SUPREME COURT OF CANADA CONFIRMS: *CCAA* SUPER-PRIORITY CHARGES RANK AHEAD OF CRA'S DEEMED TRUSTS

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The Supreme Court of Canada's recent decision in *Canada* v. *Canada North Group Inc.*[1] provided much needed clarity regarding the order of priority for unremitted source deductions in restructuring proceedings. In a 5-4 split decision, the Supreme Court confirmed that super-priority charges granted in a *Companies' Creditor Arrangement Act* ("***CCAA***") proceeding can take priority over statutory deemed trusts advanced by the Crown. Importantly, this decision resolves the apparent conflict between super-priority charges that arise from provisions of the *CCAA* and deemed trusts that arise from provisions of the *Income Tax Act* ("***ITA***"), *Canada Pension Plan*, and the *Employment Insurance Act* (collectively, the "**Fiscal Statutes**").

Background

Canada North Group and six related corporations initiated restructuring proceedings under the *CCAA*. They requested relief including the creation of super-priority charges in favour of an interim lender, the debtor's directors and insolvency professionals (collectively, the "**Priming Charges**"). In 2017, the Court of Queen's Bench issued an order granting the debtor companies protection under the *CCAA* and ranking the Priming Charges ahead of the Crown's interest arising under any federal or provincial statute.[2]

The Crown subsequently applied to vary the order giving rise to the Priming Charges, arguing that the deemed trust created by subsection 227(4.1) of the *ITA* for unremitted source deductions could not, at law, be subordinated to the Priming Charges. The application to vary was dismissed, and the Crown appealed.

In a split decision, the Court of Appeal upheld the decision of the chambers judge.[3] The majority found that the Crown's deemed trust under the Fiscal Statutes was in the nature of a floating charge. Based on this position, and with a view to interpreting the *CCAA* and the Fiscal Statutes harmoniously, the majority characterized the Crown as a secured creditor. Accordingly, the Court found that the lower court's decision to order the Priming Charges and subordinate the Crown's interest in unremitted source deductions was acceptable. The majority further noted that adopting the Crown's view would introduce "an unacceptable level of uncertainty" into insolvency proceedings.

The Supreme Court

The Crown raised two arguments in its final appeal. First, the Crown argued that Priming Charges made in a CCAA proceeding are a security interest and therefore, by virtue of subsection 227(4.1) of the *ITA*, are automatically subordinate to a deemed trust. Second, the Crown argued that the Priming Charges cannot take priority over a deemed trust made under the Fiscal Statutes as the trust is held beneficially for the Crown, and therefore never forms any part of the insolvent company's property.

The Majority Opinion

The lead decision, written by Justice Côté, emphasised the broad language used in section 11 of the *CCAA* that allows the court to grant super-priority charges over the Crown's deemed trust interest. Section 11 gives a court discretion to make any order that it considers appropriate in a restructuring proceeding. The court cannot, however, subordinate property owned by another party, the character ascribed by the Crown to its deemed trust over unremitted source deductions.

Addressing the nature of the Priming Charges, the majority held that they were not a "security interest" within the meaning of subsection 224(1.3) of the *ITA*. While the majority acknowledged that the definition of security in the *ITA* is broad, examining the nature of examples of security interests made it clear, to the majority, that a Priming Charge did not fall within this category. Unlike other security interests, the Priming Charges were made to benefit all of the parties in an insolvency proceeding rather than any individual creditor and were not made by a consensual agreement between the parties. As the Priming Charges were not a security interest, they were not automatically subordinate to the Crown's deemed trust by virtue of the *ITA*.

Addressing the nature of the deemed trusts, the majority found that a trust in favour of the Crown made under subsection 227(4.1) of the *ITA*, unlike a common law trust, does not create a proprietary interest in the debtor's property. The deemed trusts lack hallmarks of beneficial ownership necessary for a proprietary trust to arise: certainty of subject matter, right to enjoyment and a fiduciary obligation on the trustee. In the absence of a proprietary interest, the court was permitted to exercise its discretion by subordinating the statutory deemed trust to a super-priority charge under section 11 of the *CCAA*.

Importantly, the majority reason also addressed the Crown's right to unremitted source deductions under section 37 of *CCAA* — a discussion that was noticeably missing in the Court of Appeal decision as we discussed here. While subsection 37(1) nullifies deemed trusts in favour of the Crown during *CCAA* proceedings, subsection 37(2) explicitly excludes source deductions from its scope. The majority explained that this exclusion does not necessarily require that the Crown's source deductions rank in absolute priority in a *CCAA* proceeding; rather, section 37 maintains the status quo for source deductions while subordinating the Crown's interest in other deemed trusts to that of an ordinary creditor. This result, it would seem, suggests that deemed trusts maintain a preferred ranking over other Crown interests in an insolvency proceeding, even if the deemed trusts

do not automatically rank above Priming Charges.

In separate concurring reasons, Justice Karakatsanis and Justice Martin agreed that section 11 of the *CCAA* grants courts the flexibility to rank priming charges ahead of the Crown's deemed trust for unremitted source deductions. Specifically, the concurring decision reasoned that ranking a priming charge ahead of the Crown's deemed trust does not conflict with the Fiscal Statutes for two reasons. First, as long as the Crown is paid in full under a plan of compromise, the Crown's right under subsection 227(4.1) remains intact. Second, granting a super-priority charge is in line with the remedial objective of the *CCAA* and can be necessary to obtain interim financing, which is crucial to the restructuring process.

The Dissenting Opinion

The four dissenting Supreme Court justices all found that the court-ordered Priming Charges conflict with the interests of the Crown conferred by the Fiscal Statutes. Specifically, the dissenting justices agreed that the purpose of section 227(4.1) of the *ITA* and the related deemed trust provisions under the Fiscal Statutes can only be interpreted as giving priority to the Crown's deemed trust over all other claims. Justice Moldaver disagreed with Justices Abella, Brown and Rowe on the nature of the Crown's interest in source deductions and issued a separate dissenting opinion on that point.

In their dissenting opinion, Justice Abella, Brown and Rowe point to the language of subsection 227(4.1) of the *ITA*, which they say indicates a blanket paramountcy clause that prevails over all other statutes in granting the Crown priority rights over source deductions.

Even if priming charges are not security interests, the dissenting justices disagreed with the majority's decision not to characterize the deemed trust as a proprietary interest. In their view, source deductions never join the property of the debtor and are instead held beneficially for the Crown; therefore, they cannot be subject to any charges against the debtor. The dissenting justices referenced section 37 of the *CCAA* as supporting this view, finding that Parliament clearly intended to prohibit section 11 from being used to subordinate the deemed trust by exempting deemed trusts from nullification.

Notably, Justices Abella, Brown and Rowe found that the Court of Appeal erred in characterizing the Crown's deemed trust as a "security interest", an argument that we discussed here. The Court of Appeal interpreted Justice Iacobucci's reasons from First Vancouver as equating a deemed trust to a floating charge.[4] As the *CCAA* defines a charge as a security interest, interpreting Justice Iacobucci's opinion this way led the Court of Appeal to conclude that a deemed trust is a security interest. The dissenting justices disagreed with the Court of Appeal's interpretation; instead, they found that Justice Iacobucci's reasons merely suggest that a deemed trust operates similarly to a floating charge, but that they remain distinct legal concepts. The so-called floating charge crystallizes as a beneficial ownership interest over the specific assets in the *CCAA* proceeding, to the

extent of the deemed trust claim.

For the purposes of his decision granting absolute priority over source deductions to the Crown, Justice Moldaver did not find it necessary to settle the nature of the Crown's interest – whether it constituted a proprietary interest, security interest or something else entirely. In his view, as the unremitted source deductions do not form part of the debtor's company's property, priming charges could never attach to those source deductions, and a Court would have no authority to do so under the specific priming provision or the Court's broad discretionary power under section 11 of the *CCAA*. In his view, "it is not clear that the issue of competing priority between the Crown's interest and court-ordered priming charges ever arises, as the source deductions would be simply inaccessible to anyone other than the Crown."

Implications

The Supreme Court's decision in Canada North clarifies that super-priority charges favouring parties such as the monitor, counsel, an interim lender or directors and officers, can rank ahead of the Crown's statutory deemed trusts relating to unremitted source deductions. With appeals now exhausted, this decision provides some certainty and protection for lenders and insolvency professionals in *CCAA* proceedings.

Despite the Supreme Court's decision, it is important to understand that priority ranking is not automatic. In light of the remedial purposes of the *CCAA* and the importance of interim financing in restructuring proceedings, supervising courts retain a great deal of discretion on whether to grant super-priority charges that supersede the Crown's interests. To succeed on a request for the creation of priming charge that subordinate the Crown's interest, a party should demonstrate that the charge is both necessary and in line with the remedial principles of the *CCAA*.

[1] 2021 SCC 30.
[2] 2017 ABQB 550.
[3] *Canada v Canada North Group Inc*, 2019 ABCA 314.
[4] *First Vancouver Finance v MNR*, 2002 SCC 49.

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A Cautionary Note

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