Caisse Populaire: Solidifying Crown priorities in Bankruptcy

By: Eleonore L. Morris, Associate
Minden Gross LLP, a member of MERITAS Law Firms Worldwide.

In its highly anticipated decision rendered in Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny, 2009 SCC 49 ("**Caisse Populaire**"), the Supreme Court of Canada confirmed the judgment of the Quebec Court of Appeal and held that the Quebec Sales Tax ("**QST**") and the Goods and Services Tax ("**GST**") amounts that have been collected on behalf of the tax authorities but not remitted, or are collectible at the time of the bankruptcy, form part of the patrimony of the bankrupt estate.

At issue in Caisse Populaire was whether the federal and provincial tax authorities (collectively, or individually, the "**Crown**") had a property right by way of a deemed trust in the tax portion of the outstanding accounts receivable of the bankrupt and, if so, would those amounts (if ascertainable) vest as property of the Crown. Conversely, if the Court found the Crown had no ascertainable property right in the tax portion of those accounts receivable, such amounts would form part of the bankrupt's estate and the Crown's claims for the GST and the QST unremitted by the bankrupt supplier would be ordinary unsecured claims in the bankruptcy.

The Court found the Crown's position that the deemed trusts established by the legislature should continue to exist after a bankruptcy "conflicts with both the words and the intent of the statutory provisions in question, and is inconsistent with the nature of the tax authorities' rights under the system for the collection and remittance of the GST and QST".

Where a supplier company goes bankrupt, the Crown does not 'own' GST and QST amounts. Instead, it has an unsecured claim.

GST and the QST (as well as other provincial sales taxes) are "direct" taxes, meaning that they are imposed directly by the Crown on taxable supplies when received. The supplier of such taxable goods, on behalf of the Crown, is required to collect the tax payable from the recipient, and to remit same to the Crown in turn.

Consequently, a supplier is deemed to hold in trust for the benefit of the Crown those amounts collected, where such deemed trust continues until the supplier has met the entirety of its obligations to collect and remit the tax in question.

The 1992 amendments to the Bankruptcy and Insolvency Act ("**BIA**"), and concordant amendments to the Excise Tax Act ("**ETA**"), provide that all provable claims of the Crown, including but not limited to the deemed trusts established by the ETA and the Quebec Act respecting the Ministère du Revenue ("**AMR**"), are terminated at the time of bankruptcy. Subject to a statutory exception in favour of claims for salary deductions under federal and provincial laws[1], the special priority secured rights granted to the tax authorities are extinguished, and each ranks as an unsecured claim following a bankruptcy.

In essence, the provisions of the BIA mandate that, following a bankruptcy, property may not be regarded as being held in trust unless it would be so regarded in absence of a statutory priority.

In the past, uncertainty in the legislative scheme was derived from the fact that certain of the provincial acts, including the AMR and the Act respecting the Quebec Sales Tax (and similarly in Ontario, the Retail Sales Tax Act), did not contain exemptions akin to that found in the ETA which specifically negated the deemed trusts of the Crown, thereby failing to align the provisions of the provincial acts with those of the BIA. Understandably, the Crown maintained the position that without such negating exemptions, notwithstanding the BIA provisions, the deemed priorities with respect to amounts owing for, amongst others, QST (and in Ontario, PST) continued following bankruptcy.

In Caisse Populaire, this issue of conflicting provincial and federal legislation was settled, with the Court holding that the BIA provisions trump the provincial acts. In making this determination, the Court found that "Parliament's legislative authority over bankruptcy prevents the provincial legislatures from modifying the order of priority established in the BIA."

Overall, the decision has given clarity as to the nature of the rights of the Crown, the trustee in bankruptcy, and other stakeholders of the bankrupt in circumstances where GST, QST and other provincial sales tax arrears exist. Having certainty that the Crown does not have a right of ownership in these tax amounts and instead merely enjoys the rights of an ordinary unsecured creditor will allow greater flexibility and creativity for companies developing post-bankruptcy restructuring plans, and will give comfort to trustees charged with the responsibility to distribute the bankrupt's assets amongst creditors.

The insolvency community continues to wait for the Supreme Court decision in Century Services Inc. v. Attorney General of Canada, a British Columbia case which deals with deemed trusts for tax collected by companies subject to the Companies' Creditors Arrangement Act. The application for leave to appeal was granted on November 5, 2009.

It will be interesting to see how the Court rules with respect to same. A ruling which adheres to the principles established in Caisse-Populaire will serve to provide the insolvency community with even greater certainty as to how to deal with, and strategize against, Crown claims.

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[1] Certain other statutory exemptions exist for claims which are not relevant to this particular case comment.