
# THE *QUEEN V. CALLIDUS CAPITAL CORPORATION* OVERTURNED; LENDERS BREATHE A SIGH OF RELIEF, BUT FOR HOW LONG?

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We previously wrote about the decision in The Queen v. Callidus Capital Corporation of the Federal Court of Appeal in our Restructuring and Tax Bulletin, here. The decision, released in July 2017, was overturned on November 8, 2018 by the Supreme Court of Canada, offering sought-after certainty for secured lenders. Access the ruling here.

In Callidus, the Federal Court of Appeal decided that proceeds of sale of a debtor's assets paid to a secured creditor prior to a debtor's bankruptcy, which were subject to the Crown's GST/HST deemed trust interest, remained vulnerable to a Crown claim subsequent to the debtor's bankruptcy. Moreover, it was held that the secured creditor may be personally liable to the Crown for the amount of the deemed trust.

This appellate-court decision overturned the trial-level decision, but included a dissenting opinion from Justice Pelletier who explained that in his view, the deemed trust collapsed once the debtor went into bankruptcy. As of the date of bankruptcy, due to ss. 222(1.1) of the Excise Tax Act (giving effect to ss. 67(2) of the BIA), there were no remaining amounts subject to the deemed trust under ss. 222(1) of the ETA. The subject matter of the deemed trust no longer existed.

Without the deemed trust, Justice Pelletier reasoned, the extension of the deemed trust to the proceeds of sale under ss. 222(3) of the ETA was impossible. There was no longer any deemed trust to be extended to, and asserted against, the proceeds to the exclusion of any security interest. Justice Pelletier saw no basis for distinguishing between: (1) reducing the ss. 222(1) GST/HST deemed trust due to payments made on account of the GST/HST collected; and (2) a reduction of the deemed trust that occurs by operation of law (as the result of the bankruptcy).

Callidus sought leave to appeal to the Supreme Court of Canada, which was granted on March 22, 2018.

At the Supreme Court of Canada, Callidus – supported by interventions made by the Canadian Association of Insolvency and Restructuring Professionals, the Insolvency Institute of Canada, and the Canadian Bankers Association – argued that the language of the ETA did not support a finding that, if any liability of secured creditors existed pursuant to the deemed trust for having received assets from a tax debtor, such liability

survived the bankruptcy of the tax debtor. The deemed trust simply created a super-priority in favour of the Crown, which super-priority was extinguished upon bankruptcy. Deciding otherwise would defeat the legislative intent that the Crown be treated as an ordinary creditor.

It argued as well against the impractical and unfair consequences of the Federal Court of Appeal's majority decision. Since it is impossible for a creditor (secured or otherwise) to determine whether its debtor is in arrears on account of GST remittances, a creditor cannot be certain that the payment will not be clawed back at a later date, nor would it know the amount of the potential claw-back. A creditor would never know if the payments it received were final, a trustee would not know how to allocate proceeds, nor how to assess the viability of a proposal, creating uncertainty which could only be definitively resolved by bankruptcy. Furthermore, this purported liability of secured creditors towards the Crown has the effect of subverting the order of distribution set out under the BIA. Indeed, though a claim of unremitted GST/HST is an unsecured claim in bankruptcy, allowing the Crown to recover a pre-bankruptcy claim from another creditor – an innocent third party, as remarked by Justice Rowe - was in effect extending the deemed trust's effect beyond bankruptcy. Finally, it was argued that the deemed trust operated as a floating charge, and could not « follow » property which was disposed of by the debtor in the course of business, regardless of whether the property at issue was goods or money.

The appeal was heard by a full 9 member panel of the Court, which – remarkably – rendered its unanimous judgement from the bench. The Court adopted the reasons of Justice Pelletier's minority opinion in their entirety, and granted the appeal.

Unfortunately for lenders, and the insolvency community as a whole, the Court expressly declined to rule on the broader question of a creditor's liability when receiving payments from a tax debtor outside of a bankruptcy context. In the court's view, the question of law before them was limited to considering the effects of the tax debtor's bankruptcy on the Crown's purported ability to recover the amount of the debtor's unremitted GST/HST from a secured creditor who received a pre-bankruptcy payment from that debtor at a time when GST/HST remittances were in arrears. The arguments made by the Crown at the hearing leave little doubt that it will aggressively pursue similar claims in the future, and the broader question should find itself again before the courts in short order.

For now however, lenders can breathe a little easier, knowing that post-bankruptcy claims against them by the Crown are a little less likely.

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