

Date: 20070326

Docket: T-731-06

Citation: 2007 FC 313

Ottawa, Ontario, March 26, 2007

Present: The Honourable Mr. Justice Simon Noël

BETWEEN:

ATTORNEY GENERAL OF CANADA

Plaintiff

and

TORONTO DOMINION BANK

Defendant

REASONS FOR JUDGMENT AND JUDGMENT

[1] This is a simplified action under sections 292 to 299 of the *Federal Courts Rules*, SOR/98-106. The Attorney General of Canada (the plaintiff) is claiming \$7,784.70 from the Toronto Dominion Bank (the defendant). This claim is based on the deemed trust provisions for the benefit of Her Majesty the Queen in subsections 227(4) and (4.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (the *ITA*) and in subsections 86(2) and (2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23 (the *EIA*). The plaintiff is also claiming interest at the rate prescribed by the *ITA*

from April 8, 2003, until payment in full, under subsections 36(2) and 37(2) of the *Federal Courts Act*, R.S.C. 1985, c. F-7.

I. Admission

[2] The morning of the hearing, the defendant admitted owing \$7,784.70 to the plaintiff but asked that the interest payable be calculated from March 1, 2005, the date of the first request for payment, instead of April 8, 2003, the date when the defendant cashed in the certificate of deposit.

II. The facts

[3] On August 28, 2001, 9093-0470 Québec Inc. (9093), a furniture company, signed a personal property mortgage in favour of the defendant, a bank constituted under the *Bank Act*, S.C. 1991, c. 46. Pursuant to this hypothec, 9003 signed a document entitled “Power of Attorney to Transfer Bonds or Shares” in favour of the defendant.

[4] The mortgage in question concerns a certificate of deposit bearing the number 8066224, in the original amount of \$41,500, which matured on August 28, 2002. It was then renewed until April 8, 2003, when the defendant cashed it in for \$43,040.89.

[5] From January to April 2002, 9093 deducted amounts from its employees’ wages for income tax and employment insurance. The details regarding these amounts are found in paragraph 11 of

these reasons. These deductions were not remitted to Her Majesty: therefore 9093 is in default in remitting these deductions to the plaintiff, and the plaintiff is a creditor of 9093.

[6] On January 28, 2002, the defendant's legal representatives sent a notice of default to 9093 stating that amounts were due, and that consequently the defendant was planning to cash the certificate of deposit that it held as security.

[7] On March 14, 2003, 9093 made an assignment in bankruptcy to the trustee KPMG Inc.

[8] On April 8, 2003, the defendant cashed in the certificate of deposit for \$43,040.89 (with interest) and applied it to the line of credit in 9093's name. The balance owing on the line of credit was reduced from \$64,020.97 to \$20,980.08.

[9] On March 1, 2005, Marie-France Langlois, a collection officer with the Canada Revenue Agency, sent a letter to the defendant regarding Her Majesty's claim of \$17,142.18 (the request for payment).

[10] On April 19, 2005, the defendant's representatives replied to Ms. Langlois' letter. They confirmed that the defendant had indeed applied as compensation the certificate of deposit that it held as security.

[11] On February 23, 2006, the plaintiff sent a notice of default to the defendant for payment in the amount of \$7,784.70. This notice of default was based on 9093's failure to remit \$7,784.70 to Her Majesty, which represents the amount that 9093 deducted from its employees' wages. Specifically, 9093 failed to remit to Her Majesty: (a) \$6,487.23, which it deducted under the *ITA* as tax payable by its employees from January to April 2002, and (b) \$1,297.47, which it deducted as employee contributions payable by its employees under the *EIA* from January to April 2002.

[12] According to the plaintiff, the defendant was required to pay Her Majesty in priority when it cashed in the certificate of deposit, pursuant to subsections 227(4) and (4.1) of the *ITA* and subsections 86(2) and (2.1) of the *EIA*.

II. The relevant statutory provisions

[13] For our purposes, the relevant provisions are set out in subsections 86(2) and (2.1) of the *ITA* and 227(4) and (4.1) of the *EIA*. Since these provisions are very similar, it is sufficient to reproduce only the *ITA* provisions:

227. (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

227. (4) Toute personne qui déduit ou retient un montant en vertu de la présente loi est réputée, malgré toute autre garantie au sens du paragraphe 224(1.3) le concernant, le détenir en fiducie pour Sa Majesté, séparé de ses propres biens et des biens détenus par son créancier garanti au sens de ce paragraphe qui, en l'absence de la garantie, seraient ceux de la personne, et en vue de le verser à Sa Majesté selon les modalités et

manner and at the time provided under this Act.

(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 provided 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

(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 a security 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

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.

[Emphasis added]

dans le délai prévu par la présente loi.

(4.1) Malgré les autres dispositions de la présente loi, la Loi sur la faillite et l'insolvabilité (sauf ses articles 81.1 et 81.2), tout autre texte législatif fédéral ou provincial ou toute règle de droit, en cas de non-versement à Sa Majesté, selon les modalités et dans le délai prévus par la présente loi, d'un montant qu'une personne est réputée par le paragraphe (4) détenir en fiducie pour Sa Majesté, les biens de la personne, et les biens détenus par son créancier garanti au sens du paragraphe 224(1.3) qui, en l'absence d'une garantie au sens du même paragraphe, seraient ceux de la personne, d'une valeur égale à ce montant sont réputés:

a) être détenus en fiducie pour Sa Majesté, à compter du moment où le montant est déduit ou retenu, séparés des propres biens de la personne, qu'ils soient ou non assujettis à une telle garantie;

b) ne pas faire partie du patrimoine ou des biens de la personne à compter du moment où le montant est déduit ou retenu, que ces biens aient été ou non tenus séparés de ses propres biens ou de son patrimoine et qu'ils soient ou non assujettis à une telle garantie.

Ces biens sont des biens dans lesquels Sa Majesté a un droit de bénéficiaire malgré toute autre garantie sur ces biens ou sur le produit en découlant, et le produit découlant de ces biens est payé au receveur général par priorité sur une telle garantie.

[Je souligne]

III. Analysis

[14] As mentioned above, the defendant admitted the amount in dispute at the hearing.

Accordingly, I need only determine the date that the interest on this amount begins to accrue. Is it

the date of the request for payment, i.e. March 1, 2005, or the date of the compensation when the certificate of deposit was cashed, i.e. April 8, 2003?

[15] I should point out that because of the similar wording in subsections 86(2) and (2.1) of the *EIA* and subsections 227(4) and (4.1) of the *ITA*, the same result applies to the deductions for employment insurance and the deductions for income tax.

[16] The Supreme Court of Canada, *per* Mr. Justice Iacobucci, dealt with source deductions in *First Vancouver Finance v. M.N.R.*, [2002] 2 S.C.R. 720 at paragraphs 22-23 and 28. To assist in understanding these reasons, I reproduce the following paragraphs:

22 The collection of source deductions has been recognized as “at the heart” of income tax collection in Canada: see *Pembina on the Red Development Corp. v. Triman Industries Ltd.* (1991), 85 D.L.R. (4th) 29 (Man. C.A.), at p. 51, *per* Lyon J.A. (dissenting), quoted with approval by Gonthier J. (dissenting on another issue) in *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, at para. 36. Because of the importance of collecting source deductions, the legislation in question gives the Minister the vehicle of the deemed trust to recover employee tax deductions which employers fail to remit to the Minister.

23 It has also been noted that, in contrast to a tax debtor’s bank which is familiar with the tax debtor’s business and finances, the Minister does not have the same level of knowledge of the tax debtor or its creditors, and cannot structure its affairs with the tax debtor accordingly. Thus, as an “involuntary creditor”, the Minister must rely on its ability to collect source deductions under the ITA: Pembina on the Red Development, supra, at pp 33-34, per Scott C.J.M., approved by Cory J. in Alberta (Treasury Branches), supra, at paras. 16-18. For the above reasons, under the terms of

the ITA, the Minister has been given special priority over other creditors to collect unremitted taxes.

...

28 It is apparent from these changes that the intent of Parliament when drafting ss. 227(4) and 227(4.1) was to grant priority to the deemed trust in respect of property that is also subject to a security interest regardless of when the security interest arose in relation to the time the source deductions were made or when the deemed trust takes effect. This is clear from the use of the words “notwithstanding any security interest” in both ss. 227(4) and 227(4.1). . . .

[Emphasis added]

[17] I summarize the Supreme Court’s statements as follows:

:

- The collection of source deductions is at the heart of income tax collection;
- The tax debtor’s bank is more familiar with the debtor’s business and finances than the Minister;
- Source deductions have priority over other creditors with respect to the collection of unremitted taxes;
- The special priority granted to the deemed trust prevails over property given as security, regardless of whether the security interest arose before or after the deductions for income tax or employment insurance were made;

[18] From January to April 2002, the deductions made by 9093 for tax and employment insurance were not remitted to the plaintiff, and a deemed trust became operative. These deductions were no longer part of 9093’s property. Thus, when the certificate of deposit in the amount of

\$43,040.98 was cashed in on April 8, 2003, the defendant appropriated a part of the amount that no longer was part of 9093's property: this amount belonged to the plaintiff because of the deemed trust and special priority.

[19] On March 1, 2005, the plaintiff sent a letter to the defendant requesting payment of the source deductions and employment insurance contributions. This date is one factor to consider in determining the date on which interest begins to run.

[20] However, when the defendant applied the proceeds of the certificate of deposit as compensation on April 8, 2003, the defendant misappropriated the amount of \$7,784.70. Indeed, subsections 227(4) and (4.1) of the *ITA* and 86(2) and (2.1) of the *EIA* provide that when an employer fails to remit source deductions for tax and contributions for employment insurance, a deemed trust is created. This trust has priority over any security given before or after the trust arises.

[21] In this case, the default in remitting the source deductions and the contributions occurred in the first half of 2002, which means that the deemed trust existed since that time. From that point on, 9093's property no longer included the amount of \$7784.70. Therefore, when the certificate of deposit was cashed on April 8, 2003, the defendant appropriated an amount to which it was not entitled.

[22] Two other dates could also be determinative: the date of the request for payment or the date the defendant became aware that an amount was due in priority. However, in this case, it appears to

me that the fact that the defendant appropriated an amount to which it was not entitled is the decisive factor. Accordingly, I adopt April 8, 2003 as the date for purposes of the interest calculation.

IV. Costs

[23] Since the defendant admitted owing the amount claimed, I am awarding costs to the plaintiff.

JUDGMENT

FOR THESE REASONS, THE COURT:

- Allows the plaintiff's action;
- Orders the defendant to pay the plaintiff the amount of \$7,784.70 with interest at the rate prescribed by the *Income Tax Act* from April 8, 2003, to payment in full, in accordance with subsections 36(2) and 37(2) of the *Federal Courts Act*;
- Awards costs to the plaintiff.

“Simon Noël”

Judge

Certified true translation
Mary Jo Egan, LLB

FEDERAL COURT
SOLICITORS OF RECORD

DOCKET: T-731-06

STYLE OF CAUSE: Attorney General of Canada v. Toronto Dominion Bank

PLACE OF HEARING: Montréal, Quebec

DATE OF HEARING: March 20, 2007

REASONS FOR ORDER BY: The Honourable Mr. Justice Simon Noël

DATED: March 26, 2007

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