

Episode 6 – Return of the Secured Creditors

Bankruptcy and Insolvency | GST | HST | Insolvency & Restructuring | Litigation | Litigation & Dispute Resolution

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Callidus Capital has struck back against what some call the evil empire aka CRA. In a unanimous decision on November 8th the Supreme Court of Canada allowed Callidus's appeal of a Federal Court of Appeal ("FCA") decision obliging it to pay the sum of \$177,000 plus years of interest because of the operation of the deemed trust provisions of the Excise Tax Act (GST/HST).

When the FCA shone a laser on this potential liability, secured creditors drew breath and retreated to their base. Their contingent exposure to a CRA deemed trust claim was potentially unrecoverable.

The Callidus situation is not unusual for the world of secured lenders. The transaction started with Bank of Montreal lending money to Cheese Factory Road Holdings Inc. – a real estate investment company (despite the name). The usual sorts of security were obtained. Cheese went into default. Callidus then bought the debt from BMO and entered into a forbearance agreement with Cheese. It also agreed to provide certain other credit facilities.

One of Cheese's properties was to be sold with proceeds delivered to Callidus. This happened and Callidus got all the money. As well, blocked accounts at RBC were to be opened by Cheese and all money from property rents had to be deposited in those accounts. The Blocked Account money was swept every day into the Callidus accounts.

In April of 2012, CRA's Death Star arrived in the form of a letter to Callidus demanding money under the deemed trust provisions of the ETA since Cheese had not paid its HST obligations. Callidus rebelled and fought back causing Cheese to file an assignment in bankruptcy hoping to relegate CRA's HST demand to the status of unsecured. Battle was joined when the Empire sued Callidus in Federal Court for \$177,000 on the deemed trust claim.

The space age weapon CRA was using was section 222(1) of the ETA which says "every person who collects (any tax amounts) is deemed for all purposes, and despite any security interest, to hold the amount in trust (for CRA)...". But section 222(1.1) says "this section does not apply at or after the time a person becomes a bankrupt...to any amounts that, before that time, were collected or became collectible...".

Callidus was victorious before the Federal Court and all was right with the universe. But on appeal to the Federal Court of Appeal, that victory was dashed. The FCA concluded that the bankruptcy had no effect on priorities to money collected *prior* to the bankruptcy. In this case the \$177,000. CRA excitedly began to send letters to banks and secured creditors in other loan collection cases, (some of them old and cold), demanding deemed trust payments.

Fortunately for Callidus and the alliance of secured creditors the Supreme Court of Canada has restored its victory. It did so in a unanimous decision from the bench at the conclusion of argument with reasons to follow.

What might be said in those reasons will be important of course but for now secured creditors can rest easier that a bankruptcy process will relegate all HST claims against the debtor to unsecured status in that bankruptcy and that collections and recoveries that the creditor might have made before that bankruptcy will not expose them to later claims for unpaid GST/HST

Stay tuned for Episode 7 – Revenge of the Agency. May section 222(1.1) be with you.

(This blog is provided for educational purposes only, and does not necessarily reflect the views of Gardiner Roberts LLP).

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