



# A battle of priorities

## Municipal property taxes and court orders in insolvency proceedings



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Revenue from taxes on land and improvements are the life blood of municipal services. As such, it is not surprising that each of Canada's provinces and territories have enacted legislation to authorize not only the imposition and collection of such "property taxes," but also to secure their collection. While there are some differences in the statutory language between the jurisdictions, the various provincial and territorial statutes dealing with municipal government (or property and assessment) all generally provide that taxes due and payable in respect of taxable real property are a lien (charge or hypothec) on that property, having priority over the claims, privileges, liens, or encumbrances of every other person, except the Crown. In most jurisdictions, the lien does not need to be registered against the title to the land in question to be effective or enforceable. Further, property tax indebtedness usually "runs with the lands," such that a new owner of land would be liable to pay any property taxes that arose prior to, but that remain unpaid after, the transfer to the new owner.

Accordingly, conventional municipal understanding is that a municipality's claim for property taxes is a secured claim taking priority over all other non-Crown secured creditors, such as banks holding mortgages on title to the

land. However, what is often overlooked is that this priority status of municipal taxes is jeopardized when property owners become insolvent.

Under the constitutional division of powers in Canada, the matters of bankruptcy and insolvency fall within the exclusive jurisdiction of the federal government. Insolvency proceedings are predominantly governed by two statutes that apply nationwide: the *Bankruptcy and Insolvency Act* (BIA) and the *Companies Creditors Arrangement Act* (CCAA). These federal statutes have paramouncy over any provincial legislation and would govern in case of any conflict or priority dispute in an insolvency proceeding. The CCAA applies only to companies, while the BIA applies to both individuals and organizations, such as companies and partnerships.

### Understanding the Forms of Proceedings

Insolvency proceedings under the CCAA and BIA can take a few different forms. The most common forms of proceedings are restructuring, receivership, and bankruptcy. A restructuring is intended to allow an insolvent corporate debtor to financially reorganize its affairs while also maintaining control of its business and assets. The CCAA is more commonly used for large corporate restructurings, under which a

court appointed “monitor” oversees the reorganization. Under the BIA, a “proposal trustee” is appointed to assist the company with its restructuring and to monitor its activities. In a receivership under the BIA, a “receiver” or “receiver-manager” is appointed to take possession of and liquidate certain assets, or operate and manage the business until it is sold as a going concern. A bankruptcy under the BIA involves the liquidation of a debtor’s assets by a “trustee in bankruptcy.”<sup>1</sup>

## Statutory Super-Priority Charges

Commencing any of these proceedings can affect existing creditor priorities. In general, as soon as an insolvency proceeding is commenced, certain charges in favour of the Crown, which did not exist before, are created by the operation of certain statutes. These are given immediate “super-priority” status ranking above any other claim, right, lien, or encumbrance against the property, notwithstanding the provisions of any other federal or provincial statute. These statutory super-priority charges include, for example, employee-related charges for unpaid wages, and deducted but unpaid pension contributions. As claims of the Crown, these charges would take precedence over a municipality’s special lien for property taxes.

In addition to these statutory super-priority charges that automatically arise with an insolvency proceeding, restructuring and receivership proceedings also give rise to other super-priority charges that are also newly created – by way of court orders.

## Court Ordered Super-Priority Charges

A restructuring under the CCAA and a receivership under the BIA each usually include court orders to govern the

conduct of the proceedings. There are two aspects of such orders that are most relevant to municipalities that are owed overdue taxes. Firstly, these orders usually provide for a stay of proceedings, rights, and remedies, effectively precluding a municipality from conducting a tax sale or taking other measures to collect a property tax debt. Secondly, these orders usually also create new charges that leapfrog over existing secured creditors. These new court ordered super-priority charges routinely include:

- an administrative or receiver’s charge, to secure the payment of fees and costs of the monitor or receiver, including the fees and expenses of financial, legal, or other experts; and
- a financing charge, to secure payment to new third-party lenders who agree to provide financing to the debtor or receiver to facilitate the restructuring or receivership.

Accordingly, there is tension between provincial or territorial legislation that grants municipal property tax liens with a special priority status against the real property on which the taxes are assessed (subject only to claims of the Crown), and the court orders that are routinely issued in insolvency proceedings with the apparent effect of subordinating these municipal priority liens to the new super-priority charges.

Some monitors and receivers have, when notified early during the insolvency process, acknowledged the special priority status of a municipality’s property tax lien and have either paid, or have required that the purchaser pay, all outstanding property taxes as part of a sale transaction for the land in question. In other situations, notably when municipalities have failed to file proofs of claim or are otherwise late to the game, receivers and monitors have resisted such payment, in reliance on the court ordered super-priority charges. Further, when real property and improvements are sold in an insolvency proceeding, the court’s vesting orders usually contain language that the transfer to the purchaser is “free and clear” of all charges and liens, including the existing municipal tax claim. If property taxes are not paid at the closing of the sale transaction, then, instead of “running with the land,” a municipality’s lien for the unpaid taxes may be transferred

to the sale proceeds with the same priority as the claim had against the real property. As a result, not only would a municipality in this situation be unable to claim payment from the new owner, but monitors and receivers could then seek to retain the sale proceeds and pay the property taxes only after the amount of the statutory and court ordered super-priority charges are determined at the end of the insolvency proceeding. Depending on the amount of available assets to satisfy these super-priority charges, a municipality may receive only partial or no payment at all. In that case, there may be little option but to wait with unsecured creditors for the shortfall – and possibly write-off the debt.

## Recent Case Law

There are very few cases that address the question of the priority of municipal property taxes over court ordered charges to secure a monitor’s or receiver’s expenses. However, in February 2018, the Court of Queen’s Bench in Alberta issued a decision in the *Reid-Built Homes* case<sup>2</sup> that suggests a receiver’s super-priority charge may in fact be subordinate to and rank lower than a municipality’s claim for property taxes in certain circumstances. In this case, soon after a receivership order was issued with the usual court ordered super-priorities, the City of Edmonton brought an application seeking a declaration that its property taxes had priority over the receiver’s fees and borrowing expenses. Although the court agreed with the receiver that the BIA and court orders made under the BIA had paramountcy over Alberta’s *Municipal Government Act*, the court noted that the BIA gave the court a discretion to grant the receiver a super-priority charge for its expenses and borrowing costs. The court made a distinction between restructuring and liquidating proceedings and found that, in a liquidating receivership, there was no reason for the municipal taxes to be subordinated.<sup>3</sup>

The 2018 *Reid-Built* decision from Alberta is fact-specific and may not apply to all situations involving a conflict between municipal claims for overdue taxes and receivers’ or monitors’ claims for their expenses. Nevertheless, it is a good reminder that municipalities should

1 Bankruptcy and insolvency is a complex area of law in Canada, and proceedings under the CCAA and BIA can sometimes overlap.

2 *Royal Bank of Canada v Reid-Built Homes Ltd*, 2018 ABQB 124. Given the BIA and CCAA are federal statutes, insolvency cases from different provinces and territories, while not necessarily binding, are certainly persuasive to the courts of other Canadian jurisdictions.

3 This decision is being appealed and, accordingly, the ultimate outcome may change in future.

act early and fast to try and protect their status as secured and priority creditors.<sup>4</sup>

Some early due diligence actions could include:

- keeping an eye on property owners who are behind with their property tax payments and staying alert for potential insolvency proceedings that may be commenced prior to tax sale proceedings;

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<sup>4</sup> Municipalities may wish to consider lobbying for amendment to the BIA or CCAA to clarify that municipal security interests have priority over court ordered super-priority charges.

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- registering the property tax lien on title to the lands, even if registration is not a statutory requirement; and
- before insolvency proceedings commence, considering what other remedies are available for recovery of property taxes, such as seizure and sale of goods and chattels.

Once insolvency proceedings are commenced, municipalities should ensure that all notices and documents received relating to the insolvency are reviewed and dealt with in a timely manner, including promptly filing proofs of claim. In addition, if incurring additional costs to recover the taxes is feasible, municipalities should seek

legal advice and become involved in the proceedings. Such involvement could ensure the court's awareness of the special municipal lien, seek clarification from the court on priorities, oppose or seek amendment of any court orders that compromise the municipal secured priority position, and perhaps seek leave of the court to lift the stay and carry out a statutory tax sale.

While it may not always be possible to have property taxes recognized as taking precedence over court ordered super-priority charges, municipalities that are proactive about protecting their status as secured priority creditors may have a better chance of getting paid. **MW**

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