

# Security Interests / Tax Law

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Fasken Martineau DuMoulin LLP

## Hypothecation of Québec Refundable Tax Credits: End of the Saga

*Special collaboration\**

In the wake of the decision rendered by the Superior Court of Montréal on August 7, 2006 *In the matter of the bankruptcy of: 111295 Canada Inc. and H.H. Davis & Assoc. Inc. v. Royal Bank of Canada*,<sup>1</sup> the ministère des Finances of Québec published Information Bulletin 2006-3 on October 16, 2006 announcing that the tax legislation would be amended to allow a corporation to hypothecate the right to claim an amount payable to it under the *Taxation Act* (Quebec) (the “QTA”).

For a more in-depth study of the grounds for this legal decision, read the article entitled “Can Québec refundable tax credits still be validly hypothecated?”<sup>2</sup>

In substance, the court arrived at the conclusion that, because section 1055.2 of the QTA, which went into force March 9, 1999, had not changed the unseizability of Crown debts, article 2668 of the *Civil Code of Québec* had to be applied, which states that property exempt from seizure may not be hypothecated. The court thus declared the hypothec invalid.

The National Assembly acted quickly to remedy the situation, which caused an uproar in both the banking and new economy industries.

Former section 1055.2 of the QTA was therefore replaced by a new one pursuant to section 212 of Bill 41,<sup>3</sup> which was assented on December 6, 2006.

The new section 1055.2 clearly enacts that, despite any inconsistent provision of any law, a corporation may not only assign, but also hypothecate, the right to claim any amount payable under the QTA.

What is more, it is also specified that this rule holds for any agreement entered into after March 9, 1999 that aims to hypothecate such an amount, except for cases pending on October 16, 2006 in which the right to charge this amount with a hypothec by reason of the unseizability of this amount has been invoked as of that date.

Consequently, everything falls back into place without it being necessary to contract new hypothecs to replace those entered into between March 9, 1999 and December 6, 2006, date on which Bill 41 was assented.

Note, however, that nothing has changed in terms of the general principal that the Crown is in no way bound by an assignment or hypothec of an amount payable by virtue of the QTA.

Consequently, even if an amount payable by virtue of the QTA is validly hypothecated, the Minister of Revenue still retains discretion to pay or not to pay the amount to the hypothecary creditor. In addition, even

if this amount is validly hypothecated in favour of a creditor, the Minister of Revenue can still use it to compensate any other tax debt of the taxpayer that constituted the hypothec.

Despite these reservations that have always existed, hypothecating Quebec refundable tax credits should continue to be an effective means of funding new economy companies.

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1) *111295 Canada inc. (Syndic de)*, 2006 QCCS 4455 (CanLII); S.C.M.: 500-11-025249-059, August 7, 2006, Joël Silcoff, jcs; See: <http://www.canlii.org/qc/cas/qccs/2006/2006qccs4455.html>; Permission to appeal granted on September 14, 2006 (C.A.M. 500-09-017021-064);

2) See the *Beyond Results* newsletter, Fall 2006, by the same authors, posted on our website: [www.fasken.com](http://www.fasken.com);

3) Bill 41: *Act to again amend the Taxation Act and other legislative provisions*, approved and entered into force December 6, 2006, time at which it became S.Q. 2006, chapter 36.