CRA Trumps Unsecured Creditors

The CRA used to be a preferred creditor under the Bankruptcy and Insolvency Act (BIA). However, the BIA was amended in 1992 to specifically remove that preferred creditor status and to put the CRA on the same footing as other unsecured creditors. In *I. Waxman & Sons Ltd. (Re)* (2010 ONCA 447), the CRA circumvented the 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. Pursuant to subsection 225.1(7), the CRA had collected one-half of the tax debt through garnishment proceedings before the application to appoint a receiver was made. The other half of the debt 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) after being served by the taxpayer with a notice of application to appoint a receiver. The CRA obtained the 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 CRA's application was that "it could [otherwise] take no steps to attempt to collect or to secure its position vis-à-vis other creditors. . . . [I]f 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 any funds that remained after the secured creditors . . . were paid." 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, and that this was a sufficient foundation for a jeopardy collection order. The Federal Court agreed with this argument.

The receiver 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."

The corporate taxpayer was ultimately declared bankrupt some six months later, and the former receiver was appointed the trustee in bankruptcy. The trustee then moved 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 could 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 its appeal before the Ontario Court of Appeal. The principal ratio was that the motion was a collateral attack against the validity of the jeopardy collection order.

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

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 Income Tax Act? Or has the CRA found a very effective means of repositioning itself as a preferred creditor, provided that it moves quickly enough to obtain and execute an ex parte jeopardy collection order whenever there is a pending receivership or bankruptcy?

If the CRA only has to argue that it would otherwise be an unsecured creditor under applicable insolvency legislation, then, for all practical purposes, its preferred creditor privileges may have been reinstated in respect of any tax debtor who must give the CRA notice of an impending receivership or bankruptcy.

Whether the CRA has successfully created its own preferred creditor procedure will be tested only when another similarly obtained jeopardy collection order is challenged in the Federal Court system.

Maralynne A. Monteith
WeirFoulds LLP, Toronto

The Amended Restricted Covenant Rules

On July 16, 2010, the Department of Finance released a series of proposed amendments to the Income Tax Act. These amendments included changes to the taxation of restrictive covenants (RCs) under proposed section 56.4, which was originally introduced on October 7, 2003, with further changes proposed on February 27, 2004 and July 19, 2005.

In *Manrell* (2003 FCA 128), the court held that RCs were not "property," and therefore the proceeds received by the taxpayers in respect of the RCs granted were not subject to taxation. Following the *Manrell*