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Supreme Court of Canada Judgment: Limiting Crown Claims for unremitted sales taxes in CCAA cases

decision in brief

On December 16, 2010, the Supreme Court of Canada determined that in *Companies' Creditors Arrangement Act* ("CCAA") reorganization proceedings, the Crown enjoys no super-priority status in relation to its claims for unremitted sales taxes arising under the Goods and Services Tax (the "GST") or similar provincial sales taxes.

The highest Court's decision in *Century Services Inc v Attorney General of Canada ("Century Services")*[1] has the effect of harmonizing the rules applicable in CCAA and *Bankruptcy and Insolvency Act* ("BIA") cases on this topic. Specifically, this decision follows quickly on the heels of, and is consistent with, the Supreme Court's findings in *Quebec c Caisse populaire Desjardins de Montmagny,*[2] wherein the Court confirmed that no deemed trust exists in favour of the Crown with regard to GST claims arising in BIA-based cases.

The *Century Services* decision sheds light on what appeared to be a discrepancy between the CCAA and the federal *Excise Tax Act* (the "ETA") as to whether the deemed trust for unremitted GST survives in a CCAA restructuring context. The Supreme Court held that the CCAA provisions nullifying certain deemed trusts prevail over the provisions of the ETA to the contrary effect. In the result, the Crown's GST claim was considered an unsecured, and benefitting of no trust or other priority status.

effects of the decision

In the result, Century Services should facilitate the work of insolvency professionals and clarify the rules to the benefit of all stakeholders. An added benefit is that the decision also confirms the broad discretion of the courts in insolvency matters. Moreover, it is telling that the Supreme Court

[1] 2010 SCC 60.

[2] 2009 SCC 49.

put significant emphasis on what it considered to be the desired effects of Canada's insolvency statutes – namely, that the preservation of businesses and value should find favour in the harmonized restructuring regimes of the CCAA and BIA.

In practical terms, the decision entails that, other than for a few exceptions, Crown claims do not have priority over those of other creditors. The decision also avoids the scenario of there being inconsistent regimes under the BIA and CCAA. Such a scenario may have tempted debtors, as well as other interested parties seeking to maximize stakeholder returns, to engage in "statute shopping" by opting for bankruptcy-induced liquidation proceedings under the BIA rather than seeking to restructure under the CCAA and run the risk of prioritizing the Crown's claims.

context – detailed analysis of the case

In Century Services, the debtor had collected, but not yet remitted, significant sums representing GST amounts owing to the Crown.

at first instance

In the course of the CCAA proceedings, before the Court of first instance, it became clear that reorganization would not be successfully completed. In September 2008, the debtor sought leave to make an assignment in bankruptcy under the BIA. The Crown immediately sought an order that it be paid the GST amount then being held in trust by the Monitor, on the basis that such amounts were subject to a deemed trust in favour of the Crown. This application was dismissed. In addition, considering the failure of the reorganization and the resulting termination of the CCAA proceedings, the Court ordered that the CCAA-based stay remain in effect while the proceedings were "moved" into BIA liquidation proceedings in which it was clear that the deemed trust under the ETA would not survive.

at the Court of Appeal

The British Columbia Court of Appeal unanimously reversed the decision to allow the BIA-based liquidation to proceed without the remittance of the GST amounts to the Crown. The Court of Appeal reiterated the existing conflict between the deemed trust created in favour of the Crown under the ETA and the absence of recognition of such trust under the CCAA. The Court of Appeal applied the 2005 decision of *Ottawa Senators Hockey Club Corp ("Ottawa Senators"),*[3] and specifically the "implied repeal" interpretive doctrine. In the *Ottawa Senators* decision, it was decided that the (then-) more recent amendments of the ETA were deemed to "trump" the (then-) older provisions of the CCAA to the effect that the deemed trust had no application in CCAA proceedings.

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[3] *Canada (Attorney General) v Fleet National Bank,* 2005 CanLII 21.

On this basis, the British Columbia Court of Appeal found that the deemed trust continued to be effective in a CCAA proceedings, and further determined that the trial judge did not have authority to continue the stay commenced under the CCAA into proceedings initiated under the BIA and thereby override the express ETA provisions.

the Supreme Court's decision

After acknowledging the existing conflict between the applicable provisions of the ETA and the CCAA, Madame Justice Deschamps, for the majority of the Supreme Court, rejected the implied repeal doctrine followed in *Ottawa Senators* and by the Court of Appeal in the matter at hand.

Rather, Justice Deschamps opted for an interpretation of the provisions of the CCAA that takes into consideration Parliament's intent to create a harmonized insolvency regime that seeks to encourage the restructuring of business rather than their liquidation. In analyzing Parliament's intent with respect to the CCAA, Justice Deschamps found that notwithstanding certain statutory lacuna between tax laws and the CCAA, the real intention of the Parliament was to limit the precedence of Crown claims to very specific cases. In general, Canada's insolvency statutes exclude Crown priorities, save for certain source deductions created by the *Income Tax Act*, the *Canada Pension Plan Act* and the *Employment Insurance Act*. Thus, Crown priorities are to be treated as the exception, rather than the rule. Giving precedence to the ETA, as the Court of Appeal sought to do, would create an asymmetry in the insolvency regime: the Crown would have a priority claim under the CCAA, whereas no such priority would exist under the BIA. The practical effect of such an approach would be to decrease the interest in the most flexible and facilitating reorganization process in favour of liquidation proceedings under the BIA, thereby potentially encouraging "statute shopping" by secured creditors seeking to maximize their returns rather than to preserve the debtor's business as a going concern.

The Supreme Court also disagreed with the Court of Appeal's finding that the first instance judge did not have authority to stay payment of the Crown's GST claims while the matter transited into the BIA liquidation proceedings. The Supreme Court found that the order was made to ensure that no creditor would be disadvantaged by the CCAA proceedings prior to the continuation of the BIA proceeding. This order was clearly in line with the objectives of the insolvency legislation and fell within the trial judge's discretionary powers. Madame Justice Deschamps found that the two regimes form part of a broader insolvency regime and should not be considered in dissociation. The transition from one to another, though not provided for by law, falls under the Court's discretion.

concluding remarks

The Supreme Court's decision in *Century Services* should clarify the state of the law, give insolvency professionals better guidance and reassure parties to CCAA proceedings. Though the result is of little surprise to the insolvency community in Canada, the rationale for the ruling was somewhat unexpected. The interpretative process adopted by the majority of the Supreme Court comes as a surprise. The Court could have applied the implied repeal doctrine and relied on the fact that recent amendments to the CCAA render it a more recent statute than the ETA. However, by focusing on a new interpretative analysis, the Supreme Court has limited the possibility of revisiting this issue in the future if and when either statute undergoes further amendment.

Indeed, the Court's analysis puts emphasis on the desired effects of the reorganization regime and on the Parliament's intent to create a harmonized regime which limits Crown claims, to the benefits of other creditors. Reorganizations protect employees, creditors and more general social interests by avoiding the loss of value occasioned by forced liquidations. The Supreme Court's interpretation should serve to avoid undermining the restructuring regimes of the CCAA and BIA, which are considered the most flexible and efficient processes to bring a crippled company back to health.

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