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ARTICLE

Supreme Court of Canada Callidus Decision Provides Certainty to CRA Deemed Trust Rules

On November 8, 2018, in a decision delivered unanimously from the bench, the Supreme Court of Canada confirmed that the Crown's superpriority over unremitted *Goods and Services Tax/Harmonized Sales Tax* (GST/HST) is ineffective against a secured creditor who received, prior to a tax debtor's bankruptcy, proceeds from that taxpayer's assets.[1]

Our earlier bulletin sets out the facts of this decision and our comments on the Federal Court of Appeal's decision. At issue before each level of Court was the interplay between these three subsections upon CFR's bankruptcy. Did CFR's bankruptcy extinguish *just* the Crown's deemed trust over unremitted GST/HST? Or did CFR's bankruptcy trigger both the unremitted GST/HST deemed trust *and* the deemed trust over a CFR property (now held by Callidus as secured creditor)? As framed by the Supreme Court of Canada:

Does the bankruptcy of a tax debtor and subsection 222(1.1) of the [ETA] render the deemed trust under section 222 of the ETA ineffective as against a secured creditor who received, prior to the bankruptcy, proceeds from the assets of the tax debtor that were deemed to be held in trust for the Plaintiff?[2]

Callidus' submissions reflected the predominant view of secured creditors, insolvency professionals, and tax professionals that subsection 222(1.1) extinguished the Crown's superpriority upon a debtor's bankruptcy, effectively transforming the Crown into an unsecured creditor with interests subordinate to secured creditors.

The Supreme Court of Canada ruled in favour of Callidus, adopting Pelletier JA's dissenting opinion from the Federal Court of Appeal decision. In essence, Pelletier JA held that the subsection 222(3) deemed trust over property is calculated based on (and its existence is predicated on) the subsection 222(1) deemed trust over unremitted GST/HST. Where a debtor's bankruptcy triggers 222(1.1) and extinguishes the 222(1) deemed trust, the subsection 222(3) trust then has no value, and therefore fails for lack of subject-matter.[3] As held by Pelletier JA:

[A]fter bankruptcy, there is no amount deemed to be held in trust pursuant to subsection (1) for amounts collected as tax but not remitted pre-bankruptcy. The subsection (3) trust which arose prior to bankruptcy no longer has any subject matter because the trust only attaches to property of the tax debtor to the extent of the subsection (1) trust which no longer exists. This is true for the tax debtor as well as for the tax debtor's secured creditors.[4]

Decision Significance

The Supreme Court's decision to adopt Pelletier JA's dissent is a practical, technical interpretation of section 222. Consistent with our hopes expressed in our previous bulletin, this decision restores certainty to Canada's secured financing and priority regime, and provides much needed guidance to priority disputes across Canada — in particular with respect to the ETA's deemed trust mechanism, but possibly in respect of deemed trust mechanisms in other statutes, such as the ITA, *Alcohol and Gaming Regulation and Public Protection Act*, *The Tax Administration and Miscellaneous Taxes Act*, and the *Revenue Administration Act*.[5]

In particular, this decision ensures that secured creditors enjoy at least the same protection from the Crown as their debtors with regards to the debtor's GST/HST obligations. Had the Federal Court of Appeal's majority decision been left to stand, the Crown would have had the power to recover GST/HST from a bankrupt debtor's secured creditors where the ETA explicitly bars the Crown from doing so directly from the bankrupt debtor themselves.

Should you have any questions regarding the issues raised in *Callidus* and how they affect your situation, please contact the authors or a member of our Insolvency or Tax Litigation and Dispute Resolution groups.

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[1] *Callidus Capital Corp v Canada*, 2018 SCC 47.

[2] *Ibid*.

[3] 2017 FCA 162 at para 57.

[4] *Ibid* at para 63.

[5] Callidus Capital Corporation, Supreme Court of Canada Application for Leave to Appeal, submitted September 26, 2017 at para 5.

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