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SCC rules that CCAA charges take priority

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On 28 July 2021, the Supreme Court of Canada (SCC) released its decision in *The Queen v. Canada North Group Inc.*, 2021 SCC 30. In its decision, the SCC dismissed the Crown's appeal of an order made under the *Companies' Creditors Arrangement Act* (CCAA), rejecting the position that court-ordered super-priority charges (or "priming charges") could not take priority over the deemed trust for unremitted source deductions created by subsection 227(4.1) of the *Income Tax Act* (ITA).

A narrow majority of the SCC agreed with the taxpayer that the priming charges prevailed over the deemed trust. The reasons for judgment indicated that a court-ordered super-priority charge under the CCAA was not a security interest within the meaning of subsection 224(1.3) of the ITA, and that subsection 227(4.1) did not create a proprietary interest in a tax debtor's property. A concurring decision reasoned that the broad discretionary power under section 11 of the CCAA permitted a court to rank priming charges ahead of the Crown's deemed trust for unremitted source deductions.

The priming charges claimed consisted of:

- i. An administration charge of up to \$1,000,000 in favour of legal counsel, a monitor, and chief restructuring officer in respect of fees incurred;
- ii. A \$1,000,000 financing charge in favour of an interim lender; and
- iii. A \$150,000 directors' charge protecting directors and officers from liabilities incurred after the commencement of CCAA proceedings.

The Alberta Court of Queen's Bench granted an initial order (the Order) in favour of the taxpayer and six related corporations (together, the Debtors) on the terms requested, subject to a \$500,000 reduction in the administration charge. The Order indicated (para. 44) that the priming charges "[...] shall rank in priority to all other security interests, trusts, liens, charges and encumbrances, claims of secured creditors, statutory or otherwise [...] in favour of any Person." Further, the charges would not (para. 46) "[...] be limited or impaired in any way by [...] the provisions of any federal or provincial statutes."

The Debtors then sought supplementary orders extending the stay and increasing interim financing. Counsel advised that Her Majesty the Queen would be filing a motion to vary the Order on the grounds that it failed to recognize the Crown's priority interest in unremitted source deductions. Shortly thereafter, the Crown filed its motion, arguing that the nature of the Crown's interest is determined by subsection 227(4.1) of the ITA, which – in the Crown's view – created a proprietary interest.

The Crown's motion was dismissed by the Court of Queen's Bench on the grounds that the deemed trust created by subsection 227(4.1) of the ITA is not a proprietary interest. Rather, the ITA creates something similar to a floating charge over all the debtor's assets, permitting the debtor to alienate property subject to the deemed trust. Because these characteristics are inconsistent with a proprietary interest, subsection 227(4.1) cannot be said to create such an interest. Further, the lower court held that subsection 227(4.1) did not create a security interest requiring the deemed trust to take priority over court-ordered charges because the CCAA authorized the reorganization of priorities by court order. The charges included in the Order were critical to the restructuring process and thus required by the CCAA regime.

Although the Debtors determined that there were sufficient assets in the estate to satisfy both Her Majesty's interest and the beneficiaries of the priming charges, the Crown sought and obtained leave to appeal to seek appellate guidance on the nature of the Crown's priority. A split decision of the Court of Appeal of Alberta dismissed the appeal, although the judges were divided as to whether the priming charges had priority over the Crown's claim. The Crown then appealed to the SCC.

The decision of the Supreme Court of Canada

The central issue considered by the SCC was whether the CCAA authorized courts to grant super-priority charges that have priority over a deemed trust created by subsection 227(4.1) of the ITA. A narrow majority (5-4) of the Court held that section 11 of the CCAA was broad enough to do so and dismissed the appeal.

Facts and judicial history

The Debtors sought to restructure under the CCAA. In their initial CCAA application, the Debtors included an affidavit from one of their directors attesting to a \$1,140,000 debt to Her Majesty the Queen in respect of unremitted source deductions and Goods and Services Tax (GST). The Debtors requested a standard package of relief including a thirty-day stay on all proceedings against them, the appointment of a monitor and the creation of three super-priority charges (which would become the priming charges under dispute).

The majority of the SCC held that there was no conflict between the ITA and CCAA provisions at issue. In the reasons for judgment (per Chief Justice Wagner, Justice Coté and Justice Kasirer) the SCC held that the priming charges prevailed over the deemed trust for two reasons:

- i. Subsection 227(4.1) did not create a proprietary interest in the debtor's property; and
- ii. A court-ordered super-priority charge under the CCAA was not a security interest within the meaning of subsection 224(1.3) of the ITA.

A concurring decision by Justices Karakatsanis and Martin agreed with the result, but on the basis that the broad discretionary power under section 11 of the CCAA permits a court to rank priming charges ahead of the Crown's deemed trust for unremitted source deductions.

A joint dissent from Justices Abella, Brown and Rowe would have allowed the appeal on the basis that the Crown's deemed trust was to enjoy priority over all other claims, including priming charges granted under the CCAA. Per this dissent, the deemed trust created by the ITA was intended to take priority regardless of the operation of the CCAA due to the "paramountcy" language in subsection 227(4.1) and the dissent's conclusion that the priming charges constitute a security interest as defined in subsection 224(1.3). Justice Moldaver, who penned a separate dissent, agreed with the joint dissent, but would have held that the relevant provisions of the CCAA and ITA directed that the Crown's interest would take priority over priming charges, and that section 11 of the CCAA was, regardless, restricted by subsection 227(4.1).

Implications

The decision of the SCC brings welcome clarity concerning the interplay of the CCAA and the Crown's deemed proprietary interest in unremitted source deductions. The SCC's decision means that it is now established law that a court may grant super-priority charges ahead of a Crown's security interest in a tax debtor's property. This ultimately brings certainty to the insolvency process and provides for viable restructurings under the CCAA.

However, there remain many unanswered questions, particularly because of the split decisions of the SCC. While a narrow majority of the SCC agreed on the outcome of the decision, there were four written sets of reasons, including two concurring reasons that interpreted the Crown's property interests differently. These issues – and in particular, the nature of the Crown's property interest – will likely need to be considered further in future decisions.

Learn more

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