SUPREME COURT OF NOVA SCOTIA

Citation: *Canada (National Revenue) v. Harris*, 2014 NSSC 417

Date: 20140711
Docket: Hfx No. 362262
Registry: Halifax

Between:

The Attorney General on behalf of Her Majesty in right of Canada as represented by the Minister of National Revenue

Applicant

v.

David Graham Harris and BDO Canada Limited, trustee in the Proposal of David Graham Harris

Respondent

Judge:	The Honourable Justice Denise M. Boudreau
Heard:	July 3, 2014, in Halifax, Nova Scotia
Oral Decision:	July 11, 2014
Written Decision:	November 20, 2014
Counsel:	Deanna M. Frappier, for the Applicant D. Bruce Clarke, QC, for the Defendant BDO Canada Limited

By the Court: (Orally)

[1] The matter before the Court is an application made by the Attorney General of Canada as represented by the Minister of National Revenue. The Applicant seeks an order pursuant to section 135(5) of the *Bankruptcy and Insolvency Act*, vacating a notice of disallowance signed by the trustee in bankruptcy in the matter of the Proposal of David Graham Harris.

[2] In reviewing the sections of the *Bankruptcy and Insolvency Act*, it seems to me that the application actually should be requested pursuant to section 135(4), not (5). This does not change anything substantive.

[3] As a preliminary issue, there was a supplemental affidavit from Mark Rosen filed by the Respondent with the court, sworn July 2, 2014. That affidavit provided further information, notably situations with respect to other persons also involved in Proposals with Mr. Rosen. At the hearing of this matter, counsel on behalf of the Applicant objected to this affidavit, arguing that it spoke to matters not relevant to this matter.

[4] I have reviewed that affidavit. It has, in my view, some limited relevance with respect to the practice that has taken place in other matters involving Mr.

Rosen, and his experience in these particular matters. I will allow it to be admitted, but I do agree that it has fairly limited relevance.

[5] Many of the facts here are not in dispute. David Graham Harris filed a Proposal to creditors pursuant to the *Bankruptcy and Insolvency Act* in October 2011. He did this with the assistance of BDO Canada Limited as the trustee, specifically Mr. Rosen.

[6] Within that Proposal, Mr. Harris listed his assets and liabilities as they existed at that time. With respect to creditor Canada Revenue Agency (CRA), the Proposal dealt with debts involving a number of different years. 2011 is the year that is the source of the dispute. The Proposal provided, at page 7, for a 2011 "pre-Proposal" amount of $10,000 of unsecured debt owing to CRA.

[7] All parties agree that this number represented an estimate made by Mr. Harris as to his 2011 "to date" income tax liability. As the Proposal was filed in 2011, Mr. Harris' 2011 income tax return had not yet been prepared or filed.

[8] The Proposal was then sent to creditors of Mr. Harris. A meeting was scheduled on November 3, 2011 to vote on this Proposal, with the trustee recommending the acceptance of the Proposal. The creditors were advised by

letter of this meeting date, and of the option of filing a "proof of claim" in advance of the meeting.

[9] CRA did not file a proof of claim in advance of this meeting, and did not attend the meeting, which did take place and, of those creditors attending, there was unanimous acceptance of the Proposal.

[10] Following that meeting, the trustee next sought the Court's approval of the Proposal. An order approving the Proposal pursuant to section 58 of the *Bankruptcy and Insolvency Act* was granted November 25, 2011, in the Supreme Court of Nova Scotia, in bankruptcy.

[11] The (now Court approved) Proposal, at paragraph 4, provided that in relation to unsecured creditors, "dividends who are referred to in this section may approximate a range of 40 cents on the dollar of the proven claims calculated".

[12] CRA was specifically named in the Proposal. I refer to paragraph 5(b):

> There shall be an allocation for the year 2011 for income tax purposes. For the sake of clarity, 2011 income shall be treated as pre and post proposal income with the pre-proposal income tax set for the period of January 1, 2011, to an including August 30, 2011, estimated to be the sum of $10,000.00.

[13] CRA issued a Proof of Claim form with respect to 2011 (as a contingent claim form) on February 27, 2012, confirming their claim of $10,000. On January

29, 2013, a further amended Proof of Claim was issued. Changes were made with respect to some other years at issue, but, for 2011, the document still shows the contingent claim of $10,000.

[14] There was no filing at the time of the Proposal of any Provisional income tax return. Mr. Harris filed his 2011 income tax return, in April of 2012, for the entire 2011 year. There was no distinction made between pre- and post-Proposal earned income.

[15] I have been provided a document (hereinafter the "CAIRP Standard") referred to by both parties, which provides practice standards in such cases. It was included in the affidavit of Katherine Riley at Tab G. This document is meant to provide "practice standards and policy regarding the filing of proofs of claim and interim tax returns where a tax debtor has filed a Proposal". The CAIRP Standard was reached by the working together of CRA and the Canadian Association of Insolvency Professionals.

[16] Both parties agree that the CAIRP Standard is not binding. However, it does provide guidelines as to the best practice in this area of bankruptcy law, and was developed by professionals working in this area.

[17] The CAIRP Standard discusses the possibility of a Provisional Return being filed by a debtor, at Section 3, "Assisting the Insolvent Debtor", more specifically section 3.01. According to that section, a debtor may prepare and file a Provisional Return at the time of filing the Proposal. This would reflect taxable income earned during the pre-proposal period, based on reasonably complete and accurate documentation and calculations. The CAIRP Standard also suggests that if a debtor is unable to file such a return at the time of filing the Proposal, he is to disclose CRA as a creditor, and show the amount owing as "unknown". He then is to file the provisional return no later than 10 days prior to the creditors' meeting and vote.

[18] The CAIRP Standard goes on to discuss the ramifications if these events do not occur.

> 3.02 The member shall inform the debtor that if he is unwilling or unable to meet these requirements, CCRA will not file a provisional proof of claim and any actual current year pre proposal income tax debt will become a post proposal debt. The member shall inform the debtor that if the amount of the actual current year pre proposal income tax debt exceeds the estimated current year pre proposal income tax debt, the excess will become a post proposal debt unless CCRA exercises its discretion.

[19] All parties agree that the CAIRP Standard was not followed here, in a number of respects. There was no Provisional return filed here, and no Provisional Proof of Claim filed. The CRA filed Proofs of Claim on the basis of Mr. Harris'

estimate of $10,000. That number continually appeared on their Proofs of Claim, as the matter proceeded through the next few years.

[20] As I have already mentioned, Mr. Harris filed his income tax return for the year 2011 on April 27, 2012. His assessment by CRA, according to the evidence before me, took place in May 2013, which is over a year later. It is unclear why that delay happened, and could not be explained by the parties. In any event, following this assessment, Mr. Harris' 2011 tax liability was fixed in the amount of $48,392.86.

[21] In the present dispute, the Respondent argues that Mr. Harris' pre-proposal debt should therefore be calculated by pro-rating this total amount, by the number of months involved (January to October). The Applicant argues, in response, that Mr. Harris' pre-Proposal debt should remain at the amount estimated in his Proposal. This is the amount which was accepted by his creditors, voted upon, and later accepted by the Court.

[22] There is no evidence before this Court as to <u>when</u> in the year 2011 Mr. Harris earned income, and whether it was earned pre- or post-Proposal.

[23] I also refer to an internal policy document of CRA, that was also provided as an exhibit to the affidavit of Katherine Riley, as Exhibit H. This particular policy

(dated 2004-03-01) seems to have been created as a response to a court decision from Ontario on this question. (*Gollner v. CCRA* [2003] O.J. No. 3309)

[24] This policy specifically deals with Provisional Proofs of Claim, in cases where a Provisional tax return is filed by the person who is making (or has made) a Proposal. The policy provides advice from CRA to their front-line officers.

[25] According to the policy, the calculation of tax liability should be done by assessing the time when the income was earned by the taxpayer during the year. In other words, rather than simply prorating the entire year's income or his entire year's tax liability to the number of months that are pre-proposal.

[26] The 2004 policy refers to the *Gollner* case, stating that it stands for the proposition that it is inappropriate to arbitrarily allocate pre- and post-Proposal periods without some consideration of when money was actually earned. Under the section "Pre-Conditions to the Filing of Provisional Proofs of Claim",

> Hence it is the responsibility of tax debtors and trustees to file with the revenue collection section of tax services offices a provisional return indicating the amount of taxable income and the resulting tax liability for the current year pre-proposal period. The provisional return must be based on accurate calculations and supporting documentation. So long as the above conditions are met, collections officers who will file a provisional proof of claim based on the tax liability as calculated by the trustee and the tax debtor.

[27] Again that is not a policy which is binding on any party, or Mr. Harris. However, it certainly provides context for what took place here, and what takes place generally.

[28] In this case, the Respondent trustee eventually disallowed the Proof of Claim from CRA for $10,000, given their position that a pro-rating of the person's income is the most reasonable and appropriate way of determining pre- and post-tax liability.

[29] The Applicant objects to that method of proceeding. Since no Provisional return was filed, there is no evidence as to when the income was actually earned. According to the Applicant's submission, the parties should be bound by the $10,000 figure which was contained in the court approved Proposal.

[30] It is interesting to note that this issue is not resolved by either the *Bankruptcy and Insolvency Act* or the *Income Tax Act*. The two policies that I have noted are the only direction that has been provided to me on this point, and the only case I have been directed to is the *Gollner* case (supra).

[31] The *Gollner* case dealt with a previous, different directive of CRA, where the prorating of pre- and post-Proposal income tax liability was suggested as

appropriate. The Court in *Gollner* disagreed with that procedure. In response, new policies have been put in place by CRA.

[32] It must be remembered that in cases of actual bankruptcy, there are legislated instructions with respect to separating income tax returns pre- and post-bankruptcy. That is not the case where the matter proceeds by Proposal. The court in *Gollner* makes a point that is found in the *Bankruptcy and Insolvency Act*: where a Proposal is approved by a court, the Proposal is then binding on creditors.

[33] In the *Gollner* case, there was no Provisional return filed, but rather one tax return filed for the entire year, as in the case at bar. However, there was evidence before the court that the income had, in fact, all been earned pre-Proposal. In those circumstances, the court determined that it was inappropriate to prorate income tax liability, where the evidence clearly showed that, in fact, it had all been earned prior to the date of the filing of the Proposal. As a result, the Court in *Gollner* ordered that CRA was bound by the Proposal.

[34] In the case at bar, the difference is that there is no evidence as to when the income was actually earned, i.e., was it pre-Proposal or post-Proposal.

[35] Having reviewed the *Gollner* case, I would agree with the Respondent that *Gollner* does not stand for the proposition that prorating is never appropriate. The court in *Gollner* decided that it was not appropriate in that particular case.

[36] The Trustee here has disallowed the Respondent's claim of $10,000 as pre-proposal debt, and I am to review that decision. The first question is the appropriate standard of review. I was referred to the *Oil Lift Technology Inc.* case, *In the Matter of the Bankruptcy of Sapient Grid Corp* 2012 ABQB 357:

> Subsections 135(1) and (1.1), which deal with proof of claims and provable contingent or unliquidated claims, are mandatory in terms of the Trustee's duties and obligations. The decided cases tell us that the standard of review of a Trustee's rejection of a claim is "correctness". The standard of review of a Trustee's *valuation* of a contingent or unliquidated claim is "reasonableness".

[37] I have considered this question. It seems clear that what is taking place here is a valuation of a claim. No one is suggesting that CRA has no claim or that their claim is being rejected. Therefore, I conclude that the appropriate standard of review is that of reasonableness.

[38] The next step is to determine the reasonableness of the trustee's decision here, to disallow that claim, and to suggest that pro-rating the amount is more appropriate. In terms of determining whether his decision is reasonable, I have noted the following as relevant in that determination.

[39] Firstly, the CAIRP standard gives an outline as to the procedure that is to be followed where people make Proposals pursuant to the *Bankruptcy and Insolvency Act*. That standard could be described as the "best practice" in the industry. It seeks to have everything in place before the first creditor's meeting; in particular, the preparation of a Provisional income tax return.

[40] In this case, a Provisional Return was never done. It was not done before the first meeting, it was not done ten days later, it was not done at all. It would appear, based on the supplemental affidavit of Mr. Rosen, that that is unusual in his experience.

[41] The Respondent argues that, in a perfect world, the CAIRP standard would be followed 100% each time, but it is not necessary to show perfect compliance as it is not binding. I accept their point. However, in this case, not only was it not followed to the letter, it was not followed <u>at all</u>. That is not the same as imperfect compliance. The CAIRP Standard is a standard that has been arrived at, as was described by Ms. Reilly in her affidavit, by CRA and the Canadian Association of Insolvency Professionals. Those groups would understand the process intimately and would, in my view, produce a fairly reliable standard of reasonableness, as experts in the field, as to appropriate process. I consider that important when assessing the reasonableness of the events in this case.

[42] Secondly, the point of filing a Provisional return, is that the relevant number is the amount of money earned to that date. Therefore, when a provisional return is filed, clear information is given as to pre- and post-Proposal earnings. This information is necessary to be able to proceed further in the matter.

[43] At the time of filing this Proposal, Mr. Harris estimated $10,000 as the 2011 CRA debt. That number came from him. Mr. Harris was the only person who had the information needed to make that estimate, and that is the number he estimated. He included it in a formal Proposal that was sent to creditors, and was voted on and approved. It was then approved by the Court.

[44] The Respondent argues that CRA could have checked back in Mr. Harris' past history to see if $10,000 was a reasonable amount of January to October 2011 earnings, based on past years.

[45] In my view, it would be inappropriate and unrealistic to ask CRA to undertake such reviews. Even if it were done, it would not even necessarily be helpful, because CRA does not know if the debtor's situation has changed. Perhaps he has lost his job, perhaps he has been laid off, perhaps he has earned nothing.

[46] Of course, the converse is true. Mr. Harris, in making his Proposal, could have checked previous years to see if he was approximating a number that was appropriate or not. This was certainly information within his possession. Having said that, Mr. Harris alone knew what he had earned January to October 2011.

[47] The Respondent further argues that it is not always easy to determine pre-proposal income and post-proposal income. Where people are self-employed, for example, those persons cannot simply look at their T4 and split it into 52 weeks, as others can. While I accept this reality, in my view it is not a convincing point.

[48] Mr. Harris came forward with this Proposal. He, and only he, knew the accuracy of what he put forward. He was the person who had the onus of declaring his assets and liabilities. He asked his creditors, in this Proposal, to effectively take 40 cents on the dollar. If Mr. Harris chose to estimate, and not do the work of actually calculating the amounts, then it seems to me that there is some peril to him in doing that.

[49] Presumably Mr. Harris calculates his income tax once a year, as do we all. While I agree that for some people it is easier to do than others, it cannot be avoided simply because it is difficult. It would here require two returns for 2011 instead of one, in order to obtain a significant benefit. The option of bringing a

Proposal is of great benefit to persons at risk of bankruptcy. I note the CRA internal policy that I have already mentioned, which states:

> In 1992, Parliament decided to encourage the filing of Proposals as an alternative to having debtors filing for bankruptcy.

[50] I highlight that this is a system which is a good and valuable thing, and is to be encouraged. It results in a court order which is binding on creditors, but that those creditors on good faith have agreed to. The procedure contained in the CAIRP standard encourages Proposals to move forward where CRA is involved, and allows matters to proceed in an orderly way.

[51] The CAIRP standard further notes that if the amount owing to CRA in a Proposal turns out to have been misstated, CRA does retain the option of recovering a different amount. If the amount has been overstated, CRA may only recover the amount actually owing. If it is understated, then there is a discretion.

[52] Here, the court approved Proposal for CRA was based on Mr. Harris' estimate. I do not know whether it was under reported or over reported, because I have no evidence of when this money was earned. Neither does CRA. The information, if anyone has it, would be in the hands of Mr. Harris.

[53] Finally, one thing is clear: before me is a court accepted Proposal, indicating a debt of $10,000. There is nothing before me in the policies or standards that I have discussed, or the law, that addresses the situation where a trustee unilaterally changes an amount approved by the Court.

[54] In making this decision, I am not suggesting that pro-rating income is always inappropriate in these cases. The above-noted points are important in relation to the reasonableness of this particular decision. In my view, the most important is that there is a court approved Proposal in existence, setting the amount.

[55] In *Gollner*, at paragraph 26 the court concludes:

> In any event, the court accepts the fundamental submissions that the CCRA is bound by the proposal and that Gollner's income tax liability for 1999 is governed by the terms of the proposal and the *Bankruptcy and Insolvency Act*.

[56] Similarly I find that Mr. Harris and the trustee are bound by their Proposal and the resulting court order. I find that the trustee's Notice of Disallowance of the claim of CRA here was not reasonable, for all of the reasons I have already given. I shall allow the application made by the Applicant to vacate this disallowance by the trustee. The applicant's Proof of Claim for $10,000 will stand.

Boudreau, J.