Revenue Quebec succeeds with claim that bankrupt's GST belongs to Crown

By Éric Vallières

When Parliament amended s. 86 of the *Bankruptcy and Insolvency Act* (BIA) in 1992, it made clear that, save for a few listed exceptions, all Crown claims would rank in future bankruptcies as unsecured claims. Claims for Goods and Services Tax ("GST") and Quebec Sales Tax ("QST") remittances not being among the listed exceptions, the Crown clearly has no priority in respect of such remittances.

It was also generally recognized that the Crown does not enjoy any direct right whatsoever in the accounts receivable of bankrupt companies. To hold the contrary would be inconsistent with the purpose of s. 86 BIA and with the collection mechanism set out by the *Excise Tax Act* ("ETA") and the corresponding provincial legislation.

This was plain and simple. Perhaps too much so!

In a recent push, Revenue Quebec, which is responsible for GST and QST collection in Quebec, decided to assert the position that the GST and QST which form part of the bankrupt's accounts receivable "belong" to the Crown. According to Revenue Quebec, the Crown "owns" the GST and QST, thereby short-circuiting the above mentioned bankruptcy rules. Consequently, Revenue Quebec now systematically requires bankruptcy trustees and secured creditors in Quebec (and in other provinces) to set aside, in a separate trust account, the GST and QST they collect.

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At first glance, the arguments of Revenue Quebec are appealing: the ETA and the *Quebec Sales Tax Act* (QSTA) both provide that the taxes are payable *by the acquirer* of a taxable good or service. Moreover, s. 422 of the QSTA adds that the tax is collected by the seller as a "mandatary of the minister" (the concept of mandate being roughly akin to that of agency in the common law).

However, as mentioned above, this reasoning is inconsistent with s. 86 of the BIA and s. 221 (1.1) of the ETA. It also conflicts with the collection mechanism set out by the ETA and the QSTA, which both provide for a book-based system whereby suppliers are required to report and remit the tax amounts, net of input tax credits for the GST and QST which is charged to them by their suppliers, regardless of whether the tax has been actually collected or not.

A number of bankruptcy trustees and secured creditors resisted the position asserted by Revenue Quebec and several of these matters were referred to the Quebec Superior Court. Surprisingly, the decisions so far rendered have sided with Revenue Quebec.

Revenue Quebec's arguments were accepted, for instance, in *9083-4185 Québec inc. (MPX) (Syndic de)*, J.E. 2006-1005, where Justice Gérald Boisvert held that the tax portion of the accounts receivable collected do indeed "belong" to the Crown and that bankruptcy trustees act only as agents of the Crown. In short, s. 86 of the BIA would simply not apply.

A few days later, in *Alternative granite et marbre inc. (Syndic d')*, B.E. 2006BE-710, Justice Jean Bouchard applied the same reasoning to the treatment of tax amounts collected by a secured creditor. A third case to the same effect was also rendered in *Consortium Promecan Inc. (Syndic de)*, (615-11-000793-044, Sept. 20, 2006).

Not only do these cases appear to be squarely against the BIA and ETA, but they raise several significant concerns for bankruptcy practitioners across Canada (the cases apply in respect of the QST and GST).

First, they divert assets away from the bankrupt estate (or from the secured creditors). Second, they impose on trustees a new administrative burden, which unduly complicates bankruptcy administration. Third, they may create confusion. Who is entitled to collect? Can the trustee issue rebates or credits to facilitate payments? Finally, and more importantly for bankruptcy trustees, in MPX, Justice Boisvert indicated that in his view, failure to separately account for GST and QST would amount to a criminal act under s. 2 and s. 336 of the *Criminal Code*.

All of the above three cases are presently in appeal before the Quebec Court of Appeal. In the interim, however, the new line of cases is certainly the law of the land in Quebec, and, if confirmed, there is a possibility that the decision will spill over into the rest of Canada. Nothing indeed precludes Revenue Québec from attempting to assert the same logic as against trustees located outside of Quebec (where QST is collected), nor is there anything preventing the authorities in other provinces from following suit with respect to GST.

As the current never-ending reform of the BIA amply indicates, no matter how desirable it is, a legislative solution to this imbroglio could take some time. In the interim, bankruptcy trustees would probably be well-advised to segregate and hold in a trust account the GST and QST they collect, just...*au cas où*!

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