Cassels

Alberta Court of Appeal Releases Anticipated Decision in Canada v Canada North Group Inc.

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September 5, 2019

Introduction

A recent decision of the Alberta Court of Appeal has confirmed that court ordered restructuring charges granted pursuant to the *Companies' Creditors Arrangement Act* (CCAA) enjoy a higher priority than amounts owing to Canada Revenue Agency (CRA) for deducted but unremitted source deductions. This outcome is largely viewed as positive for restructuring proceedings, on the basis that restructurings could be hindered or not occur if interim lenders and insolvency professionals did not have the certainty of such restructuring charges being in priority to CRA source deduction claims.

In *Canada v Canada North Group Inc.*[1], the majority of the Alberta Court of Appeal concluded that CRA's statutory deemed trusts in relation to source deductions are properly characterized as security, and not proprietary interests. In reaching this conclusion, the majority provided important clarification on the following issues:

- the nature of CRA statutory deemed trusts in CCAA proceedings, which in *Canada North* arose pursuant to the *Income Tax Act* (ITA), the *Canadian Pension Plan Act* (CPPA), and the *Employment Insurance Act* (EIA and, together with the ITA and the CPPA, the "Fiscal Statutes") as a result of debtor company's failure to remit the source deductions required by these statutes;
- the rights and entitlements that CRA can assert pursuant to a statutory deemed trust in a CCAA proceeding; and
- whether a CCAA court possesses the jurisdiction to grant "super-priority" charges that rank in priority to CRA's rights and entitlements derived from statutory deemed trusts.

Prior to the release of the *Canada North* decision, these issues had been the subject of contradictory decisions in Canada, none of which had been at the appellate level.[2]

Background on *Canada North*: CRA's Assertion of Statutory Deemed Trusts

The facts of *Canada North* are relatively straightforward. On July 5, 2017, the Court of Queen's Bench of Alberta granted an initial order in favour of Canada North Group Inc. (CNGI) pursuant to the CCAA (the "Initial Order"). The Initial Order granted certain "super-priority" charges, which secured various forms of obligations in priority to the claims of existing secured creditors. Such charges included a "super-priority"

security interest in favour of Business Development Bank of Canada (BDC). The purpose of this super-priority charge was to give BDC security for interim financing it had agreed to provide to CNGI during the restructuring process (otherwise known as Interim Financing).

At the time the Initial Order was granted, CNGI owed CRA over $1 million for unremitted source deductions. CRA had been properly served with the initial notice of application and a copy of the Initial Order, but did not contest the "super-priority" charges at that time.

On July 27, 2017, CNGI sought an order increasing the amount of interim financing that was provided in the Initial Order. CRA appeared, but did not take a formal position at the hearing of CNGI's application.[3] However, after the Court granted the relief sought by CNGI and amended the Initial Order to increase the amount of interim financing, counsel to CRA advised that CRA would be filing a motion to amend the terms of the Initial Order such that the "super-priority" charges would be made subject to CRA's rights derived from the statutory deemed trusts.[4]

CRA's motion proceeded on August 11, 2017, with CRA asserting that the provisions of the Fiscal Statutes, elevated CRA's interest "…beyond a mere secured creditor because they do not just **deem** the Crown to be the owner of the interest, but rather, [say] that it **is** the owner."[5] Relying on the interpretation of these provisions as set out in *Rosedale Farms*, CRA asserted that its interest in CNGI's property was *proprietary* in nature and could not be subordinated to the "super-priority" charges, including the charge in favour of BDC, that had been granted by the court in the Initial Order.[6]

On September 11, 2017, Justice Topolniski released the Chambers Decision, in which she, in reliance on Temple City, concluded that CRA's interest was properly characterized as a security interest, and that "the CCAA gives the Court the ability to rank the Priority Charges ahead of CRA's security interest arising out of the deemed trusts."[7] CRA subsequently sought and obtained leave to appeal the Chambers Decision on the following issue:

Whether the chambers judge erred in law in determining that the "super priority" charges made in favour of the interim financier, the directors of the debtor companies, and the Monitor and its counsel under the *CCAA* have priority over statutory deemed trusts in favour of the Crown for unremitted source deductions as created by the ITA, the CPP, EIA.[8]

CRA's appeal was heard on October 4, 2018.

Decision on Appeal

On appeal, CRA argued that the language of the Fiscal Statutes was clear: Parliament intended that the Crown's interest in unremitted source deductions was proprietary in nature and could not be subordinated to other secured interests, including court-ordered priority charges.[9] Accordingly, CRA asserted that the

Chambers Judge had erred in the Chambers Decision by concluding that CRA's interest was a "security interest" that could be subordinated pursuant to the provisions of the CCAA.

However, the majority of the Alberta Court of Appeal dismissed CRA's arguments on this issue for the following reasons:

- the presumption of statutory coherence requires that the provisions of the CCAA and the Fiscal Statutes be read to work together as part of a larger statutory scheme that must be considered as a whole[10];
- applying principles of harmonious interpretation to the CCAA and the Fiscal Statutes avoids an absurdity – being the erosion of interim financing in CCAA proceedings[11]. In short, interim lenders would be reluctant to offer interim financing where such financing was subordinate to CRA statutory deemed trust amounts;
- if CRA's statutory deemed trusts had absolute priority in CCAA proceedings, section 6(3) of the CCAA (which requires the payment of deemed trust amounts within six months of sanction of a CCAA Plan) would be unnecessary and, since "every provision serves a purpose," CRA's interpretation could not be correct[12];
- since the Court has the authority to displace CRA's claims in CCAA proceedings[13], Parliament intended to authorize courts to exercise control over the Crown's interests while monitoring restructuring proceedings[14]; and
- even if there was, as CRA had asserted, a conflict between the CCAA and the Fiscal Statutes, the implied exception rule (*generalia specialibus non derogant*) supported the Chambers Decision because the *CCAA* applies in special circumstances, whereas the Fiscal Statutes are of general application.[15]

The Honourable Mr. Justice Wakeling issued a lengthy dissent from the majority's decision. Although Justice Wakeling recognized that his interpretation of the CCAA and the Fiscal Statutes "might reduce the efficacy of the [CCAA]"[16], he ultimately found that, on a plain reading of the relevant statutes, CRA's statutory deemed trust was proprietary in nature because the Fiscal Statutes state that the Crown "is the beneficial owner" of amounts subject to a deemed trust. Accordingly, and as the beneficial owner, the Crown would be "entitled to these funds in priority to those who are beneficiaries of the priming charges."[17]

Conclusion

The *Canada North* decision is the first appellate decision that has squarely considered the nature of CRA's deemed trusts in insolvency proceedings. In dismissing CRA's appeal, the Alberta Court of Appeal has added some much-needed clarity on this issue which had, prior to the Chambers Decision, been the subject of contradictory decisions in Canada. While it is unclear whether CRA intends to appeal the *Canada North* decision further, this decision will hopefully provide comfort to insolvency professionals and interim financiers with respect to the priority of their charges in circumstances in which there is a CRA deemed trust

claim.

Arguing the appeal on behalf of the Respondent, Business Development Bank of Canada was Jeffrey Oliver and Mary I.A. Buttery, Q.C., with Jared Enns, of Cassels Brock & Blackwell LLP.

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[1] *Canada v Canada North Group Inc*, 2019 ABCA 314 (*Canada North*), which upheld the decision of Justice Topolniski in: *Canada North Group Inc*, 2017 ABQB (550) (the *Chambers Decision*)
[2] *Temple City Housing Inc. (Companies' Creditors Arrangement Act)*, 2007 ABQB 786 (*Temple City*); *Rosedale Farms Limited, Hassett Holdings Inc., Resurgam Resources (Re)*, 2017 NSSC 160 (*Rosedale Farms*)
[3] *Chambers Decision*, supra note 1, at para 17
[4] *Ibid*
[5] *Ibid*, at para 82
[6] *Ibid*, at paras 2-3
[7] *Ibid*, at para 114
[8] *Canada North*, supra note 1, at paragraph 2; see also *Canada v Canada North Group Inc*, 2017 ABCA 363
[9] *Canada North*, supra note 1, at para 44
[10] *Ibid*, at para 45
[11] *Ibid*, at para 49
[12] *Ibid*, at para 53
[13] see, for example, section 11.09(1) of the CCAA which grants the Court the power to stay the Crown's garnishment rights under section 224(1.2) of the ITA. As noted by the Court of a Appeal, if CRA's position was correct, that would imply that "a court ordered stay would not apply to the Crown's claim" (*Canada North*, at para 54)
[14] *Canada North*, supra note 1, at para 54
[15] *Ibid*, at para 55
[16] *Ibid*, at para 83
[17] *Ibid*, at para 158
