts in Canada North Group



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Authors: Randal Van de Mosselaer, Emily Paplawski

Introduction

On August 29, 2019, the majority of the Alberta Court of Appeal held in *Canada v. Canada North Group Inc.*, 2019 ABCA 314 (*Canada North*) that priming charges granted in a *Companies' Creditors Arrangement Act* (CCAA) Initial Order can have priority over the Crown's deemed trust for unremitted source deductions. [1]

The decision came nearly 12 years after the Alberta Court of Appeal dismissed the Crown's application for leave to appeal the decision of the Honourable Justice Romaine in *Minister of National Revenue v. Temple City Housing Inc.*, 2008 ABCA 1 (*Temple City*), which raised the same issue. Thus, for the first time in Canada an appellate court has opined on the issue of whether priming charges granted by a Court under the CCAA can have priority over statutory deemed trusts for unremitted source deductions which arise pursuant to various federal statutes (namely, the *Income Tax Act,* RSC 1985, c 1 (5th Supp.) (ITA), the *Employment Insurance Act*, SC 1996, c 23, and the *Canada Pension Plan*, RSC 1985, c C-8 (together, the Fiscal Statutes)).

The decision underscores the significant implications of the issue to the ability of insolvent companies to restructure under the CCAA. In a 2-1 split, the majority held that the Crown's deemed trust for unremitted source deductions constitutes a "security interest" within the definition of the ITA and prior jurisprudence. As the CCAA provides that, "[t]he court may order that the security or charge rank in priority over the claim of any secured creditor of the company," the majority held that the court has jurisdiction to "prime" (i.e., take priority over) the Crown's claim for unremitted source deductions. According to the majority, if the Crown's position were accepted, it would result in absurd consequences by undermining the objectives of the CCAA, thereby resulting in fewer restructurings and reduced tax revenue. In other words, the majority held that if the Crown's position were correct, it would be "biting off the hand that feeds it."

In his dissent, the Honourable Mr. Justice Wakeling disagreed with the lower court and the majority of the Court of Appeal, holding that "there is only one plausible meaning" to the deemed trust provisions in the Fiscal Statutes: that they enjoy "unassailable priority." In reaching this conclusion, Justice Wakeling limited himself to a strict statutory interpretation of the Fiscal Statutes, holding that any concern about the viability of restructurings under the CCAA should be addressed by Parliament, not the courts.

Background

On July 5, 2017, the Court of Queen's Bench granted the Canada North Group[2] protection under the CCAA (the Initial Order). As is typical, the Initial Order provided for various priming charges, namely, an administration charge, an interim lender's charge and a director's charge (collectively, the Priming Charges) which provided necessary and important security for participants in the restructuring process. The Initial Order provided that the Priming Charges "shall rank in priority to all other security interests, trusts, liens, charges and encumbrances, claims of secured creditors, statutory or otherwise … in favour of any person."

On July 31, 2017, the Crown applied to vary the Priming Charges in the Initial Order on the grounds that the Initial Order failed to recognize the priority of the Crown's statutory deemed trust for unremitted source deductions. At the date of the Initial Order, two of the Canada North corporations had failed to remit to the Crown a total of $685,542.93 in source deductions. The Crown submitted that the Fiscal Statutes provide the Crown with priority for such unremitted source deductions, and that the Court did not have the jurisdiction under the CCAA to grant charges which would prime that priority.

Madam Justice Topolniski of the Alberta Court of Queen's Bench dismissed the Crown's application, holding that the deemed trust provisions under the ITA give the Crown a security interest, not a proprietary interest, and that accordingly the CCAA gives the Court authority to grant the Priming Charges which take priority over the Crown's deemed trust.

The Crown sought leave to appeal the decision to the Alberta Court of Appeal and leave to appeal was granted on a single issue: whether the chambers judge erred in law in determining that the Priming Charges have priority over statutory deemed trusts in favour of the Crown for unremitted source deductions created by the Fiscal Statutes.

Decision of the majority

Writing for the majority, Madam Justice Rowbotham held the Crown's position was inconsistent both with the definitions of "security interest" under the ITA and CCAA, and prior case law of the Supreme Court of Canada.

The Fiscal Statutes define "security interest" as "any interest in … property that secures payment … and includes an interest … created by or arising out of a … deemed or actual trust …." A "secured creditor" is defined (in part) as a person who has a "security interest in the property of another person." Based on a plain reading of these definitions, the majority held that the Crown was undoubtedly a "secured creditor" of Canada North as a holder of a deemed trust under the Fiscal Statutes to secure payment of unremitted source deductions.

However, unlike the Fiscal Statutes, the definition of "security interest" under the CCAA does not explicitly include the holder of a deemed trust. The Crown used this as the basis for its argument that the CCAA therefore does not grant the Court the ability to grant Priming Charges which take priority over the Crown's deemed trust. Notwithstanding this, the

majority held that: (a) the Crown's interest could be characterized as a "charge" so as to be covered within the CCAA; and (b) in any event, if the Fiscal Statutes are read harmoniously with the CCAA, as is required, Parliament has defined "security interest" under the Fiscal Statutes as including a deemed trust.

According to the majority, the foregoing interpretation of the Fiscal Statutes accords with prior case law of the Supreme Court of Canada in *First Vancouver Finance v. MRN*, 2002 SCC 49 which characterized the Crown's deemed trust under the ITA as a "floating charge over all of the assets of the tax debtor in the amount of the default." As Justice Rowbotham noted, "deemed trusts are not true trusts as they do not attach to particular assets."

Based on the foregoing, the majority held that the provisions of the CCAA which provide that, "[t]he court may order that the security or charge rank in priority over the claim of any secured creditor of the company," granted the Court jurisdiction to prime the Crown's deemed trust for unremitted source deductions under the Fiscal Statutes.

The conclusion of the majority was reinforced by the "absurd consequences" which would follow if the Crown's position was accepted. According to the majority, the Crown's position ignored the reality that CCAA restructurings facilitate the survival of companies, the production of goods and services, and ultimately jobs, all of which serve as fuel for the fiscal base. Undermining the remedial objective of the CCAA for the sake of tax collection disregards the obvious benefit for the government of successful corporate restructurings.

Decision of the minority

Writing in dissent, Justice Wakeling adopted a strict statutory interpretation of the Fiscal Statutes, holding that he would have allowed the Crown's appeal. In Justice Wakeling's view, the provisions of the Fiscal Statutes which grant the deemed trust are capable of only one interpretation: that the Crown is the beneficial owner of a corporation's assets in an amount equal to the amount that the company failed to remit to the Crown. These amounts must be paid to the Crown notwithstanding the security interest of any other secured creditors – including the holders of a Priming Charge.

In reaching this conclusion, Justice Wakeling made three key findings:

1. The Fiscal Statutes have express priority over all other federal legislation. Because there is no comparable blanket paramountcy provision in the CCAA, Justice Wakeling held that there is no need to look beyond the four corners of the Fiscal Statutes to determine the scope of the "unassailable priority" they create.
2. Priming Charges are "security interests" within the meaning of the Fiscal Statutes, and the Fiscal Statutes are unequivocal that unremitted source deductions are to be paid to the Receiver General "in priority to all security interests," including priming charges.
3. The Fiscal Statutes specifically provide that funds which are not properly remitted to the Crown "form no part of the estate or property" of the corporation that withheld them and, as a result, they are beneficially owned by the Crown.

Based on the foregoing interpretation, Justice Wakeling held that the Crown's priority position cannot be usurped by the Priming Charges.

Impact

The decision of the majority is a welcome development for Canadian insolvency law, for lenders and professionals involved in insolvency proceedings, and is a recognition of the important role the CCAA (and all insolvency law) plays in the Canadian economy. As the majority noted, restructurings under the CCAA promote the public good by facilitating the survival of companies, the production of goods and services, the preservation of jobs and the continued survival of the Canadian tax base.

The decision provides much needed protection for participants in insolvency proceedings, including interim lenders and court officers who oftentimes must rely on Priming Charges for protection at a time when the state of an insolvent company's account with the Crown can be very much in doubt. The question of the quantum of unremitted source deductions owing to the Crown by an insolvent company is one which can take weeks or months to answer following a filing. If it had been the majority, one of the implications of the minority judgment in *Canada North* would be that court officers would be asked by the court to accept an appointment, and interim lenders would be asked to extend credit, without certainty with respect to the quantum of a prior charge. Hence, such participants would be unable to assess the extent of their security or risk. Such a result would no doubt have created a chill over the prospect of future CCAA filings (a fact which was acknowledged by the Crown in argument in the court below).

The intersection between the deemed trust provisions in the Fiscal Statutes for unremitted source deductions and Priming Charges granted under the CCAA has been ripe for further consideration for some time. In 2008, the Crown mounted the same challenge to the Court's ability to prime its deemed trust for unremitted source deductions in *Temple City*. Justice Romaine dismissed the Crown's challenge for reasons which mirror, in many ways, the decision of the majority in *Canada North*. While the Crown sought leave to appeal Justice Romaine's decision to the Alberta Court of Appeal, leave to appeal was denied. (See: *Minister of National Revenue v. Temple City Housing Inc*, 2008 ABCA 1).

The Alberta Courts are not alone in considering this issue. In June 2017, the Supreme Court of Nova Scotia released its decision in *Rosedale Farms Limited, Hassett Holdings Inc., Resurgam Resources (Re)*, 2017 NSSC 160, which considered essentially the same question. For reasons similar to those of Justice Wakeling in *Canada North*, the Nova Scotia Court found in favour of the Crown, holding that the CCAA did not allow a court to grant Priming Charges that take priority over the Crown's deemed trust. That decision was not appealed and, as a result, continues to represent the state of the law in Nova Scotia.

Based on the current disagreement in Canadian jurisprudence on the issue, the strong dissent of Justice Wakeling and the fact that *Canada North* is the first Canadian appellate level judgment to consider this issue, it may be that this question is ripe for further appellate consideration by other courts. For now, the decision of the majority in *Canada North* provides authority for an increased level of certainty in CCAA filings, provides much needed protection for participants in such proceedings and avoids the chill which would certainly have resulted from a contrary decision.

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[1] The authors represented the Canadian Association of Insolvency and Restructuring Professionals as intervenor before the Alberta Court of Appeal.

[2] Canada North Group Inc, Canada North Camps Inc, Campcorp Structures Ltd, DJ Catering Ltd, 816956 Alberta Ltd, 1371047 Alberta Ltd, and 1919209 Alberta Ltd.