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SUPREME COURT OF CANADA SETTLES EXCISE TAX ACT PRIORITIES IN CCAA ACTION

MARY BUTTERY WINS IMPORTANT CASE FOR CENTURY SERVICES INC.

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On December 26, 2010, the Supreme Court of Canada held in *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60 ("*Century*") that the Crown does not enjoy super-priority in relation to unremitted Goods and Services Tax ("GST") under the provisions of the *Companies' Creditors Arrangements Act* ("*CCAA*"). Century Services Inc. was successfully represented by lead counsel Mary Buttery, now the head of Davis LLP's Business Solutions and Restructuring Group in Vancouver.

The Court in Century was asked to interpret a potential discrepancy between competing provisions of the Excise Tax Act ("*ETA*") which provides for a deemed trust for unremitted GST in favour of the Crown except in bankruptcy, and the *CCAA* which contains no such provision. The effect of this decision was to harmonise the treatment of unremitted GST in *CCAA* and Bankruptcy and Insolvency Act ("*BIA*") proceedings. The Court noted that the two acts are meant to operate in tandem and accordingly interpreted them harmoniously.

History

The dispute arose over the sale of certain redundant assets by the debtor company Ted LeRoy Trucking Ltd. during a *CCAA* proceeding. The assets were sold, and the majority of the proceeds were paid to Century as the senior secured creditor. However, a portion of the proceeds (the "Disputed Funds") were held by the Monitor on account of GST, because the result of the restructuring was unclear, and the Crown's priority for GST would vary depending on the outcome.

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The *CCAA* restructuring was not successful, and the stay of proceedings was lifted for the limited purpose of allowing the debtor to file for bankruptcy. The Crown unsuccessfully contested the stay being lifted for this limited purpose because a bankruptcy would eliminate the Crown's deemed trust, arguing that:

(a) Pursuant to the *ETA* the Crown held the property of the debtor, including the Disputed Funds, in trust on account of unremitted GST, and that this deemed trust was not affected by the *CCAA* proceedings;

(b) The supervising judge did not have the authority to lift the stay for the sole purpose of allowing the debtor to file for bankruptcy when he knew that any restructuring under the *CCAA* was doomed to fail; and

(c) The effect of putting the Disputed Funds into the Monitor's trust account created an express trust in favour of the Crown.

The Crown appealed the decision of Brenner CJ's (as he then was), and argued that the Court ought to have recognized the Crown's deemed trust under the *ETA*, and that there was no discretion left to the Court to suspend the operation of the deemed trust. The British Columbia Court of Appeal agreed, and overturned the trial court's decision, finding that when the restructuring efforts of the debtor came to an end, the chambers judge did not have the discretion to ignore the deemed trust provisions under the *ETA*. The Court also found that an express trust had been created by the chambers judge when the funds were first segregated to the Monitor.

Century sought and obtained leave to appeal the decision to the Supreme Court of Canada.

Supreme Court of Canada's Analysis and Decision

Section 222(3) of the *ETA* provides that, despite any statute, other than the *BIA*, all property of a debtor is deemed to be held in trust for the Crown for unremitted GST. However, section 37 of the *CCAA* (formerly s. 18.3) provides that any statutorily deemed trusts in favour of the Crown are not effect unless:

(a) they would be regarded as a trust in the absence of the statutory provision; or

(b) the trust is one of those enumerated in s. 37(2) of the *CCAA*, which deals primarily with unremitted employment insurance premiums, CPP contributions, and other employee withholdings. Unremitted GST is not included in the enumerated list.

The *BIA* contains identical provisions as the *CCAA*. The Court accordingly had to reconcile what appears to be two anomalous provisions as between the ETA and the *CCAA*.

After reviewing the history of the Canadian insolvency legislation, and the movement of Parliament away from granting Crown priorities, the majority allowed the appeal. They held at para. 45:

> *The CCAA and BIA are in harmony, preserving deemed trusts and asserting Crown priority only in respect of source deductions. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the CCAA or the BIA. Unlike source deductions, which are clearly and expressly dealt with under both these insolvency statutes, no such clear and express language exists in those Acts carving out an exception for GST claims.*

The Court further reasoned that to permit the anomaly of the Crown maintaining priority in a

CCAA proceeding but losing it in a *BIA* proceeding would encourage statute shopping and would fail to recognise the identical, explicit Crown deemed trust priorities that are maintained in both the *CCAA* and the *BIA*. In reaching its conclusion, the Court overruled the Ontario Court of Appeal decision in *Re Ottawa Senators Hockey Corp.* (2005), 73 O.R. (3d) 737. The result is that, in both *CCAA* and *BIA* proceedings, the Crown is an unsecured creditor in relation to unremitted GST.

The Court went on to affirm the broad powers of a supervising judge in *CCAA* proceedings to make orders necessary to promote the policy objectives of the *CCAA*. The Court held at para. 70:

> *The general language of the CCAA should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising CCAA authority. Appropriateness under the CCAA is assessed by inquiring whether the order sought advances the policy objectives underlying the CCAA. The question is whether the order will usefully further efforts to achieve the remedial purpose of the CCAA — avoiding the social and economic losses resulting from liquidation of an insolvent company.*

Accordingly the Court affirmed the supervising judge in Century's ability to order that the stay imposed in the *CCAA* proceeding be lifted for the limited purpose of allowing the debtor to file for bankruptcy without lifting the stay to permit enforcement by creditors in the intervening "gap". The Court cited Laskin J.A. in *Re Ivaco* (2006), 83 O.R. (3d) 108, at paras. 62-63 in noting that:

> *…"[the CCAA and BIA] are related" and no "gap" exists between the two statutes which would allow the enforcement of property interests at the conclusion of CCAA proceedings that would be lost in bankruptcy.*

The final argument raised by the Crown was dismissed on fundamental trust law principles, with the Court finding that there was no clear beneficiary of the trust at the time of settlement.

Conclusion

Century provides clear direction from the Supreme Court of Canada that Crown deemed trust claims in *CCAA* and *BIA* proceedings are to be treated consistently and with limited application to those trusts specifically preserved by the respective acts. The clarification provides certainty in advising debtors, and discourages "statute shopping" to defeat Crown claims.

Further, the Court's reasons are an endorsement for the flexible, responsive position taking by Canadian courts in *CCAA* proceedings. The Supreme Court of Canada in *Century* affirms that the guiding principles for courts is achieving the underlying principles of the *CCAA*: namely avoiding the social and economic losses resulting from liquidation, and ensuring baseline considerations of appropriateness, good faith, and due diligence.

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