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MEMORANDUM

To: [REDACTED]

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Subject: CRA Deemed Trusts – Issues and Approaches

FACTS/BACKGROUND

Canadian Revenue Agency (“CRA”) Extended Deemed Trust requests to the Global Dispute team have increased over the last several months. CRA Deemed Trust demands require the development of an internal framework for processing and handling, because of their increased risk profile.

A review of the relevant jurisprudence and statutory interpretation raise a number of issues for analysis and discussion.

ISSUE(S)

Background

A CRA Extended Deemed Trust arises when a taxpayer fails to remit voluntary Harmonized Sales tax (“HST”) ¹ and payroll deductions.² A common practice for these businesses is to divert these voluntary tax remittances to temporarily free

¹ Excise Tax Act (R.S.C., 1985, c. E-15), s. 221 - Division V, Collection and Remittance of Division II Tax, *Subdivision a Collection* [<http://laws-lois.justice.gc.ca/eng/acts/e-15/page-188.html#h-119>].

² *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.), s. 153 - Payment of tax [<http://laws-lois.justice.gc.ca/eng/acts/l-3.3/page-271.html#h-95>].

up operational cash flow. As a result of unremitted voluntary taxes, the CRA becomes an involuntary creditor.³ Since a Deemed Trust is a statutory trust, it is not governed by common law requirements.⁴

This memo considers the current jurisprudence and the statutory interpretation of the applicable legislation. The focus is on analyzing CRA Extended Deemed Trust risk factors. The aim is to generate discussion on internal strategies to develop a procedural framework that mitigates RBC's exposure risk.

- 1) What are the effects of a CRA Deemed Trust?
- 2) What is the overarching risk of CRA Extended Deemed Trusts to RBC?
- 3) What are the CRA Extended Deemed Trust limitations?

ANALYSIS/DISCUSSION

- 1) What are the effects of a CRA Deemed Trust?

When a business makes payroll deductions and fails to remit them to CRA, all of their assets are deemed to be held in priority trust for the benefit of the Crown, notwithstanding any security interest or any other Canadian legislation.⁵

- 2) What is the overarching risk of CRA Deemed Trusts to RBC?

When RBC receives proceeds from a business in default, the proceeds attach to the recoverable amount CRA's Deemed Trust claim. RBC becomes personally liable to pay the proceeds to CRA.⁶

Moreover, the Crown can file a claim in either Federal Court or Superior Court, to compel RBC to remit the Deemed Trust claim amount, including pre-judgment interest⁷ to the Receiver General of Canada.⁸

³ Louis L'Heureux, Bill Walker, CRA Deemed Trusts, Toronto, The Law Society of Upper Canada – Continuing Professional Development, 2013 at 5-2 [CRA Deemed Trusts].

⁴ *First Vancouver Finance v. Minister of national Revenue*, 2002 SCC 49 [<http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/1989/index.do>] [*First Vancouver*]

⁵ *CRA Deemed Trusts*, *supra*, note 3 at 5-4.

⁶ *Canada (Attorney General) v. National Bank of Canada*, 2004 FCA 92, at para 40. [<http://decisions.fca-cf.ca/fca-cf/decisions/en/item/33668/index.do?r=AAAAAQALMjAwNCBmY2EgOTIB>] [*National Bank*]
Note: Applicable exceptions found under *Income Tax Regulations*, C.R.C., c. 945, s. 2200 - PART XXII - SECURITY INTERESTS [http://laws-lois.justice.gc.ca/eng/regulations/C.R.C.%2C_c.945/page-80.html#h-183].

⁷ *Income Tax Act*, *supra* note 2 at s. 227 - Withholding taxes. NOTE: Interest is calculated at the prescribed rate as at CRA Deemed Trusts *supra* not 3 at 5-12.

⁸ *Ibid.*

3) What are the CRA Deemed Trust limitations?

Inception

The Extended Deemed Trust is determined to come into existence from the moment the business fails to remit payroll deductions or collected HST to Her Majesty as and when required by legislation.⁹ This holds true irrespective of the liability being discovered by CRA.¹⁰

In the initial stages of conception (barring consent), the CRA is neither, authorized or obliged to communicate taxpayer information to the secured creditor.¹¹ Once the secured creditor and CRA communicate, the CRA will normally trigger a “trust exam” of the taxpayer.¹²

Scope of the Trust

The Extended Deemed Trust encompasses all of the debtor’s property,¹³ in the form of a ‘floating charge’¹⁴. There are a number of exceptions, including conditional sales and leasing agreements¹⁵ and assets that are sold in the ordinary course to third party purchasers.¹⁶ Further, there are specific guidelines for prescribed security interests in real property mortgages.¹⁷

However, under the language of subsection 227 (4.1), the Crown’s beneficial right is not subordinated. Any voluntary sale of an asset by a debtor followed by a voluntary payment to a creditor triggers the creditor’s obligation to turn over the proceeds to the Receiver General of Canada. The Federal Court’s decision was upheld on appeal.¹⁸

Generally speaking, the CRA limits their claim against creditors to the net proceeds of realization¹⁹

⁹ *First Vancouver*, *supra* note 4 at 29 [<http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/1989/index.do>].

¹⁰ *CRA Deemed Trusts*, *supra* note 3 at 5-9.

¹¹ *Ibid.*

¹² *Ibid.*

¹³ *Ibid.* Note: *National Bank*, *supra*, note 6; applicable exceptions found under *Income Tax Regulations*.

¹⁴ *Ibid* at 5-18

¹⁵ *Ibid* at 5-21

¹⁶ *First Vancouver*, *supra* note 9 at 46.

¹⁷ *CRA Deemed Trusts*, *supra* note 3 at 5-25.

¹⁸ *The Attorney General of Canada v La Caisse Populaire Desjardins De Lyster*, 2005 FC 949.

[<http://decisions.fct-cf.gc.ca/fc-cf/decisions/en/item/52404/index.do?r=AAAAAQAMMjAwNSBmY2EgOTQ5AQ>], *affd.* by 2006 FCA 367 [<http://decisions.fca-caf.gc.ca/fca-caf/decisions/en/item/35365/index.do?r=AAAAAQAJZGUgbHlzdGVyAQ>].

¹⁹ *CRA Deemed Trusts*, *supra* note 3 at 5-32.

Limitation Period

The *Income Tax Act* (“ITA”) is silent on a specific limitation period for recovery provisions against creditors,²⁰ except to specify the Deemed Trust triggering event begins from the time when the Minister becomes aware of the failure by the secured creditor to pay the Receiver General.²¹

Nonetheless, the general six-year limitation period under s. 32 of the *Crown Liability and Proceedings Act*²² does apply under the ITA to recovery provisions for deemed trust amounts from creditors. Moreover, under s. 313 (2.) of the *Excise Tax Act* (“ETA”), the time limitation is 10 years from the time when the Minister becomes aware of the failure by the secured creditor to pay the Receiver General, and creates a tax debt that is not subject to an assessment.²³

CONCLUSION AND/OR RECOMMENDATION

It is clear from the jurisprudence on statutory interpretation that Parliament intended the Crown to have ‘absolute priority’ in Deemed Trust matters.²⁴ The jurisprudence continues to support the position that as a general principle, the Banks should exercise their due diligence when dealing with debtors by:

- 1) Requiring CRA assessment and statement of account documents at the time of credit extension, to determine any outstanding monies owed to CRA.²⁵
- 2) Seek personal guarantees to balance the risk their debt will be super-seeded pursuant to the statutory CRA Deemed Trust.²⁶

²⁰ *National Bank, supra*, note 6 at 41.

²¹ *CRA Deemed Trusts, supra* note 3 at 5-33.

²² *Crown Liability and Proceedings Act* (R.S.C., 1985, c. C-50), s.32.

²³ *CRA Deemed Trusts, supra* note 3 at 5-33.

²⁴ *National Bank, supra*, note 6 at 27 – 28, 34.

²⁵ *CRA Deemed Trusts, supra* note 3 at 5-40.

²⁶ *Canada (Minister of National Revenue) v. HSBC Bank of Canada*, 2004 FC 467 at 17 [<http://decisions.fct-cf.gc.ca/fc-cf/decisions/en/item/47261/index.do>]

Legislation

Bank Act, S.C. 1991, c. 46. [<http://laws-lois.justice.gc.ca/eng/acts/b-1.01/>]

Crown Liability and Proceedings Act, R.S.C., 1985, c. C-50. [<http://laws-lois.justice.gc.ca/eng/acts/c-50/FullText.html>]

Excise Tax Act, R.S.C., 1985, c. E-15. [<http://laws-lois.justice.gc.ca/eng/acts/e-15/FullText.html>]

Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.) [<http://laws-lois.justice.gc.ca/eng/acts/l-3.3/>]

Income Tax Regulations, C.R.C., c. 945. [http://laws-lois.justice.gc.ca/eng/regulations/c.r.c.,_c._945/FullText.html]

Jurisprudence

Caisse populaire Desjardins De Lyster/Inverness/Val-Alain v. Canada (Attorney General), 2006 FCA 36 [<http://decisions.fca-caf.gc.ca/fca-caf/decisions/en/item/35365/index.do?r=AAAAAQAJZGUgbHlzdGVyAQ>]

Canada (Attorney General) v. National Bank of Canada, 2004 FCA 92. [<http://decisions.fca-caf.gc.ca/fca-caf/decisions/en/item/33668/index.do?r=AAAAQALMjAwNCBmY2EgOTIB>]

Canada (Minister of National Revenue) v. HSBC Bank of Canada, 2004 FC 467. [<http://decisions.fct-cf.gc.ca/fc-cf/decisions/en/item/47261/index.do>]

Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd., [1980] 1 SCR 1182. [<https://scc-csc.lexum.com/scc-csc/scc-csc/en/item/5697/index.do>]

First Vancouver Finance v. Minister of National Revenue, 2002 SCC 49 [<http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/1989/index.do>]

Royal Bank of Canada v. Sparrow Electric Corp., [1997] 1 SCR 411. [<http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/1483/index.do>]

The Attorney General of Canada v La Caisse Populaire Desjardins De Lyster, 2005 FC 949 [<http://decisions.fct-cf.gc.ca/fc-cf/decisions/en/item/52404/index.do?r=AAAAQAMMjAwNSBmY2EgOTQ5AQ>]

Secondary Material

L'Heureux, Louis; Bill Walker. *CRA Deemed Trusts*, The Law Society of Upper Canada – Continuing Professional Development (Toronto, 2013).

P.W. Hogg and J.E. Magee, *Principles of Canadian Income Tax Law* (1995), Section 22.3 "Strict and purposive interpretation", at pp. 453-54