

Real Estate

Lender options for super-priority GST/HST liens: Title insurance, litigation

By Harjot Atwal



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(July 10, 2020, 12:49 PM EDT) -- My colleague, Pallett Valo LLP lawyer Steven Pordage, was recently interviewed by *The Lawyer's Daily* regarding his article on the concerning implications of April's *Toronto-Dominion Bank v. Canada* 2020 FCA 80 decision. In addition to discussing the case's fearsome spectre of increased lender liability, he mentions how title insurance can mitigate risks associated with super-priority GST/HST liens. Such liens may take priority over registered mortgages in power of sale (POS) proceedings, which further exacerbate shortfalls in recovery funds typically available to lenders.

In *Toronto-Dominion Bank*, the lender's title insurance would have covered the entire lien amount of \$67,854, since all GST liability arose prior to the policy date. If title insurance coverage is not available for some reason, impacted lenders can try to pursue litigation against the borrower, if possible. Otherwise, if such lenders do not pay the GST/HST amount to the Canada Revenue Agency (CRA), they will face litigation from the Crown.

In order to understand the issues involved, how this increased lender liability arises, and when lenders should exercise title insurance and litigation options, consider the following sample scenario. Prior to registering a mortgage in 2020 for \$400,000, a lender becomes concerned after reading the court's decision in *Toronto-Dominion Bank*. Following the court's suggestion, it anxiously obtains its borrower's authorization to contact the CRA directly about the borrower's possibly outstanding GST/HST liability.

After painstakingly searching for the right CRA representative handling the borrower's file, the lender is simply told that the borrower's tax filings are up-to-date. Since the borrower has not yet been audited, the CRA cannot give an "unqualified answer" as to whether the borrower currently owes unpaid taxes. Knowing audits can take years to complete, the lender is forced to rely on documentary evidence of tax compliance to make a financing decision.

Unfortunately, said documentary evidence incorrectly shows that the borrower remitted all of the GST/HST it collected in 2016-2018 to the CRA. Thinking the borrower is no riskier than any other small business owner, the unaware lender decides to go ahead with funding. Later on, it is discovered that the borrower failed to remit a whopping total of \$300,000.

After the lender sells the property under POS proceedings for \$500,000, the CRA sends a "deemed trust letter" to the lender. It outlines the borrower's outstanding GST/HST liability, explains the CRA's authority to act pursuant to the *Excise Tax Act*, and warns that the lender's failure to pay the required GST/HST amount may result in legal proceedings. Ultimately, the CRA recovers all \$300,000 of its desired tax revenue, but the unlucky lender is left limping in the red with a \$200,000 loss.

Thankfully, the lender's commercial real estate lawyer obtained a title insurance policy that provides coverage for the loss incurred here. For example, Stewart Title Guaranty Company insures the lender against "[t]he lack of priority of the Insured Mortgage upon the Title over any other lien." While coverage is normally limited to losses incurred prior to the policy date (which is the date the mortgage is registered on title), the lender remains covered here as all of the unremitted GST/HST

was collected prior to the policy being ordered in 2020.

However, if the borrower had collected but not remitted \$150,000 of GST after the 2020 policy date, then the impacted lender would not have insurance coverage for this extent of the GST/HST lien losses. Instead, the lender could only recover \$50,000 of the total \$200,000 loss from their title insurer. What can the lender potentially do in such circumstances to recover the remaining \$150,000 loss?

An option here is to pursue litigation against the borrower. However, such an approach will only make sense if the borrower is not "judgment proof." This would be the case if the borrower would not have enough income or assets available for the secured lender to seize by court order for debt repayment, even if the lender's litigation proves successful.

If the lender instead engages in litigation with the CRA, the lender should try to settle with the CRA for as much of the remaining \$150,000 loss amount as possible. On what basis can this be done? As noted in the *Toronto-Dominion Bank* decision, to the extent that the lender's registered mortgage constitutes a "prescribed security interest," it will be afforded a limited priority over the CRA's lien pursuant to s. 222(4) of the Act.

In practice, this protection afforded to a "prescribed security interest" is very narrow due to exclusions mentioned in the term's definition in the Security Interest (GST/HST) Regulations, SOR/2011-55. The first exclusion refers to payments received by the secured lender after the borrower failed to remit GST/HST to the CRA, and the second exclusion involves adjusting for the value of any collateral security — such as personal property security or guarantees — held by the secured lender.

For example, if the borrower is a corporation and the lender has a personal guarantee from the borrower corporation's director for \$400,000, then the prescribed security interest would be reduced to zero. Similarly, any monthly payments (including for interest) received by the lender after the borrower's failure to remit would also be deducted from the prescribed security interest amount. If the prescribed security interest is reduced to zero, this means the lender will have no priority over the CRA lien.

As a result, the exact calculation of the prescribed security interest often becomes a point of contention between the CRA and a secured lender. Evidence will need to be led about the date of the advance under the security interest as compared to the date the GST/HST liability arose, the value of any collateral security that the lender has obtained and the value of any payments received by the lender after the borrower's failure to remit. Ultimately, though, if title insurance is not available, the prospects of litigating or settling with the CRA to recover the lender's losses appear to be quite bleak.

In the wake of the *Toronto-Dominion Bank* decision, secured lenders should thus always ensure title insurance policies are ordered on their behalf by their commercial real estate lawyers. Since the protections afforded prescribed security interests are limited, and despite the difficulties involved with obtaining unqualified answers from the CRA, secured lenders must now seemingly do their utmost to confirm that no GST/HST liability has arisen in the borrower wherever and whenever possible.

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