CURRENT CASES

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THE SUPREME COURT OF CANADA

CROWN DENIED GST PRIORITY UNDER THE COMPANIES' CREDITORS ARRANGEMENT ACT

Century Services Inc. v. Canada (Attorney General)
2010 SCC 60

KEYWORDS: CREDITORS ■ GST ■ GOODS AND SERVICES TAX ■ HST ■ HARMONIZED SALES TAX ■ INSOLVENCY

INTRODUCTION

On December 16, 2010, the Supreme Court of Canada clarified that goods and services tax (GST) deemed trusts do not survive a proceeding under the Companies' Creditors Arrangement Act[1] (CCAA), resulting in the Crown's losing its priority claim over the GST amounts held by the debtor company. The *Century Services* decision provides for the consistent treatment of GST and harmonized sales tax (HST) claims across Canada under the Bankruptcy and Insolvency Act[2] (BIA) and the CCAA. This decision is a welcome clarification of the relationship between the GST deemed trust provisions in part IX of the Excise Tax Act[3] (ETA) and the CCAA.

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1 RSC 1985, c. C-36, as amended.

2 RSC 1985, c. B-3, as amended.

3 RSC 1985, c. E-15, as amended. HST is also imposed under part IX of the ETA and is subject to the same deemed trust provisions.

BACKGROUND

In December 2007, Ted LeRoy Trucking Ltd. ("LeRoy Trucking") commenced proceedings under the CCAA and obtained a stay of proceedings with a view to reorganizing its financial affairs. Among the debts owed by LeRoy Trucking was an amount for collected but unremitted GST owing to the Crown.

In the context of the CCAA proceedings, the British Columbia Supreme Court approved a payment to Century Services Inc., LeRoy Trucking's major secured creditor, of funds from a sale by LeRoy Trucking of redundant assets.[4] The court ordered that $305,202.30, an amount equal to the collected but unremitted GST, be held back in the monitor's trust account until the outcome of the reorganization was known.

Approximately four months later, having concluded that reorganization was not possible, LeRoy Trucking sought leave to make an assignment in bankruptcy under the BIA. The Crown applied for an order that the GST monies held by the monitor be paid to the receiver general of Canada. In this context, the BC Supreme Court considered whether it had the discretion to continue a CCAA stay of proceedings while the stay was partially lifted to allow for the debtor company to be assigned into bankruptcy.

The Crown objected to the stay's continuation because the Crown would then lose the opportunity to enforce its priority over the GST deemed trust amounts during the interim period between the CCAA and BIA proceedings. Once the bankruptcy proceeding commenced under the BIA, the Crown would lose its priority over the GST deemed trust amounts: the BIA would take precedence over section 222 of the ETA (discussed below), and such amounts would no longer be subject to a GST deemed trust.[5]

The court held that, under the CCAA, it was required to maintain the status quo as of the date of the CCAA filing and continue the stay, except for allowing the bankruptcy proceeding.[6] As of the date of the filing, it was contemplated that the Crown would receive payment of the GST deemed trust amounts only if the court approved a viable plan.[7] Since there was no such plan under the CCAA proceeding, the stay would continue and the Crown would lose its priority over the GST deemed trust amounts on the commencement of bankruptcy. The Crown appealed this decision to the British Columbia Court of Appeal.

The BC Court of Appeal overturned the BC Supreme Court's decision. The BC Court of Appeal determined that once the restructuring efforts under the CCAA proceeding came to an end, the BC Supreme Court no longer had the discretion to

4 *Re Ted LeRoy Trucking Ltd. and 383838 BC Ltd.* (29 April 2008), Vancouver 5018473 (BCSC).

5 *Ted LeRoy Trucking Ltd. and 383838 BC Ltd. (Re)*, 2008 BCSC 1805, at paragraphs 2-3.

6 Ibid., at paragraph 5.

7 Ibid., at paragraph 6.

stay the Crown's enforcement of its GST deemed trust claim.[8] Therefore, following the failure of the CCAA proceeding, the Crown should have immediately been paid the GST deemed trust amounts. In addition, the BC Court of Appeal found that when the BC Supreme Court ordered the segregation of the GST amounts from the debtor company's other funds, an express trust in favour of the Crown was created for these amounts.[9]

Century Services Inc., the secured creditor, appealed the BC Court of Appeal's decision to the Supreme Court of Canada. A majority of that court held that the BC Court of Appeal had erred by "treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law."[10] The larger issue, however, was whether the GST deemed trust provisions applied during CCAA proceedings.

CONFLICTING FEDERAL STATUTES

Section 222 of the ETA establishes a statutory scheme whereby monies collected as or on account of GST (or property equal to the value thereof) are deemed to be held separate and apart from the debtor's estate on behalf of the federal Crown. Since deemed trust monies or property do not form part of the debtor's estate, they are not available to the debtor's creditors (other than the Crown) to satisfy their claims. The Crown would thereby avoid having its GST claims made subject to the general distribution scheme available to secured and unsecured creditors. Subsections 222(1.1) and (3) of the ETA, however, expressly state that the GST deemed trust is subject to the provisions of the BIA. Specifically, no GST deemed trust applies to any amounts collected by a debtor before its bankruptcy.[11] There is no reference, however, to an exception from the GST deemed trust in the case of a CCAA proceeding, suggesting that the GST deemed trust provisions continue to apply in such a proceeding.

However, under the CCAA, once a CCAA proceeding is commenced, former section 18.3(1) (now section 37(1)) of the CCAA nullifies all pre-filing statutory deemed trust claims, including those for GST. The Crown's priority can be preserved by way of a trust claim only if there is a trust recognized at law or possibly by equity. The Crown's deemed trust claims for source deductions (amounts withheld from pay to employees or others to be remitted to the Crown for income taxes, Canada Pension Plan contributions, and employment insurance premiums) are exempt from former section 18.3(1) (now section 37(1)) and preserved in a CCAA proceeding.[12]

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8 *Ted LeRoy Trucking Ltd. (Re)*, 2009 BCCA 205, at paragraph 22.

9 Ibid., at paragraph 24.

10 *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, at paragraph 78.

11 This treatment is consistent with BIA section 67(2).

12 Former section 18.3(2) (now section 37(2)) of the CCAA. There are parallel provisions to former sections 18.3(1) and (2) (now sections 37(1) and (2)) of the CCAA in sections 67(2) and (3) of the BIA.

PRIOR ATTEMPTS TO RECONCILE THE ETA AND THE CCAA

Courts have previously attempted to reconcile the conflicting deemed trust provisions of the ETA and the CCAA. In prior Ontario and Alberta cases, the courts found that in CCAA proceedings, the Crown's GST deemed trust claims and priority for such claims are maintained under subsection 222(3) of the ETA, while acknowledging that the Crown would lose those claims and priority under the BIA.[13]

The Ontario and Alberta cases relied heavily on the Supreme Court of Canada's decision in *Doré v. Verdun (City)*.[14] In *Doré*, the Supreme Court considered whether the conflicting provisions of the Civil Code of Québec[15] (CCQ) or the Cities and Towns Act[16] (CTA) should apply to the circumstances of the case. Both of the provisions in conflict stipulated that they would apply "notwithstanding" other provisions to the contrary. The appellant argued that the more specific CTA should apply over the more general CCQ.[17] The Supreme Court disagreed and concluded that, given that both statutes contained "notwithstanding" language, the "implied repeal rule" of statutory interpretation should be applied, by which the more recently enacted provisions in the CCQ must prevail to the exclusion of earlier conflicting provisions.[18] At the time of the Ontario and Alberta cases, the relevant ETA provisions in section 222 had been most recently amended in 2000 and the relevant CCAA provisions had been last amended in 1997. Recognizing that *Doré* was binding, given the similarities of that case, the Ontario Court of Appeal and the Alberta courts applied the implied repeal rule in concluding that subsection 222(3) of the ETA should override former section 18.3 (now section 37) of the CCAA.[19]

In *Ottawa Senators*, the Ontario Court of Appeal examined the intent of Parliament when it drafted subsection 222(3) of the ETA. It found that Parliament's intention was paramount to all maxims or canons of statutory interpretation, such as "the specific prevails over the general (*generalia specialibus non derogant*)."[20] In the court's view, had Parliament intended for section 18.3 of the CCAA to override section 222

13 *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 OR (3d) 737 (CA); rev'g. in part (2003), 68 OR (3d) 603 (SCJ); *Solid Resources Ltd. (Re)* (2002), 40 CBR (4th) 219 (Alta. QB); and *Re Gauntlet Energy Corporation (Companies' Creditors Arrangement Act)*, 2003 ABQB 894.

14 [1997] 2 SCR 862.

15 SQ 1991, c. 64, as amended.

16 RSQ, c. C-19.

17 *Doré*, supra note 14, at paragraph 41.

18 Ibid.

19 *Ottawa Senators*, supra note 13 (CA), at paragraphs 46-49; and *Gauntlet Energy*, supra note 13, at paragraph 17.

20 *Ottawa Senators*, supra note 13, at paragraph 42 (CA). In the lower court decision overturned by the Ontario Court of Appeal, the Ontario Superior Court of Justice had applied the "implied exception rule" of statutory interpretation, by which the more specific amendments contained in former section 18.3 (now section 37) of the CCAA are read as an exception to the GST deemed trust amendments imposed by the ETA, a general taxing statute.

of the ETA and nullify the Crown's pre-filing GST deemed trust claims, it could have expressly done so in the same manner that it gave priority to the BIA in subsection 222(3) of the ETA.[21] The Crown therefore maintained its priority over GST deemed trust amounts in the CCAA proceeding.

THE DECISION

In *Century Services*, a 6-1 majority of the Supreme Court of Canada overturned the BC Court of Appeal and, in turn, overruled *Ottawa Senators*. Although one of the justices in the majority (Fish J) wrote his own reasons in support of the decision, our case comment focuses on the judgment written on behalf of the other five concurring members of the court. The lone dissenting justice agreed with the BC Court of Appeal and *Ottawa Senators* decisions.

In overruling *Ottawa Senators*, the majority of the court emphasized that the decision and its views on GST deemed trusts were not universally accepted in all provinces.[22] In addition, the court held that *Doré* did not require the automatic application of the implied repeal rule.[23] The court found that, in *Doré*, the implied repeal rule was applied only following a purposive and contextual analysis of the relevant legislation, and that the legislation and circumstances were distinguishable from those of the case at hand.[24] To resolve the apparent conflict between the ETA and the CCAA and determine the interpretation intended by Parliament, the court engaged in a purposive and contextual analysis of the CCAA.[25]

First, the court engaged in a comprehensive review of Canadian insolvency law and recognized that the purpose of the CCAA "is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets."[26] Where reorganization of the debtor company is not possible, the BIA permits the distribution of the debtor's assets in an orderly manner pursuant to specific priority rules.[27] The court also recognized that there has been a concerted effort by Parliament to harmonize aspects of insolvency law common to the CCAA and the BIA.[28]

The court then reviewed how Crown claims have generally been treated throughout the history of the CCAA and BIA. Prior to the 1990s, the Crown generally enjoyed priority for its various claims, including deemed trusts, in insolvency

21 *Ottawa Senators*, supra note 13 (CA), at paragraph 43.

22 *Century Services*, supra note 10, at paragraph 27. See *Komunik Corporation (Arrangement relatif à)*, 2009 QCCS 6332.

23 *Century Services*, supra note 10, at paragraph 52.

24 Ibid.

25 Ibid., at paragraphs 10-11 and 50.

26 Ibid., at paragraph 15.

27 Ibid.

28 Ibid., at paragraph 24.

proceedings.[29] With the CCAA amendments in the 1990s, however, the Crown maintained its priority in respect of source deductions pursuant to former sections 18.3(2) and 18.4(3) (now sections 37(2) and 38(3)) of the CCAA and true trusts at law or possibly equity, but would be relegated to unsecured creditor status for its other claims, including deemed trust claims, pursuant to former sections 18.3(1) and 18.4(1) (now sections 37(1) and 38(1)) of the CCAA. Similarly, in a bankruptcy, with the exception of deemed trusts for source deductions under sections 67(3) and 86(3) of the BIA, the combined effect of sections 67(2) and 86(1) of the BIA is to rank deemed trust claims as unsecured.[30] In the court's opinion, Parliament has demonstrated a willingness to reduce the number of Crown claims that can claim priority, including those for GST deemed trusts.[31]

The court found that the CCAA and the BIA both deliberately discriminated in the same manner between deemed trust claims for source deductions and GST. Under federal tax legislation, both source deductions and GST are deemed to be held by the debtor in trust for the Crown. As exceptions to the general rule that deemed trusts do not survive an insolvency proceeding, the CCAA and the BIA explicitly provide for source deduction deemed trusts to remain in effect pursuant to former sections 18.3(2) and 18.4(3) of the CCAA and sections 67(3) and 86(3) of the BIA. However, no such express statutory exception exists for preserving GST deemed trusts under either insolvency statute.[32] Given that both the CCAA and the BIA expressly provide protection for the Crown's interest with respect to source deduction deemed trusts but not GST deemed trusts, "it would be inconsistent to afford a better protection to the [GST] deemed trust absent explicit language in the *CCAA*."[33]

In the court's view, the amendments made to the CCAA in 2005, subsequent to the last amendment of subsection 222(3) of the ETA in 2000, provided further evidence of Parliament's intention to not preserve and maintain the priority of GST deemed trusts in CCAA proceedings. Among other CCAA amendments made in 2005, the relevant provisions dealing with priorities and deemed trusts were renumbered and reformulated under the CCAA. Had Parliament wished to preserve the priority of GST deemed trusts in a CCAA proceeding and conform with subsection 222(3) of the ETA, it could have incorporated this priority for GST deemed trusts into the 2005 amendments. It did not do so. These subsequent amendments undermine the logic in this case of applying the implied repeal rule adopted in *Ottawa Senators*. It could no longer be presumed that Parliament intended to treat subsection 222(3) of the ETA as paramount because subsection 222(3) of the ETA was no longer the most recently amended relevant provision.[34]

29 Ibid., at paragraph 28.

30 Ibid., at paragraphs 29 and 39.

31 Ibid., at paragraph 45.

32 Ibid., at paragraphs 39 and 45.

33 Ibid., at paragraph 46.

34 Ibid., at paragraphs 53-54.

The court recognized that subsection 222(3) of the ETA did not include an exception for the CCAA but attributed such a fact to a "drafting anomaly" by Parliament.[35] The court found it plausible that Parliament could have inadvertently neglected to exclude the CCAA from the application of the GST deemed trust provisions when amending subsection 222(3) of the ETA "as part of a wide-ranging budget implementation bill in 2000."[36] This anomaly could be resolved "by looking at the broader approach taken to Crown priorities and by giving precedence to the statutory language of [former] s. 18.3 of the *CCAA* in a manner that does not produce an anomalous outcome."[37] Such an anomalous outcome, where the Crown would be able to assert priority over pre-existing GST deemed trust claims in CCAA proceedings but not in bankruptcy proceedings, as *Ottawa Senators* permits, would result in statute shopping by secured creditors where they favour bankruptcy liquidation under the BIA over a CCAA reorganization in order to preserve their priority over GST deemed trust claims.[38] In the court's opinion, there was very little evidence to support the idea that Parliament had intended such an anomalous outcome.[39] In addition, such an outcome would run contrary to the policy objective of the CCAA and the BIA to encourage reorganization of an insolvent company where possible. Therefore, pursuant to former sections 18.3(1) and 18.4(1) (now sections 37(1) and 38(1)) of the CCAA, the Crown's interest in the GST amounts was to be treated as an unsecured claim and not as a deemed trust claim ranking first in priority.

Finally, the court overturned the BC Court of Appeal's finding of an express trust for the GST deemed trust amounts because, in its view, the common-law requirements of an express trust were not met.[40] In particular, there was no certainty of the object (beneficiary) of the trust because it was uncertain whether the Crown would be the beneficiary of the monies set aside under an earlier lower court order.[41]

CONCLUSION

In *Century Services*, the Supreme Court of Canada has, in our view, correctly clarified the law relating to whether GST deemed trust claims survive the commencement of CCAA proceedings and give the Crown priority over these amounts. The decision harmonizes the results under the CCAA and the BIA and eliminates the incentive for

35 Ibid., at paragraph 50.

36 Ibid., at paragraph 49. By contrast, the dissenting judge viewed Parliament's failure when amending subsection 222(3) of the ETA in 2000 to provide for an exception for the CCAA, and Parliament's continuing lack of action in this regard, to be evidence of Parliament's intention to preserve the GST deemed trust priority in a CCAA proceeding.

37 Ibid., at paragraph 50.

38 Ibid., at paragraph 47.

39 Ibid., at paragraph 49.

40 Ibid., at paragraphs 82-84.

41 Ibid., at paragraph 85.

statute shopping between them that would otherwise result from inconsistencies created by the *Ottawa Senators* and Alberta cases. The decision in *Century Services* recognizes that the reform and overhaul of federal insolvency legislation during the 1990s and subsequently was intended to harmonize and rationalize insolvency legislation. It should, in appropriate cases, keep open the door to CCAA protection and restructuring, thereby possibly avoiding the devastating effects to stakeholders of bankruptcy liquidation. The decision should also decrease risk for secured lenders. Debtors, creditors, and monitors should now be aware that the Crown's priority interest in GST deemed trust amounts arising prior to CCAA proceedings ceases to exist once CCAA proceedings commence and is replaced with an unsecured claim.

Jamie M. Wilks and Jeffrey Fung

THE FEDERAL COURT OF APPEAL

CENTRAL MANAGEMENT AND CONTROL TEST FOR DETERMINING THE RESIDENCE OF A TRUST CONFIRMED

St. Michael Trust Corp. v. Canada
2010 FCA 309

KEYWORDS: RESIDENCE ■ TRUSTS ■ TREATIES

INTRODUCTION

St. Michael Trust Corp. is an appeal by St. Michael Trust Corp. ("the trustee"), in its capacity as the trustee of the Fundy settlement ("the Garron trust") and the Summersby settlement ("the Dunin trust," together with the Garron trust, "the trusts"), from the decision of Woods J in the Tax Court of Canada in *Garron Family Trust v. The Queen*.[42] That decision held that the trusts were resident in Canada for Canadian income tax purposes, and therefore were liable for Canadian tax on a substantial capital gain realized on the shares of two Canadian corporations.

In the Tax Court, Woods J decided that the residence of the trusts should be determined on the basis of the "central management and control test" used to determine the residence of corporations for income tax purposes. Applying this test, she found that the trusts were managed and controlled in Canada and, accordingly, were resident in Canada for Canadian income tax purposes. This was the first time that the "central management and control test" had been used in Canada to determine the residence of a trust.

42 *Garron Family Trust v. The Queen*, 2009 TCC 450. For comment on the Tax Court's decision, see this feature in (2009) 57:4 *Canadian Tax Journal* 857-79, at 864-70.