GRECHI CARTER
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Protecting Lenders from Super Priorities and Deemed Trusts

Assignment Explained in Simple Terms

Private lenders have been on pins and needles due to the recently learned concept of Super-Priorities and Deemed Trusts fearing the dreaded scenario where they could be on the hook for a borrower's HST arrears owing to the Federal government. It is even more concerning that payment could be demanded long after a mortgage has been paid out and discharged. Luckily there have been recent efforts by title insurance companies to rescue lenders from Super Priorities and Deemed Trusts.

SUPER PRIORITY AND DEEMED TRUSTS – WHAT ARE THEY?

Super-Priorities and Deemed Trusts became the topic du jour after the Federal Court ruling in Toronto-Dominion Bank v. Canada 2020 FCA 80. The decision affirmed the federal government's ability under s. 222 of the Excise Tax Act to create a trust between private mortgage lenders and the Receiver General (the "Crown") whenever a mortgage borrower owes HST. The HST arrears owing transforms any secured creditor (mortgage lender) into an agent of the Crown to both collect said arrears from the debtor (mortgage borrower) and remit it to the Crown. The result is a Deemed Trust in favour of the Crown and gives the Crown Super Priority over all the debtor's secured creditors (which includes mortgages).

THE FEDERAL COURT OF APPEAL AFFIRMS SUPER PRIORITY AND DEEMED TRUSTS

In the above decision, Toronto-Dominion Bank ("TD Bank") provided a mortgage loan to a borrower in 2010. Unbeknownst to TD Bank, the borrower's landscaping business accrued HST arrears in the sum of $87,654 between 2007 and 2008. It is important to note that a tax lien was never registered on the borrower's property. In 2011, the borrower sold its property and with the sale proceeds paid out TD Bank's mortgage. TD Bank thereafter discharged its interest from the property.

In 2013 and 2015, the Crown commenced an action against TD Bank arguing that since TD Bank did not collect and remit the borrower's HST arrears ($87,654.00), TD Bank was then responsible for paying the sum to the Crown. Both the Federal Court and Federal Court of Appeal ruled in favour of the Crown and upheld the Super Priority and Deemed Trust provisions created by s. 222 of the Excise Tax Act.

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WHAT DOES SUPER PRIORITY AND DEEMED TRUSTS MEAN FOR LENDERS?

The Federal Court decision should make any private mortgage lender hesitant to lend on future loans due to the following scenarios:

1. BAD DREAM SCENARIO

If the borrower's HST arrears are owing to the Crown, the Crown can register a tax lien against the property which will take super-priority over all registered mortgages. In the event that a mortgage lender was relying on a particular loan to value, this could jeopardize the equity being relied upon by the lender and the lender can find its loan security over-leveraged.

2. NIGHTMARE SCENARIO (which is what happened to TD Bank)

Long after a private mortgage lender is paid out and discharged from the property, the Crown could commence an action against a previous lender for any of the borrower's HST arrears. This is particularly concerning because, unlike the BAD DREAM SCENARIO, the private lender no longer has a secured interest in the borrower's property.

LITTLE PROTECTION UNDER LAW

Suggestions by the courts and lawyers to better protect private mortgage lenders are few and, at best, are only half measures. Some of the recommendations thus far include:

1. Pull title searches before discharging any mortgages

This would identify any tax liens registered prior to providing a mortgage discharge however this would not reveal any non-registered HST arrears owing by a borrower;

2. Demand proof of borrower's tax compliance

This would ensure that the borrower is in fact filing HST returns and making remittances but it is not guaranteed that the borrower is in fact filing and remitting correctly.

Under both recommendations, HST arrears could still be owing and could still have Super Priority over any private mortgage loans.

TITLE INSURANCE TO THE RESCUE

In recent weeks, private lenders have finally received assistance in the form of extended title insurance coverage. Title insurers, such as FCT and Stewart Title, have recently introduced extended Super Priority lien and Deemed Trust coverage to private lenders for residential transactions. Super Priority Lien and Deemed Trust coverage can now be purchased for a minimal price (approx. $50.00 to $75.00) to protect private lenders against claims made by the Crown within 10 years following the discharge of a mortgage, up to a maximum of $500,000.00.

The extended coverage for Super Priority Liens and Deemed Trusts should alleviate many of the anxieties raised by the Federal Court of Appeal and lenders should include such coverage as a condition for all future mortgage loans.

For more information, please feel free to contact us at **GRECHI CARTER HAMILTON**