<u>IN THE SUPREME COURT OF NOVA SCOTIA</u>
<u>IN BANKRUPTCY AND INSOLVENCY</u>
Citation: Wilcox (Re), 2014 NSSC 291

Date: August 1, 2014
Docket: 36792
Registry: Halifax

District of Nova Scotia
Division No. 1
Court No. 36792
Estate No. 51-1681518

In the Matter of the Proposal of Darrell Joseph Wilcox

D E C I S I O N

Registrar: Richard W. Cregan, Q.C.

Heard: May 22, 2014, in Halifax, Nova Scotia

Counsel: Tim Hill, Q.C., for BDO Canada Limited, Trustee under the Proposal of Darrell Joseph Wilcox

Deanna Frappier, for the Canada Revenue Agency

<u>Background</u>

[1] This is the application of BDO Canada Limited ("BDO"), in its capacity as Trustee under the Proposal of Darrell Joseph Wilcox, for an order under Section 34(1) of the *Bankruptcy and Insolvency Act,* R.S.C., c. B-3 (*"BIA*") directing and declaring that the Canada Revenue Agency ("CRA") is bound by the terms of the Proposal, that no part of the sum of $116,100 relating to the 2012 pre-proposal income tax of Mr. Wilcox may be collected by CRA as a post-proposal debt and that CRA is not entitled to certain interest and penalties which it has assessed against him.

[2] Mr. Wilcox had two creditors, CRA for personal income tax and HST in the approximate amount of $1,000,000 and a bank for a credit card balance of approximately $20,000.

[3] He filed the Proposal under Division I of the *BIA* on October 30, 2012. On November 27, 2012 he filed an Amended Proposal. It was accepted by his creditors on December 17, 2012 and approved by the Court on January 27, 2013.

[4] With respect to the debt due to CRA, the Amended Proposal provides the following in paragraph 4:

> (a) THAT included in the insolvent's pre-Proposal obligations, as a dischargeable debt under the Proposal, will be any liability for personal income taxes resulting from the insolvent's taxable income relative to any full taxation years up to and including October 29, 2012, and any taxes thereon shall be subject to the Proposal.
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> (b) THAT the 2012 tax year shall be split for Proposal purposes.

[5] The Trustee had provided CRA with a provisional income tax return to October 29, 2012, which showed an estimated balance owing to CRA for the pre-proposal income tax for 2012 of $107,200. Provisional returns are required before a proposal is voted on to assist CRA in preparing its proof of claim. It is normally understood that they may be subject to adjustment.

[6] The Trustee submitted Mr. Wilcox's actual 2012 pre and post-proposal income tax returns in March 2013. They reported a pre-proposal tax liability of $116,100, somewhat more than the $107,200 reported in the provisional return, and a post-proposal tax liability of $4,576 for a total of $120,676.

[7] Leonard M. Shaw, the individual Trustee who has been in charge of the Proposal, advised the Court that these returns were submitted at that time by delivering them to CRA's office in Sydney where they were inserted in a drop box designated for that purpose. This was well before the April 30th deadline. He further advised that CRA does not have at this office any provision whereby someone can obtain a written receipt confirming delivery. The Trustee never received acknowledgement of the receipt of these returns. Counsel for CRA advised the Court that CRA has no record of the Trustee having filed these returns in March 2013. However, I find that the returns were submitted as Mr. Shaw has advised.

[8] There were no communications regarding returns until October 2013, when someone from CRA called the Trustee's office and requested that it file a complete 2012 tax return. Such a return was prepared and submitted before the end of October 2013. An assessment for $120,676 was issued by CRA on December 16, 2013 for the full 2012 tax year, with the breakdown between pre-proposal and post-proposal not $116,100 and $4,576, but rather the provisional figures of $107,200 and $13,476. It also assessed $6,622.97 in interest and penalties of $9,654.08 because of late filing.

[9] The position of the Trustee is that the fair construction of Paragraph 4(a) and (b) of the Proposal, quoted above, is that the sum of $116,100, being the amount submitted in the return prepared by the Trustee as the pre-proposal income, is the amount which CRA has agreed should be its claim in the Proposal and further that there is no basis for CRA to seek interest or impose penalties, whether within or outside the Proposal.

Law

[10] The main issue on which this application turns is authoritatively considered in a series of cases involving the proposal of a taxpayer named Gollner.

[11] He apparently had a dispute with the Canada Customs and Revenue Agency ("CCRA"), as CRA was then known, which was similar to that in this application, namely how the taxable income in the year he made his proposal should be divided as pre-proposal and post-proposal.

[12] Gollner's position was that all the income for the year should be considered pre-proposal as in fact it had all been earned during that period. CCRA's position as expressed in its assessment was that it should be allocated pro-rata between the pre-proposal and post-proposal periods, in accordance with an internal directive of CCRA.

[13] The matter came before a Judge of the Superior Court of Ontario who accepted CCRA's position. This decision was appealed to the Ontario Court of Appeal. The Court's endorsement in the appeal, which is reported in **Gollner v. Canada (Customs and Revenue Agency),** [2002] O.J. No. 4442, and Court of Appeal File No. C 37944, is as follows:

> 1. **WEILER J.A.** (endorsement):- - The real issue is the meaning and effect of the appellant's proposal in bankruptcy and the intentions of the parties with respondent, particularly as it relates to his tax liability. This was not a dispute about the appellant's assessment. Therefore it is more appropriately dealt with by the bankruptcy court.
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> 2. The appeal is allowed, the order of Forget J. is set aside and the matter remitted to the bankruptcy court. Costs of the appeal on a partial indemnity basis to the appellant fixed at $9,941.71.

This confirmed that the matter was properly before the Bankruptcy Court.

[14] The matter was then heard by Sedgwick, J. whose decision is reported in [2003] O.J. No. 3309 and 45 C.B.R. (4th) 76.

[15] The proposal provided that CCRA's claim for unpaid income tax would include tax accrued and owing as of the date of the proposal. The amount claimed was what he had earned to that date. During the balance of the year, he had no further taxable earnings. Apparently he continued his professional practice to the end of the year through a corporation. During that time he received no dividends or salary. CCRA, relying on its internal directive regarding provisional proofs of claim, said that the income should be allocated pro-rata between the pre and post-proposal periods. This was rejected because as stated in paragraph [16]:

> Yet his tax liability or debt "comes into existence the moment the money is earned". It is not created by an assessment of his taxable income, merely confirmed.

and because there is no provision in the *Income Tax Act*, R.S.C. 1985 (5th Supp.) ("*ITA*") which gives authority to such directives. They have no statutory foundation.

[16] In effect, CCRA was bound by the proposal under the provision of the *BIA* by its own agreement. It had voted in favour of the proposal. Any suggestion that the agreement of CCRA was subject to the requirements of the directive was rejected.

Tax Subject to the Proposal

[17] The principal issue in the present application is to what did CRA agree was the subject of the Proposal. The Trustee says that the amount is the pre-proposal tax as stated in the return made in March 2013, namely $116,100. CRA says it should be the amount in the provisional return which was used in CRA's proof of claim, namely, $107,200.

[18] CRA's position has the effect of increasing the amount of the post-proposal tax which is unaffected by the Proposal. Apparently, CRA's directive to its assessors is that such be done. The result is that, if the actual tax is greater than the provisional tax, the difference is to be considered as post-proposal tax.

[19] Counsel for CRA referred the Court to a Standard of Professional Practice adopted by the Canadian Association of Insolvency and Restructuring Professional Association, which is the professional association to which many trustees belong. I understand it was prepared subsequent to the **Gollner** case. One of its provisions requires a member of the profession to inform a debtor of certain requirements for a proposal involving income tax. There is nothing before me as to whether there was compliance by the Trustee. The requirements are essentially to meet the directive which CRA has regarding provisional proofs of claim. It was issued in 2003. The relevant part of this Standard is that where a provisional proof of claim is made by CRA, it will be understood that should the actual tax, as determined later by assessment, for the pre-proposal portion of the tax year is more than the provisional amount, the difference, nevertheless, will be allocated to the post-proposal portion of the tax year. The effect then will be that the proposal will only cover the amount stated in the provisional return and reflected in the provisional proof of claim. In other words, the debtor will be bound by whatever is stated in the provisional documents, unless CRA agrees to the contrary. Obviously such agreement is not being provided in this situation.

[20] There is no mention of this Standard or the directive, nor is there anything brought to the Court's attention whereby either of these are given any statutory authority or otherwise incorporated into the Proposal. The Standard is that of the profession. It apparently has not been followed. There is nothing to suggest that the debtor is bound by it or that this Proposal is subject to it.

[21] Similarly the directive is no more than a directive or internal instructions to assessors as to the terms required of a proposal involving splitting the tax year. It has not been shown to me that it has any statutory authority and there is nothing to show that its terms should be incorporated into the Proposal or otherwise implied to be part of it.

[22] I do not see that CRA questions the calculation provided by the Trustee in its returns. It simply says that in making its assessment it is following its directive and the Standard, and exercising its discretion in a way favourable to it.

[23] Accordingly, I find that the pre-proposal tax for 2012, the amount subject to the Proposal, is $116,100.00.

Interest

[24] CRA claims interest of $6,622.97. I understand it is calculated on the total tax assessment for 2012, that is $120,676. However, Subsection 62 (1.1) of the *BIA* makes it very clear that claims of creditors on a proposal are to be determined as of the date of the intention or of the proposal, if an extension has not been filed. Interest which accrues after that date is not provable. This is confirmed in *Riddler (Re),* 3 C.B.R. (3d) 273, (BC, Campbell, C.J. S.C.). Relying on Section 62 of the *BIA*, as it then read, the material parts of which are similar in effect to the present wording of this Section, Campbell, C.J.S.C. said:

> The proposal here was filed July 18, 1985. Clearly then the applicant cannot include in her proof of claim any amount for interest arising after July 18, 1985, nor can she claim the costs of the 1987 litigation since these were incurred after the effective date of the proposal. Thus, she can only claim the principal amount of her claim against the proposer, together with whatever interest had accrued on it to the effective date of the proposal. Equally clearly, the proof of claim filed includes postproposal amounts, including interest.
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> Thus, the applicant is only entitled to file a proof of claim as of July 18, 1985. This eliminates the interest and costs of the 1987 litigation and all other matters arising subsequent to that date.

My understanding is that the basis for this claim of interest is the failure to file the returns for 2012 before the end of April 2013. However, as previously stated, I accept the Trustee's evidence that he filed the returns before that date.

[25] I am satisfied that the claim of CRA in the Proposal cannot include interest on the pre-proposal portion of the 2012 tax debt. The entitlement of CRA with respect to this debt was settled as of the date of the Proposal. The terms of the Proposal are silent as to interest. Once CRA filed its proof of claim, it had submitted itself to the *BIA* with respect to the debt. This overrides any other authority given by the *ITA* respecting interest and overrides any argument that the Bankruptcy Court is usurping the Tax Court.

[26] However, as the post-proposal 2012 tax debt is not a debt proved in the Proposal, the Bankruptcy Court has no jurisdiction with respect to the interest assessed respecting it.

Penalties

[27] The penalties claim of $9,654.08 I understand is again for the failure to file returns on time. As mentioned above, I accept the advice that the returns were filed in March 2013. The problem was the internal handling of them by CRA. The penalties which relate to the pre-proposal income tax, as with interest, cannot be imposed by CRA, as it had agreed to the amount respecting the debt it was entitled to under the terms of the Proposal. As with interest, the Bankruptcy Court has no jurisdiction over the penalties to the extent that they arise with respect to the post-proposal 2012 income tax, as it is not part of the Proposal.

[28] Additionally, the Trustee submits that imposing interest and penalties is in violation of Section 69.1 of the *BIA* which I quote:

> 69.1 (1) Subject to subsections (2) to (6) and sections 69.4, 69.5 and 69.6, on the filing of a proposal under subsection 62(1) in respect of an insolvent person,
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>> (a) no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged or the insolvent person becomes bankrupt;

[29] The imposition of interest and penalties are proceedings under this Section. Thus they are stayed and of no present effect unless an application is made under Section 69.4 to lift the stay *nunc pro tunc*. Such has not been sought.

[30] In summary under this point, I am satisfied that the CRA by voting for the Proposal is bound by its terms. It cannot add riders based on its practices and internal directives or the Standard of the Bankruptcy and Insolvency profession. The terms are very clear, the pre-proposal 2012 income tax is subject to the Proposal. The amount has been settled as $116,100. This sum does not appear to be disputed. What is disputed is the further calculations made by CRA in accordance with its directive and the Standard of Professional Practice.

Amendment to Proposal

[31] CRA also submits that the Trustee is attempting to amend the proposal which it cannot do without resubmission to the creditors unless it is within the terms of Rule 92. It cites *Re Cheevers,* 2013 NSSC 67, a decision of this court. This case concerned a proposal which contained specific provision for the debtor to pay into the proposal the value of his equity in a property, which in his Statement of Affairs

he stated was $75,000.00. He was to make a payment of $15,000, six months later a payment of $25,000 and the balance in two years. He paid the first instalment. Then he obtained an appraisal of the property which suggested that the value of his equity was little more than the first instalment of $15,000. It was held that the debtor was bound by the terms of the proposal. The proposal made no provision for post approval review or presentation of an appraisal. The creditors were entitled to rely on the facts presented to them at the time they accepted the proposal.

[32] This is quite different from the facts in the present case. Here CRA agreed to the pre-proposal tax being its claim in the Proposal. Both parties knew that the exact amount would have to be determined through the regular assessment process. Mr. Wilcox and the Trustee did what was required, namely file returns in a timely way which were eventually accepted. It is not they who are attempting to change the terms of the Proposal. It is CRA which in attempting to change the terms by requiring Mr. Wilcox to pay interest and penalties respecting the pre-proposal tax debt. This it cannot do.

[33] CRA agreed that the pre-proposal debt was to be satisfied by the Proposal. The parties knew that it would be determined after final returns were filed. The imposition of interest and penalties is not provided. If CRA had dealt with the returns when they were delivered, they would not have imposed them. CRA cannot now impose them.

Conclusion:

[34] The amount of the indebtedness to CRA in the Proposal for pre-proposal tax for 2012 is set at $116,100. No part of it can be collected by CRA as a post-proposal debt. To the extent, that the interest and penalties claimed by CRA are calculated on this sum, they are disallowed. This Court has no jurisdiction with respect to the interest and penalties calculated on the post-proposal tax for 2012.

[35] The Trustee is entitled to costs.

R.

Halifax, NS

August 1, 2014