SUPREME COURT OF NOVA SCOTIA
IN BANKRUPTCY AND INSOLVENCY

Citation: *Rosedale Farms Limited, Hassett Holdings Inc., Resurgam Resources (Re)* 2017 NSSC 160

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Docket: Halifax, No. 39412
Registry: Halifax

In the Matter of the Bankruptcies of
Rosedale Farms Limited,
Hassett Holdings Inc., and
Resurgam Resources Inc.

DECISION

Judge:	The Honourable Justice Gerald R.P. Moir
Heard:	April 6, 2017, in Halifax, Nova Scotia
Final Written Submissions:	May 5, 2017
Counsel:	Gavin D.F. MacDonald and Peter Lamey, for Grant Thornton Limited Trustee of the Bankrupts Michael Pugsley, Q.C., for the Nova Scotia Farm Loan Board Deanna Frappier, for the Minister of National Revenue Bruce Clarke, Q.C., for TEC Capital Incorporated

Introduction

[1] Rosedale Farms and two related companies were in the mink business for many years. They raised mink on farms in Digby county and sold pelts at the international fur auctions.

[2] The value of mink fur declined drastically. By the summer of 2015, the companies were out of money. They could not afford to feed the mink to maturity. The companies sought protection under the *Companies' Creditors Arrangement Act*, but switched to the proposal provisions under the *Bankruptcy and Insolvency Act*.

[3] The prices for mink fur declined more in the autumn of 2015, the companies were unable to make a viable proposal, and they automatically became bankrupt early in 2016. In the meantime, the companies had obtained an order for debtor in possession financing secured in priority to "all other security, interests, trusts, liens, charges, and encumbrances, statutory or otherwise".

[4] TCE Capital Incorporated provided the DiP financing on the condition that the court appoint an interim receiver, which it did. TCE advanced funds starting in

September of 2015. This enabled the companies to stay in operation, including feeding the mink until they could be pelted.

[5] It seems that Rosedale maintained the payroll for employees of all three companies. The Canada Revenue Agency claims $198,601 for taxes withheld by Rosedale from employees in 2014 and 2015 and not remitted to Revenue. Grant Thornton Limited as trustee of each of the debtors moves to resolve a dispute between, on the one hand, the trustee, DiP lender, and Nova Scotia Farm Loan Board, and Revenue, on the other hand, about whether the DiP financing or the deemed trust for withholdings has priority. The trustee also moves for approval of a proposed interim distribution and for passing the fees and expenses of the trustee and its counsel.

Temple City

[6] The trustee, the DiP lender, and the Farm Loan Board rely on *Re: Temple City Housing Inc.* 2007 ABQB 786, leave to appeal refused *Canada (National Revenue) v. Temple City Housing Inc*. 2008 ABCA 1.

[7] The Queen's Bench decision is by Justice Romaine. Temple City made prefabricated homes and engineered roof trusses. It employed 195 people. It sought protection under the C*CAA*, and Justice Romaine found that it met the criteria for

an initial order authorizing a plan of arrangement. She also found that DiP financing with super-priority was "necessary and in the best interests of the company's stakeholders generally" para. 14. The contentious issue was whether the DiP security would have priority over the deemed trust for unremitted withholdings.

[8] Revenue relied on the deemed trust provisions in s. 227 of the *Income Tax Act.* It submitted "the deemed trust created by s. 227(4.1) prevents the CRA's claim from being superseded by the super-priority of a DiP order under the CCAA": para. 9.

[9] Justice Romaine reviewed *First Vancouver Finance v. Canada (National Revenue)* 2002 S.C.J. 25. She concluded, at para. 13, that the interpretation of the deemed trust provisions in *First Vancouver* "is inconsistent with CRA's argument that [s. 227(4.1)] creates a property interest that cannot be superseded by a DIP charge."

[10] Here is what Justice Romaine said at para. 11 and 12 of *Temple City* about Justice Iacobucci's reasons in *First Vancouver*:

> He noted that the deemed trust takes priority in situations where the CRA and secured creditors of a tax debtor both claim an interest in the tax debtor's property. On the issue of whether the deemed trust attached to after-acquired property, Iacobucci J. found that the language of the relevant section implied that

> "Parliament has contemplated a fluidity with respect to the assets of the debtor to which the trust [attaches]": para. 32. He commented that, since the deemed trust is a statutory creation, it is not subject to the "restraints imposed by ordinary principles of trust law"; para. 34. Thus, while conceptually it could be considered that the source deductions themselves are the corpus of the trust, according to the language of the section, "property of the person…equal in value to the amount so deemed to be held trust is deemed" to be held in trust. As the Court noted, this saves the CRA from having to trace specific assets to the funds originally deducted for sources deductions. Iacobucci, J. referenced the comments of Gonthier, J. in *Royal Bank v. Sparrow Electric Corp*., [1997] 1 S.C.R. 411 (SCC) at para. 31 that the "trust is not in truth a real one, as the subject matter of the trust cannot be identified from the date of the creation of the trust…"
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> Following logically from this characterization of the statutory trust, Iacobucci, J. found on the issue of whether the deemed trust continued to operate on property that had been sold to third parties that "the deemed trust is in principle similar to a floating charge over all the assets of the tax debtor in the amount of the default": para. 40. He thus found that while the trust has priority, it does not attach specifically to particular assets, and that the debtor is thus free to alienate property in the ordinary course of business. The Court noted that, from the language of the section, "it is anticipated that the character of the tax debtor's property will change over time." This interpretation allows the tax debtor to carry on business without the uncertainty that would be created if the CRA's claim was allowed to follow an asset that had been sold to innocent third parties, and prevents a situation where the deemed trust, in effect, freezes the debtor's assets and prevents it from carrying on business, "clearly not a result intended by Parliament": para. 45.

[11] Justice Romaine concluded from this elucidation of Justice Iacobucci's reasons that *First Vancouver* is inconsistent with the proposition that s. 227(4.1) "creates a property interest that cannot be superceded by a DIP Charge": para. 13.

[12] Justice Romaine was also of the view that the definition of "security interest" in the *Income Tax Act*, especially the inclusion of the phrase "deemed or actual trust", supports her interpretation of s. 227(4.1).

[13] Revenue tried to appeal Justice Romaine's decision. The leave application was heard by Justice Rowbottom, and she gave reasons in writing for refusing leave: *Canada (National Revenue) v. Temple City Housing Inc.* 2008 ABCA 1. She characterized Justice Romaine's decision this way at para. 8:

> The CCAA judge held that the Supreme Court of Canada's decision in *First Vancouver Finance v. Minister of National Revenue*, 2002 SCC 49, [2002] 2 S.C.R. 720, was authority that the deemed trust is similar in principle to a floating charge. Thus, although the property of the employer is subject to the deemed trust, Her Majesty's interest in the property did not continue, for example, once property was sold to a third party. She also found that her interpretation was further supported by the definition in the *Income Tax Act*, which states that a "security interest" means "any interest in property that secures payment or performance of an obligation and includes an interest created by or arising out of a …deemed or actual trust…". Therefore, she held that Her Majesty's security interest could be treated the same way as any other security interest under the CCAA.

[14] Justice Rowbottom also made reference to "the inherent jurisdiction of a CCAA court". Her para. 9 reads:

> Exercising the inherent jurisdiction of a CCAA court, the CCAA judge held that in the circumstances, particularly, given the number of employees affected and the spirit of the CCAA, which is to promote the continuation of the corporation so that it can emerge from insolvency protection, she granted the DIP Lender first priority to the extent of $300,000 over any claims by the applicant.

[15] The parties supporting priority of the Rosedale Farms DiP financing submit that the provisions for DiP financing in the *Bankruptcy and Insolvency Act* are so like those in the *CCAA*, both in their text and their context, that *Temple City* is

persuasive authority for interpreting the *Bankruptcy and Insolvency Act* provisions similarly. I agree with that.

[16] With great respect, I disagree with the decisions in *Temple City*. There are three parts to the core reasons in *First Vancouver*. The problem with the conclusion reached by Justices Romaine and Rowbottom is that it renders the third part contradictory of the other two parts.

First Vancouver

[17] Justice Iacobucci wrote for the majority of a divided court in *Sparrow Electric*, which is cited in the quotation from para. 11 of Justice Romaine's decision above. He wrote for a unanimous court in *First Vancouver*. Parliament responded to *Sparrow Electric* by amending s. 227(4) and by creating s. 227 (4.1) to give priority to the deemed trust for withholdings over other security interests: para. 24 to 30 of *First Vancouver*. In the next part of his reasons, Justice Iaccobucci shows that the deemed trust attaches to after-acquired property: para. 31 to 38. The third part shows that the attachment ceases when an account receivable is sold (in *First Vancouver*, under a factoring agreement), or inventory is sold, in the ordinary course of business: para. 39 to 46.

[18] Let us take a closer look at these subjects in *First Vancouver*.

[19] (1) *The deemed trust for withholdings has priority over other security interests*. Justice Iacobucci began by referring to *Sparrow Electric* and the deemed trust provisions for withholdings as they applied when *Sparrow Electric* was decided in 1997: *Income Tax Act*, R.S.C. 1985 (5th sup.) c.1, s. 227(4) and (5). The court held that the deemed trust attached to the employer's property "as long as it was not subject to [a] fixed charge at the time the source deductions were made": *First Vancouver*, para. 25.

[20] The Royal Bank's fixed and specific charge over inventory had priority over the deemed trust: also, para. 25. "However, in reaching this conclusion, the majority of the Court [i.e. Justice Iacobucci's opinion in *Sparrow Electric*] noted at para. 112 that Parliament was free to grant absolute priority to the deemed trust by adopting the appropriate language…": *First Vancouver*, para. 26.

[21] Indeed, Justice Iacobucci's decision in *Sparrow Electric* went so far as to suggest text that would accomplish an absolute priority: also, para. 112. A year later, Parliament created the present s. 227(4) and (4.1): *Income Tax Amendments Act, 1997*, S.C. 1997-98, c. 19, s. 226(1). The amended s. 227(4) and the new s. 227(4.1) read:

> **Trust for moneys deducted**
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> (4) Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.
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> **Extension of trust**
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> (4.1) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provide under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed
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> > (a) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such an interest, and
> >
> > (b) to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to such a security interest
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> and is property beneficially owned by Her Majesty notwithstanding any security interest in such property and in the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

[22] At para. 27 of *First Vancouver*, Justice Iacobucci analysed the textual changes. At para. 28, he concluded that the Parliamentary intent in s. 227(4) and (4.1) "was too grant priority to the deemed trust in respect of property that is also subject to a security interest". This is so "regardless of when the security interest arose in relation to the time the source deductions were made or when the deemed trust takes effect": also, para. 28. He puts it another way at the end of para. 28: "In

other words, Parliament has reacted to the interpretation of the deemed trust provisions in *Sparrow Electric*, and has amended provisions to grant priority to the deemed trust in situations where the Minister and secured creditors of a tax debtor both claim an interest in the tax debtor's property". This was reaffirmed in *Century Services Inc. v. Canada* 2010 S.C.J. 60 at para. 33.

[23] These holdings contradict the conclusion in *Temple City* that the deemed trust can be superceded by a charge for DiP financing.

[24] (2) *The deemed trust attaches to after-acquired property*. This discussion begins at para. 31 and concludes at para. 38. It is titled "Does the Deemed Trust Attach to After-Acquired Property of the Tax Debtor?" The answer to this question is provided immediately in para. 32: "In my view the plain language of the provisions leads to the inevitable conclusion that the deemed trust attaches to after-acquired property." The deemed trust operates in a continuous manner, attaching to any property which comes into the hands of the debtor as long as the debtor continues to be in default, and extending back in time to the moment of the initial deduction": para. 33. This holding is reiterated at para. 38 of *First Vancouver* and para. 33 of *Century Services*.

[25] In this respect, the deemed trust is not like a floating charge. The floating charge needs default and crystallization before it attaches to inventory, receivables, and other property. The deemed trust attaches to property continuously.

[26] (3) *The deemed trust does not follow property sold to others*. The discussion on the third point is at para. 39 to 46 of *First Vancouver*, and it includes the comment about similarity to a floating charge that was relied upon in *Temple City* for the proposition that the deemed trust can be "superceded by a DIP Charge": *Temple City*, para. 13. The difficulty with that is the third subject was not about security. "[T]he question of the priority of secured creditors does not arise." :*First Vancouver*, para. 39.

[27] First Vancouver factored accounts receivable. That is to say, it purchased receivables at a discount. It became the owner of the factored debts: *First Vancouver*, para. 7. Thus, "…First Vancouver is not a secured creditor of Great West, but a third-party purchaser of book debts.": para. 39.

[28] The analogy to a floating charge is provided in the course of a discussion about alienation (usage in para. 39, 40, 41, 42, and 43) or sale (usage in para. 40, 42, 43, and 45) to purchasers (usage in para. 39, 43, and 44). The distinction between a factor and a security interest is made explicit at para. 43: "It is

significant in this regard that purchasers for value are not included in ss. 227(4) and 227(4.1) whereas secured creditors are." The analogy to a floating charge has to be understood in the context of a discussion that was about trading in current assets and was not about creating security. The deemed trust is like a floating charge in that it permits a business to continue trading in its' current assets by not attaching to specific assets when they are sold.

There was no discussion in *First Vancouver* about crystallization. The decision cannot be taken to suggest that the deemed trust can be superceded by security the way a new fixed charge might attach in priority to an earlier, uncrystallised floating charge. As I said, such an interpretation contradicts the other two holdings in *First Vancouver*: the deemed trust has priority over all security interests, and the deemed trust attaches to after-acquired property.

Deemed Trust and DiP Financing

[29] With great respect for the reasons of Justice Romaine and Justice Rowbottom, I have to say that *First Vancouver* is authority for the proposition that the deemed trust for unremitted withholdings takes priority over any security, other than the security prescribed under s. 227(4.2) and *Income Tax Regulations*, CRC c. 945, s. 2201 and s. 2202. *First Vancouver* holds that property sold to purchasers is

not subject to the trust, not that DiP financing or any other secured financing supercedes the trust. Therefore, *First Vancouver* is sufficient to end the present discussion.

[30] While the Supreme Court of Canada provided a clear interpretation of the provisions about the priority of the deemed trust, and that interpretation compels me to hold that deemed trust for income tax withheld from employees by Rosedale Farms has priority over the security it gave for DiP financing, there are a few subjects touched upon by the parties that may provide more context for the interpretation. I will briefly explain why these support the interpretation that gives priority to the deemed trust over security interests.

Definitions in *Income Tax Act* s. 224

[31] I do not understand how the definitions of "secured creditor" and "security interest" in s. 227(4.1) assist an interpretation that the deemed trust for unremitted witholdings loses priority to security for DiP financing.

[32] As the opening words of the subsection make clear, the definitions were created in the context of s. 224(1.2), which concerns garnishment to collect, among other things, unremitted withholdings. The garnished funds "become property of

Her Majesty…and shall be paid to the Receiver General in priority to any such security interest": s. 224(1.2).

[33] The text of s. 224(1.2) on its own, and understood in context, makes the Parliament's intent clear. A garnishment for unremitted withholdings takes priority over secured interests.

[34] Subsections 227(4) and (4.1) extend the s. 224(1.3) definitions to the deemed trust protection of unremitted withholdings. To take the inclusion of "deemed or actual trust" in the definition of "security interest" as removing the specific deemed trust for unremitted withholdings from the priority provisions in s. 227(4) and (4.1) is to make the later redundant. The correct contextual interpretation is that the inclusion of the definitions is to give the deemed trust for unremitted witholding priority over all security interests including other federal and provincial statutory deemed trusts.

"Notwithstanding any other provision of…the Bankruptcy and Insolvency Act"

[35] "Notwithstanding any other provision of this Act, the Bankruptcy and Insolvency Act (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law…". These are the opening words of s. 227(4.1). They expressly override s. 50.6 of *the Bankruptcy and*

Insolvency Act, the authority for ordering DiP financing and security for it priority. To hold that the court can grant priority to DiP security over the s. 227(4.1) deemed trust is to ignore these words.

Unremitted Withholdings in the Scheme of Distribution

[36] Until 2007, unsecured Crown debts ranked as preferred claims and were paid in priority to most other unsecured claims on distribution of property of a bankrupt. The scheme of distribution was reformed by S.C. 2007, c. 36, s. 47 to s. 50. Section 136 was amended to phase out the preference for Crown debts.

[37] At the same time, Parliament abolished the priorities created through the deemed trust device under various provincial and federal enactments: s. 67(2) as amended by S.C. 2007, c. 36, s. 32. An exception was made for the deemed trust under s. 227(4) and s. 227(4.1) of the *Income Tax Act* and a few related statutory deemed trusts: s. 67(3).

[38] The reformed scheme of distribution distinguishes unremitted withholdings from all other kinds of Crown debt. The deemed trust is protected, where other Crown debts are no longer preferred. This is a strong indication of Parliament's intent to give priority to the collection of unremitted withholdings.

Unremitted Withholdings in Proposals

[39] For a proposal to be successful, it must receive the majority in number and two thirds in value, of the votes in each class of unsecured creditor*: Bankruptcy and Insolvency Act*, s. 54(2). If the proposal receives the required support it may be submitted to the court for approval. When approved, the proposal is binding on the unsecured creditors and classes of secured creditors who were included in the proposal and who voted in like numbers and values: s. 62(2).

[40] As Mr. Clarke pointed out, unremitted withholdings are included in the proposal provisions, but in a restricted way. For voting purposes, the debt is not in any class of secured debts: s. 54(2.1). The court cannot approve the proposal, unless it provides for payment in full of the debt for unremitted withholding within six months: s. 60(1.1).

[41] In my opinion, Parliament has reiterated it's intention to give the upmost priority to collection of unremitted witholdings by requiring payment in full under a proposal. It allows one exception in s. 60(1.1): "Unless Her Majesty consents". More will be said about that later. The point for now is the extraordinary protection Parliament enacted, distinct from all other security interests.

Reliance on the Charging Order

[42] Mr. Clarke submits on behalf of the DiP lender:

> The wording of the Charging Order could not be clearer in that the DIP Charge was to have priority over all securities, trusts, liens, charges and encumbrances, including those created by legislation. It is vital for insolvency practice across the country that DIP Lenders not face uncertainty as to whether the Court Order is effective or not. The Orders must mean what they say.

[43] During oral argument, Mr. Pugsley submitted on behalf of the Nova Scotia Farm Loan Board that DiP lenders should be entitled to rely on charging orders.

[44] There is a positivistic response to these observations. The law grants priority for payment of unremitted withholding. The court is obligated to apply law made constitutionally by Parliament.

[45] There is a broader response. We do not take rights away from people without giving them an opportunity to be heard.

[46] In ordinary litigation, the order binds parties. It may bind a person so related to a party, that issue estoppel applies. See, *Toronto v. C.U.P.E. Local 79*, 2003 SCC 63.

[47] Bankruptcy proceedings are different. It is as if the assignment or the bankruptcy order start one large proceeding with many parties. In these collective proceeding, binding effect often depends on notice.

[48] Before the DiP financing amendments to the *CCAA* and the *Bankruptcy and Insolvency Act*, some courts asserted power to order priority for a limited time in cases of urgency. See, *Royal Oak Mines Inc*., [1990] O.J. 864 (O.C.J.) and the discussion at p. 387 and 388 of Roderick J. Wood, *Bankruptcy and Insolvency Law*, 2ed (Toronto: Irwin Law, 2015).

[49] Professor Wood said at p. 388 "a comeback provision provided only a limited check on overreaching orders". So, "the initial order should be limited to terms that are reasonably necessary for a brief time on an urgency basis". In my view, a party who supports a draft order that overreaches bears the risk that the order will not bind a person who receives no notice.

[50] Section 50.6 of the *Bankruptcy and Insolvency Act* was created by S.C. 2007, c. 36, s. 18. Subsection 50.6(2) empowers the court to order "priority over the claim of any secured creditor" for DiP financing security. Subsection 50.6(1) allows for the financing and its security but only "on notice to the secured creditors who are likely to be affected by the security or charge". These clear words answer

any notion there may have been that secured creditors may lose their rights without having an opportunity to be heard.

[51] The Canada Revenue Agency received no notice of the motion for DiP financing. Therefore, even if the *Income Tax Act* did not give the deemed trust for unremitted holdings priority over all security including that for DiP financing, the charging order would not bind Revenue.

[52] The parties supporting priority for the DiP charge complain that they were unaware of the debt for unremitted withholdings. Again, there is a narrow and a broader response.

[53] The statute does not require notice only to the secured creditors of which the party seeking a charging order is aware.

[54] More broadly, an insolvent business with employees might well be in default of their obligation to remit funds withheld from employees. While the exact amount may not be known right away, the fact of a sizable default was ascertainable through a review of bank records by the interim receiver. Those would show when payrolls were met and whether payments were remitted to Revenue.

[55] That said, Ms. Frappier showed me protocols developed with the assistance of the Superintendent of Bankruptcy for dealings between trustees under proposals and the Canada Revenue Agency when DiP financing is required. The possibility of negotiation with Revenue is express in s. 60(1.1).

Inherent Jurisdiction

[56] *Canada v. Currogh Inc.*, [1994] O.J. 953 (O.C.J.) and other decisions in insolvency proceedings vigorously asserted various powers based on the inherent jurisdiction. The assertion no longer has such vigor. See, *The Big Sky Living Inc.*, [2002] A.J. 886 (Q.B.) and *GMAC Commercial Credit v. T.C.T. Logistics Inc.*, [2004] O.J. 1356 and *Century Services Inc. v. Canada* at para. 63 to 66. Jurisdiction in *CCAA* and proposal proceedings is grounded in statute, and the inherent jurisdiction cannot override valid legislation.

Conclusion

[57] Despite the text of the charging order, the Canada Revenue Agency claim for unremitted withholding has priority over the security for DiP financing on the proceeds of the Rosedale Farms Limited assets. The interpretation of *Income Tax Act* s. 224(7) and s. 227(4.1) by the Supreme Court of Canada in *First Vancouver* and the discussion at para. 33 of *Century Services*, compel that conclusion.

[58] The Canada Revenue Agency has first claim to the proceeds of Rosedale Farms Limited assets. I approve the interim distribution proposed by the trustee for the proceeds of assets of Hassett Holdings Inc. and Resurgam Resources Inc. and I find that the trustees fees and expenses, and those if it's counsel, are necessary and reasonable.

J.