Tax Topics

June 2, 2020
Number 2517

COVID-19 Update

Provincial 2

International........ 5

One Priority To Rule Them All: CRA's "Super priority" Over Secured Creditors 6

Recent Cases 11

International News................ 11

ADP

Wolters Kluwer

COVID-19 UPDATE

Canada

Consultation on CEWS (May 25, 2020)

On May 25, 2020, the Department of Finance launched a consultation of the Canada Emergency Wage Subsidy ("CEWS"), which will close on June 5, 2020. The Department is seeking information and feedback from businesses of all sizes, labour representatives, not-for-profits, and charities on potential changes to the program, with a view to maximizing employment in Canada and encouraging growth. Further information regarding the consultation can be found at: https://www.canada.ca/en/department-finance/programs/consultations/2020/canada-emergency-wage-subsidy-consultation.html

Tax Court Cancels More Sittings and Calls (May 27, 2020)

The Chief Justice of the Tax Court of Canada has further cancelled all sittings and conference calls scheduled between July 6th, 2020 and up to July 17th, 2020, inclusively. At this time, sittings that are scheduled beyond August 17th, 2020 will proceed. Should circumstances allow for the resumption of the Court's operations in the coming weeks, the Court will sit during the four-week summer recess and appeals will be scheduled between July 20th and August 13th, 2020. Parties whose hearings were interrupted in March by the closure of the Court or whose general appeals were adjourned in March and April can expect to be contacted in priority to schedule the continuation or hearing of their appeal.

CRA Resumes Some Audit Activities (May 28, 2020)

The CRA is resuming a full range of audit work, but is prioritizing actions that are beneficial to the taxpayer or where taxpayers have indicated there is an urgency to advancing their audit. The CRA is also focusing on higher dollar audits first, audits close to completion, and those with a strategic importance to the Government of Canada, provinces and territories, or tax treaty partners. In addition, efforts to combat suspected fraud and other criminal activity are advancing.

New methods of taxpayer and registrant interaction will be required, and the CRA is working to develop procedures and protocols to adapt these to the current reality. For example, taxpayers are provided with the option to send information via e-mail. Some key changes will relate to offering additional time and upfront consultation on requests to provide the CRA with information and access. Public Health directives will be respected, and additional reasonable measures will be extended both in terms of timing or another aspect of a CRA request.

In addition, Requirements for Information ("RFIs") issued prior to March 16 and due after that date will be reviewed, and taxpayers and third parties, including financial institutions, will be contacted where the CRA continues to require the information in the RFI.

Obtaining International Waivers and Notifications for Certificates of Compliance (May 27, 2020)

The CRA provided an update on its website with regard to its process for reviewing international waivers and requests for a certificate of compliance under section 116. The CRA has created a temporary procedure allowing taxpayers and their representatives to electronically submit urgent requests. Processing times might be longer than usual. For further information, see https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/international-waiver-compliance-certificate.html.

Clearance Certificate Update (May 26, 2020)

The CRA recently provided an update regarding its processing of requests for clearance certificates. The CRA continues to process clearance certificates, but its employees have limited access to their offices due to COVID-19. They are receiving minimal submissions sent by mail or fax, and therefore any documentation or new clearance request applications sent to the CRA after March 12, 2020 may not have been included in the inventory for processing. Legal representatives who submitted a clearance request after March 12, 2020 are encouraged to resubmit the request and supporting documents electronically, either through Represent a Client or by email.

As part of the response to COVID-19, the CRA has created a temporary procedure allowing taxpayers and their representatives to submit clearance certificate requests and supporting information via email. To submit the request via email, the legal representative must contact the CRA by sending an email, without confidential information, to CCTX19G@cra-arc.gc.ca and including in the subject line the province where the executor lives. A CRA officer will reply by email, outlining the potential security risks of using email to transmit confidential information. If you reply by email accepting the risks, the CRA will allow you to submit the clearance application and supporting information.

Temporary Business Assistance Hotline Launches (May 25, 2020)

The federal government has introduced a four-week hotline service called the Business Resilience Service. This service will help entrepreneurs and small business owners in need of financial planning advice, particularly those who may not have access to an accountant. The service will also be open to not-for-profit organizations and charities. The hotline is a national, bilingual service operated by the Canadian Chamber of Commerce. Small business owners with pressing financial needs can call 1-866-989-1080 (toll-free), seven days a week, from 8 a.m. to 8 p.m. (ET).

125 members of CPA Canada will provide customized financial guidance to the smallest business owners in the most urgent need and help them make the best decisions for their business as they navigate this crisis. Advisors can answer questions about taxes and the implications of COVID-19, inform business owners about government support programs, and provide strategic financial planning.

Provincial

Alberta

Corporate Tax Return Deadline Extended (May 25, 2020)

The filing deadline for an Alberta Corporate Income Tax Return ("AT1") has been extended to September 1, 2020 for an AT1 that would otherwise have a filing deadline in June, July, or August 2020. The deadline is June 1, 2020 for an AT1 that would otherwise have a filing deadline after March 18 and before June 1, 2020. Alberta will not assess a late-filing penalty with respect to an AT1 otherwise due during these deferral periods if the AT1 is filed on or before the respective extended deadline noted above.

Furthermore, the filing deadline for a Notice of Objection (Form AT97) that would otherwise have a filing deadline after March 18 and before June 30, 2020 is extended to June 30, 2020.

Manitoba

Tax Appeals Commission Update (May 26, 2020)

If a taxpayer wants to appeal to the Tax Appeals Commission ("TAC") a Notice of Assessment issued after the state of emergency was declared on March 20, 2020, the 90-day period does not start until the earlier of September 21, 2020 or the end of the state of emergency. If the taxpayer or the Taxation Division want to appeal to the Court of Queen's Bench a decision rendered by the TAC after the state of emergency was declared on March 20, 2020, the 90-day period does not start until the earlier of September 21, 2020 or the end of the state of emergency.

Support for Persons With Disabilities (May 26, 2020)

The province is extending $4.6 million in direct and immediate financial support to low-income Manitobans with disabilities during the COVID-19 pandemic through the new Disability Economic Support Program. More than 23,000 Manitobans receive monthly benefits under the disability category of Employment and Income Assistance. Under the Disability Economic Support Program, each of these Manitobans will be mailed a $200 cheque in early June for one-time support. This payment will not be considered taxable income and will not affect any other benefits received.

New Brunswick

Property Tax Reduction Cancelled (May 27, 2020)

In light of the financial impact of the COVID-19 pandemic, the provincial government will not proceed with the proposed property tax reductions contained in the 2020–2021 Budget. In its Budget, the government had announced phased-in reductions to the provincial property tax on non-owner-occupied residential properties, often referred to as the double tax, and to non-residential properties.

Wage Increase for Essential Workers (May 20, 2020)

The province has sent a request to the federal Finance Minister proposing a program to provide a monthly top-up of approximately $500 for 16 weeks for front-line workers in a number of sectors. Those eligible for the funding include employees in:

- early learning and child care facilities;
- home support;
- special care homes, community residences, and group homes;
- homeless shelters and food banks; and
- domestic violence outreach and transition homes.

Workers must earn $18 per hour or less to be eligible. The top-up will be paid by employers every four weeks. The exception will be child care facilities, which will split the first and last payments to align with existing payment schedules. Workers at early learning and child care facilities will receive their top-up retroactive to May 19 and it will continue for 16 weeks. This is in recognition of their return to work as the child care sector reopened. All other sectors will be paid retroactively from March 19 to July 9. Employers will be reimbursed by the departments of Education and Early Childhood Development or Social Development.

Newfoundland and Labrador

Various New Measures (May 22, 2020)

On May 22, 2020, the province announced that, effective immediately, the following measures are in place:

- Collection of WorkplaceNL assessments from employers has been deferred to after August 31, 2020, with no interest or penalties;

- Clearance letters will continue to be provided during the payment deferral period to allow contractors that meet certain reporting criteria to continue to bid on work and operate;
- The interest-free payment plan for workplace injury insurance is extended beyond 2020 to March 31, 2021 to allow employers more flexibility to pay;
- Safety training certificates are extended to August 31, 2020 for confined space entry, fall protection, mine rescue, power line hazards, traffic control person, first aid, and Occupational Health and Safety Committee members;
- Elimination or offer of rebates on aquaculture licence fees, and deferral of annual Crown Lands fees for aquaculture sites;
- Full rebate of base fish processor and buyer licensing fees to assist fish processing plants and fish buyers;
- Licences will not be cancelled for non-application for renewals until the public health restrictions have been lifted for real estate salespersons and agents, mortgage brokers, insurance companies, insurance adjusters, agents, representatives, and brokers, and prepaid funeral services;
- New licence applications will be processed for real estate salespersons and agents, mortgage brokers, insurance companies, and insurance adjusters, representatives, agents, and brokers;
- Businesses are eligible to have a portion of vehicle registration fees for vehicles registered to the business refunded if they are not in use;
- Commercial vehicles of 4,500 kilograms or greater are not required to have their safety inspection completed while they are not operational;
- Deferral of the requirement for businesses to file yearly returns under Companies and Deeds Online ("CADO") and remittance of the accompanying filing fee; and
- Payment of water use charges for 2019 related to microbreweries and wineries and aquaculture due in the 2020–2021 fiscal year have been waived; payment of water use charges for all other industries will be deferred until March 31, 2021.

Support of Tourism and Hospitality Sectors (May 25, 2020)

To assist eligible tourism and hospitality-based operators impacted by the COVID-19 pandemic, on May 25 the Provincial Government announced the Tourism and Hospitality Support Program. Under the program, eligible small and medium-sized tourism operators will be able to apply for a one-time, non-repayable working capital contribution of either $5,000 or $10,000, dependent on gross sales. Visit www.gov.nl.ca/tcii/ for details. Eligible operators can apply starting June 8.

Ontario

Non-Resident Speculation Tax Update (May 20, 2020)

The Ministry of Finance understands that the effect of COVID19 and the state of emergency could make it difficult for individuals who seek a Non-Resident Speculation Tax ("NRST") rebate to fulfil the condition that they occupy a property as their principal residence within 60 days after the date of purchase. Therefore, the Ministry will apply an administrative concession to extend the period of time within which a person must occupy a property as their principal residence for the purposes of an NRST rebate to 60 days after the final day of the state of emergency. The administrative concession will be applied only to purchases that have occurred from January 17, 2020 to the final day of the state of emergency. The administrative concession will not apply with respect to purchases that occurred on or before January 16, 2020, or purchases that occur after the state of emergency is no longer in effect. Rebates must be applied for within four years after the day on which the NRST became payable, except for the rebate for a foreign national who becomes a permanent resident of Canada. The rebate for a foreign national who becomes a permanent resident of Canada must be applied for within 90 days of the foreign national becoming a permanent resident, and no application may be made more than four years and 90 days from the date the NRST became payable. All rebate applications must be made using the Ontario Land Transfer Tax Refund/Rebate form for NRST.

Support for Apprentices (May 22, 2020)

The government is providing an Ontario Tools Grant of $2.5 million in 2020–2021 and $7.5 million in 2021–22 and ongoing to help new eligible apprentices purchase the equipment they need to start their careers. The funding amounts will be distributed as follows:

- $1,000 for those in motive power sector trades;
- $600 for those in construction and industrial sector trades; and
- $400 for those in service sector trades.

To be eligible for the new grant, apprentices must have:

- completed level 1 training on or after April 1, 2020;
- an active registered training agreement; and
- been registered as an apprentice for at least 12 months.

The government is also forgiving more than $10 million in outstanding loans owed by apprentices for tool purchases made at the beginning of their careers. The Loans for Tools Program allowed thousands of new apprentices to buy tools, equipment, clothing, manuals, and code books required for their trade. About 19,000 apprentices who participated in the program owed, on average, $495.

Quebec

Deadline for Corporate Tax Returns Extended (May 25, 2020)

Revenu Québec is extending the income tax return filing deadline for certain corporations to September 1, 2020. This new relief measure is for corporations that would have otherwise been required to file their income tax return between June 1 and August 31, 2020 (corporations whose taxation year ended between December 1, 2019 and February 29, 2020). In March 2020, Revenu Québec announced that corporations normally required to file their income tax return between March 17 and May 31, 2020 would have until June 1, 2020 to do so. The payment deadline for instalment payments and any income tax balance owing that would otherwise be due between March 17 and August 31, 2020 was extended to September 1, 2020 for both individuals and corporations.

Deadline for Trust Tax Returns Extended (May 25, 2020)

Revenu Québec is extending the information return and income tax return filing deadlines for certain trusts to September 1, 2020. This new relief measure is for trusts that would have otherwise been required to file their information return or income tax return between June 1 and August 31, 2020 (trusts whose taxation year ended between March 2 and May 31, 2020). In March 2020, Revenu Québec announced that trusts normally required to file their information return or income tax return between March 31 and May 31, 2020 would have until June 1, 2020 to do so.

International

IRS Posts FAQs on Medical Condition Exception in Light of COVID-19

On May 27, 2020, the United States Internal Revenue Service (“IRS”) posted some frequently asked questions on its website relating to the relaxation of the tax rules for those who are temporarily resident in the US but unable to leave due to the COVID-19 virus.

Under current rules, individuals who intend to leave the US but cannot do so due to medical problems may be able to claim the medical condition exception, which excludes certain days of US presence from the substantial presence test.

Under the substantial presence test, a person is considered resident in the US for tax purposes if they were physically present in the US on at least:

- 31 days during the current year, and
- 183 days during the three-year period that includes the current year and the two years immediately before that, counting:
  - all the days the person was present in the current year, and
  - 1/3 of the days they were present in the first year before the current year, and
  - 1/6 of the days they were present in the second year before the current year.

To obtain the medical condition exception, taxpayers must generally file Form 8843, Statement for Exempt Individuals and Individuals With a Medical Condition, which requires a signed statement from a physician or other medical official that an individual was unable to leave the US due to a medical condition or medical problem.

However, due to circumstances unique to the COVID-19 emergency, the IRS acknowledges that it may be difficult to obtain a signed statement attesting to the individual's inability to leave due to a medical condition. Accordingly, the FAQs modify the requirements for completing Form 8843 for certain individuals claiming the medical condition exception during calendar year 2020.

The FAQs also provide information regarding relevant record keeping requirements for persons filing Form 8843 without a physician's statement, either pursuant to the FAQs or the relief granted in Revenue Procedure 2020-20.

Revenue Procedure 2020-20, published on May 11, 2020, provides that, under certain circumstances, up to 60 consecutive calendar days of US presence that are presumed to arise from travel disruptions caused by the COVID-19 emergency will not be counted for purposes of determining US tax residency and for purposes of determining whether an individual qualifies for tax treaty benefits for income from personal services performed in the United States.

ONE PRIORITY TO RULE THEM ALL: CRA'S "SUPER PRIORITY" OVER SECURED CREDITORS

— Jacques Roberge, Wolters Kluwer Canada Limited

The Federal Court of Appeal ("FCA") recently rendered an important decision in *Toronto-Dominion Bank v. Canada.*[1] The decision confirms unequivocally the lower court's judgment;[2] it is worth reviewing the facts and issues.

The Facts of the Case

Mr. M. Weisflock (the "debtor") owned and operated a landscaping business as a sole proprietorship. He was required to collect and remit GST to the Receiver General. In 2007 and 2008, before he became a banking customer of the Toronto Dominion Bank ("TD Bank"), the debtor collected, but did not remit to the Receiver General, GST in the amount of $67,854 in relation to his landscaping business.

In 2010, TD Bank extended loans and lines of credit to Mr. Weisflock and his spouse totaling $598,000. These were secured by a charge and a mortgage in favour of TD Bank registered against a property owned by the debtor (the "property"). When the loans were issued, TD Bank was unaware that their client owed money to the Canada Revenue Agency ("CRA").

In October 2011, the property was sold to a third party and part of the proceeds was used to repay the bank loans and mortgage, discharging the charges against the property.

On April 18, 2013 and February 2, 2015, the CRA asserted a deemed trust claim under section 222 of the *Excise Tax Act* against TD Bank on the basis that the proceeds it received from the sale of the property ought to have been paid to the Receiver General up to the amount deemed to be held in trust. The amount of the deemed trust claim was $67,854. TD Bank refused to pay and the Crown began an action against the bank (based on an agreed statement of facts) at the Federal Court and subsequently at the Federal Court of Appeal.

[1] 2020 DTC 5042, April 29, 2020.

[2] 2018 GTC 1020 (FC), May 25, 2018.

The issue was the correct interpretation to give to subsections 221(1) and (3) of the *Excise Tax Act*: Is a secured creditor who receives proceeds from a tax debtor's property at a time when the debtor owes GST to the Crown required to pay the proceeds, or a portion thereof equaling the tax debt, to the Receiver General in priority to all security interests?

The legislation providing for this "super priority", which also exists under the *Income Tax Act* and other legislation (see section 227 of the *Income Tax Act*, subsection 23(3) of the *Canada Pension Plan*, and subsection 86(2) of the *Employment Insurance Act*) has been the subject of much litigation and been amended in the past.

For instance, in *Royal Bank of Canada v. Sparrow Electric Corp.*,[3] the Supreme Court of Canada considered the scope of the deemed trust provisions of the *Income Tax Act* then in force. Subsections 227(4) and (5) of the *Income Tax Act* then provided in material part:

> (4) Every person who deducts or withholds any amount under this Act shall be deemed to hold the amount so deducted or withheld in trust for Her Majesty.
>
> (5) Notwithstanding any provision of the *Bankruptcy Act*, in the event of any liquidation, assignment, receivership or bankruptcy of or by a person, an amount equal to any amount
>
> (a) deemed by subsection (4) to be held in trust for Her Majesty . . .
>
> shall be deemed to be separate from and form no part of the estate in liquidation, assignment, receivership or bankruptcy, whether or not that amount has in fact been kept separate and apart from the person's own moneys or from the assets of the estate.

By way of comparison, subsections 222(1) and (3) of the *Excise Tax Act* at that time read:

> (1) Subject to subsection (1.1), where a person collects an amount as or on account of tax under Division II, the person shall, for all purposes, be deemed to hold the amount in trust for Her Majesty until it is remitted to the Receiver General or withdrawn under subsection (2).
>
> [. . .]
>
> (3) In the event of any liquidation, assignment, receivership or bankruptcy of or by a person, an amount equal to the amount deemed under subsection (1) to be held in trust for Her Majesty shall, for all purposes, be deemed to be separate from and to form no part of the estate in liquidation, assignment, receivership or bankruptcy, whether or not that amount has in fact been kept separate and apart from the person's own moneys or from the assets of the estate.

In *Sparrow*, the majority of the Supreme Court held that the deemed trust which arose in favour of the Crown by operation of subsection 227(4) of the *Income Tax Act* did not take priority over the security interests that the Royal Bank possessed under the *Bank Act* and the *Personal Property Security Act*. The deemed trust did not have the effect of undoing an existing security interest; rather, it was "a device for going back in time and seeking out an asset that was not, at the moment the income taxes came due, subject to any competing security interest." That said, the majority emphasized that it was open to Parliament to use clear language to "assign absolute priority to the deemed trust."

Revised Legislation

Parliament accepted this invitation, and amendments were made to section 227 of the *Income Tax Act*, section 222 of the *Excise Tax Act*, and the equivalent provisions of the *Canada Pension Plan* and the *Employment Insurance Act*. The amended, deemed trust provisions of the *Income Tax Act* were then considered by the Supreme Court of Canada in *First Vancouver Finance v. M.N.R.*[4] At that time, subsections 227(4) and (4.1) provided:

> (4) Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.
>
> (4.1) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at

[3] [1997] 1 S.C.R. 411, 208 N.R. 161.

[4] 2002 SCC 49, 2002 2 S.C.R. 720.

> any time an amount deemed by subsection (4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed
>
> (*a*) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, and
>
> (*b*) to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to such a security interest
>
> and is property beneficially owned by Her Majesty notwithstanding any security interest in such property and in the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

Justice Iacobucci, writing for a unanimous Supreme Court in *First Vancouver*, held that Parliament had amended the deemed trust provisions "to grant priority to the deemed trust in situations where the Minister and secured creditors of a tax debtor both claim an interest in the tax debtor's property." The deemed trust did not, however, impress the property of a tax debtor sold to a *bona fide* purchaser for value.

In the present case, the Federal Court of Appeal reviewed the text, context, and purpose of subsections 222(1) and (3) of the *Excise Tax Act*:

> Post-*Sparrow* amendments comparable to the amendments made to subsection 227(4) of the *Income Tax Act* were made to the deemed trust provision in subsection 222(1) of the *Excise Tax Act*. The words "despite any security interest in the amount" were added. Thus, "every person who collects an amount as or on account of" GST is "deemed, for all purposes" to hold the amount in trust for the Crown "despite any security interest in the amount" collected until the amount is remitted to the Receiver General or properly withdrawn.
>
> Again, comparable to the post-*Sparrow* amendments made to the *Income Tax Act*, subsection 222(3) of the *Excise Tax Act* was amended to extend the scope of the deemed trust to include "property of the person and property held by any secured creditor . . . that, but for a security interest, would be property of the" tax debtor. Subsection 222(3) was also amended to remove reference to the triggering events of liquidation, assignment, receivership or bankruptcy. Instead, "if at any time an amount deemed . . . to be held by a person in trust . . . is not remitted to the Receiver General" or properly withdrawn, the property of the tax debtor and "property held by any secured creditor" of the tax debtor that "but for a security interest, would be property" of the tax debtor is deemed to be held "from the time the amount was collected by the [tax debtor] in trust for Her Majesty . . . whether or not the property is subject to a security interest". While subsection 222(3) continued to provide that monies deemed to be held in trust were also deemed to be separate and apart from the property of the tax debtor, the phrase "whether or not the property is subject to a security interest" was added. Finally, subsection 222(3) was amended to add that the property deemed to be held in trust is further deemed to be "property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests."

Federal Court Decision

In *Canada v. Toronto-Dominion Bank*, the Federal Court found that subsection 222(3) of the *Excise Tax Act* obliged TD Bank to remit that portion of the sale proceeds caught by the deemed trust. In reaching this conclusion, the Federal Court found:

- The amounts paid by the debtor to the Bank were "proceeds" of the sale of the debtor's property and were subject to the deemed trust [. . .].
- Upon the sale of a tax debtor's property, the debtor is obliged to pay the proceeds, or the portion of the proceeds required to retire the tax debt, to the Receiver General [. . .].

- In the present case, the debtor was obliged to pay his tax debt out of the sale proceeds of the property, but failed to do so. Instead, he used the proceeds to pay the Bank, a secured creditor. In this circumstance, the Bank had a statutory obligation to pay the tax debt out of the proceeds it received [. . .].
- As a secured creditor of the debtor, the Bank cannot invoke the *bona fide* purchaser defence to counter the statutory obligation imposed by subsection 222(3) of the Act. To allow the Bank to invoke the defence would defeat the purpose of the deemed trust, rendering it meaningless [. . .].
- No triggering event is necessary to bring the deemed trust created by section 222 of the Act into operation [. . .].
- The Crown's deemed trust is the reflection of a considered legislative priority scheme between certain tax debts and secured claims. Parliament's intention to confer a super priority to the Crown for unremitted GST over secured creditors is clear [. . .].
- Parliament considered the potential challenges posed by the deemed trust on secured lenders by providing a remedy in the form of the prescribed security interest under subsection 222(4) of the Act [. . .].

This decision was clearly not acceptable to TD Bank and was appealed at the Federal Court of Appeal, supported by the Canadian Bankers' Association.

Federal Court of Appeal

TD Bank raised three issues in the appeal. TD Bank also raised three hypothetical examples that intended to reflect the "absurdity" of the interpretation adopted by the Federal Court. The intervener made a number of policy arguments, including:

- Unless a secured creditor is entitled to receive ordinary course payments from its borrower unencumbered by the deemed trust, a secured creditor will be unlikely to give credit for any cheques or cash deposits made by a tax debtor or to provide a discharge of its security on payment without continuous confirmation from the Canada Revenue Agency that all deemed trust amounts have been paid.
- It is anomalous and illogical that a secured creditor receiving proceeds of property of the tax debtor in the ordinary course is personally liable to pay the Crown the unpaid amount of GST when there is no such liability imposed upon a lender providing an unsecured credit facility, or any other unsecured creditor whose claim ranks subordinate to the secured creditor.
- The interpretation of the Federal Court promotes liquidation and bankruptcy over restructuring alternatives that may preserve going concern value, employment and other benefits for shareholders.

The Federal Court of Appeal's decision is elaborate and unequivocally successfully demolishes these arguments. This article summarizes only the most significant points of the decision. Persons interested by the decision should read the full judgment.

1) Did the Federal Court err by finding that the deemed trust does not require a triggering event which causes the trust to crystallize around specified assets?

This first question submitted, among other arguments, that it is inherent in the concept of priority that priorities are to be assessed at the time competing claims come into conflict. Because the right to a priority is essentially remedial in nature, it arises upon the exercise of enforcement or bankruptcy remedies by creditors.

This submission was tethered to the text of the deemed trust provisions by the use of the word "priority" at the end of subsection 222(3) of the *Excise Tax Act*. As well, TD Bank argued that in both *Sparrow* and *First Vancouver* the Supreme Court understood the deemed trust structure to be a structure to deal with priority disputes. TD Bank supported this submission by reference to *Sparrow* and the Supreme Court's implied or express reference therein to the concept of priority.

The Federal Court of Appeal disagreed, stating that the word "priority" appears only once in subsections 222(1) and (3); the word is found at the end of subsection 222(3), wherein it is provided that property deemed to be held in trust "is property beneficially owned by Her Majesty . . . despite any security interest in the property or in the proceeds thereof" and that the proceeds of the property "shall be paid to the Receiver General in priority to all security interests."

In addition, the FCA found that the Bank's submission failed to take into account the legislative evolution of the deemed trust provisions. As described above, the words that spoke to the triggering events of "liquidation, assignment, receivership or bankruptcy" were found in the *prior* iteration of the deemed trust provisions but removed from the current version.

This reflects, in the view of the Federal Court of Appeal, Parliament's intent that no triggering event is required to cause the trust to crystallize around specified assets. Instead, the legislation deems property of a tax debtor and property held by a secured creditor to be held in trust once GST is collected but not remitted.

2) Did the Federal Court err by finding that secured creditors cannot avail themselves of the "*bona fide* purchaser for value" defence?

The Federal Court of Appeal quoted the Supreme Court of Canada in *i Trade Finance Inc. v. Bank of Montréal*[5] as follows:

> The full name of the equitable defence is 'bona fide purchase of a legal interest for value without notice of a pre-existing equitable interest.' The effect of the defence is to allow the defendant to hold its legal proprietary rights unencumbered by the pre-existing equitable proprietary rights. In other terms, where the defence operates, the pre-existing equitable proprietary rights are stripped away and lost in the transaction by which the defendant acquires its legal proprietary rights.[6]

The Federal Court of Appeal added that, seen in this light, it would be irrational for Parliament, in an effort to ensure that collected but unremitted GST was to be recovered in priority to all debts, to intend the *bona fide* purchaser defence to undo the Crown's pre-existing beneficial interest in the property of the deemed trust. As the Federal Court found, this would eviscerate the deemed trust provisions.

3) Did the Federal Court err by failing to consider that the security interests of TD Bank were not created and granted in a transaction providing financing to the debtor's business?

TD Bank argued that the Federal Court ought to have distinguished between the tax debtor carrying on business as a sole proprietorship and the tax debtor transacting in his personal capacity.

The Federal Court of Appeal saw no merit in these arguments. Subsection 222(1) of the *Excise Tax Act* states that "every person who collects an amount as or on account of [GST] is deemed . . . to hold the amount in trust for Her Majesty". It was TD Bank's debtor that collected amounts as or on account of GST and who was obliged to remit the amounts collected to the Crown.

With respect to the "hypothetical arguments" mentioned above, the Federal Court of Appeal stated:

> [84] In my view, the answer to these concerns is that Parliament made a considered policy choice to prioritize protection of the fisc over the interests of secured creditors. Parliament tempered the potential harshness of this choice by providing for prescribed security interests and by waiving the Crown's deemed trust rights in cases of bankruptcy and arrangements under the *Companies' Creditors Arrangement Act*.
>
> [85] Moreover, secured lenders are not without some ability to manage the risk posed by deemed trusts. For example, they may identify higher risk borrowers (which might include persons operating sole proprietorships), require borrowers to give evidence of tax compliance, or require borrowers to provide authorization to allow the lender to verify with the Canada Revenue Agency whether there are outstanding GST liabilities then known to the Agency.

Accordingly, the appeal was dismissed with costs. The Federal Court of Appeal wrote such a strong decision, it seems unlikely to be appealed to the Supreme Court of Canada. Again, as we often conclude, only time will tell.

---

[5] 2011 SCC 26, [2011] 2 S.C.R. 360.

[6] Emphasis added by the Federal Court of Appeal.

RECENT CASES

Taxpayer granted discharge conditional on paying the Trustee all of his surplus income as calculated by the Trustee

The 47-year-old taxpayer, a first-time bankrupt, made an assignment into bankruptcy, citing business failure as the reason for his bankruptcy. At the time of his assignment into bankruptcy the taxpayer was a self-employed consultant working for an e-commerce business owned by his father and stepmother. The only proven unsecured claim in this bankruptcy was a tax debt owing to the CRA in the amount of $252,206.90 comprising $171,166.32 in personal income tax owing for 2011 to 2016, and a further $81,040.58 in unremitted GST/HST for 2011 and 2012. The taxpayer, who was self-represented, applied to the Ontario Superior Court of Justice in Bankruptcy and Insolvency for a discharge from his bankruptcy.

The taxpayer was granted a conditional discharge. Although the taxpayer's income tax debt did not meet the $200,000 threshold required for a tax-driven bankruptcy pursuant to subsection 172.1(1) of the *Bankruptcy and Insolvency Act*, the legal principles for such bankruptcies provided some guidance in this case. Here the evidence showed a pattern of non-compliance by the taxpayer with his tax return filing obligations before and during his bankruptcy. He also had demonstrated wilful blindness regarding his income and expenses. As a result, he was granted a conditional discharge, conditional upon his paying the sum of $26,005.88 in surplus income at the minimum rate of $500 per month, and upon demonstrating ongoing compliance with his tax return filing and tax payment obligations.

¶50,482, *Reid (Re)*, 2020 DTC 5037

Taxpayer's application for discharge from his fourth bankruptcy dismissed with leave to re-apply in no less than four years

In his application to the Supreme Court of Nova Scotia in Bankruptcy and Insolvency for a fourth discharge from bankruptcy, the taxpayer cited failure to make tax remittances along with marital separation and health issues.

The taxpayer's application was refused, but with leave to re-apply. The taxpayer's health status, although not to be ignored, played a secondary role in this case. As a condition of his discharge next time, the taxpayer would have to demonstrate a consistent pattern of tax performance, and was not to look upon the bankruptcy court as a "fiscal carwash". Also, there was no reasonable prospect that the taxpayer could make any reasonable contribution towards his bankrupt estate at this time. As a result, his application for a fourth discharge was refused but with leave to re-apply in no less than four years, with proof of total compliance with his tax obligations at that time. He was also warned that his discharge would be jeopardized if any filing upon which such discharge was obtained were later reassessed adversely.

¶50,481, *Yeo (Re)*, 2020 DTC 5036

INTERNATIONAL NEWS

German Cabinet Agrees Hike to Carbon Taxes

On May 20, 2020, the German Cabinet agreed on new regulations that will set higher carbon prices from 2021 than those originally envisaged in the Government's Climate Protection Program, which was partially approved by parliament in November 2019.

Initially, the scheme entailed the introduction of emissions allowances at €10 (US$11) per tonne of CO2 in 2021, rising to €35 per tonne in 2025. Then, from 2026, carbon permits were to be auctioned, with the program setting a minimum price of €35 per tonne and a maximum price of €60 per tonne in this second phase.

The changes mean that carbon allowances will be set at €25 per tonne in 2021 and will increase to €55 per tonne by 2025. From 2026, carbon permits will be auctioned within a price band of €55 to €65 per tonne.

The changes were agreed following discussions regarding the carbon price in parliament's mediation committee, which includes members of the lower and upper houses. However, the new prices still need parliamentary approval before they can enter into effect in 2021.

The carbon pricing scheme will cover sectors not currently included in the European Union Emissions Trading Scheme. These include the transport and building sectors, and greenhouse gases from heating.

TAX TOPICS

Published weekly by Wolters Kluwer Canada Limited. For subscription information, see your Wolters Kluwer Account Manager or call 1-800-268-4522.

For Wolters Kluwer Canada Limited

Email: cservice@wolterskluwer.com *Phone: 1-800-268-4522 or (416) 224-2248 (Toronto)*

Notice: *Readers are urged to consult their professional advisers prior to acting on the basis of material in Tax Topics.*

Wolters Kluwer Canada Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
1 800 268 4522 tel
1 800 461 4131 fax
www.wolterskluwer.ca

© 2020, Wolters Kluwer Canada Limited

Wolters Kluwer