Toronto Law Journal

The Statement of Defence - A Few Considerations

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Introduction

The statement of defence provides a concise roadmap of a defendant's position. It is the first opportunity to respond to the allegations contained in the statement of claim. A defendant may admit, deny or plead insufficient knowledge about the paragraphs contained in the statement of claim. In addition, a defendant will state the material facts that form the basis of the defences that will be raised. It is worth noting that failing to admit an allegation that the defendant knows to be true may cause unnecessary delays and ultimately put that defendant at risk of an adverse costs award.

The *Rules of Civil Procedure* establish the timeline for the delivery of the statement of defence. Where a statement of claim has been served in Ontario, a defence shall be delivered within twenty days.[1] The *Rules* allow forty days for the delivery of a defence on claims served elsewhere in Canada as well as the United States, and sixty days for those served anywhere else in the world.[2] The defendant will prepare a statement of defence and serve it on the plaintiff. Once served, a copy will be filed with the court along with proof of service.

Where a defendant delivers a Notice of Intent to Defend within the time prescribed for the delivery of a defence, that defendant will be entitled to ten additional days to serve a defence.[3] If a defence cannot be delivered within the timeline prescribed by the *Rules,* it is critical that the defendant communicate with plaintiff's counsel to request an indulgence. Counsel may agree on a timeline for the delivery of same. The failure to communicate with opposing counsel if a defence has not been delivered within the timeline prescribed by the *Rules* will put a defendant at risk of being noted in default pursuant to subrule 19.01(1).

When preparing the statement of defence, counsel may look to a precedent database to save time and keep costs low. This approach can prove efficient as clients will not be interested in having their counsel reinvent the wheel when it comes to preparing a straightforward defence. However, no two cases are identical. Accordingly, it is critical that counsel review each statement of claim with their client thoroughly to contemplate the defences available and seek instructions in order to prepare the appropriate response. A well thought out defence will reduce the likelihood of the need for an amendment later down the road and the risks as well as costs associated with same. With that in mind, this paper will highlight a few considerations to keep in mind when reviewing the statement of claim. This is not a conclusive list of factors to think about as each claim is different and brings its own unique nuances.

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[1] *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 [*Rules of Civil Procedure*], Rule 18.01(a).
[2] *Rules of Civil Procedure*, Rule 18.01(b) and (c).
[3] *Rules of Civil Procedure*, Rule 18.02(1).

1. Identification of the Parties

The plaintiff may be unsure of a defendant's correct legal name or inadvertently misspell it on the statement of claim. It is important that counsel review the claim closely to confirm that the party served with the claim has been identified by their correct legal name on the pleading. The statement of defence is a critical opportunity to address any inaccuracies or misspellings of the defendant's legal name.

Pursuant to subrule 5.04(2) and Rule 26, a plaintiff may bring a motion to amend the claim to rectify any such errors. Subrule 5.04(2) grants the court the discretion to add, delete or substitute a party or correct the name of a party, provided that it does not give rise to prejudice that is not compensable by costs or an adjournment. Similarly, Rule 26 stipulates that the court shall grant leave to amend a pleading, including the addition or substitution of a party, unless it results in non-compensable prejudice.

The doctrine of misnomer permits the substitution of a party on the claim. This test will be met where the court is satisfied that the proposed defendant, though identified incorrectly on the claim, would know upon reviewing the claim that the "litigating finger" was being pointed at them. The court will consider whether a reasonable person reviewing the claim and looking at the case as a whole would know that the plaintiff meant to name them but simply got their name wrong. The doctrine of misnomer applies notwithstanding the passage of the limitation period. As a result, a plaintiff will not be precluded from pursuing a claim due to a typographical or other minor error, so long as it can be established that the defendant knew that he/she was being sued.

It is worth noting that depending on the nature and seriousness of the error, counsel may decide, upon instruction by their client, that an amendment is not necessary. This will minimize the time and costs incurred by opposing counsel to address a minor error and will go a long way in building rapport between the parties over the course of the litigation.

2. Appropriateness of Venue

A plaintiff may commence their claim where they wish. Pursuant to subrule 13.1.02(2), a defendant can bring a motion to seek to change the venue of the claim. The court may, on any party's motion, order that the proceeding be transferred to the county where it should have been commenced.[4]

When considering this request, the court will look at whether it is likely that a fair hearing cannot be held in the county where the proceeding was commenced or if a transfer is desirable in the interest of justice. To determine whether a transfer is in the interest of justice, the court will consider a number of factors including, but not limited to, where a substantial part

[4] *Rules of Civil Procedure*, Rule 13.1.02(2).

of the events that gave rise to the claim occurred, where damages were sustained, and the convenience of the parties.

In the context of a claim arising from a motor vehicle collision, the plaintiff's place of residence as well as the region where the accident occurred will be key considerations in determining the appropriate venue for the proceedings. When reviewing the statement of claim, it is important to pay close attention to whether a jurisdictional issue exists. If the proposed venue has no rational connection to the cause of action or the parties, counsel can raise the appropriateness of the venue in the defence. This will help lay the groundwork for any potential motions that are contemplated in the future.

3. Limitation Periods/Discoverability

The *Limitations Act*[5] provides that court proceedings in respect of an action must be initiated within a certain period of time. This Act sets out a basic limitation period of two years from the day the claim is or ought to have been "discovered" to commence a legal proceeding. For example, a plaintiff will have two years from the date of a motor vehicle collision to commence an action for damages arising from injuries sustained. Set against this backdrop, when reviewing the statement of claim, defence counsel should verify the date of loss, whether it be through a motor vehicle accident report or their client's recollections to ensure that the claim was issued, electronically or otherwise, within the two year period. If this has not happened, a limitation defence can be raised to indicate that the claim is time-barred.

The determination of when a claim is discovered may not always be straightforward. Section 5 of the *Act* provides that a claim is discovered on the earlier of,

> *(a) the day on which the person with the claim first knew,*
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> > *(i) that the injury, loss or damage had occurred,*
> >
> > *(ii) that the injury, loss or damage was caused by or contributed to by an act or omission,*
> >
> > *(iii) that the act or omission was that of the person against whom the claim is made, and*
> >
> > *(iv) that, having regard to the nature of the injury, loss or damage, a proceeding would be an appropriate means to seek to remedy it; and*
>
> *(b) the day on which a reasonable person with the abilities and in the circumstances of the person with the claim first ought to have known of the matters referred to in clause (a).*

[5] *Limitations Act, 2002*, S.O. 2002, c. 24.

It is presumed that a plaintiff is aware of the matters in clause (a) on the day that the act/accident/omission giving rise to the claim occurred. However, this is not always the case. The considerations under section 5(a) are typically at the forefront of claims where damages or the events/parties responsible for same may not be readily identifiable. In these instances, the plaintiff bears the onus of establishing that he/she did not know of these matters on the day that the act/accident/omission giving rise to the claim occurred. Where a plaintiff is successful in establishing these elements, the limitation period will be deemed to run from the time the loss was first discovered.[6]

Concluding Remarks

It is critical that defence counsel review the statement of claim carefully and consider all aspects in preparation of their defence. Counsel should speak with their client to go over the claim to get the defendant's account of the facts and seek instructions. A review of the claim with the client at first opportunity is critical as memories and recollections are likely to be fresher. Moreover, there will be an opportunity to look for other sources that corroborate their client's account if counsel can move quickly to arrange a discussion with their client. When drafting the defence, it is helpful to keep in mind that it will more than likely go before a presiding judge. Accordingly, it is recommended that counsel prepare a concise statement that avoids hyperbole, argument and posturing as much as possible.

[6] The plaintiff need only prove that the actual discovery of the claim was not on the date the events giving rise to the claim took place. They must offer a reasonable explanation about why the claim was not discoverable through exercising reasonable diligence. This is a low evidentiary threshold and the court will give the plaintiff's reasoning a generous reading.

Toronto Law Journal

Proposals to Amend the *Libel and Slander Act*

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In April 2020, Attorney General Doug Downey asked certain stakeholders to provide feedback about proposals contained in the Law Commission of Ontario (LCO)'s report titled *Defamation Law in the Internet Age* (Report).[1] The LCO did a thorough job in their review of the existing law and their consideration of the amendments needed to reflect the internet age. There are, however, some recommendations in the Report which we believe need to be tweaked. In particular, in our view:

- There should not be a mandatory four-week negotiation period before issuing a claim, as had been proposed in the Report;
- The shorter limitation period for news media should be preserved to encourage a more active and vigorous press. The Report proposes abolishing the existing short limitation periods for newspapers and broadcasters in the current *Libel and Slander Act*;
- The takedown regime proposed in the Report should be modified;
- The definition of "publisher" in a new *Defamation Act* should not absolve an intermediary platform, such as Google, from responsibility for the publication where the platform has been given notice of a defamatory publication on its platform and fails to take it down; and
- A specialized tribunal should be established to dispose of defamation claims under $10,000.

There are three primary recommendations that we believe need to be included in any new legislation: (1) preserving a shorter limitation period for the news media; (2) expanding liability for online platforms; and (3) creating a specialized defamation law tribunal.

1. Preserving the Shorter Limitation Period for News Media

It is still important in terms of encouraging an active and vigorous press to provide for the shorter limitation period. The impact of the publication by a newspaper or broadcaster is swift, meaning that if someone has a complaint, they need to address it immediately to mitigate the damage. The significance and the seriousness of the complaint against a media report

[1] The author provided submissions to the Attorney General regarding the Report (co-authored with Eryn Pond): Eryn Pond and Howard Winkler, *Submissions to the Attorney General of Ontario on the Law Commission of Ontario's Defamation in the Internet Age Final Report*, July 2020, available online: https://www.winklerresolution.com/wp-content/uploads/2020/08/Winker-Law-Submission-to-the-AG-on-the-LCOs-Defamation-Law-in-the-Internet-Age-Final-Report.pdf

diminishes over time. A shorter limitation period provides protection for publishers and broadcasters, so they do not continue to face the exposure and risk of lawsuits that inhibit their ability to do their necessary job in our democracy.

Under the current law, a plaintiff must give notice of their complaint within six weeks and then must commence the action within three months. The LCO was concerned that a six-week notice of libel period was too short for unsophisticated, unrepresented parties, and they might miss it because they were not aware of the limitation period which, if missed, becomes a complete bar to them taking action. But the answer is not to completely abolish the shorter limitation period. The purpose of a notice of libel is to give the broadcaster or publisher an opportunity to consider the matter and publish a correction, an apology, or a retraction to mitigate the harm where they conclude they made a mistake.

Given the purpose of the current law, we suggest keeping the three-month limitation period for news media. However, we suggest that if complainants do not avail themselves of the opportunity of the notice of libel within the six-week period, they should not lose the right to sue.

We also propose a simple solution to offset the impact of the short limitation period on unrepresented, unsophisticated persons. Specifically, we propose a requirement that media outlets must post a notice in their contact sections alerting people that they have three months in which to commence an action about any matter contained in their publication. That way, if someone has a problem with a newspaper or broadcaster, they simply go to the contact page to figure out who to contact, and they will see the notice. This balances the protection of unsophisticated plaintiffs and the public interest in an unfettered media.

2. Expanding Liability for Online Platforms

More must be done to hold online platforms such as Google liable when they refuse to remove defamatory material after they have been made aware of it. Unless these platforms take down offending material after it is brought to their attention, there should be a right to include them as a defendant in any defamation action.

We propose that online platforms should have *prima facie* liability as a secondary publisher after having been put on notice of defamatory content, but it should then be a complete defence if they comply with the takedown obligations proposed by the LCO (subject to certain modifications). As it stands now, under the LCO recommendations, someone can make a takedown request of Google if something is published on the internet that they find offensive. Google then contacts the original publisher or author and alerts them to the request. If that person does not respond, Google removes it. But if the originator objects to the takedown notice, the posting remains. The Report suggests that, in these circumstances, Google may keep the identity of the original publisher confidential.

We believe that is wrong. In our view, if somebody wants to take a stand and have the material stay up, Google should be required to give the plaintiff identifying information for that person for service of a statement of claim. If Google cooperates in providing the identifying information, then the true wrongdoer can be held to account and only then should Google be immune from liability. Allowing Google to maintain the anonymity of the original poster leaves the offended person with little recourse to clear their name.

We acknowledge there may be good public policy reasons for the author of a post to remain anonymous. However, under the current law, it is up to the plaintiff to uncover their identity, which could include filing a motion or multiple motions for *Norwich* orders —that compel third parties to hand over information that identifies the original publisher — which can be time-consuming and very expensive. In our view the onus should be on the person who wants to remain anonymous to go to court and obtain that relief. Instead of forcing the plaintiff who has been harmed to spend tens of thousands of dollars, Google should have to give up the identity of the person if they want the information to stay online. If the original poster believes there is a public interest in their staying anonymous, then they should incur the expense of seeking an order from the court.

3. Creating a Specialized Defamation Law Tribunal

When a person's reputation has been defamed, immediate action is essential, but the current legal system falls short in providing swift justice. We propose creating a Defamation Law Tribunal (DLT) to handle damage claims under $10,000. The tribunal would be staffed with decision-makers with subject matter expertise, and the process would be conducted in writing.

The problem with such a tribunal is that in many cases the plaintiff seeks the removal of content, not only a declaration that they were wronged. A tribunal would not have the jurisdiction of a judge to grant an injunction. Accordingly, we envision that the tribunal would be empowered to make a recommendation as to the relief that should be available to the plaintiff. The plaintiff could then move before a judge of the Superior Court of Justice to obtain that relief. Such a process would be fast and cheap and could provide the kind of remedy that people really seek, namely, vindication and the removal of defamatory content.

Conclusion

The LCO was asked to report on reform of the defamation system. They have fulfilled that mandate. Stakeholders have now commented on the recommendations of the LCO.

Now it is over to the Attorney General to consider whether to amend the *Libel and Slander Act* and what recommendations to accept if it is amended.

Toronto Law Journal

Henson Trusts – A Need for Reform?

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Introduction

Estate planning serves a vital function in the management and administration of one's financial affairs after death. For instance, effective estate planning can aid in minimizing the impact of probate and income taxes on an individual's estate upon death.[1] Protecting against wealth erosion is particularly important for people from low-income households who are leaving behind dependants, such as a disabled child or spouse. These disabled beneficiaries will most likely continue to need ongoing support from the deceased's estate in order to maintain their standard of living. Due to this potential reality, *Henson* trusts have become a popular estate planning tool for trust and estate lawyers.[2]

A *Henson* trust, sometimes referred to as an absolute discretionary trust, grants the trustee complete discretion in the amount of capital they can allocate from the trust to the disabled beneficiary.[3] The trust's discretionary nature creates no legal interest in the trust property for the beneficiary, thereby still making the beneficiary eligible for means tested government support programs, such as subsidized housing or income assistance.[4] Therefore, *Henson* trusts help ensure the longevity of the disabled beneficiary's own financial resources by having other avenues of support available.[5] However, despite the economic boon that *Henson* trusts are able to provide, there is cause for concern. The fact that the trust is completely discretionary leaves these potential beneficiaries entirely at the mercy of the trustee(s). Furthermore, there is the issue of *Henson* trusts being used as sham trusts, where the beneficiary has control over the trust property in all but name. To make matters worse, there has been a noticeable absence in both case law and government legislation in Ontario in addressing these issues.

Self-serving and Overbearing Trustees

Conflicts of Interest

Given the level of freedom trustees have in *Henson* trusts, serious misuse can arise if the trustee in question has motives other than helping the disabled beneficiary. Due to the personal nature

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[1] Christine Van Cauwenberghe, "Segregated Funds - A Unique of Investment" (2013) 32: 4 Estates, Trusts & Pensions J 363 at 365 [Cauwenberghe].
[2] Joel Nitikman, "Henson Trusts: A Sham in Sheep's Clothing: A Comment on *S.A. v. Metro Vancouver Corp*" (2019) 38: 3 Estates, Trusts & Pensions J. 205 at 207 [Nitikman].
[3] Adam Parachin, "Trusts and Accumulations of Income" (2010) 29: 1 Estates, Trusts & Pensions J. 41 at 92 [Parachin]; *Ontario (Ministry of Community and Social Services, Income Maintenance Branch) v. Henson*, [1989] O.J. No. 2093, 36 E.T.R. 192 (C.A.) [*Henson*].
[4] *Henson, supra* note 3; Nitikman, *supra* note 2.
[5] Elisabeth Evans-Olders & Marilyn Piccini Roy, "Legitimacy Accorded in Quebec to Estate Planning Technique for the Incapable: Quebec" (2014) 33: 3 Estates, Trusts & Pensions J. 236 at 242 [Evans-Olders et al.].

of these kinds of trusts, a reoccurring theme that settlors engage in is naming a close family member or friend to act as trustee.[6] One of the biggest problems in assigning a close family member as a trustee, such as a sibling, is that they are oftentimes named as a beneficiary to the remainder of the trust.[7] This is likely to create conflicts of interest, in which the trustee(s) may be less inclined to disperse of the trust capital because the more they allocate to the intended recipient, the less they will inherit for themselves. This is seen in the case of *Borges*, where a mother sets up a *Henson* trust for one of her children, but the trustees who were entitled to the remainder withheld the funds.[8] Despite the court ruling in favour of the trustees in *Borges*, in *obiter*, the Judge addressed the trustees' actions as going against the settlor's desired intentions of ensuring the beneficiary's well-being.[9] Thus, the discretionary nature of *Henson* trusts allow for opportunities to arise in which self-serving trustees can enrich themselves, all the while keeping the trust recipients in an economically vulnerable state. Given the court's stance on beneficiaries not having legal standing to enforce payments, should the courts not consider the rights and interests of the settlor?

Domineering Trustees

Since the trustee has the final say in whether the trust capital is to be dispersed, the beneficiary is heavily reliant on the goodwill of the trustee for economic support.[10] This in turn creates a substantial power imbalance between the trustee and the beneficiary regarding their relationship both within and outside the trust. Concerns have been raised regarding malicious or overbearing trustees using their position as leverage to exert control over the beneficiary in their daily life.[11] Failure to comply with a trustee's demands could result in the beneficiary being withheld funds for an indefinite period of time. The trustee could even use the trust as a way to disqualify the intended beneficiary from means tested public support.[12] Additionally, given that these beneficiaries are suffering from physical or mental disabilities, they are in greater need for medical equipment and health services, which can be costly — especially when the disability is severe or long-lasting.[13] Therefore, these beneficiaries are likely to be more susceptible to following an overbearing trustee's demands.

Problems with Preventative Measures

Employing the services of a trust company to oversee the disbursement of funds would help in addressing the problems of self-serving and malicious trustees. However, this alternative is not

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[6] Anne Werker, "The Percentage Trust: Uniting the Objectives of the Life Tenant and Remainder person in Total Return Investing by Trustees" (2006) 25 Estates, Trusts & Pensions J. 329 at 338 [Werker].
[7] Arthur Fish, "Melting the Iceberg: Estate Planning for the Parents of Disabled Children" (2011) 30: 1 Estates, Trusts & Pensions J. 26 at 48 [Fish].
[8] *Borges v. Santos*, 2017 ONCJ 651 [*Borges*].
[9] *Ibid.* at 70-71.
[10] Fish, *supra* note 7 at 54.
[11] Carolyn Hogan, "The Role of the Courts in a Trustee's Exercise of Discretion: A Comment on Re Toigo Estate" (2019) 38: 4 Estate, Trusts & Pensions J. 309 at 312 [Hogan]; *Fox v Fox Estate* [1996] O.J. No. 375, 28 O.R. (3d) 496 (C.A.) [*Fox*].
[12] *Novak v. Novak Estate*, 2019 SKQB 261 [*Novak*].
[13] Fish, *supra* note 7 at 46.

ideal because it can be incredibly expensive, even for modest estates. This is significant to note since *Henson* trusts are generally geared towards assisting disabled individuals from poor backgrounds.[14] While hiring a trust company is attainable for affluential individuals, settlors from low-income households are less likely to follow suit because they would perceive it as wasting their already limited resources, which could otherwise be used for the disabled beneficiary's benefit.[15]

The removal of the trustee is another unappealing alternative due to the fact that it is a time-consuming and expensive process, even in instances where there is a clear finding of abuse of power by the trustee.[16] To add to this fact, a beneficiary's disability may further hinder themselves from seeking legal counsel and bringing a claim for removal. Even if a claim to remove a trustee were to reach the courts, unless there is a suitable trustee lined up, the severity of abuse by a trustee must be especially egregious for a court to remove them.[17] While the existence of the Office of the Public Guardian and Trustee (OPGT) could help resolve this matter, the courts lack the authority to order the OPGT to step in as trustee.[18]

Sham Trusts

Blurring Lines between Henson and Sham Trusts

Sham *Henson* trusts are problematic as they allow for beneficiaries who control the entirety of the trust to obtain social assistance. Thus, while these beneficiaries appear poor on paper for the purpose of receiving additional government support, their absolute control over the funds practically guarantees that the trust property is theirs.[19] There have been several cases in recent years that suggest that beneficiaries have more than a mere hope of obtaining money from a *Henson* trust in Canada. Funds from *Henson* trusts have been used to pay for beneficiaries' ongoing court fees on legal matters such as support obligations and qualifying for government benefits.[20] This seems to suggest a certain degree of certainty from the beneficiaries that by proceeding with their legal claims, their interest in the trust will aid in covering court expenses. The Supreme Court has also recently ruled that beneficiaries are permitted to serve as co-trustees in the very same trust as well as have the ability to choose other co-trustees.[21] One legal scholar aptly described the current state of *Henson* trusts as beneficiaries having their cake and eating it too.[22] The reason for this is because beneficiaries

[14] Nitikman, *supra* note 2 at 213-214.
[15] Fish, *supra* note 7 at 47.
[16] Hogan, *supra* note 11 at 312-313.
[17] *Ibid*. at 314.
[18] *Potrzebowski v. Potrzebowski*, 2016 ONSC 6981 at para. 9 [*Potrzebowski*].
[19] Nitikman, *supra* note 2 at 213.
[20] *S.A. v. Metro Vancouver Housing Corp.*, 2019 SCC 4 [*S.A.*]; *Bigelow Estate (Re)*, [2008] O.J. No. 3856, 170 A.C.W.S. (3d) 433 (Sup. Ct.) [*Bigelow*]; *Ontario (Ministry of the Attorney General) (Re)*, [2015] O.I.P.C. No. 4 [*Ontario MAG*].
[21] *S.A.*, *supra* note 20.
[22] Nitikman, *supra* note 2 at 214.

are able to benefit from the trust's certain and repeated disbursements while still being able to claim that it is not an asset for means tested reasons.

Negative Societal Impact

A serious consequence regarding the exploitation of *Henson* trusts is the burden it places on social support programs that aid people with disabilities. Since these government programs are meant for society's most economically vulnerable, their increased usage by undeserving individuals unnecessarily strains these initiatives' limited resources.[23] Furthermore, *Henson* trusts may be inappropriately used by individuals to avoid other responsibilities, such as paying child or spousal support.[24] This not only negatively impacts the living conditions of the child and/or spouse seeking support, but potentially taxpayers as well. Due to a child or spouse's inability to garnish from a *Henson* trust, this may place them in such an economically vulnerable position that they must then apply for government aid.

Conclusion

While *Henson* trusts may have served an altruistic purpose at the time of its inception in terms of helping a vulnerable class of people, the absence of legislative reform has since created opportunities for misuse and abuse. Attempts at resolving these matters by way of removal of trustees or naming impartial trustees has been met with numerous complications ranging from the cost and availability of alternate trustees to the judiciary's reluctance in interfering in trust disputes. *Henson* trusts have also created opportunities for undeserving individuals to exploit social service programs. In order to better combat these issues, it is recommended that the judiciary and legislature have a more lenient test for the removal of trustees in *Henson* trusts, bestow social service agencies the authority to garnish from *Henson* trusts, as well as reinforcing a stricter arms-length principle between the beneficiary and the trust.

[23] Fish, *supra* note 7 at 46.
[24] Nitikman, *supra* note 2 at 207, 213; *Ontario MAG, supra* note 20 at 17; *Borges, supra* note 8 at para 71.

Toronto Law Journal

A Primer on CRA's Collection Powers and its Effect on Secured and Unsecured Creditors

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The Canada Revenue Agency ("**CRA**") has several collection powers under the *Income Tax Act*[2] ("**ITA**") and the *Excise Tax Act*[3] ("**ETA**") to ensure the remittance of taxes. When taxes are not remitted, the CRA has an arsenal of collection tools including the deemed trust, garnishment, and certification of tax debts with the Federal Court to obtain a judgment. These remedies have different impacts on secured creditors and unsecured (judgment) creditors. They are also treated differently in a bankruptcy situation, with some of the remedies maintaining Crown priority and others losing priority status.

It is important to understand the distinctions between the collection mechanisms and how they operate under the ITA and the ETA in order to advise secured and unsecured creditors or lenders working with individuals who have a tax debt. This article examines each of the collection mechanisms and attempts to clarify the distinctions between them.

Overview

Unremitted employee source deductions under the ITA and collected but unremitted Harmonized Sales Tax and Goods and Services Tax ("**HST/GST**") under the ETA, are obligations owing to the Crown which give rise to a deemed trust. The deemed trust applies to the whole of the tax debtor's property and to the proceeds of that property equal in value to the amount owed to the Crown. In particular, the deemed trust provides the Crown with a super-priority against all other secured and unsecured creditors (with one exception dealing with "prescribed security interests" as discussed below), if the CRA enforces its deemed trust claim.

Where an obligation owed to the Crown arises from other provisions in the ITA or the ETA (*e.g.*, individual income tax, corporation income tax, benefit overpayments, defaulted Canada Student Loans), or arises under some other statute (*e.g.*, customs or levies under the *Customs Act*[4] or the *Excise Act*),[5] there are various other collection remedies available to the CRA within the legislative schemes, like garnishment or certification of the tax debt with the Federal Court, but they do not necessarily provide the Crown with a super-priority as against secured or unsecured creditors.

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[2] R.S.C. 1985, c. 1 (5th Supp.).
[3] R.S.C. 1985, c. E-15.
[4] R.S.C. 1985, c. 1 (2nd Supp.).
[5] R.S.C. 1985, c. E-14.

When a bankruptcy occurs, the Crown is treated as an unsecured creditor by operation of s. 86 of the *Bankruptcy and Insolvency Act* (**"BIA"**),[6] except in respect of unremitted employee source deductions owing to the Crown under the ITA. In that case, the deemed trust created under the ITA survives. By contrast, the deemed trust created under the ETA for collected but unremitted HST/GST amounts is extinguished on a bankruptcy. Obligations owed to the Crown under the *Canada Pension Plan*[7] and the *Employment Insurance Act*[8] are treated the same as the deemed trust created under the ITA within and outside of bankruptcy.

Where the Crown proceeds to collect on an outstanding obligation through garnishment, its Requirement to Pay issued under the ITA or the ETA will survive a bankruptcy if the statutory requirements are satisfied before a bankruptcy occurs. If the Crown certifies its tax debt in Federal Court and obtains a judgment, the Crown may enforce the judgment through execution processes available to other judgment creditors. However, the Crown will rank as an unsecured creditor unless the Crown takes the necessary steps to secure the judgment.

Deemed Trusts

Deemed trusts that arise in conjunction with the obligation to remit employee source deductions under the ITA and HST/GST under the ETA exist by operation of law. A deemed trust exists continuously from the date of the initial collection of source deductions or HST/GST not remitted to the CRA.[9] It attaches to the property of the debtor (and to any proceeds of the property) to the extent of the amount of the unremitted deductions. This is true whether or not the property is subject to a security interest. Where a deemed trust exists, the Crown can enforce its deemed trust against the debtor and any creditor who has obtained proceeds which are rightly owing to the Crown equal in value to the amount of the unremitted tax, and the CRA does not have to take any steps to enforce its deemed trust (i.e. notice, registration).[10]

The implications of a deemed trust are the same for secured creditors and unsecured creditors, except where a secured creditor holds a "prescribed security interest". A prescribed security interest is an interest in land or in a building (a mortgage or hypothec) registered against the tax debtor's property *before* the tax debtor failed to remit the deductions which gave rise to the deemed trust in favour of the Crown.[11]

Deemed Trusts and Secured Creditors

Unless a secured creditor's interest satisfies the "prescribed security interest" exception described above, secured creditors are vulnerable to the Crown's deemed trust claim. Where

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[6] R.S.C. 1985, c. B-3.
[7] R.S.C. 1985, c. C-8.
[8] S.C. 1996, c. 23.
[9] *Canada v. Toronto-Dominion Bank*, 2018 FC 538 at para. 54 [*Bank FC*], aff'd 2020 FCA 80 [*Bank Appeal*]; *Callidus Capital Corporation v. Canada*, 2017 FCA 162 at paras. 51–57, rev'd 2018 SCC 47, dissenting reasons of Pelletier J.A. adopted at para. 1 [*Callidus*].
[10] *Bank FC*, *supra* note 9 at paras. 17, 31; *First Vancouver Finance v. M.N.R.*, 2002 SCC 49 at paras. 1–6.
[11] *Royal Bank v Sparrow Electric Corp.*, [1997] 1 S.C.R. 411. A "prescribed security interest" will give a secured creditor priority over the Crown's deemed trust claim where the criteria have been satisfied.

a secured creditor holds a security interest in the property of a tax debtor who has outstanding obligations under s. 227(4) of the ITA or s. 222(3) of the ETA, the secured creditor's interest is subordinate to the Crown's deemed trust claim. This is true even where the secured creditor realizes on its security. If a deemed trust exists in favour of the Crown, it attaches to the tax debtor's property and to any proceeds of that property. The Crown may enforce its deemed trust against the secured creditor up to the amount owing against any amounts collected by the secured creditor from the tax debtor.

The Federal Court's decision in *Canada v. Toronto-Dominion Bank*, recently upheld by the Federal Court of Appeal,[12] affirmed the law regarding the formation of a deemed trust. In that case, the debtor owned and operated a landscaping business as a sole proprietorship which was required to collect and remit GST to the CRA. In 2007 and 2008, the debtor collected but failed to remit GST in the amount of $67,854. In 2010, the Toronto-Dominion Bank (the "**Bank**") extended two loans to the debtor which were secured by a residential Home Equity Line of Credit and a residential mortgage in favour of the Bank against the debtor's property in the amounts of $246,000 and $352,000 respectively. The security did not qualify as an eligible "prescribed security interest" since it was created after the failure to remit. At the time of both loan applications, the Bank was unaware of any debts owed by the debtor to CRA.

In 2011, the tax debtor sold and transferred the property to third party purchasers. Following payment of the loans by the debtor from the sale proceeds, the Bank discharged the charges registered against the property. In 2013 and 2015, the Crown asserted a deemed trust claim under s. 222 of the ETA against the Bank and sought payment from the proceeds received by the Bank in the amount of $67,854. It was easier for the Crown to pursue the Bank, instead of the debtor directly.

The Federal Court found that s. 222(3) of the ETA obliged the Bank to remit that portion of the sale proceeds caught by the deemed trust. The Court found that the amounts paid by the debtor to the Bank were "proceeds" of the sale of the debtor's property and were subject to the deemed trust.[13] The debtor was obliged to pay his tax debt out of the sale proceeds of the property, but paid the Bank, a secured creditor, instead.[14] The Court therefore held that the Bank had a statutory obligation to pay the tax debt out of the sale proceeds.[15] The Federal Court also held that as a secured creditor, the Bank could not invoke the *bona fide* purchaser defence to counter the statutory obligation,[16] and held that no triggering or crystallizing event was necessary to bring the deemed trust created by s. 222 of the Act into operation.[17]

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[12] *Bank Appeal*, *supra* note 9.
[13] *Bank FC*, *supra* note 9 at para. 16.
[14] *Ibid*. at para. 31.
[15] *Ibid*. at para. 33.
[16] *Ibid*. at paras. 44, 46: To allow the Bank to invoke the defence would defeat the purpose of the deemed trust, rendering it meaningless. Another exception may include those whose interest arises from leases or conditional sales contracts.
[17] *Ibid*. at paras. 54–56.

On appeal, the Bank argued, *inter alia*, that the Federal Court erred by finding that the deemed trust did not require a triggering event to cause the deemed trust to crystallize around specific assets, and erred by finding that secured creditors could not avail themselves of the *bona fide* purchaser defence.[18] The Federal Court of Appeal dismissed the Bank's arguments and dismissed the appeal, holding that the Federal Court did not err in its interpretation and application of the deemed trust provisions of the ETA.[19]

The Bank is seeking leave to appeal the Federal Court of Appeal's decision. Since the debtor sold the business or property in order to repay loans, one can only speculate that it did not make economic sense for the Bank to pursue directly a "no asset" debtor. *Canada v. Toronto-Dominion Bank* serves as a cautionary tale to secured creditors who fail to obtain full and complete information concerning a prospective debtor's tax liabilities. Only secured interests which satisfy the criteria for a "prescribed security interest" are immune to a deemed trust in favour of the Crown.

Deemed Trusts and Unsecured Creditors

Unsecured creditors, or judgment creditors who undergo an enforcement process like filing a writ of seizure and sale, are vulnerable to the Crown's deemed trust claim without exception under the legislation. If an unsecured creditor enforces its judgment and commences the execution process, the Crown can enforce a deemed trust claim against the judgment or unsecured creditor and override the execution process until obligations owing to the Crown are satisfied. The Crown can also "claw-back" any amounts distributed to the judgment creditor by the Sheriff under the *Creditors' Relief Act, 2010*.[20] If an unsecured creditor never had any right or title to the proceeds of the property subject to a deemed trust, the Crown is entitled to enforce its deemed trust claim and seek repayment of the proceeds made to any execution creditors.

Canada (Attorney General) v. GlassCell Isofab Inc.[21] is an example of how a deemed trust takes precedence over a judgment creditor. In that case, GlassCell Isofab Inc. ("**GlassCell**") commenced an action against the tax debtor for the costs of goods sold and delivered. After obtaining default judgment against the debtor for $219,460.90 plus costs, GlassCell had a Writ of Seizure & Sale issued against the tax debtor as a judgment debtor and had three garnishments issued and served. The garnishments included $129,000 owing to the debtor from a third party and $9,177.40 and $435.15 from two of the tax debtor's bank accounts all of which were paid to the Sheriff pursuant to the garnishments.[22]

On February 10, 2010, the Sheriff issued three notices of proposed distribution relating to the three garnishments naming GlassCell and the Province of Ontario under corporate tax legislation, as creditors. CRA disputed the notices of proposed distribution and asserted that

[18] *Bank Appeal*, *supra* note 9 at para. 18.
[19] *Ibid.* at paras. 69, 78, 86.
[20] S.O. 2010, c. 16, Sched. 4.
[21] 2011 ONSC 2660 [*GlassCell*].
[22] *Ibid.* at paras. 1–3.

the amounts were the property of the Crown because the tax debtor had failed to remit source deductions from 2006 up to and including the date of issuance of the garnishments and the date of distribution.[23] The Sheriff dismissed CRA's objections due to a procedural deficiency, following which the CRA brought a motion seeking an extension of time to contest the proposed distribution of funds. The Court declined CRA's relief and the Sheriff paid GlassCell and other execution creditors the garnished amounts.[24] The CRA brought an application to require GlassCell to pay the amount obtained through the execution process to the Crown.[25]

The Ontario Superior Court held that the garnishment by GlassCell of its judgment debt was ineffective because the tax debtor's interest in the garnished property was subject to the Crown's super-priority under the deemed trust for unremitted source deductions. Accordingly, the garnishment and the proposed distribution of the proceeds of garnishment were ineffective. GlassCell and other execution creditors under the Sheriff's scheme of distribution had no right or title to the proceeds of garnishment until the full amount of the claim under the deemed trust was satisfied.[26] The Court also held that the Crown's involvement in the distribution process did not preclude it from asserting and obtaining the relief sought in this application.

Based on *Canada (Attorney General) v. GlassCell*, an unsecured creditor's interest is subordinate to the Crown's deemed trust, regardless of whether the unsecured creditor chooses to enforce its judgment.

Deemed Trusts in a Bankruptcy

Section 67(2) of the BIA eliminates all federal and provincial deemed trusts unless the trust exists under common law or where a trust has been adopted by Parliament under s. 67(3). Notably, s. 67(3) preserves the deemed trust under the ITA for unremitted employee source deductions, but eliminates the deemed trust under the ETA for collected but unremitted HST/GST amounts.[27] Section 222(1.1) of the ETA states that the deemed trust does not apply, at or any time after the person becomes bankrupt, to any amounts of tax collected or collectible by the person before that time.

In *Callidus Capital Corporation v. Canada*, the Supreme Court of Canada held that because a debtor's bankruptcy triggers s. 222(1.1) of the ETA and extinguishes the s. 222(1) deemed trust for unremitted HST/GST, the super-priority granted to the Crown by s. 222 becomes ineffective as against a secured creditor in bankruptcy.[28]

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[23] *Ibid.* at para. 37.
[24] *Ibid.* at paras. 8–9.
[25] *Ibid.* at paras. 4–7.
[26] *Ibid.* at para. 30.
[27] *Callidus*, *supra* note 9.
[28] *Ibid.* at para. 63.

Collection Mechanism: Garnishment

As indicated above, the deemed trust applies to two tax obligations: unremitted employee source deductions under the ITA and collected but unremitted HST/GST under the ETA. The deemed trust provides ultimate protection to the Crown, subordinating almost all other interests. However, where the obligation owed to the Crown arises from other provisions in the ITA or the ETA (*e.g.*, individual income tax, corporation income tax, benefit overpayments, defaulted Canada Student Loans), or arises under some other statute (*e.g.*, customs or levies under the *Customs Act* or the *Excise Act*), there are various collection mechanisms within the legislative schemes which remain available to the CRA, such as garnishment or certification of the tax debt with the Federal Court.

Garnishment can be used by the CRA to intercept funds that a third party, such as an employer or a bank, owes the tax debtor or holds for the tax debtor. Under s. 224(1) of the ITA and s. 317(1) of the ETA, the CRA can require the third party to pay any funds otherwise payable to the tax debtor to the Crown.

In order to garnish these funds from third parties, the CRA sends the third party a "Requirement to Pay" ("**RTP**"), which instructs the third party to send the funds to the CRA. The RTP gives the Crown priority over all creditors except secured creditors. However, where the obligation owed to the Crown is source deductions or HST/GST, the CRA may choose to send an "Enhanced Requirement to Pay", which gives the CRA priority over secured creditors. It is the nature of the obligation which gives the Crown priority.

Garnishments on a Bankruptcy

On a bankruptcy, any funds subject to an RTP become the Crown's property when the garnishee receives the RTP. If the garnishment provisions of the ITA or the ETA are properly complied with, s. 70 of the BIA does not affect the Crown's interest in those funds, because the Crown has effectively garnished the funds prior to the bankruptcy.[29]

Collection Mechanism: Certification of Judgments

If a tax debtor's obligation to the Crown does not create a deemed trust, the Crown may certify its tax debt with the Federal Court of Canada. In this way the CRA obtains a certificate confirming the amounts owed to the Crown. Once registered, the certificate has the same force and effect as a court judgment obtained by an unsecured creditor.

Under s. 223 of the ITA and s. 316 of the ETA, an "amount payable" or any part thereof pursuant to a tax obligation owed by a debtor under the ITA or the ETA which has not been paid to the Crown may be certified by the Minister of National Revenue (the "**Minister**") as an "amount payable" by the debtor. A certificate registered in the Federal Court, a document issued by the

[29] *Toronto Dominion Bank v. Canada*, 2012 SCC 1 aff'g 2010 FCA 174 at para. 53. Though the decision focuses on s. 317 in the ETA, the guidance in this decision should apply equally to s. 224(1.2) of the ITA to recover liabilities owed to the Crown.

Federal Court evidencing such certificate, or a writ of that Court issued pursuant to the certificate (either referred to in the legislation as a "**memorial**"), may be filed for the purpose of creating a charge, lien, or priority on the debtor's property in the same manner as a judgment of the superior court of the province where the property resides.

Where a memorial has been filed, registered, or recorded in accordance with the above sections, s. 223(6) of the ITA and s. 316(5) of the ETA state that the charge, lien, or priority created on the property is subordinate to any charge, lien, priority or binding interest in respect of which "*all steps necessary to make it effective against other creditors were taken before the time the memorial was filed, registered, or otherwise recorded*."

Therefore, when the CRA proceeds with collection of a tax debt by registering with the Federal Court the Crown acknowledges that its priority is subordinate to all other interests which have been perfected against other creditors at that time, which is no different than the status afforded to other judgment creditors.[30] In those circumstances the Crown is an unsecured creditor, whose interest is subordinate to secured creditors.

Certified Tax Debts in a Bankruptcy

Other than where the obligation owed by the tax debtor to the Crown is for employee source deductions under the ITA (which are subject to a deemed trust that survives a bankruptcy (s. 86(3) of the BIA)), the Crown is an unsecured creditor in bankruptcy by operation of s. 86 of the BIA. Unsecured creditors rank *pari passu* in a bankruptcy. However, the Crown may, prior to a bankruptcy, register its charge, lien, or priority in accordance with s. 87(1) of the BIA pursuant to s. 223(11.1) of the ITA and s. 316(10.1) of the ETA. Where an amount owing is registered in accordance with the system of securities registration prescribed in s. 111 of the *Bankruptcy and Insolvency General Rules*, it is deemed to be a claim secured by a security and ranks as a secured claim under the BIA, but is subordinate to securities properly registered ahead of it (s. 87(2)).

Through registration the Crown can acquire secured creditor status.[31] However, in the event of a bankruptcy the Crown's secured interest will be limited to the amount owing at the time of the registration under s. 87(2) of the BIA. This is different than a deemed trust which increases as the value of the obligation owed to the Crown increases.

Conclusion

The CRA has a number of enforcement options. Of all the obligations a tax debtor may owe to the Crown under the ITA and the ETA, Parliament has given the most protection to unremitted employee source deductions under the ITA and collected but unremitted Harmonized Sales Tax and Goods and Services Tax ("**HST/GST**") under the ETA. Where the Crown holds a deemed trust, it may enforce the deemed trust against any unsecured or secured creditor irrespective

[30] *Trang v. Nguyen*, 2012 ONCA 885 at paras. 7–8, 13, 76–78; *Krates v. Crate*, 2018 ONSC 2399.
[31] *Ledrew, Re.*, 2005 CarswellOnt 2751.

of the creditor's relationship to the debtor and the debtor's property, except a secured creditor who holds a "prescribed security interest".

Where the obligation owed to the Crown arises from other provisions of the ITA or the ETA, or arises under another statute, there are various collection mechanisms within the legislative schemes which the CRA can employ, such as garnishment or certification of the tax debt with the Federal Court. Under these mechanisms, the Crown is an unsecured creditor subordinate to secured creditors (subject to the Enhanced RTP issued to garnishees where the obligation owed is for source deductions or HST/GST). As long as the Crown completes all necessary steps before bankruptcy, a garnishment will survive a bankruptcy. Otherwise the Crown loses its priority in bankruptcy.

The Crown may also register and certify its tax debt with the Federal Court of Canada and in so doing become an unsecured judgment creditor. The Crown's interest will be subordinate to all other judgment creditors who took steps to enforce their judgment before the Crown registered its interest.

In the event of a bankruptcy, the Crown's deemed trust will survive in respect of unremitted source deductions but not in respect of collected but unremitted HST/GST. For other obligations owed to the Crown, the Crown may choose to improve its position in the event of a bankruptcy by registering its lien in accordance with the BIA. In doing so, the Crown retains a secured creditor status, but its interest remains subordinate to securities registered before the Crown's interest.

The Crown has enhanced powers to collect amounts owed under revenue statutes. Though the priority afforded the Crown may seem harsh to lenders or creditors, it serves to protect employees first and foremost. Lenders and other creditors are cautioned to make thorough inquiries to determine the tax liabilities of prospective debtors to avoid unfortunate surprises when they enforce their secured or unsecured debt.

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