

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

BETWEEN:

ROYAL BANK OF CANADA

Plaintiff

- and -

**GALMAR ELECTRICAL CONTRACTING INC., BRENNAR HEATING & AIR
CONDITIONING LTD., GALMAR ELECTIC LIMITED, 1125055 ONTARIO
LIMITED, GALMAR GROUP (2012) LTD., LUIGI MARTELLACCI also known as
LOUIE MARTELLACCI, 1342153 ONTARIO LIMITED ("1342153") carrying on
business as MJM MECHANICAL CONTRACTORS, 551297 ONTARIO LTD., TERRA
MODA BEACHES INC., TERRA-MODA BUILDING CORP., C.G.M.F. ENTERPRISES
INC. and MERCELLO DI FRANCESCO**

Defendants

RESPONDING FACTUM OF THE CANADA REVENUE AGENCY

(for Receiver's distribution motion returnable on September 3, 2015 and
the Union's distribution motion returnable on September 3, 2015)

September 1, 2015

Department of Justice
Ontario Regional Office
Tax Law Services Section
The Exchange Tower
130 King Street West
Suite 3400, Box 36
Toronto, Ontario
M5X 1K6

Diane Winters / Angela Shen
Tel: (416) 973-3172 / 952-7284
Fax: (416) 973-0810
LSUC# 20824V / 55375V

TO: SERVICE LIST

Lawyers for the Canada Revenue Agency

SERVICE LIST

CATHERINE FRANCIS & KENNETH KALLISH

Minden Gross LLP
Barristers and Solicitors
2200 – 145 King Street West
Toronto, ON M5H 4G2

Tel: (416) 369-4137

Fax: (416) 864-9223

Email: cfrancis@mindengross.com / kkallish@mindengross.com

Lawyers for the Plaintiff

DEMETRIOS YIOKARIS, ELIZABETH M. MITCHELL, JEFFREY LONG & DAMON S. STODARD

Koskie Minsky LLP
Barristers & Solicitors
20 Queen Street West, Suite 900
Toronto, ON M5H 3R3

Tel: (416) 595-2130

Fax: (416) 204-2810

Email: dviokaris@kmlaw.ca / emitchell@kmlaw.ca / jlong@kmlaw.ca / dstoddard@kmlaw.ca

Lawyers for IBEW Local 353 and Sheet Metal Workers' International Association, Local Union No. 285

MICHAEL A. TIBOLLO

Tibollo & Associates Professional Corporation
Barristers & Solicitors
11 Director Court, Suite 201
Woodbridge, ON L4L 4S5

Tel: (905) 850-2269

Fax: (905) 850-4516

Email: Michael@tibollo.net

Lawyers for the Defendants other than Galmar Electric Limited, C.G.M.F. Enterprises Inc. and Marcello Di Francesco

JOSEPH SPIDALIERI

Email: jspidalieri@rogers.com

MARCELLO DI FRANCESCO and C.G.M.F. ENTERPRISES INC.
Email: mdfconsulting@gmail.com

NATASHA MacPARLAND & NATALIE RENNER
Davies Ward Phillips & Vineberg LLP
Barristers & Solicitors
155 Wellington Street West
Toronto, ON M5V 3J7

Tel: (416) 863-556
Email: nmacparland@dwpv.com / nrenner@dwpv.com

Lawyers for Carrier Enterprise Canada LLP

STEVEN A. KAHANSKY, General Counsel
Mattamy Homes
2360 Bristol Circle
Oakville, ON L6H 6M5

Tel: (905) 829-2424
Fax: (905) 829-2002
Email: Steve.Kahansky@mattamycorp.com

LOU BRZEZINSKI & MICHAEL FARACE
Blaney McMurtry LLP
Barristers & Solicitors
2 Queen Street East, Suite 1500
Toronto, ON M5G 3G5

Tel: (416) 593-1221
Fax: (416) 593-5437
Email: lbrzezinski@blaney.com / mfarace@blaney.com

Lawyers for Main Harris (Milton) Corporation

ED HIUTIN

Stevensons LLP
15 Toronto Street, Suite 202
Toronto, ON M5C 2E3

Tel: (416) 599-7900
Email: ehiutin@stevensonlaw.net

Lawyers for Arista Homes (Milton Trails Inc.), Arista Homes (Lilly Towns) Inc. and Arista Homes (Vaughan Valley Estates) Inc. (collectively "Arista Homes")

MICHAEL A. COHEN

Barristers & Solicitors, Notary
82 Scollard Street
Toronto, ON M5R 1G2

Tel: (416) 920-5353 Ext. 234
Fax: (416) 920-5454
Email: michaelcohen@82scollard.com

Lawyers for Lisa O'Brien in her personal capacity and as Estate Trustee of the Estate of her late husband, Robert O'Brien

and

Lawyer for Fernbrook Homes (Vandorf) Limited, Fernbrook Homes (Cornerstone) Limited, Fernbrook Homes (Etobicoke Creek) Limited and Fernbrook Homes (Fox Farms) Limited

MICHEAL SIMAAN

Kramer Simaan Dhillon LLP
Litigation Counsel
120 Adelaide Street West, Suite 2100
Toronto, ON M5H 1T1

Tel: (416) 601-0965
Fax: (416) 601-0712
Email: msimaan@kramersimaan.com

Lawyers for Galmar Electric Limited and Aldo Martellacci

BLAKE MORAN

Dentons
Barristers & Solicitors
Toronto-Dominion Centre
77 King Street West, Suite 400
Toronto, ON M5K 0A1

Tel: (416) 863-4495
Email: blake.moran@dentons.com

Lawyers for Deflect-O

STEPHEN BRUNSWICK & JENNIFER LAKE

Teplitsky, Colson LLP
70 Bond Street, Suite 200
Toronto, ON M5B 1X3

Tel: (416) 365-9320
Fax: (416) 365-7702
Email: sbrunswick@teplitskycolson.com / jlake@teplitskycolson.com

Lawyers for Zancor Homes Ltd. And Your Homes Developments (Kingston) Inc.

JEFFREY J. SIMPSON

Torkin Manes LLP
151 Yonge Street, Suite 1500
Toronto, ON M5C 2W7

Tel: (416) 777-5413
Fax: (416) 1-888-587-9143
Email: jsimpson@torkinmanes.com

Lawyers for Home Trust Company

JEFFREY LEVINE

McMillan LLP
Brookfield Place
181 Bay Street, Suite 4400
Toronto, Ontario M5J 2T3

Tel: (416) 865-7791
Fax: (416) 865-7048
Email: Jeffrey.Levine@mcmillan.ca

Lawyers for Monarch Corporation

ALEX ILCHENKO

Pallett Valo
Barristers & Solicitors
77 City Centre Drive, Suite 300
Mississauga, ON L5B 1M5

Tel: (905) 273-3022 Ext. 203
Fax: (905) 273-6920
Email: ailchenko@pallettvalo.com

Lawyers for 4536631 Canada Inc., o/a Rona Ontario

EDWARD J. DREYER

Madorin, Snyder LLP
P.O. Box 1234
55 King Street West, 6th Floor
Kitchener, ON N2G 4G9

Tel: (519) 744-4491
Fax: (519) 741-8060
Email: edreyer@kw-law.com

Lawyers for ASCA Office Solutions

JAMES RENIHAN

Lax O'Sullivan Scott Lisus LLP
145 King Street West, Suite 2750
Toronto, ON M5H 1J8

Tel: (416) 598-1744
Fax: (416) 598-3730
Email: jrenihan@counsel-toronto.com

Lawyers for ASCA Office Solutions

JEFFREY SCHWARTZ

Schwartz & Schwartz Professional Corporation
258 Wilson Avenue
Toronto, ON M3H 1S6

Tel: (416) 636-1949
Fax: (416) 636-3431
Email: jeffrey@schwartzandschwartz.ca

Lawyers for J.D.L. Finance Limited

BILL WALKER

Gowling Lafleur Henderson LLP
One Main Street West
Hamilton, ON L8P 4Z5

Tel: (905) 540-3250
Fax: (905) 523-2517
Email: bill.walker@gowlings.com

Lawyers for Home Trust Company

CALVIN HO

Gowling Lafleur Henderson LLP
100 King Street West, Suite 1600
Toronto, ON M5X 1G5

Tel: (416) 862-5788
Fax: (416) 862-7661
Email: Calvin.Ho@gowlings.com

Lawyers for Home Trust Company

ELAINE RICHARD

Nelligan O'Brien Payne
50 O'Connor Street, Suite 1500
Ottawa, ON K1P 6L2

Tel: (613) 231-8298
Fax: (613) 788-2355
Email: elaine.richard@nelligan.ca

Lawyers for Carleton Condominium Corporation No. 353

IAN K. LATIMER

Speigel Nichols Fox LLP
30 Eglinton Avenue West, Suite 400
Mississauga, ON L5R 3E7

Tel: (905) 366-9700
Fax: (905) 366-9707
Email: ian@ontlaw.com

Lawyers for Paramount Power Systems Ltd.

ENZO DI IORIO

Rotundo Di Iorio Quaglietta
Barristers & Solicitors
3901 Highway No. 7, Suite 400
Vaughan, ON L4L 8L5

Tel: (905) 264-7800
Fax: (905) 264-7808
Email: ediiorio@tdqlaw.com

Lawyers for Faga Group Construction Limited

BRUCE R. JAEGER

Fluxgold Izak Jaeger LLP
50 West Pearce Street, Suite 10
Richmondhill, ON L4B 1C5

Tel: (905) 763-3770 Ext. 212
Fax: (905) 763-3772
Email: bjaeger@fijlaw.com

Lawyers for Total Power Limited

PAUL HANCOCK

Goldman Sloan Nash & Haber LLP
80 University Avenue, Suite 1600
Toronto, ON M5G 1V2

Tel: (416) 597-6477
Fax: (416) 597-3370
Email: hancock@gsnh.com

Lawyers for 436184 Canada Inc. carrying on business as Noble Trade

KENNETH V. DUGGAN

Barrister & Solicitor
11 Waterloo Street, Suite 203
London, ON N6B 2M4

Tel: (519) 672-5360
Fax: (519) 433-6975
Email: kvduggan@bellnet.ca

Lawyers for Trisha Levy

PAUL STARKMAN

Starkman Barristers
675 Cochrane Drive, Suite 304
Markham, ON L3R 0B8

Tel: (905) 477-3110
Fax: (905) 477-3210
Email: paul@starkmanbarristers.com

Lawyers for Brookfield Homes (Ontario) Limited

PATRICK G. MORRIS

McElderry & Morris
Barristers, Solicitors & Notaries
80 Woolwich Street
Guelph, ON N1H 3T9

Tel: (519) 822-8150
Fax: (519) 822-1921
Email: pgmorris@mcelanderrymorris.com

Lawyers for L.P Engineering Inc.

MAURIZIO P. ARTALE

Eccleston LLP
Toronto Dominion Bank Tower
P.O. Box 230
66 Wellington Street West, Suite 4020
Toronto, ON M5K 1J3

Tel: (416) 913-2043
Fax: (416) 504-2686
Email: Maurizio@ecclestonllp.com

Lawyers for Independent Electric Supply Inc.

GALMAR GROUP (2012) LTD.

c/o John Canpolin
44 Bella Vista Court
Woodbridge, ON L4L 7P4

B2B BANK

Francois Desjardins
130 Adelaide Street West, 2nd Floor
Toronto, ON M5H 3P5

MICHAEL KOLENC

c/o Piccin, Bottos

4370 Steeles Avenue West, Suite 201

Woodbridge, ON L4L 4Y4

COSMEA HOLINGS INC.

80 Flatbush Avenue

Woodbridge, ON L6L 8K2

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**GALMAR ELECTRICAL CONTRACTING INC., BRENNAR HEATING & AIR
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LOUIE MARTELLACCI, 1342153 ONTARIO LIMITED (“1342153”) carrying on
business as MJM MECHANICAL CONTRACTORS, 551297 ONTARIO LTD., TERRA
MODA BEACHES INC., TERRA-MODA BUILDING CORP., C.G.M.F. ENTERPRISES
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Defendants

RESPONDING FACTUM OF THE CANADA REVENUE AGENCY

(for Receiver’s distribution motion returnable on September 3, 2015 and
the Union’s distribution motion returnable on September 3, 2015)

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OVERVIEW

1. These submissions are in response to the distribution motions (the “Motions”) brought by Grant Thornton Limited, the court-appointed receiver (the “Receiver”) of Galmar Electrical Contracting Inc. (“GECI”), Brenmar Heating & Air Conditioning Ltd. (“Brenmar”), Galmar Electric Limited (“GEL”), 1125055 Ontario Limited (“1125055”) and Galmar Group (2012) Ltd. (collectively, the “Galmar Group”) and the International Brotherhood of Electrical Workers Local 353 (the “Union”).

(a) Receiver’s Motion

2. The Receiver seeks to distribute the net proceeds of sale from the sale of the Steinway Property (previously owned by GEL) and the Canotek Property (previously owned by 1125055).
3. GEL collected but failed to remit source deductions in the amount of \$186,385.22 from its employees. Pursuant to subsections 227(4) and (4.1) of the *Income Tax Act*¹, the CRA has a source deduction deemed trust in the amount of \$186,385.22.
4. The CRA acknowledges that the RBC has a prescribed security interest in the Steinway Property. The CRA asserts priority to the proceeds remaining following the payment to RBC.
5. The CRA seeks an order to compel the Receiver to distribute the amount of \$246,497.13 which is the amount that the Receiver had intended to distribute to Service Canada with

¹ *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.), as amended (the “ITA”).

respect to payments made to the employees of GECI, GEL and Brenmar under the *Wage Earner Protection Program Act*.²

6. The Receiver should distribute \$246,497.13 to the CRA as the Receiver acknowledges that the CRA has priority pursuant to its deemed trust over both Service Canada and the Union.

(b) The Union's Motion

7. The CRA relies on subsections 227(4) and (4.1) of the *ITA* and asserts priority over the Union's claims, including its claims under sections 81.3 and 81.5 of the *Bankruptcy and Insolvency Act*.³

PART I – STATEMENT OF FACTS

A. The Tax Debts

(i) GECI

8. GECI is currently indebted to Her Majesty the Queen as represented by the Minister of National Revenue (the "Crown") in the aggregate amount of \$2,562,665.36.⁴
9. GECI is currently indebted to the Crown in the amount of \$1,292,022.90 with respect to unpaid source deductions. The CRA has filed a property claim of \$1,039,830.01 (with respect to amounts that GECI deducted from its employees for federal and provincial income tax, employment insurance and Canada Pension Plan contributions but failed to remit to the CRA).

² *Wage Earner Protection Program Act*, S.C. 2005, c. 47, s. 1, as amended.

³ *Bankruptcy and Insolvency Act*, RSC, 1985, c. B-3, as amended (the "BIA").

⁴ Affidavit of Marko Bobar, affirmed September 1, 2015, para. 2.

10. The CRA has also filed unsecured proofs of claim with respect to GECI's other tax debts:

- Unpaid employer-side source deductions: \$252,192.89;
- Unpaid corporate tax in the amount of \$144,574.04; and
- Unremitted GST: \$1,126,068.42.

(ii) GEL

11. GEL is currently indebted to Her Majesty the Queen as represented by the Minister of National Revenue (the "Crown") in the aggregate amount of \$517,655.⁵

12. GEL is currently indebted to the Crown in the amount of \$268,835.32 with respect to unpaid source deductions. The CRA has filed a property claim of \$186,385.22 (with respect to amounts that GEL deducted from its employees for federal and provincial income tax, employment insurance and Canada Pension Plan contributions but failed to remit to the CRA).

13. The CRA has also filed unsecured proofs of claim with respect to GEL's other tax debts:

- Unpaid employer-side source deductions: \$82,450.10; and
- Unremitted GST: \$248,819.68.

(iii) 1125055

14. 1125055 is currently indebted to the Crown in the amount of \$30,952.57 for unremitted GST.⁶

⁵ *Ibid.*

⁶ *Ibid.*

(iv) Brenmar

15. Brenmar is currently indebted to the Crown in the amount of \$115,472.19 for unremitted GST.⁷

B. The Sale of the Canotek and Steinway Properties

16. On March 31, 2014, this Honourable Court approved the sale of the Canotek Property.
17. On August 10, 2015, this Honourable court approved the sale of the Steinway Property.

PART II – POINTS IN ISSUE

18. The Motions raise three issues:
 - 1) What are the priorities to the Galmar Group's estate (excluding the Steinway and Canotek Properties) as between the CRA, RBC and the Union?
 - 2) What are the priorities to the net proceeds of sale from the Steinway Property as between the CRA, RBC and the Union?
 - 3) Should the Receiver be compelled to distribute to the CRA, the funds, or a portion thereof, that it was previously seeking court approval to distribute to Service Canada?

⁷ *Ibid.*

PART III – SUBMISSIONS

A. The CRA is in first priority position with respect to the Galmar Group's estate (excluding the Steinway and Canotek Properties)

I. Subsections 227(4) and (4.1) of the *ITA* create a deemed trust in favour of the CRA that survives bankruptcy

19. The CRA has a deemed trust over the entirety of the funds, currently in the amount of \$473,865, in the Galmar Group's estate.

20. Pursuant to subsection 227(4) of the *ITA*, persons who have withheld employee source deductions but have not remitted the deductions to the CRA are deemed to hold those source deductions in trust for the Crown. The Crown has a deemed trust over the withholding notwithstanding any security interest therein.

21. By virtue of subsection 227(4.1) of the *ITA*, the deemed trust extends to: a) the property of those persons; b) the property held by the person's secured creditors; and c) the proceeds from these assets.

22. The Supreme Court of Canada has described the extended deemed trust created by subsection 227(4.1) as a "floating charge" over all of the assets of the tax debtor's assets in favour of Her Majesty,

The trust arises at the moment the tax debtor fails to remit source deductions by the specified due date, but is deemed to have been in existence from the moment the deductions were made. As long as the tax debtor continues to be in default, the trust continues over the tax debtor's property. Thus, at any given point in time, whatever property then belonging to the tax debtor is subject to the deemed trust.⁸

⁸ *First Vancouver Finance v. Canada (Minister of National Revenue)*, 2002 SCC 49 at para. 4.

23. The CRA's deemed trust under subsections 227(4) and (4.1) gives the CRA absolute priority over the employer's assets and over the interests of secured creditors (subject to one exception that will be discussed below). The Federal Court of Appeal explained by the deemed trust's priority over the interests of secured creditors as follows,

However, the ITA and EIA deemed trust provisions are complete and explicit as to their effect on property taken in possession by secured creditors in the exercise of their security interest, judging from the Supreme Court's reasons in *First Vancouver*: the Crown has an absolute priority over the proceeds from the property subject to the deemed trust, which must be paid to the Receiver General.

....

In this case, Parliament's intention is not hard to decipher...Parliament evidently wished to confer on the Crown an ongoing interest in the property that is deemed to be held in trust for as long as the tax debtor's default persists, and to subject the secured creditor to the obligation to remit to the Receiver General the proceeds arising from the property held in trust in absolute priority, to the extent of the unpaid debt.⁹

24. The CRA's deemed trust for source deductions survives bankruptcy. While subsection 67(2) of the BIA provides that all deemed trusts created by federal or provincial legislation for Her Majesty are rendered invalid, subsection 67(3) provides an exception for source deduction deemed trusts (under subsection 227(4) and (4.1) of the *ITA*).

II. Sections 81.3 and 81.5 of the BIA apply to the Union's claims against GECI, GEL (and Brenmar) as these corporations have been assigned into bankruptcy

25. The Union's reliance on sections 81.4 and 81.6 is misplaced given that GECI and GEL were assigned into bankruptcy on May 29, 2013. As of the date of assignment, sections 81.3 and 81.5 became the operative provisions with respect to the Union's claims for unpaid wages and unpaid pension amounts.

⁹ *Canada (Minister of National Revenue) v. National Bank of Canada*, 2004 FCA 92, at paras. 34 and 50

26. As held in *The Bank of Nova Scotia v. Huronia Precision Plastics Inc.*¹⁰, a debtor in receivership may be assigned into bankruptcy to alter the statutory priority under the *BIA*.

27. The applicable subsections, 81.3(4) and 81.5(2), explicitly state that the Union's security is subject to "amounts referred to in subsection 67(3) that have been deemed to be held in trust." As noted above, subsection 67(3) maintains the CRA's source deduction deemed trust in bankruptcy.

B. Only RBC's prescribed security interest in the Steinway Property has priority over the CRA's deemed trust

28. There is one exception to the deemed trust absolute priority position with respect to certain secured creditors – those that hold a "prescribed security interest" which is,

...a mortgage securing the performance of an obligation of the person, that encumbers land or a building where the mortgage is registered pursuant to the appropriate land registration system before the time the amount is deemed to be held in trust by the person.¹¹

29. RBC has a prescribed security interest in the Steinway Property, and has a priority over the CRA's deemed trust to the extent of that interest.

30. A secured creditor's prescribed security interest is calculated in accordance with the following formula:

The amount of the obligation outstanding under the mortgage at the time of the failure to remit the payroll deductions,

minus the total of

¹⁰ *The Bank of Nova Scotia v. Huronia Precision Plastics Inc.*, [2009] OJ No. 312.

¹¹ *ITA* ss. 227(4.2) and *Income Tax Regulations*, CRC, c. 945, regulation 2201.

- a) The value of all other security interests held by the mortgagee, calculated as of the time of the failure to remit; and
 - b) All amounts applied after the time of the failure to remit on account of the obligation.
31. The CRA claims priority to the amount remaining from the Steinway proceeds of sale after the RBC receives payment for its prescribed security interest. The Receiver has not yet advised what the net proceeds from the sale of the Steinway Property are. Accordingly, the CRA has commenced its review of the prescribed security interest in this case but has not yet completed a detailed calculation.

C. The Receiver should be compelled to distribute to the CRA the funds that it previously sought to distribute to Service Canada

32. The CRA is entitled to the funds that the Receiver sought to pay to Service Canada in its Notice of Motion (dated July 28, 2015) and as described in its Fifth Receiver's Report.
33. Among the relief sought in the Receiver's motion was approval to pay Service Canada the amount of \$246,497.13.
34. In its First Supplemental Report to the Fifth Report of the Receiver, the reports that, "[It] now understands that CRA's source deduction claim is in priority to both the Employee Claim Payment [the amount of \$246,497.13] and the Union's Claim."
35. Accordingly, the CRA seeks an order compelling the Receiver to distribute \$246,497.13 to the CRA.

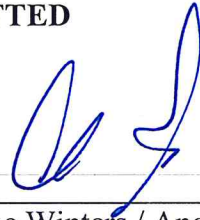
PART IV – ORDER SOUGHT

36. The CRA respectfully requests:

- a) An order declaring that the CRA has priority over all other creditors to funds in the Galmar Group's estate to the extent of the CRA's deemed trust claims against the assets of GECI and GEL.
- b) An order declaring that the CRA has priority to the net proceeds of sale of the Steinway Property after RBC's prescribed security interest therein.
- c) An order directing the Receiver to distribute the amount of \$246,497.13 from Galmar Group's estate to the CRA.
- d) Costs.
- e) Such further and other relief as counsel may request and this Honourable Court may deem just.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Dated at Toronto this 1st day of September, 2015.



Diane Winters / Angela Shen
Lawyers for Canada Revenue Agency

APPENDIX A – LIST OF AUTHORITIES

1. *Canada v. National Bank of Canada*, 2004 FCA 92.
2. *First Vancouver Finance v. Canada*, 2002 SCC 49.
3. *The Bank of Nova Scotia v. Huronia Precision Plastics Inc.*, [2009] OJ No. 312.

APPENDIX B – STATUTES AND REGULATIONS

1. *Bankruptcy and Insolvency Act*, RSC, 1985, c. B-3
2. *Income Tax Act*, RSC, 1985, c. 1 (5th Supp.)
3. *Income Tax Regulations*, CRC, c. 945

ROYAL BANK OF CANADA

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Plaintiff

GALMAR ELECTRICAL CONTRACTING INC., ET AL
Defendants

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Proceeding Commenced at Toronto

**RESPONDING FACTUM OF THE
CANADA REVENUE AGENCY**

Department of Justice
Ontario Regional Office
The Exchange Tower
130 King Street West
Suite 3400, Box 36
Toronto, Ontario M5X 1K6

Per: Diane Winters / Angela Shen
Tel: (416) 973-3172 / 952-7284
Fax: (416) 973-0810
Email: Angela.Shen@justice.gc.ca
LSUC# 20824V / 55375V

Lawyers for the Canada Revenue Agency