CRA gets ahead of the line

BY MARALYNNE MONTEITH
For Law Times

In a sleight-of-hand move dexterously played by the Canada Revenue Agency, it managed to secure advance collection of a disputed corporate income tax debt by obtaining an *ex parte* jeopardy collection order after receiving notification 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 government amended the legislation in 1992 to specifically remove that preferred-creditor status and put the CRA on the same footing as other unsecured creditors.

Speaker's Corner

But in the decision of the Ontario Court of Appeal in *I. Waxman & Sons Ltd.*, the CRA managed to skate around the Bankruptcy and Insolvency Act to collect the entire amount of a disputed corporate tax debt.

The taxpayer in the case had filed a notice of objection to certain corporate income tax assessments. The CRA proceeded to collect half of the tax debt through garnishment proceedings prior to the application to appoint a receiver. That's no surprise given that, as the taxpayer was a large corporation, the CRA could collect 50 per cent of the taxes in dispute pursuant to s. 225.1(7) of the Income Tax Act.

The government collected the other half, however, under the authority of a jeopardy collection order that the CRA obtained *ex parte* from the Federal Court pursuant to s. 225.2(2) of the tax act after receiving notice from the taxpayer of an 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 that it could otherwise "take no steps to attempt to collect or secure its position vis-a-vis other creditors. . . . If the receivership order were granted, the CRA's claim in the receivership would be unsecured."

In other words, the CRA argued that if it didn't get the jeopardy collection order, the provisions of the bankruptcy act would unfold in the ordinary course with it 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 of the other unsecured creditors in a move evoking the actions 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 company's estate were addressed," the appeal court ruling noted.

The corporate taxpayer was ultimately declared bankrupt some six months later, after which the former receiver became 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 in order to distribute them in accordance with the bankruptcy act or, alternatively, directing it 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? Because the motion was a collateral attack against the jeopardy collection order, the appeal court ruled. In *obiter*, the court found that the jeopardy order was "completely executed" before the bankruptcy within the meaning of s. 70(1) of the bankruptcy act so that neither the provisions of s. 86(1), which makes the CRA an unsecured creditor, nor those of s. 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 s. 225.2(8) and (9) of the income tax legislation? Or has the CRA found a very effective rear window to get itself back into a preferred-creditor position provided that 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 bankruptcy legislation, then for all practical purposes, preferred-creditor privileges may once again be relevant in respect of any tax debtor who must give 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. LT

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