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Callidus Capital Corporation v HMQ: Last Word Goes to the Secured Creditor

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The Supreme Court of Canada (the SCC) has overturned the decision rendered by a majority of the Federal Court of Appeal (the FCA) in *Callidus Capital Corporation v Her Majesty the Queen*.

The case originated out of a motion filed in the Federal Court (the FC) by Callidus Capital Corporation (Callidus) to determine the following question of law:

Does the bankruptcy of a tax debtor and subsection 222(1.1) of the [Excise Tax Act (the ETA)]¹ render the deemed trust under section 222 of the ETA ineffective as against a secured creditor who received, prior to the bankruptcy, proceeds from the assets of the tax debtor that were deemed to be held in trust?

The FC answered this question in the affirmative, but was subsequently reversed by a majority of the FCA, with Pelletier JA dissenting. In its reasons for judgment, delivered orally from the bench on November 8, 2018 (with written reasons to be issued shortly), the SCC (Gascon J) endorsed the dissenting reasons given in the FCA's decision.

The Deemed Trust Mechanism

Subsection 222(1) creates a deemed trust in favour of the Crown, whereby every person who collects an amount on account of goods and services tax (GST) and harmonized sales tax (HST) is deemed, despite any security interest in the amount, to hold the amount in trust for the Crown until it is remitted to the Receiver General. Subsection 222(3) extends this deemed trust to the property of the debtor, which is deemed to be held in trust for the Crown; as a result, the proceeds of such property must be paid to the Receiver General in priority to all security interests.

Pursuant to subsection 222(1.1) and subsection 67(2) of the *Bankruptcy and Insolvency Act* (the BIA), the deemed trust ceases to apply, as of the moment that a debtor becomes a bankrupt (within the meaning of the BIA), to any amounts of GST/HST that were collected or became collectible by the debtor before the bankruptcy. At the heart of the case was the question of whether a debtor's bankruptcy has the effect of extinguishing the extended deemed trust under subsection 222(3) in addition to the subsection 222(1) deemed trust.

The Background

By the end of the year 2011, Cheese Factory Road Holdings Inc. (Cheese Factory), a real estate investment company, was suffering from financial hardship. A forbearance agreement was thus entered into between Cheese Factory and Callidus, its then new secured creditor, pursuant to which Cheese Factory undertook: (i) to market one of its properties for sale and deliver the net sales proceeds to Callidus, and (ii) to deposit in a blocked bank account, as of December 2011, the rent proceeds earned from another of its properties.

Meanwhile, between 2010 and 2013, Cheese Factory collected amounts of GST/HST that it failed to remit to the Receiver General. Consequently, in April 2012, following the sale of one of Cheese Factory's properties, the proceeds of which were delivered to Callidus, the Canada Revenue Agency issued to Callidus a demand for payment pursuant to section 222. However, the Crown took no further step to enforce this demand until the bankruptcy of Cheese Factory.

In November 2013, Cheese Factory made an assignment in bankruptcy under the BIA. The Crown subsequently commenced an action against Callidus, claiming the full amount of GST/HST unremitted by Cheese Factory plus interest, on the basis of the deemed trust mechanism. In the course of this proceeding, Callidus brought a motion requesting the FC to determine the question of law outlined above regarding the impact of a debtor's bankruptcy on the effectiveness of the deemed trust mechanism against a secured creditor.

The SCC Decision

Having reversed the FCA's decision, the SCC went on to reinstate the FC's holding that the bankruptcy of a debtor (such as Cheese Factory), rendered the deemed trust under subsection 222(3) ineffective against a secured creditor (such as Callidus) that had received, prior to the bankruptcy, proceeds from the assets of the debtor that were deemed to be held in trust for the benefit of the Crown (such as proceeds from property sold or leased by the debtor).

Pelletier JA, whose dissenting reasons were adopted by the SCC, found that the deemed trusts created under subsections 222(1) and (3) are distinct but interlinked. As a result of subsection 222(1.1), no amount of unremitted GST/HST is deemed to be held in trust as per subsection 222(1) after a bankruptcy, which has the effect of extinguishing the extended deemed trust under subsection 222(3). This is true for the debtor as well as for the debtor's secured creditors.

Pelletier JA added that his interpretation reflected Parliament's intention, as evidenced by previous amendments to the BIA, to ensure that the Crown did not put itself in a priority position in the context of a bankruptcy and instead ranked on the same footing as unsecured creditors. The only exceptions are expressly outlined in subsections 67(2) and (3) BIA, which provide that only the deemed trusts created for the benefit of the Crown with respect to unremitted source deductions subsist upon a debtor's bankruptcy. According to Pelletier JA, these provisions, as well as the absence of a restriction equivalent to subsection 222(1.1) in the legislation governing deemed trusts for unremitted source deductions, tend to show that Parliament intended to create a special regime for source deductions in the event of bankruptcy, but that no such regime was intended in respect of deemed trusts created under the ETA for unremitted sales taxes.

The effect of Pelletier JA's reasoning, as now endorsed by the SCC, is that, as of the date of a debtor's bankruptcy, there are no longer any amounts subject to the subsection 222(1) trust, and therefore no property of the debtor is subject to a deemed trust under subsection 222(3). As a result, no proceeds of such property are payable to the Crown by a secured creditor that received the proceeds prior to the debtor's bankruptcy.

The SCC's decision is favourably received insofar as it clarifies the applicable law with respect to the continuance of the subsection 222(3) deemed trust in the context of a bankruptcy. However, it is worth noting that the SCC specifically declined to decide whether a creditor would be directly liable to the Crown upon receiving payments from a debtor that fails to remit GST/HST outside of a bankruptcy context.

¹Unless otherwise stated, all references to a statute herein are to the ETA.

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