

## **THE SCC RULES ON THE DEEMED TRUST PROVISIONS OF THE EXCISE TAX ACT AND OVERTURNS THE FEDERAL COURT OF APPEAL RULING IN CALLIDUS CAPITAL CORPORATION V. HER MAJESTY THE QUEEN**

June 1st, 2022

### **Callidus Capital Corporation v. Her Majesty the Queen, 2018 SCC 47 (SCC)**

Callidus was a secured creditor of Cheese Factory Road Holdings Inc. Pursuant to a trust agreement, Cheese Factory held all funds received in trust for Callidus and remitted them to be applied to its debt. The amounts paid to Callidus under this arrangement included tax proceeds which Cheese Factory had failed to remit to the CRA. When the Crown asserted entitlement to the unremitted tax proceeds by virtue of the deemed trust mechanism in s. 222 of the Excise Tax Act (ETA), R.S.C. 1986, c. E-15, and demanded payment, Cheese Factory made an assignment in bankruptcy. The Crown then commenced a proceeding against Callidus in Federal Court to recover Cheese Factory's tax debt. In support of the relief claimed against Callidus, the Crown relied on the 'superpriority' status created by s. 222(3) of the ETA, which mandates that proceeds subject to a deemed trust are to be paid to the Crown in priority to all security interests.

The ETA also provides, however, that once a tax debtor becomes bankrupt, the deemed trust ceases to be effective in respect of any amounts that, prior to bankruptcy, were collected or became collectible by the tax debtor (s. 222(1.1)). The result is that after bankruptcy, there is no amount deemed to be held in trust pursuant to s.222 (1) for amounts collected as tax but not remitted. Callidus argued that this provision operated to likewise render the deemed trust ineffective against a secured creditor, such as Callidus, who received proceeds of property subject to the deemed trust from the debtor pre-bankruptcy. Callidus advanced a motion to have this question of law determined by the Court.

The Federal Court agreed with Callidus that the deemed trust, and the accompanying priority, are extinguished upon bankruptcy of the debtor, such that the Crown becomes an unsecured creditor in respect of unremitted amounts.

Any liability that arises under section 222(3) compelling a secured creditor to disgorge proceeds is dependent on the continuing existence of the deemed trust and is therefore extinguished upon bankruptcy by the operation of section 222(1.1).

The majority of the Federal Court of Appeal allowed the Crown's appeal, finding that the Crown could advance a claim against a secured creditor who had received a repayment from its borrower prior to bankruptcy when the borrower also owed unremitted GST obligations to the Crown. The dissenting judge, Pelletier J.A., sided with Callidus, finding that, as of the date of bankruptcy, by operation of section 222 (1.1), there were no longer any amounts subject to the deemed trust created by section 222(1) and therefore no property of Cheese Factory remained subject to a deemed trust pursuant to section 222(3), and no proceeds of that property were payable to the Crown by Callidus.

The decision of the Federal Court of Appeal majority was widely criticized by the lending community due to the uncertainties that it created for secured creditors, who were faced with potential indeterminate future liability after recovering repayment from assets subject to CRA deemed trust claims.

On 22 March 2018, the Supreme Court of Canada granted leave to appeal. The appeal was heard on 8 November 2018. In a unanimous decision, delivered orally by Gascon J. from the bench, the Court reversed the Federal Court of Appeal majority decision and endorsed the dissenting judgment of Pelletier J.A., confirming that the deemed trust will not extend to pre-bankruptcy payments made to a lender. The Supreme Court did caution that, in reaching this result, it was "not commenting, one way or the other, on the scope of the deemed trust or any liability under s. 222 of the ETA prior to bankruptcy".

This decision is a clear victory for secured creditors, who now have significant reassurance and certainty regarding the priority and treatment of GST/HST arrears in a bankruptcy.



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