

CANADA / JUDGMENT

1074022 B.C. Ltd. v. Li

2020 BCSC 65

COURT

Supreme Court of British Columbia

DECIDED

20 January 2020

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2020 BCSC 65 1074022 B.C. Ltd. v. Li

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

1074022 B.C. Ltd. v. Li,

2020 BCSC 65

Date: 20200120

Docket: S200289

Registry: New Westminster

Between:

1074022 B.C. Ltd.

Petitioner

And

Tong Li,

Rong Zan Wu,

The Owners Strata Plan VR.2540

John Doe and Jane Doe (Tenants)

Respondents

Before: Master Harper

Reasons for Judgment

Counsel for the Petitioner:

J. Micner

Respondents:

No appearances at this hearing

Counsel for the Application Respondent, Attorney General of Canada on behalf of Her Majesty the Queen:

S. Singh

Counsel for the Attendee, Bank of Montreal:

K.A. Robertson

Place and Dates of Hearing:

Vancouver, B.C.

May 15, August 22, and

November 6, 2019

Place and Date of Judgment:

Vancouver, B.C.

January 20, 2020

Introduction

- [1] The application before the court arises out of a foreclosure proceeding. The petitioner, 1074022 B.C. Ltd., held a second mortgage over property in Vancouver owned by the respondent mortgagor, Tong Li (the "property"). The court approved the sale of the property by an order made June 21, 2018 (the "order approving sale"). As a result, the property was conveyed to and vested in the purchaser. The order approving sale set out the priorities for payment of the net sale proceeds in the usual way, including the amount Mr. Li owes to the mortgagees.
- [2] Mr. Li is a not a Canadian resident. Therefore, pursuant to s. 116 of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.) [ITA], Mr. Li was required to send a notice to the Canada Revenue Agency ("CRA") setting out the details of the sale, including the amount of the sale proceeds and the amount of the adjusted cost base. CRA would then issue a clearance certificate in conjunction with the appropriate amount of tax, or security in lieu, being remitted. The relevant portions of s. 116 are attached to these reasons as Appendix "A".
- [3] Because Mr. Li did not send in the required notice, CRA did not issue a clearance certificate. As a result, and as required by s. 116 of the ITA, \$200,000, being 25% of the purchase price of approximately \$800,000 (all numbers are rounded in these reasons) was remitted to CRA to secure payment of Mr. Li's tax liabilities. The \$200,000 remitted to CRA bears no relationship

to Mr. Li's actual tax liabilities. Although CRA has not yet conclusively determined Mr. Li's tax liabilities, it is clear that he only owes about \$46,000, leaving \$154,000 (the "excess funds") that should rightly be paid to the secured creditors in accordance with the priorities for payment set out in the order approving sale.

- [4] Mr. Li has provided CRA with a written irrevocable authority and direction to pay the funds to his lawyer in trust (the "direction to pay"). It is common ground that if the funds are paid in that manner, they will be dealt with in accordance with the priorities set out in the order approving sale.
- [5] When the property was sold, the Bank of Montreal was paid out almost in full. But as a result of the excess funds being remitted to CRA, the petitioner was only partly paid out, and the third mortgagee was not paid anything. The petitioner is owed \$130,000. The excess funds are sufficient to pay out the Bank of Montreal and the petitioner. As the third mortgagee did not participate in the application, it is not clear whether the remaining excess funds are sufficient to pay out the debt owing to him.

The Application

- [6] The petitioner is the applicant. The petitioner named Canada Revenue Agency ("CRA") as a respondent on the notice of application. The proper party is the Attorney General of Canada on behalf of Her Majesty the Queen. I will refer to this respondent as "Canada".
- [7] The application is framed as seeking an order that the excess funds be paid to the petitioner's lawyer in trust, or into court, to be held and paid out according to the terms of the order approving sale.
- [8] Submissions in support of the application were made primarily by the Bank of Montreal with the petitioner in a supportive role.
- [9] Canada takes the position that there is no legislative authority requiring, or even permitting, it to return the funds to the secured creditors, to pay the funds into court to the credit of the proceeding, or even to comply with the direction to pay. Canada says that it is compelled by law to pay the excess funds to Mr. Li as a tax refund. Mr. Li apparently lives in Hong Kong. If the court accedes to CRA's position, Mr. Li will receive money he owes his secured creditors and the priorities for payment required by the order approving sale will be defeated. The petitioner and the Bank of Montreal say that Canada's position ignores the statutory and common law principles that apply to foreclosures and that if the court accepts Canada's position, a commercial absurdity would result.
- [10] I agree with the petitioner and the Bank of Montreal. For the reasons that follows, I have concluded that the excess funds should be paid to the secured creditors in accordance with the order approving sale either by paying the excess funds into court or into a lawyer's trust account.

The Issues

[11] The issues to be determined on this application are:

- 1) Is CRA obligated to comply with the direction to pay?
- 2) If the answer to question #1 is "no", is CRA required to pay the excess funds into court to the credit of this proceeding, or into a lawyer's trust account, to be dealt with in accordance with the priorities set by the order approving sale?

discussion

- 1) Is CRA obligated to comply with the Direction to Pay?
- [12] The analysis of this issue assumes, for the sake of argument, that Canada's characterization of the excess funds is correct, namely, that the excess funds are a tax refund to be paid to the non-resident taxpayer.
- [13] Canada argues that the Crown is immune from orders that are coercive in nature unless explicitly permitted by legislation: *Daniels v. Daniels*, 2011 MBCA 94 at paras. 79-80. This argument is misplaced. The petitioner simply asks CRA to comply with the taxpayer's direction to pay. This request should not require a coercive court order. CRA could have, and should have, simply complied with the request.
- [14] Canada further argues that there is no legal basis to order Canada to pay a tax refund to a third party. Canada argues that the holdback is remitted on behalf of the non-resident, and remitted as tax under ss. 116(5) such that the "refund" can only be remitted to the tax debtor, relying on the Financial Administration Act, R.S.C. 1985, c. F-11 [FAA] which prohibits the assignment of an income tax refund due or becoming due unless permitted by the FAA itself, or by another Act of Parliament: FAA, s. 67. In further support of this position, Canada cites s. 164 of the ITA. That section provides that a refund is paid to the taxpayer.
- [15] In my view, Canada's interpretation of s. 67 of the FAA and s. 164 of the ITA is overly narrow. If CRA pays the excess funds to Mr. Li's lawyer in trust, the payment is neither an "assignment" of the excess funds to a third party, nor a payment for the benefit of anyone other than Mr. Li. The funds remain Mr. Li's to be dealt with in accordance with the trust conditions agreed upon between him, his lawyer and the secured creditors. Mr. Li's agreement that the funds be paid out of his lawyer's trust account in accordance with the priorities of the order approving sale is none of Canada's concern.
- [16] In my view, there is nothing in the ITA that prevents CRA from complying with the direction to pay. The arrangement made for the payment of the excess funds to Mr. Li's lawyer in trust is not a violation of CRA's governing legislation. Accordingly, I have determined that Canada is obligated to pay the excess funds to Mr. Li's lawyer in trust in accordance with the direction to pay.

- [17] The bulk of the hearing was taken up with the second issue. Therefore, even though the disposition of the application can be made on the narrow basis of the direction to pay, I will consider question #2.
- 2) Is CRA required to pay the excess funds into court to the credit of the proceeding, or into a lawyer's trust account, to be dealt with in accordance with the priorities set by the order approving sale?
- [18] CRA (and hence, Canada) is neutral as to whether s. 116 of the ITA operates unfairly and says that unless and until the legislation is amended, it has no discretion to pay the excess funds into court, or, in fact, to do anything other than pay them to Mr. Li.
- [19] There is no dispute that s. 116 requires the 25% of sale proceeds to be remitted to CRA and that CRA is required to assess the overall tax owing by the debtor. The court is only being asked to determine the status of the sale proceeds once the s. 116 remittance has been made and the tax filings by the mortgagor are current and paid out of those funds and a Notice of Assessment is issued.
- [20] It is common ground that CRA has no interest in the excess funds because Mr. Li's tax liabilities will be fully paid from the excess funds.
- [21] The answer to question #2 turns on whether or not the sale proceeds remain subject to the prior validly registered mortgage security that charged the lands to which the sale proceeds relate.
- a) A Summary of the Law Applicable to Foreclosures and Vesting Orders
- [22] The court may determine summarily any issue raised between respondents, including priorities. A person having conduct of sale may apply to the court for an order confirming the sale, directing the disposition of the proceeds, and vesting title in the purchaser: Supreme Court Civil Rules, Rules 21-7(7)(f) and 21-7(9).
- [23] The order approving sale was made pursuant to s. 15 of the Law and Equity Act, R.S.B.C. 1996, c. 253.
- [24] The priority for distribution is set out in s. 20 of the Land Title Act, R.S.B.C. 1996, c. 250 [LTA].
- [25] The effect of a mortgage is a conveyance of title. The mortgagor and mortgagee are entitled to all the legal and equitable rights and remedies that would be available to them if the mortgagor had transferred the mortgagor's interest in the land to the mortgagee, subject to a proviso for redemption: s. 231(2) of the LTA.
- b) The Effect of Sale by Vesting Order

- [26] In this case, in the order approving sale, the court ordered that the sale proceeds were to be distributed in accordance with the priorities as they existed. The order did not contemplate any other person or agency to receive any of the sale proceeds.
- [27] There are important differences between a court-ordered sale and a private sale. When the court effects a sale by vesting order, title is transferred to the purchaser free and clear of all interests after the petitioning mortgagee with the sale proceeds standing in the place of the lands and subject to the same priorities. This long-standing principle is embodied in s. 231 of the LTA and in the caselaw: *Roadburg v. British Columbia* (1980), 110 D.L.R. (3d) 433 (B.C.C.A.).
- [28] It is only by court-ordered sale that clear title can be conveyed if there are deficiencies left. "When the court orders sale of the lands, the funds which remain, after payment of taxes and sales commission, stand in the place and stead of the land, subject to the same priorities to which the land was subjected": *Canada Permanent Mortgage Corp. v. Kerr* (1984), 55 B.C.L.R. 13 (B.C.S.C.), para. 1. [The reference to "taxes" in this context must mean property taxes.]
- c) The Effect of s. 116 of the ITA on Proceeds of a Court-Ordered Sale in a Foreclosure
- [29] CRA interprets s. 116 of the ITA as if this case involved a private sale. In my view, this interpretation is not correct.
- [30] The purpose of s. 116 is to ensure that funds owing for tax on capital gains arising on a disposition of property go to CRA, rather than to a tax debtor who is out of the reach of CRA collections procedures.
- [31] CRA relies on the plain wording of s. 116 to argue that it has no discretion to comply with the vesting order. However, in my view, CRA's interpretation of s. 116 is unnecessarily narrow. Nothing in the ITA, including s. 116:
- a) contemplates a sale by court order rather than private sale;
 - b) gives the Crown priority for tax obligations over a mortgage;
 - c) provides any mechanism by which sales proceeds paid to CRA under s. 116 which are encumbered by mortgage security can be effectively "cleansed" of those security interests; or
 - d) changes the nature of the mortgage itself, being a transfer of title of the property to the mortgagee subject to the right of redemption.
- [32] The statutory scheme set out in s. 116 presupposes that the sale is a voluntary sale by a registered owner which requires the vendor to clear title. There would be no unpaid secured creditors in such a sale (otherwise, the vendor would, of course, not be able to clear title) and therefore no unfairness to the secured creditors would arise as it does on the facts before me.

- [33] In the present case, the funds that CRA refers to as a "refund" are part of the funds that were encumbered by the mortgage security held on Mr. Li's property. Those funds remain in place and stead of the lands. Accordingly, the "refund" cannot be properly considered a tax refund owing to Mr. Li.
- d) Paramountcy
- [34] Canada's position is that only federal legislation could compel a remittance of the excess funds back to the Petitioner or paid into court to be dealt with under the vesting order. This argument is based on paramountcy. However, paramountcy only applies where there is a conflict between the provincial and federal legislation.
- [35] The principles of paramountcy are set out in *Orphan Well Association v. Grant Thornton Ltd.*, 2019 SCC 5. The doctrine of paramountcy should be applied with restraint. Harmonious interpretations of federal and provincial legislation should be favoured over an interpretation that results in incompatibility in the absence of very clear statutory language to the contrary.
- [36] In my view, there is no conflict because the ITA does not provide for any priority to be given to CRA, or anyone else, to amounts remitted under s. 116. The ITA fails to contemplate a sale by court order and the fact that the proceeds of sale, because of the nature of mortgage security, stand in place and stead of the lands.
- [37] Counsel for the Bank of Montreal submits that it is Canada that has created a conflict and that if I accept Canada's position and deny the mortgagees the right to be paid money rightfully owing to them, such a ruling would be a repudiation of long-standing principles around the nature of mortgage security, priority provisions that are founded in provincial foreclosure law, priorities in the LTA, the rules governing court-ordered sales set out in the Supreme Court Civil Rules, and, crucially, the authority of this court as reflected in the terms of the vesting order. I agree.
- [38] One of the major difficulties with Canada's position is that it disregards the authority of the court. The court maintains jurisdiction over its own orders. In this case, the court maintains jurisdiction over the order approving sale by which the court ordered that the proceeds of sale were to be distributed in accordance with the priorities established by date of registration: LTA, s. 28.
- [39] Nothing in s. 116 of the ITA has the effect of reversing any priorities established by the order approving sale. The intent of s. 116 is to ensure that the tax debts of non-resident property owners are paid so that funds that would go to paying those debts do not leave the country. Section 116 cannot sensibly be construed as requiring funds over and above the amount of the tax debt to be paid directly to the taxpayer who is outside the jurisdiction, thus depriving the taxpayer's creditors of the money rightfully owing to them.

- [40] Canada recognizes that this result is unacceptable, but has no solution to offer other than suggesting that any of the aggrieved creditors petition Mr. Li into bankruptcy and pursue payment of their judgments through the bankruptcy process.
- e) Is a Petition into Bankruptcy a Viable Solution to the Problem?
- [41] Canada suggests one of the mortgagees petition the debtor into bankruptcy because federal legislation permits tax refunds to be paid to a trustee in bankruptcy to be dealt with in the bankruptcy: Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 67(1)(c). *Re Nielsen*, 2018 BCSC 1161 is an example of a bankruptcy being used to pursue recovery of a secured debt arising in a foreclosure proceeding where the bankrupt was owed a tax refund. However, forcing one of Mr. Li's secured creditors to petition him into bankruptcy in order to obtain payment of its debt is not a viable solution to the problem for several reasons.
- [42] First, it is not clear whether the excess funds would lose their character as funds in the place of the lands once paid to the trustee. If the funds were considered unsecured, the funds would be distributed amongst all the bankrupt's creditors, thus defeating, or at least diluting, the creditors' recovery of funds.
- [43] Second, the trustee's fees would have to be paid. Who would pay them? If the creditor petitioning the debtor into bankruptcy has to pay the fees, the recovery is further reduced.
- [44] Third, the bankruptcy process is cumbersome. Would the bankrupt be required to attend counselling sessions? Would any other creditor oppose the discharge? A myriad of procedural requirements would have to be overcome in order for the funds to be paid out.
- [45] Fourth, there was no evidence before the court on this application to demonstrate that the bankruptcy process used in *Re Nielsen* achieved any recovery for the secured creditors.
- [46] There may well be other impediments that would make petitioning Mr. Li into bankruptcy an expensive, cumbersome and unsatisfactory means for the secured creditors to pursue recovery of their judgments. In short, I do not accept Canada's argument that bankruptcy is a solution to the problem that Canada itself has created by taking an overly-restrictive approach to s. 116.

Conclusion and Disposition

- [47] Canada misinterprets and, therefore, seeks to misapply its governing legislation. If CRA (and now, on this application, Canada) had interpreted s. 116 correctly, in harmony with the legal principles that apply to foreclosures and vesting orders, CRA would have voluntarily remitted the excess funds to Mr. Li's lawyer in trust as per the direction to pay. No court order compelling Canada to pay the excess funds would have been necessary.

- [48] Even if Canada's position were correct, a simple legislative amendment could have been put in place to solve the problem CRA has created. For instance, legislation could provide that CRA pay excess funds into court to the credit of the foreclosure proceeding. I was advised by counsel for Canada that CRA does not see its role as including making recommendations about legislative reform. There is no sign that the problem created by CRA's interpretation of s. 116 is on the legislative agenda.
- [49] The appropriate order is that CRA shall pay the excess funds to Mr. Li's lawyer in trust. Alternatively, it is acceptable that CRA pay the excess funds into court to the credit of the proceeding, or to the petitioner's lawyer in trust, if agreed.
- [50] If the parties are unable to agree on costs, a party seeking a costs order must notify the registry within 30 days of the release of these reasons and arrange a date to appear before me.

"Master Harper"

Appendix "A"

Disposition by non-resident person of certain property

116 (1) If a non-resident person proposes to dispose of any taxable Canadian property (other than property described in subsection (5.2) and excluded property) the non-resident person may, at any time before the disposition, send to the Minister a notice setting out

- (a) the name and address of the person to whom he proposes to dispose of the property (in this section referred to as the "proposed purchaser");
- (b) a description of the property sufficient to identify it;
- (c) the estimated amount of the proceeds of disposition to be received by the non-resident person for the property; and
- (d) the amount of the adjusted cost base to the non-resident person of the property at the time of the sending of the notice.

Certificate in respect of proposed disposition

- (2) Where a non-resident person who has sent to the Minister a notice under subsection 116(1) in respect of a proposed disposition of any property has
 - (a) paid to the Receiver General, as or on account of tax under this Part payable by the non-resident person for the year, 25% of the amount, if any, by which the estimated amount set out in the notice in accordance with paragraph 116(1)(c) exceeds the amount set out in the notice in accordance with paragraph 116(1)(d), or
 - (b) furnished the Minister with security acceptable to the Minister in respect of the proposed disposition of the property,

the Minister shall forthwith issue to the non-resident person and the proposed purchaser a certificate in prescribed form in respect of the proposed disposition, fixing therein an amount (in this section referred to as the "certificate limit") equal to the estimated amount set out in the notice in accordance with paragraph 116(1)(c).

Notice to Minister

- (3) Every non-resident person who in a taxation year disposes of any taxable Canadian property of that person (other than property described in subsection 116(5.2) and excluded property) shall, not later than 10 days after the disposition, send to the Minister, by registered mail, a notice setting out
- (a) the name and address of the person to whom the non-resident person disposed of the property (in this section referred to as the "purchaser"),
 - (b) a description of the property sufficient to identify it, and
 - (c) a statement of the proceeds of disposition of the property and the amount of its adjusted cost base to the non-resident person immediately before the disposition,

unless the non-resident person has, at any time before the disposition, sent to the Minister a notice under subsection 116(1) in respect of any proposed disposition of that property and

- (d) the purchaser was the proposed purchaser referred to in that notice,
- (e) the estimated amount set out in that notice in accordance with paragraph 116(1)(c) is equal to or greater than the proceeds of disposition of the property, and
- (f) the amount set out in that notice in accordance with paragraph 116(1)(d) does not exceed the adjusted cost base to the non-resident person of the property immediately before the disposition.

Certificate in respect of property disposed of

- (4) Where a non-resident person who has sent to the Minister a notice under subsection 116(3) in respect of a disposition of any property has
- (a) paid to the Receiver General, as or on account of tax under this Part payable by the non-resident person for the year, 25% of the amount, if any, by which the proceeds of disposition of the property exceed the adjusted cost base to the non-resident person of the property immediately before the disposition, or
 - (b) furnished the Minister with security acceptable to the Minister in respect of the disposition of the property,

the Minister shall forthwith issue to the non-resident person and the purchaser a certificate in prescribed form in respect of the disposition.

Liability of purchaser

- (5) Where in a taxation year a purchaser has acquired from a non-resident person any taxable Canadian property (other than depreciable property or excluded property) of the non-resident person, the purchaser, unless
- (a) after reasonable inquiry the purchaser had no reason to believe that the non-resident person was not resident in Canada,
 - (a.1) subsection (5.01) applies to the acquisition, or
 - (b) a certificate under subsection 116(4) has been issued to the purchaser by the Minister in respect of the property,

is liable to pay, and shall remit to the Receiver General within 30 days after the end of the month in which the purchaser acquired the property, as tax under this Part for the year on behalf of the non-resident person, 25% of the amount, if any, by which

- (c) the cost to the purchaser of the property so acquired exceeds
- (d) the certificate limit fixed by the certificate, if any, issued under subsection 116(2) in respect of the disposition of the property by the non-resident person to the purchaser,

and is entitled to deduct or withhold from any amount paid or credited by the purchaser to the non-resident person or otherwise recover from the non-resident person any amount paid by the purchaser as such a tax.

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Prepared on 26 October 2026 · Esheria