

Canada Revenue Agency Trumps Unsecured Creditors!

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In a sleight-of-hand move dexterously played by the Canada Revenue Agency ("CRA"), it managed to secure advance collection of a disputed corporate income tax debt by obtaining an *ex parte* jeopardy collection order after the CRA was notified of an application by the taxpayer to appoint a receiver.

The CRA used to be a preferred creditor under bankruptcy and insolvency statutes so that it could collect tax debts in front of unsecured creditors. However, the legislation was amended in 1992 to specifically remove that preferred creditor status and put the CRA on the same footing as other unsecured creditors.

In the decision of the Ontario Court of Appeal in *I. Waxman & Sons Ltd. (Re)* ((2010) 100 OR (3d) 561), the CRA managed to skate around the *Bankruptcy and Insolvency Act* ("BIA") to collect the entire amount of a disputed corporate tax debt.

The taxpayer had filed a notice of objection to certain corporate income tax assessments. The CRA proceeded to collect one-half of the tax debt through garnishment proceedings before the application to appoint a receiver was made – no surprise – the corporate taxpayer was a "large corporation" in respect of which the CRA may collect 50% of taxes under dispute pursuant to subsection 225.1(7) of the *Income Tax Act* ("ITA").

The other half, however, was collected by garnishment under the authority of a jeopardy collection order which the CRA obtained *ex parte* from the Federal Court pursuant to subsection 225.2(2) of the ITA after it had been served by the taxpayer with a notice of application to appoint a receiver. The CRA got the jeopardy order, immediately served the requirement to pay and collected the remaining disputed tax debt just days before the appointment of the receiver.

The basis for the application by the CRA to the Federal Court for the jeopardy collection order, as described by the Ontario Court of Appeal, was "because it could [otherwise] take no steps to attempt to collect or secure its position *vis-à-vis* other creditors ... if the receivership order were granted, the CRA's claim in the receivership would be unsecured ... as an unsecured claimant, the CRA would only realize its *pro rata* share of the funds that remained after the secured creditors ... were paid" (*Supra* at 564).

In other words, the CRA argued that if it did not get the jeopardy collection order, then the provisions of the BIA would unfold in the ordinary course with the CRA standing as an

unsecured creditor – this was a sufficient foundation for a jeopardy collection order. The Federal Court apparently agreed with this astonishing argument, thus affording the CRA the ability to slip ahead of all the other unsecured creditors in a move reminiscent of a race car driver.

The receiver, when appointed, filed an application in Federal Court to set aside the jeopardy order but "counsel for both parties agreed to defer the scheduling of the application until other issues in the IWS estate were addressed" (*Ibid.* at 564).

The corporate taxpayer was ultimately declared bankrupt some 6 months later and the former receiver was appointed the trustee in bankruptcy. The trustee then moved a motion before the Ontario Court of Justice for an order directing that the funds seized by the CRA pursuant to the jeopardy collection order be returned to the trustee so that they might be distributed in accordance with the BIA or, alternatively, directing the trustee to set off the distribution due to the CRA from the bankrupt estate against those funds.

The trustee's motion was unsuccessful before the motions judge. The trustee was also unsuccessful on this appeal before the Ontario Court of Appeal.

Why? The principal ratio – the motion was a collateral attack against the jeopardy collection order (2:1 decision – Justice Goudge dissenting).

In *obiter*, the Court of Appeal found that the jeopardy order was "completely executed" before the bankruptcy within the meaning of subsection 70(1) of the BIA (*Ibid.* at 572) so that neither the provisions of subsection 86(1) [which makes the CRA an unsecured creditor] nor those of subsection 73(4) [which requires seized property to be returned to the trustee] assisted the trustee's position (*Ibid.* at 573).

Was the problem that the trustee failed to pursue its attack on the jeopardy collection order in the Federal Court under subsections 225.2(8) and (9) of the ITA?

Or, has the CRA found a very effective rear window to get itself back into a preferred creditor position provided it moves quickly enough to get and execute *ex parte* jeopardy collection orders whenever there is a pending receivership or bankruptcy?

If the only argument the CRA has to make to obtain a jeopardy collection order is that it would otherwise be an unsecured creditor under applicable insolvency legislation, then for all practical purposes, preferred creditor privileges for the CRA just may have been reinstated in respect of any tax debtor who must give the CRA notice of an impending receivership or bankruptcy!

Given the outcome in the *Waxman* decision, whether the CRA has successfully created its own preferred creditor procedure will be tested only if another similarly obtained jeopardy collection order is challenged in the Federal Court system.