

**QUEBEC DEVELOPMENTS**  
**GST AND QST : ISSUES OF TRUST, PROPERTY OR AGENCY?**  
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**I. INTRODUCTION**

In recent years, the status of the Crown with respect to claims by the Crown to the goods and services tax (**GST**) and to the Quebec sales tax (**QST**) portion of accounts receivable collected in insolvency matters has evolved dramatically.

Not so long ago, with the introduction of the amendments to the insolvency legislation in 1992, practitioners believed that the Crown, with respect to the claims for GST, QST, provincial sales tax (**PST**) or harmonized sales tax (**HST**) arising from the operations of the bankrupt prior to its bankruptcy would now rank as ordinary creditor.<sup>1</sup>

Among other developments, the decision rendered by the Quebec Superior Court in the *Chibou-Vrac* case<sup>2</sup> has seriously challenged the principle introduced by section 86 BIA and has at least for now propelled the Crown to a new priority status with respect to the GST and QST portions of accounts receivable collected by trustees, interim receivers, and privately appointed receivers.

In this article, we will review the recent case law in Quebec in the aftermath of the *Chibou-Vrac* decision, and its impact on the practice of trustees, interim receivers, and privately appointed receivers.

**II. THE LEGISLATIVE FRAMEWORK REGARDING THE CROWN'S STATUS WITH RESPECT TO THE GST AND QST IN INSOLVENCY PROCEEDINGS**

**a) The Federal Crown**

Under the *Excise Tax Act (ETA)*,<sup>3</sup> section 222 enacts a deemed trust in favour of the Federal Crown while section 317 (3) ETA provides for so called enhanced garnishment provisions.

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\* Fraser Milner Casgrain LLP, Montreal, Quebec, in the context of the 4<sup>th</sup> Annual Review of Insolvency Law Conference, March 30, 2007.

<sup>1</sup> *Bankruptcy and Insolvency Act (BIA)* R.S.C. 1985, Chapter B-3, Sections 86, 87 and 67.

<sup>2</sup> *Chibou-Vrac Inc.* Re 2003 R.J.Q. 2809, 11 C.B.R. (5<sup>th</sup>) 22 (Que. S.C.).

<sup>3</sup> R.S.C. 1985, E-15.

**b) Quebec**

In Quebec, section 20 of the Act Respecting the Ministère du Revenu du Québec (**MRA**)<sup>4</sup> also enacts a deemed trust provision in favour of the Provincial Crown which encompasses claims owing to the Crown under all of Quebec's fiscal laws including an *Act Respecting the Quebec Sales Tax (QSTA)*.<sup>5</sup> Section 304 QSTA also creates a deemed trust which applies only in the context of a bankruptcy.

As it is the case for the Federal Crown, section 15 QSTA provides the Crown with garnishment rights with respect to claims owing to the fiscal debtor.

Finally, article 2651 (4) CCQ provides a priority status to the Crown with respect to its claims under its fiscal laws.

**c) Impact of the BIA**

Under a proposal or a bankruptcy pursuant to the BIA, the Crown is relegated in principle to the status of ordinary creditor notwithstanding any security provided for in Federal or Provincial legislation for the sole or principal purpose of securing a claim with the exception of security that can be obtained by persons other than the Crown or security registered pursuant to a prescribed system of registration.<sup>6</sup>

Therefore, by application of section 67 (2) BIA, the Federal and Provincial Crown's deemed trust provisions regarding the GST and QST are no longer effective. Section 67 (2) BIA specifically sets aside deemed trust provisions (except for deductions at the source) where Federal or Provincial legislation has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1) unless it would be so regarded in the absence of that statutory provision. In other words, unless there is a real trust, legislative trusts are set aside. This clearly encompasses the deemed trust provisions enacted in favour of the Crown pursuant to the ETA and the MRA.

Similarly, the priority created in favour of the Quebec Crown pursuant to article 2651 (4) CCQ becomes ineffective as a result of the application of the BIA since such a priority is not subject to a prescribed system of registration (i.e. it does not constitute a real right).

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<sup>4</sup> *Act Respecting the Ministère du Revenu (MRA)* R.S.Q., C. M-31.

<sup>5</sup> R.S.Q. C. T-0.1 which came in force on July 1st, 1991.

<sup>6</sup> Section 86 BIA.

As for the garnishment provisions enacted under section 317 (3) ETA, the Courts in other provinces have generally held that if the garnishment measures have been set-up and served prior to the bankruptcy, the Crown becomes owner of the moneys owed by the debtors to the tax debtor until the tax debtor's liability to the Crown has been fully repaid.<sup>7</sup>

Regarding the right of garnishment under section 15 MRA, the Quebec Courts have declared such garnishment ineffective proceedings, whether or not they have been set-up before or after the bankruptcy.<sup>8</sup>

#### **d) Impact of the CCAA**

In 1997, the Federal Legislator enacted similar provisions in the *Companies Creditors Arrangements Act (CCAA)*.<sup>9</sup> Section 18.3 is almost identical to section 67 (2) BIA and in principle should set aside the deemed trust provisions found in section 222 ETA, thus rendering the GST deemed trust provisions ineffective under the Act.

As is the case under the BIA, section 18.4 was introduced to render ineffective the enhanced garnishment provisions with respect to unpaid GST where an application was filed under the CCAA.

Subsequently to the enactment of sections 18.3 and 18.4, the Federal Legislator enacted paragraph 222 (3) ETA which specifically provides for the survival of the GST deemed trust in the context of the CCAA. Section 222 (3) ETA does not extend to the BIA. In the *Ottawa Senators Hockey Club Corp.* case,<sup>10</sup> the Court of Appeal of Ontario ruled that since paragraph 222 (3) ETA was enacted subsequently to articles 18.3 and 18.4 CCAA, the intention of the Federal Legislator was that the deemed trust with respect to unremitted GST remain effective in the context of the CCAA.

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<sup>7</sup> For instance *Bank of Montreal vs. Minister of National Revenue* (2003), 2003 CarswellOnt. 2695 (Ont. C.A.).

<sup>8</sup> *Giguère*, Re [2001] R.J.Q. 2584 (Que. C.A.), leave to appeal refused in 2002, dealing with section 15 MRA; *Forget*, Re [2003], 2003 CarswellQue 234 (Que. S.C.) dealing with subsection 317 (3) ATA.

<sup>9</sup> *Companies Creditors Arrangements Act* (CCAA), R.S.C., 1985 C. C-36.

<sup>10</sup> *Ottawa Senators Hockey Club Corp.* Re (2005), 6 C.B.R. (5<sup>th</sup>) 213 (Ont. C.A.).

### III. THE CHIBOU-VRAC CASE<sup>11</sup>

In the Chibou-Vrac case, the debtor had filed a notice of intention to file a proposal under the BIA on June 22, 2001. Subsequently to the filing of the notice of intention and before it went bankrupt, the debtor claimed from Noranda Inc. an amount of \$126,255 including \$16,491 representing GST and QST for services rendered to July 21, 2001 inclusively.

On January 31, 2002, the debtor filed a voluntary assignment in bankruptcy. The trustee filed proceedings against Noranda Inc. which ultimately paid to the trustee in bankruptcy the sums owing to Chibou-Vrac.

The trustee contested the right of the Minister of Revenue to collect the GST on the basis of sections 86, 87 and 67 BIA and the parties have agreed that pending the outcome of the Motion for Directions and for Declaratory Judgment presented by the trustee, the sums representing the GST and QST would be held in the trustee's attorneys' trust account.

The Court ruled in favour of Revenue Quebec (**MRQ**) on the following grounds:

- The deemed trust provisions contained in section 222 ETA are inoperative since section 222 (1.1) ETA stipulates that upon a bankruptcy, the GST collected or which became due prior to the bankruptcy and which had yet to be remitted to the Federal Crown as of the date of the bankruptcy is no longer deemed to have been held in trust.<sup>12</sup>
- With respect to the provincial deemed trust provisions pursuant to section 20 MRA, there is no corollary provision to section 222 (1.1) ETA. Accordingly the legislative trust enacted by section 20 MRA remains effective provided that the other elements necessary to conclude to the existence of a trust under Common Law are present. The Honourable Justice Guertin concludes that there is:
  - (i) Certainty with respect to the intention to create a trust. The Court bases this finding on the basis of the existence of a legislative trust in section 20 MRA.

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<sup>11</sup> Op. cit. note 2.

<sup>12</sup> *Alnav Platinum Group Inc. vs. A.P.M. DelStar Inc.* 2001 32 C.B.R. (4<sup>th</sup>) 1 Alberta's Court of Queen's Bench. In this case Mr. Justice Agrios also concludes that there may not be a deemed trust with respect to the GST in a context of a bankruptcy. However, the Court concludes that the amounts are the property of the Federal Crown.

- (ii) Certainty with respect to the subject matter.
- (iii) Certainty with respect to the beneficiary of the trust since section 20 MRA provides that the beneficiary of the trust is the Crown.
  - The same reasoning does not apply in favour of the Federal Crown regarding the GST as section 222 ETA specifically excludes its application in a bankruptcy. It cannot constitute the basis for the existence of a real legislative trust after the bankruptcy.
  - The sums held in trust representing the QST are identifiable and have not been comingled with the debtor's assets.
  - On the basis of the discrepancies between the Federal and Provincial statutes in the treatment of the GST and QST deemed trust in a bankruptcy it would be imprudent to allow MRQ to collect the QST on the basis of a real common law trust.
  - Pursuant to section 265 (1) ETA and section 20 MRA, the trustee in bankruptcy was acting as an agent of the bankrupt who in turn was an agent of the Crown for the collection of the taxes. The Court stops short of declaring the Crown owner of the amounts representing the unremitted GST and QST as was the case in *Alnav Platinum Group*.<sup>13</sup>
  - Considering that the trustee is an agent of the Crown for the purpose of collecting the GST and QST and because the amounts held in a distinct trust account can be identified, the Court finds in favour of MRQ.

The Chibou-Vrac case was not appealed.

Since this judgment, two (2) cases have followed in the wake of Chibou-Vrac. We will deal with these cases successively.

#### IV. THE MPX CASE

On April 11, 2006, the Honourable Justice Gérald Boisvert of the Quebec Superior Court rendered his judgment in the *9083-4185 Quebec Inc. (Trustee of)* case (MPX).<sup>14</sup>

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<sup>13</sup> Op. cit. note 12.

<sup>14</sup> *9083-4185 Quebec Inc. (Trustee of)*, Superior Court, District of Montmagny no. 300-11-000046-053, J.E. 2006-1005 (S.C.), in Appeal.

In this case MPX filed a voluntary assignment in bankruptcy on September 7, 2005. The trustee collected an amount of \$100,000 including GST and QST owing from Tanguay for the purchase of furniture.

The Caisse populaire held security over the accounts receivable in the form of a hypothec on the universality of claims. The deed of hypothec contained a provision whereby the borrower undertook to collect claims and to apply same against its indebtedness towards the Caisse populaire.

The trustee presented a Motion for Directions to seek instructions as to who belongs the GST and QST collected and remitted by Tanguay: the secured creditor or MRQ?

The estate did not claim an interest in the GST and QST collected and had placed the funds in a segregated trust account pending the decision of the Court.

The Court found in favour of the Tax Authorities of the following grounds:

- It is the purchaser of the goods and not the vendor who is taxed.<sup>15</sup>
- The bankrupt is only the transmission belt used to collect and remit the amount of tax owing to the Crown.
- The trustee's duty is to remit the GST and QST portions of \$100,000 received from Tanguay to MRQ.
- The trustee has the duty to remit these amounts failing which he may be exposed to penal or criminal sanctions pursuant to section 15.1 BIA and sections 2 and 336 *Criminal Code*.
- The trustee's duty is only to remit to the Crown what he has collected as GST and QST and no more. He has no obligation to review the books of the bankrupt in order to determine the amounts of GST and QST collected by the bankruptcy before the bankruptcy.
- There is no incompatibility between the agency provisions contained in the ETA and the MRA on one hand and the provisions of the BIA on the other hand.

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<sup>15</sup> *Reference re Goods and Services Tax*, [1992] 2 S.C.R. 480. *Reference re Quebec Sales Tax*, [1994] 2 S.C.R. 727. The fact that a person collects the tax does not change the fact that the consumer is ultimately the party who must pay it.

## V. THE ALTERNATIVE GRANITE CASE<sup>16</sup>

Alternative Granite et Marbre Inc. filed an assignment in bankruptcy on November 5, 2004.

National Bank of Canada held over the assets security pursuant to section 427 of the *Bank Act*<sup>17</sup> as well as a universal moveable hypothec charging claims. On the day of the bankruptcy, the Bank exercised its right under its security to notify the trustee in bankruptcy as well as all the account debtors that PricewaterhouseCoopers Inc. would collect the claims on behalf of the Bank.

Despite these notices, the trustee in bankruptcy continued to receive a few payments. It is these sums of money representing GST and QST owing to MRQ by clients which are the subject of the litigation between the Bank and MRQ.

In its submissions to the Court, MRQ has argued, as it had done in the Chibou-Vrac and MPX cases that the taxes relating to the accounts receivable of the debtors and which have not been collected as of the date of the bankruptcy are the property of MRQ.

In the Court's opinion, the debtors were never owners of the GST and QST collected and therefore these taxes never formed part of their patrimony. Consequently, the security granted by the debtors could not charge the sales' taxes relating to their accounts receivable since such amounts were not their property.

The Bank argued that the debtors, as supplier of the goods or of the services rendered, must collect and remit the taxes within a certain timeframe failing which they become personally indebted towards the Crown. In the Court's view, on a juridical basis, this statutory obligation only adds an additional debtor from whom the Crown can claim its taxes. It does not affect in any way the agency relationship which initially prevailed between the supplier services or goods and the government.

The Bank further argued that MRQ cannot claim a right of ownership over the taxes collected but not remitted on the basis of section 86 BIA which stipulates that the Crown's claims are ordinary claims.

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<sup>16</sup> *Alternative Granite et Marbre Inc., Syndic (d') : Lemieux Nolet Inc. vs. Banque Nationale du Canada*; in re *Stone Vogue Ressources Inc. : Lemieux Nolet Inc. vs. Banque Nationale du Canada* C.S.Q. no. 200-11-012939-040 and no. 200-11-012938-042, AZ-50373960 (S.C.Q.) May 5, 2006.

<sup>17</sup> 1991, Chapter 46.

Surprisingly, the Court found that in the case under study, section 86 BIA refers to the Crown's claims against the bankruptcy of the person who acquired the goods or services from the supplier and which is the party who ultimately must claim the tax. In any event, even if MRQ was an ordinary creditor, the fact remains that the debtors could not grant security in favour of the Bank on the sums representing the GST and QST relating to their accounts receivable.

In conclusion, the Court finds that MRQ is not an ordinary creditor with respect to the sums owing for the GST and QST portions of the accounts receivable collected by the trustee after the bankruptcy of the debtors. MRQ is the owner of such amounts which never formed part of the patrimony of the debtors.

## VI. WHERE DO WE STAND?

It appears from the MPX and Alternative Granite cases that MRQ's claim to a right of ownership and the sums owing but not yet remitted as of the date of the bankruptcy is gaining support.

There is another case pending since 2004 in the bankruptcy of *Duo-Communications of Canada Ltd.*<sup>18</sup> In Duo-Communications, Ernst & Young Inc. was appointed interim receiver pursuant to a petition made by a secured creditor. The appointment pursuant to subsection 47.1 BIA gave the interim receiver power to control the receipts and disbursements of Duo-Communications.

Subsequently, the debtor filed a notice of intention but the interim receiver continued to control the receipts and disbursements. Duo-Communications became bankrupt on September 3, 2003.

When the interim receiver applied for directions to dispute the proceeds and for approval of its final statement of receipts and disbursements, the motion was contested by the MRQ again claiming that it had a right of ownership in respect of the portion of the proceeds of the collection and sale of the accounts receivable equivalent to the sales tax component thereof. We understand that the hearing of this matter will be completed later this Spring.

Until the Court of Appeal rules in the MPX and Alternative Granite case and a ruling is rendered in Duo-Communications, we can summarize the impact of the existing case law as follows:

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<sup>18</sup> *Duo-Communications*, C.S.M. no. 500-11-021126-038. See also Louise Lalonde, *La TPS et la TVQ: le loup de retour dans la bergerie*, 2005, Carswell, pages 355 and following for an analysis of the arguments presented by the Interim Receiver and by Revenue Quebec in such case.

- For the sum representing the GST portion of accounts receivable which have been collected prior to the bankruptcy but have not been remitted to the Crown, the deemed provision enacted pursuant to section 222 ETA is ineffective by application of section 222 (1.1) ETA. Section 222 ETA cannot be the foundation for the existence of a real legislative trust after the bankruptcy. Therefore, the Crown will rank as ordinary creditor by application of section 86 BIA unless it can establish that in fact, the GST of accounts receivable was segregated and held in trust prior to the bankruptcy and could clearly be identified.
- For the sum representing the QST portion of accounts receivable which have been collected prior to the bankruptcy but have not been remitted, the deemed trust and presumption enacted by section 20 MRA survives the bankruptcy. It remains effective provided that the other elements necessary to have a real common law trust exist. In other words, the legislative trust must be able to be consistent with a real common law trust and meet its three requirements. The case law seems to confuse and assimilate the quantifiable character of the amounts payable with the requirement that the sums be identified.
- On the basis of the agency created in the ETA and MRA, the Crown is the owner of the amounts representing the GST and QST collected but unremitted at the time of the bankruptcy.
- Therefore, such taxes never formed part of the debtors patrimony and the trustee or secured creditor have no right to those amounts and must remit the GST and QST to the tax authorities.
- The trustee in bankruptcy does not have the obligation to review the books and records of the bankrupt in order to determine the amounts of GST and QST collected by the bankrupt before the bankruptcy. The trustee's only obligation is to remit to the Crown what he has collected as GST or QST, and no more.<sup>19</sup> Where there has been an agreement between the trustee and the Crown to deposit amounts representing the portion of GST and QST in trust, the Courts generally conclude that the sums representing the taxes could be identified.
- Where an interim receiver is appointed pursuant to the BIA and where its role is limited to carrying out his duty to control the receipts and disbursements of the debtor, it is not clear whether it falls under the

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<sup>19</sup> Op. cit. the MPX case.

definition of “receiver” as such term is defined at subsection 266 (1) ETA and section 310 QSTA. Subsection 266 (1) ETA defines “receiver” as follows:

“Receiver” means a person who:

- Under the authority of a debenture, bond or other debt security, of a court order or of an Act of Parliament or of the legislature of a province, is empowered to operate or manage a business or a property of another person.

Section 310 QSTA is basically to the same effect:

“Receiver” means a person who:

- Under the authority of a debenture, bond or other debt security, of a court order or of an Act of the Legislature of Québec, another province, the Northwest Territories, the Yukon Territory, Nunavut, or the Parliament of Canada, is empowered to manage or operate the business or property of another person.

In our view, subsection 266 (1) ETA and section 310 QSTA do not apply to an interim receiver where he does not manage or operate the business.<sup>20</sup> The question which will hopefully be answered in the Duo-Communications case is whether the interim receiver is a continuation of the supplier and whether the interim receiver can benefit from the limitation of potential liability of the trustee and the receiver with respect to the GST and QST amounts to those invoiced prior to the bankruptcy or the appointment of the receiver.

Even if the Crown were to be considered the owner of the taxes on the basis of the agency established under the ETA and the QSTA, the trustee and the receiver should only be liable up to the amounts of assets they must distribute in accordance with the applicable scheme of collocation established under law.

- For goods or services provided after the bankruptcy, the trustee will have to remit to the Crown the GST and QST portion of accounts receivable generated.

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<sup>20</sup> *Plaskett & Associates Ltd. vs. Minister of National Revenue* (119), 2 C.B.R. (3d) 13 (T.C.C.). *New Brunswick (Minister of Finance) vs. Coopers & Lybrand Ltd.* (1992), 14 C.B.R. (3d) 313 (N.B. Q.B.), leave to appeal refused (1994), 24 C.B.R. (3d) 36 (note) (S.C.C.).

## VII. ISSUES ARISING FROM THE CHIBOU-VRAC, MPX AND ALTERNATIVE GRANITE CASES

These cases raise several issues which the Court of Appeal will hopefully answer:

- In Chibou-Vrac, the Court concludes that the deemed trust enacted by section 20 MRA will survive the bankruptcy provided that this “legislative trust” respects the conditions necessary for the existence of a real common law trust. This is surprising in the context where the *Civil Code of Québec* is of no assistance in this matter. It is difficult to conceive that the MRQ could benefit from a real common law trust. Furthermore, the intention to create a trust has been questioned by authors.<sup>21</sup> Also, a trust requires that the property be specifically identifiable and not merely quantifiable.<sup>22</sup>
- The agency: Since it is the purchaser of the goods or services who is ultimately responsible for the payment of the tax and that the supplier does not remit to the Crown the tax collected but in fact an amount equivalent to the tax collected (even if such amount has not been collected yet), how can the Crown claim to be owner of the taxes?
- Is the Crown in fact the owner of the taxes and can we draw such a conclusion from the existence of a mandate given to the supplier of goods or services to collect the taxes?
- Do the trustee or receiver have an obligation to segregate the taxes received? There is no such obligation in the Acts in so far as the suppliers are concerned. The supplier’s invoices include the taxes. Again, one must distinguish amounts which can be quantifiable generally from amounts which are not identifiable.
- Can the GST and QST portions of the accounts receivable of a debtor be the subject of a secured creditor’s charge?

Clearly, we will have to wait for the outcome of the appeals in the MPX and Alternative Granite cases before these issues are finally settled.

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<sup>21</sup> Me Jean Fontaine, *Des priorités de la Couronne en situation d’insolvabilité*, Canadian Institute, September 2004; Louise Lalonde, op. cit. note 18.

<sup>22</sup> *Boutique San Francisco Inc.*, 2002 CarswellQue 1325, (C.S.).