

Post-Mortem Planning for Private Corporation Shares

Presented by: Greg Farano, Partner, LLB, CFA, TEP
November 21, 2023



The Issue

Double Taxation on Deemed Disposition of Private Corporation Shares

- “If You Fail to Plan, You Are Planning to Fail” — Benjamin Franklin



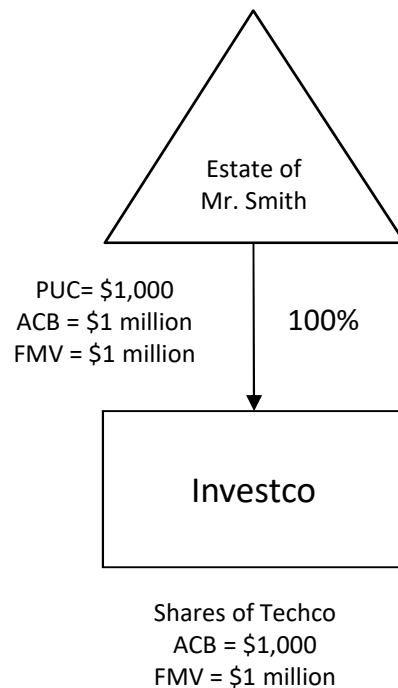
The Issue

Deemed Disposition at Death of Capital Property at Fair Market Value

- Individual taxpayer is deemed to have, immediately before the taxpayer's death, disposed of each capital property of the taxpayer and received proceeds of disposition equal to the fair market value ("FMV") of the capital property immediately before the taxpayer's death
- Individual's estate will pay tax (26.76% at the highest marginal tax rate in Ontario) on any resulting capital gain
- Estate's adjusted cost base ("ACB") of the property deemed to be FMV of the property

The Issue

Double Taxation on Deemed Disposition of Private Corporation Shares



- Mr. Smith subscribes for shares of Investco for \$1,000 in 2000
- Investco uses subscription proceeds to purchase shares of Techco for \$1,000
- Shares of Techco have a FMV of \$1 million on Mr. Smith's death
- Where Investco has no assets or liabilities other than its shares of Techco, Mr. Smith's shares of Investco also have a FMV equal to \$1 million
- Mr. Smith's estate will pay \$267,332 in tax (at highest marginal rate in Ontario) on \$999,000 capital gain resulting from deemed disposition of Mr. Smith's shares of Investco on Mr. Smith's death
- Investco will later pay tax on capital gain realized on sale of shares of Techco (second layer of tax on same economic gain)
- Mr. Smith's estate, or his beneficiaries, will pay tax on the taxable portion of the distribution by Investco of the after-tax proceeds of the sale of the Techco shares (third layer of tax on same economic gain)

Methods for Reducing Double Taxation

3 Methods

- Subsection 164(6) loss carryback
 - substitutes dividend to the estate in its first year for capital gain in deceased's final year
- Post-mortem pipeline
 - facilitates estate or beneficiaries withdrawing funds tax-free from Investco (reducing third layer of tax)
- Paragraph 88(1)(d) Bump
 - results in an increase of ACB of non-depreciable property (e.g. Techco shares) owned by Investco (reducing second layer of tax)

Subsection 164(6) Loss Carryback

Result:

- Replaces Mr. Smith's final year capital gain with a deemed dividend to Mr. Smith's estate

Mechanics:

- Investco redeems estate's shares (or Investco is wound-up) resulting in a deemed dividend to estate
- Estate realizes a loss generally equal to the amount of the deemed dividend
- Estate files subsection 164(6) election to carry back loss to deceased's final year to be applied against capital gain realized on deemed disposition of deceased's shares of Investco

Subsection 164(6) Loss Carryback

Mechanics:

- Must be completed within 12 months of Mr. Smith's death
- Estate must be a graduated rate estate ("GRE")
- By implementing a subsection 164(6) loss carryback, estate is substituting a deemed dividend taxed in estate's first year at 39.34% (eligible dividend – where Investco has a general rate income pool ("GRIP" balance) or 47.74% (other than eligible dividend) for a capital gain taxed in Mr. Smith's final year at 26.76%

Subsection 164(6) Loss Carryback

Tax Rates on Deemed Dividends vs. Capital Gains

Tax Efficiency - Lower Effective Tax Rate on Deemed Dividend With CDA and RDTOH

- Effective tax rate on deemed dividend can be reduced if Investco has (or can generate) a capital dividend account (“CDA”) balance, and Investco elects to treat a portion of the deemed dividend as a tax-free capital dividend
- To the extent that Investco has (or can generate) refundable dividend tax on hand (“RDTOH”), Investco will receive a refund on RDTOH on portion of deemed dividend to estate which is taxable dividend

Subsection 164(6) Loss Carryback

Tax Rates on Deemed Dividends vs. Capital Gains

Stop Loss Rules

- Subsection 40(3.6) – subsection 40(3.61) exception where share of corporation held by a GRE is redeemed and GRE elects under subsection 164(6) to carry back the loss to deceased's final year

Subsection 164(6) Loss Carryback

Tax Rates on Deemed Dividends vs. Capital Gains

Stop Loss Rules

- Subsection 112(3.2) – loss on redemption of GRE's shares of Investco which can be carried back under subsection 164(6) to Mr. Smith's final year is reduced to the extent that portion of deemed dividend which is a capital dividend exceeds one-half of the lesser of the loss otherwise determined and the capital gain to Mr. Smith on the deemed disposition of his shares of Investco
- Implement "50% rule" to avoid loss grind

Post-Mortem Pipeline

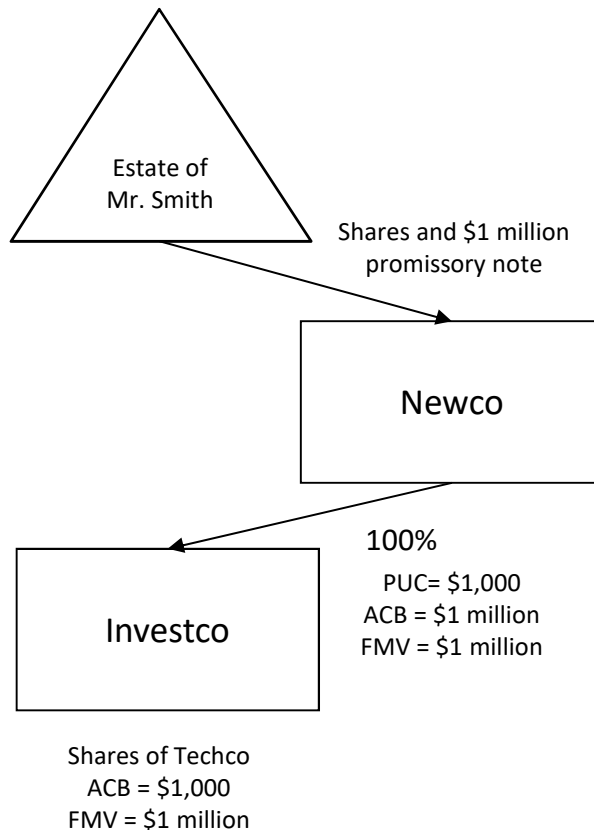
Result:

- Estate can receive tax-free distribution from Investco equal to high ACB of Investco shares

Mechanics:

- Estate transfers its high ACB shares of Investco to a Newco owned by estate and receives a promissory note in the amount of the ACB as consideration
- Investco later satisfies promissory note with cash – tax-free to estate

Post-Mortem Pipeline



- Preserves \$999,000 capital gain in Mr. Smith's final year
- Can be combined with paragraph 88(1)(d) bump of ACB of Investco's shares of Techco on subsequent amalgamation of Newco and Investco or wind-up of Investco into Newco

Post-Mortem Pipeline

- Before implementing a post-mortem pipeline, consider the anti-surplus stripping rule in section 84.1 and the deemed dividend rule in subsection 84(2)
- The CRA has ruled that it may apply anti-surplus stripping rule in section 84.1 and the deemed dividend rule in subsection 84(2) to a post-mortem pipeline unless:
 - a) Investco carries on a business or investing activities at the time of the transfer by the estate to Newco of shares of Investco, and continues to carry on the business or investing activities for a period of at least one year following the transfer;

Post-Mortem Pipeline

- b) Investco is not amalgamated or wound-up into Newco for at least one year following the transfer;
- c) the amount of the promissory note issued by Newco to the estate as consideration for the transfer to Newco of the estate's shares of Investco does not exceed the “arm’s length” ACB of the estate’s shares of Investco, and is repaid in a series of instalments following the first anniversary of the transfer of the shares;
- d) the repayment may be funded by the sale of Investco’s (or the amalgamated corporation’s) assets, and so long as it otherwise continues to carry on its business; and
- e) dividends paid out of current earnings and funded without the sale of assets are permitted

Paragraph 88(1)(d) Bump

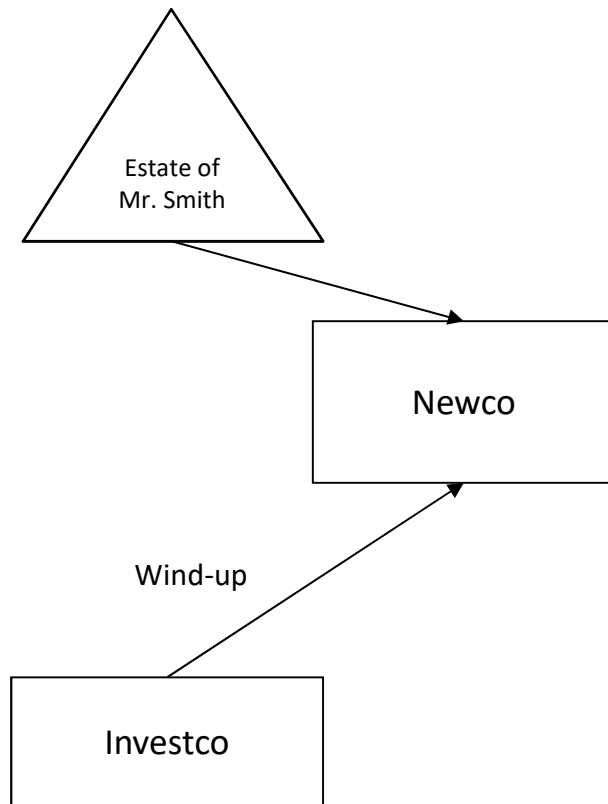
Result

- Increase cost base of non-depreciable capital property, e.g. Investco's shares of Techco, but not depreciable property, such as buildings

Mechanics

- Estate transfers high ACB shares of Investco to Newco
- Investco is amalgamated with or wound-up into Newco
- Newco designates in return non-depreciable capital property whose cost is to be increased

Paragraph 88(1)(d) Bump



Shares of Techco
ACB = increase to \$1
million
FMV = \$1 million

- Preserves capital gain in Mr. Smith's final year
- Can be combined with post-mortem pipeline

Paragraph 88(1)(d) Bump

Requirements

- Non-depreciable property, e.g. Techco shares, must be owned continuously since Mr. Smith's death
- Increase in ACB of Techco shares limited to "available bump room", being the amount by which FMV of Techco shares at Mr. Smith's death exceeds greater of ACB of shares at Mr. Smith's death and at time Investco is wound-up and reduced by:

Paragraph 88(1)(d) Bump

Requirements

- a) cost of Investco's other assets, including cash, in excess of Investco's debts and reserves; and
- b) the total of all taxable dividends, capital dividends, and life insurance capital dividends received by Newco from Investco

Choosing Between the Methods

Subsection 164(6) Loss Carryback

- Substitutes dividend in estate's first year for capital gain in Mr. Smith's final year
- At highest marginal tax rate in Ontario, capital gains taxed at 26.76%, while eligible dividends are taxed at 39.34%, and non-eligible dividends taxed at 47.74%
- Estate would choose subsection 164(6) loss carryback option where it has CDA or RDTOH, or GRIP, beneficiaries wish to wind-up Investco within short time after Mr. Smith's death, or where CRA administrative requirements for post-mortem pipeline cannot be met
- Investco can generate CDA and RDTOH by selling capital property to affiliated corporation
- Only available if Mr. Smith's estate is a GRE, must be competed within one year of Mr. Smith's death



Choosing Between the Methods

Post-Mortem Pipeline

- Preserves Mr. Smith's capital gain (taxed at 26.76%), and permits estate to receive tax-free distribution from Investco
- No time limit on implementation
- Implementation costs and delay in distribution from Investco - requires incorporation of Newco, transfer of Investco shares to Newco, and Investco must continue to carry on its business or investment activities, and Investco cannot distribute proceeds of sale of its assets, for at least one year
- Can be combined with paragraph 88(1)(d) bump

Choosing Between the Methods

Paragraph 88(1)(d) Bump

- Preserves Mr. Smith's capital gain (taxed at 26.76%)
- Only available for non-depreciable capital property
- Non-depreciable capital property must be owned Investco continuously since Mr. Smith's death
- No time limit on implementation
- Can be combined with post-mortem pipeline
- Consider complicated "bump denial rules"

Conclusion

- “If You Fail to Plan, You Are Planning to Fail” — Benjamin Franklin



Conclusion

Thank you for your time!





Questions?



Competition Act (Canada)

Wage-fixing and no-poach provisions

Presented by: Catherine Carscallen, Ken Jull, Lee Stratton
Toolbox Seminar – November 21, 2023



Competition Act – subsection 45(1.1)

Overview – Wage-Fixing and No-Poach Provisions

- Changes to Competition Act adding subsection 45(1.1) to existing criminal conspiracy provisions came into effect **June 23, 2023**
- 45(1.1) prohibits agreements between unaffiliated employers to fix or control wages or other terms of employment or to not solicit or hire each other's employees
- Prompted by simultaneous cancellation of COVID “hero-pay” by grocery chains
- Competition Bureau released its ***Enforcement Guidelines on wage-fixing and no poaching agreements*** on May 30, 2023 outlining its anticipated enforcement approach and priorities (not binding on the Bureau or a court)

Competition Bureau

Overview - Enforcement Guidelines

- Rationale for subsection 45(1.1):
 - “... protects competition in labour markets, as it prohibits agreements between employers to fix wages and restrict job mobility”
 - “....wage-fixing and no-poaching agreements undermine competition and efficient allocation of resources. Maintaining and encouraging competition among employers results in higher wages and salaries, as well as better benefits and employment opportunities for employees”

Part VI – Offences in Relation to Competition

Conspiracies, agreements or arrangements regarding employment

45(1.1) Every person who is an employer commits an offence who, with another employer who is not affiliated with that person, conspires, agrees or arranges

- **(a)** to fix, maintain, decrease or control salaries, wages or terms and conditions of employment; or
- **(b)** to not solicit or hire each other's employees.

Subsection 45(1.1)

Application

- Applies to agreements entered into between employers on or after **June 23, 2023**, and to conduct that ***reaffirms or implements*** agreements made before that date which contravene the provisions
- Applies to agreements between ***unaffiliated employers, regardless of whether they compete***; agreements are ***per se illegal*** (i.e., deemed to be illegal without requiring proof of anti-competitive effects)
- “**Employers**” – Guidelines interpret broadly to include directors, officers, and agents or employees, such as HR professionals – “senior officers” entering into an agreement may be subject to prosecution as well as the corporation on whose behalf they are acting
- “**Employee**” – not defined in Act – will be assessed as a question of fact and applicable law

Subsection 45(1.1)(a)

Wage-Fixing Agreements

45(1.1)(a) prohibits agreements between unaffiliated employers to fix, maintain, decrease or control salaries, wages or terms and conditions of employment

- Enforcement Guidelines:
 - “**terms and conditions**” include the responsibilities, benefits and policies associated with a job (e.g., job descriptions, allowances, non-monetary compensation, working hours, location, non-compete clauses or other directives that may restrict job opportunities)
 - enforcement generally is limited to those terms that could affect a person’s decision to enter or remain in an employment contract
 - whether an agreement “fixes, maintains, decreases or controls” will be measured relative to the wages, salaries or terms and conditions that likely would exist in the absence of the restraint

Subsection 45(1.1)(b)

No Poaching Agreements

45(1.1)(b) prohibits agreements between unaffiliated employers to not solicit or hire each other's employees

- Enforcement Guidelines:
 - only prohibits ***reciprocal*** agreements between employers
 - “***one-way***” agreements (in favour of one employer but not both) may still be used

Subsection 45(2)

Penalty

45(2) Every person who commits an offence under subsection (1) or (1.1) is guilty of an indictable offence and liable on conviction to imprisonment for a term not exceeding 14 years or to a fine in the discretion of the court, or to both.

Subsection 45(3)

Evidence of conspiracy, agreement or arrangement

45(3) In a prosecution under subsection (1) or (1.1), the court may infer the existence of a conspiracy, agreement or arrangement from *circumstantial evidence, with or without direct evidence of communication* between or among the alleged parties to it, but, for greater certainty, the conspiracy, agreement or arrangement must be proved *beyond a reasonable doubt*.

Defences

Ancillary Restraints Defence (ARD)

- Enforcement Guidelines:
 - Bureau distinguishes between naked restraints and ancillary restraints
 - 45(1.1) is directed at “naked restraints” on competition – these include restraints on wages or job mobility that are not implemented to further a legitimate collaboration, strategic alliance or joint venture
 - 45(4) provides a defence for “ancillary restraints”
 - ARD is available when certain desirable business transactions or collaborations require restraints on competition to make them efficient, or even possible

Subsection 45(4)

Ancillary Restraints Defence

45(4) No person shall be convicted of an offence under subsection (1) or (1.1) in respect of a conspiracy, agreement or arrangement that would otherwise contravene that subsection if

- (a) *that person establishes, on a balance of probabilities*, that
 - (i) it is ancillary to a broader or separate agreement or arrangement that includes the same parties, *and*
 - (ii) it is directly related to, and *reasonably necessary* for giving effect to, the objective of that broader or separate agreement or arrangement; *and*
- (b) the broader or separate agreement or arrangement, considered alone, does not contravene that subsection.

Subsection 45(4)

Ancillary Restraints Defence: is the reverse onus constitutional?

- Compare with Criminal Code 22.2(c) which states:
“knowing that a representative of the organization is or is about to be a party to the offence, does not take all reasonable measures to stop them from being a party to the offence”
- **This provision does not shift the legal onus, which remains on the prosecution to prove the absence of all reasonable measures**

Subsection 45(4)

Reverse Legal burdens in strict liability offences

- Strict Liability offences with a reverse legal burden have been upheld in [R. v. Wholesale Travel Group Inc](#)
- Strict liability offences were the “halfway house” created in [R. v. Sault Ste. Marie \(City\) \(1978\), 40 C.C.C. \(2d\) 353 \(S.C.C.\)](#):

Subsection 45(4)

Reverse Legal burdens in strict liability offences

- 2. Offences in which there is no necessity for the prosecution to prove the existence of *mens rea*; the doing of the prohibited act *prima facie* imports the offence, **leaving it open to the accused to avoid liability by proving that he took all reasonable care**. This involves consideration of what a reasonable man would have done in the circumstances. The defence will be available if the accused reasonably believed in a mistaken set of facts which, if true, would render the act or omission innocent, or if he took all reasonable steps to avoid the particular event. These offences may properly be called **offences of strict liability**. Mr. Justice Estey so referred to them in *Hickey's* case.

Subsection 45(4)

Reverse Legal burdens in strict liability offences

- A majority of the court in [R. v. Wholesale Travel Group Inc](#) agreed that the requirement that the accused must establish due diligence on a balance of probabilities is a reverse onus that infringes [s. 11\(d\) of the Charter](#) and **the presumption of innocence**. This conclusion shifted the battleground to a s. 1 analysis.

Subsection 45(4)

Strict Liability and **lower stigma**



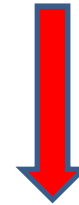
- Former Chief Justice Lamer (with whom six other members of the Supreme Court of Canada agreed on this point), placed misleading advertising on the lower end of this scale of stigma in [R. v. Wholesale Travel Group Inc.](#):²
- Given that the stigma attaching to theft was explicitly contemplated in [R. v. Vaillancourt](#) as one which may well necessitate a subjective *mens rea*, it was argued that the offence of false/misleading advertising also requires an element of subjective *mens rea* in order to comply with the principles of fundamental justice. In my view, while a conviction for false/misleading advertising carries some stigma, in the sense that it is not morally neutral behaviour, **it cannot be said that the stigma associated with this offence is analogous to the stigma of dishonesty which attaches to a conviction for theft.** A conviction for false/misleading advertising will rest on a variety of facts, many of which will not reveal any dishonesty but, rather, carelessness and the conviction of same does not brand the accused as being dishonest. In my opinion, the same cannot be said for a conviction for theft.

Subsection 45(4)

Levels of **stigma**



Low stigma



Wage or price fixing is
**tantamount to fraud which
has much higher stigma**

Canada Bread agrees to \$50M fine for role in bread price-fixing scandal: June 2023

The company made the revelation in an Ontario court on Wednesday, acknowledging that under a previous management regime, it colluded with its competitors in Canada's bakery industry to work in unison to raise the wholesale prices they charge to grocery chains, pushing up prices for consumers in the process.

The company — which makes dozens of brands of baked goods, including Dempster's, Stonemill, Vachon and others — has been owned by Mexican food giant Grupo Bimbo since 2014, but prior to that, it was majority controlled by Maple Leaf I

News release

June 21, 2023 - GATINEAU, QC - Competition Bureau



Canada Bread agrees to \$50M fine for role in bread price-fixing scandal: June 2023

***R. v. Canada Bread Co.* 2023 ONSC 3790**

19 The offences in this **case were extremely serious**. Price-fixing was aptly described in *R. v. Maxone Auto Parts*, 2012 FC 1117 at paragraph 54 **as analogous to fraud and theft**. Effectively, this was a fraud on the public. The offences had a far-reaching and long-standing impact on the victims. Bread is a dietary staple for many and these offences affected millions of consumers.

Wage fixing will arguably carry the same stigma as fraud and theft and may not pass the section 1 test under Wholesale Travel.



Subsection 45(4) - Ancillary Restraints Defence

Enforcement Guidelines: May 30, 2023

Factors the Bureau will take into account include:

- whether the parties could have achieved an equivalent or comparable arrangement through practical, significantly less restrictive means that were reasonably available to them at the time the agreement was entered into
- the ***duration***, ***subject matter*** and ***geographic scope*** of the ancillary restraint (e.g., whether it applies to employees unrelated to the collaboration)
- whether, in absence of the restraint, the agreement could only be implemented under considerably more uncertain conditions, at substantially higher cost or over a significantly longer period
- what led to the adoption of the restraint (e.g. evidence created during evaluation and negotiation of the agreement that demonstrates the objectives of the agreement, evidence of alternative options considered at the time the agreement was negotiated, and any submissions made by the parties to the Bureau)

Subsection 45(4) - Ancillary Restraints Defence

Enforcement Guidelines

- Bureau recognizes the significance that labour-related restraints can play in many business agreements. *Reasonably necessary restraints* can play an important role in stabilizing and protecting parties' business interests in the course of advancing legitimate pro-competitive objectives.
- Bureau will *generally not* assess wage-fixing or no-poaching clauses that are ancillary to *merger transactions, joint ventures or strategic alliances* under the criminal provisions.
- It also recognizes the role these types of restraints can play in certain business arrangements such as *franchise agreements and certain service provider-client relationships (e.g., staffing or IT service contracts)*.
- However, the Bureau may start an investigation under 45(1.1) where those clauses are “*clearly broader than necessary in terms of duration or affected employees*”, or where the business agreement or arrangement is a “sham”.
- Even when the ARD applies, Bureau may still examine the agreement under the reviewable matters provisions in Part VIII of the Act, including the civil agreements provision in section 90.1.

Subsection 45(1.1)

Sample Fact Scenario

- Pre-June 23, 2023 Services Agreement
 - small-mid sized service provider embedded employees with large organization
 - agreement up for renewal post June 23, 2023
 - contained reciprocal non-solicit/no-hire covenants and other restrictions regarding reassignment of service providers' key employees
 - imbalance of bargaining power
 - Considerations: remove reciprocal offending covenants; make one-way; review reasonableness of restrictions and try to establish basis for ARD (but still risk/uncertainty); ... ?

Other Exemptions and Defences

Collective Bargaining Exemption and Regulated Conduct Defence

Other exemptions or defences under the Act may apply to conduct described in subsection 45(1.1) including:

- section 4 - exemption for agreements between employers with respect to *collective bargaining* with their employees over salaries or wages and terms or conditions of employment
- subsection 45(7) - defence for conduct required or authorized by or under another Act of Parliament or the legislature of a province (*regulated conduct defence*)

Additional Considerations

Potential Additional or Other Liabilities

- Exposure to civil actions by private parties (on individual or class basis) for civil damages (e.g., pursuant to section 36 of Competition Act)
- Debarment or disqualification for public contracts under the federal integrity regime or provincial equivalents
- Reputational damage

Subsection 45(1.1)

Takeaways / Good Practices

- Review commercial agreements (pre- and post- June 23, 2023)
- Provide training to appropriate personnel (e.g., directors, officers, HR or other key employees) on new offences
- Update any applicable internal policies related to the practices targeted by the new offences
- Review/re-assess process for sharing commercially sensitive information with, or receiving commercially sensitive information from, other employers, as applicable



Questions?

Social Clubs with Share Capital Options for Continuing

Presented by: Heather Keachie
November 21, 2023



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What is a Social Club with Share Capital?

- Social Clubs with Share Capital are social companies with share capital that were incorporated under Part II of the Ontario *Corporations Act*, RSO 1990, c C.38 (“OCA”)
- Some social clubs may have been incorporated under a special act
- These “social companies” have objects that are wholly or partly social in nature and they have shareholders
- Examples include golf, tennis, curling and social clubs in which at least some of the members hold shares in the social club

Continuation Deadline

- Any social club that was either incorporated or continued under Part II of the OCA is required to continue:
 1. As a corporation without share capital under the *Not-for-Profit Corporations Act, 2010* (“ONCA”),
 2. As a co-operative corporation under the Co-operative Corporations Act (“OCCA”), or
 3. As a corporation with share capital under the Business Corporations Act (“OBCA”)
- The deadline to complete this continuation is October 19, 2026

How to Continue

1. Continuation under any of the ONCA, OCCA or OBCA must be approved by special resolution, meaning it must be approved by the directors and by two-thirds of the votes cast at a general meeting of the shareholders
 - Currently subsection 2.1(4) of the OCA requires that each class of shareholders must approve the continuation but Bill 139, *Less Red Tape, More Common Sense Act, 2023*, proposes to repeal subsection 2.1(4) of the OCA
 - If the social club is unable to achieve quorum to approve the special resolution, the social club may apply to the court for an order waiving the requirement for a special resolution

How to Continue

2. Once approved, articles of continuation should be filed and all constating documents should be updated to comply with the new legislative regime
3. If continuing under
 - a. the ONCA, provisions regarding authorized capital must be deleted and any issued shares need to be cancelled;
 - b. the OBCA, changes need to be made to reflect a for-profit mode of operations (if operating as a non-profit); or
 - c. the OCCA, changes need to be made to reflect co-operative values.
4. Any tax consequences of the continuance or new method of operations need to be addressed

Continuation Options Compared

ONCA	OBCA
Non-share capital corporation with members	Share capital corporation with shareholders
Remain a not-for-profit and tax-exempt status	Become for-profit and likely lose tax-exempt status
Operated not for profit	Operated for profit
Upon dissolution, assets may go to the Crown; a registered charity or an organization with similar purposes; or to the members, depending on whether the club is a public benefit corporation and its tax status	Upon dissolution, assets go to the shareholders

- A continuation under the OCCA will have elements of the ONCA or OBCA continuation options, depending on if the co-operative has share capital or not

Features of an ONCA Corporation

- A non-share capital corporation governed by the ONCA will have members who have the power to elect directors, appoint an auditor, approve changes to constating documents, among other powers
- The ONCA permits *ex-officio* members and directors if specified in a corporation's bylaws
- Members have rights to bring an application to the court on behalf of the corporation (derivative action) or to direct a person to comply with the ONCA (compliance order)

Features of an ONCA Corporation

- A non-share capital corporation can be a Public Benefit Corporation (“PBC”) which means it is either:
 - (a) a charitable corporation, or
 - (b) a non-charitable corporation that receives more than \$10,000 in a financial year in donations/gifts from the public (people who are not members, directors, officers or employees of the corporation) or in grants/similar financial assistance from the government or a government agency
- A Non-PBC does not meet the definition of a PBC
- Depending on whether a corporation is a PBC or a non-PBC it will have different provisions regarding the level of financial review required and whether property can be distributed to members upon dissolution

Tax Implications of Continuing under the ONCA

- A social club that wants to be or remain tax-exempt must be aware that it cannot be operated for the purpose of financial gain for its members
- Paragraph 149(1)(l) of the *Income Tax Act* exempts an organization from paying tax if they are
 - Not a charity
 - Organized and operated exclusively for [...] any other purpose except profit,
 - No part of the income of which was payable to, or otherwise available for the personal benefit of, any [...] member or shareholder

Tax Implications of Continuing under the ONCA

- The social club must decide how to convert and/or dispose of its share capital in order to continue as a corporation without share capital
- Existing shareholders may be entitled to receive compensation on the cancellation or conversion of their shares
- The conversion of the shares in the social club to membership interests in the non-share capital corporation may have tax implications, depending on whether this conversion of shares is a “disposition” as per subsection 248(1) of the *Income Tax Act*

Features of an OBCA Corporation

- A share capital corporation governed by the OBCA will have shareholders who have the power to elect directors and appoint an auditor among other powers
- Shareholders have rights to bring an application to the court on behalf of the corporation (derivative action), to direct a person to comply with the OBCA (compliance order), and to obtain an order to rectify any act or omission that unfairly disregards the interests of any security holder of the corporation (oppression remedy)
- Upon dissolution, shareholders may receive the net assets of the corporation following the payment of the corporation's liabilities

Tax Implications of Continuing under the OBCA

- If a social club continues under the OBCA it may cease to be a non-profit organization and would no longer be exempt from income taxes under 149(1)(l)
- Deemed year-end immediately before the transition from a non-profit to a for-profit organization and a new taxation year will begin as a for-profit
- All property will be deemed to have been sold and immediately reacquired at fair market value – the result being that any gain that accrued on the assets during the time the organization qualified as an NPO will generally be exempt from tax
- However, if NPO is subject to 149(5), all gains will be taxable except for gains resulting from the disposition of property used exclusively for dining, recreational or sporting facilities

Failure to Continue

- Any social club that is required to continue which fails to do so by the October 19, 2026 deadline will be dissolved effective October 20, 2026
- However, the social club will still be deemed to exist post-dissolution for the following purposes
 - To hold a meeting of shareholders to pass a special resolution to authorizing filing articles of continuance under the ONCA, OCCA or OBCA, provided that the articles of continuance are filed not later than 20 years after the date of its dissolution
 - To apply to the court to approve the special resolution to continue under the ONCA, OCCA or OBCA if the social club is unable to obtain a quorum

Practical Steps to Continue

- Identify and locate existing shareholders
- Gather copies of all constating documents (e.g. letters patent, bylaws) and share ledgers
- Identify the assets of the social club and review equity shareholdings
- Consult with accounting advisors regarding tax implications of continuance options
- Create a process and timelines for the continuation
- Prepare a communication plan to reach out to and engage shareholders and members so that they are aware of the changes that will take place

Final Thoughts

- The decision to continue to the ONCA, OBCA, or OCCA will have corporate and tax implications for the social club
- Any of the options will require significant changes to the governance structure of the social club
- Social companies and their boards should start planning for the continuation process now so that they have time to discuss and plan for the continuation changes



Questions?



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THE NEW ONTARIO *NOT-FOR-PROFIT CORPORATIONS ACT, 2010* (THE “ONCA”)

ONCA – what’s that?

- New and updated legislation specifically applicable to not-for-profit corporations
- Came into force on October 19, 2021
- Automatically applies to all non-share capital corporations incorporated under an Ontario statute, including all corporations incorporated under Part III of the *Corporations Act* (Ontario)

ONCA – when do I need to transition?

- Most corporations have three years to transition – until October 19, 2024
- All provisions that were previously valid continue to be in effect until the transition period ends
- After transition period, most (but not all) non-compliant provisions will be “deemed to be amended”

ONCA – what do I do?

1. **Collect and review corporate governing documents.** You’ll need to locate letters patent, supplementary letters patent, bylaws, and board resolutions. Once you’ve found the documents, review them carefully to understand your current governing framework. You may want to task a committee with handling the transition to the ONCA.
2. **Obtain your company key.** You’ll need to apply for it online through the “Ontario Business Registry” website, and the government will send the key to you in the mail to the registered office address that they have on file.
3. **Understand the framework of the ONCA and discuss which ONCA options work for you.** The ONCA is a lot more prescriptive than the previous legislation. Some of the provisions are mandatory, some are default, and some are elective. *Questions to ask: who are our members? what are the conditions of membership? how should members/directors be able to vote (electronically, by proxy, in person only)? how many directors? do you want a range of directors? what qualifications should directors have? how long should director terms be? what officer positions do you need? what committees do you need?*
4. **Prepare ONCA-compliant documents.** You’ll likely need the following: articles of amendment, new or revised bylaws, resolutions of the directors and the members confirming the changes, director consents to act. However, some organizations may choose not to make any changes at this time for strategic reasons.
5. **Approve and file new documents.** Once the members and the directors have approved the documents, they are filed electronically. You’ll need the company key.
6. **Ensure the Board, officers, and other staff are trained on the new governance rules and procedures.** While many basic governance procedures will stay the same, there are new things to be aware of, including considering whether you are a public benefit corporation or not, and what level of financial review is required. Registered charities previously filed their corporate annual returns with the CRA, but as of May 2021, the CRA stopped accepting them. Corporate returns must now be filed annually with the Ontario government. You’ll need the company key.
7. **Diarize the next governance review.** Best practice is to review all governance documents at least every three years to make sure that they are still up to date and reflective of your needs and practice.

If you have any questions, please contact Heather Keachie | hkeachie@grllp.com | 416-865-4017

*Deans Knight Income Corporation v His Majesty
the King, 2023 SCC 16*
Toolbox Seminar

Presented by: Ian Spiegel
November 21, 2023



Executive Summary

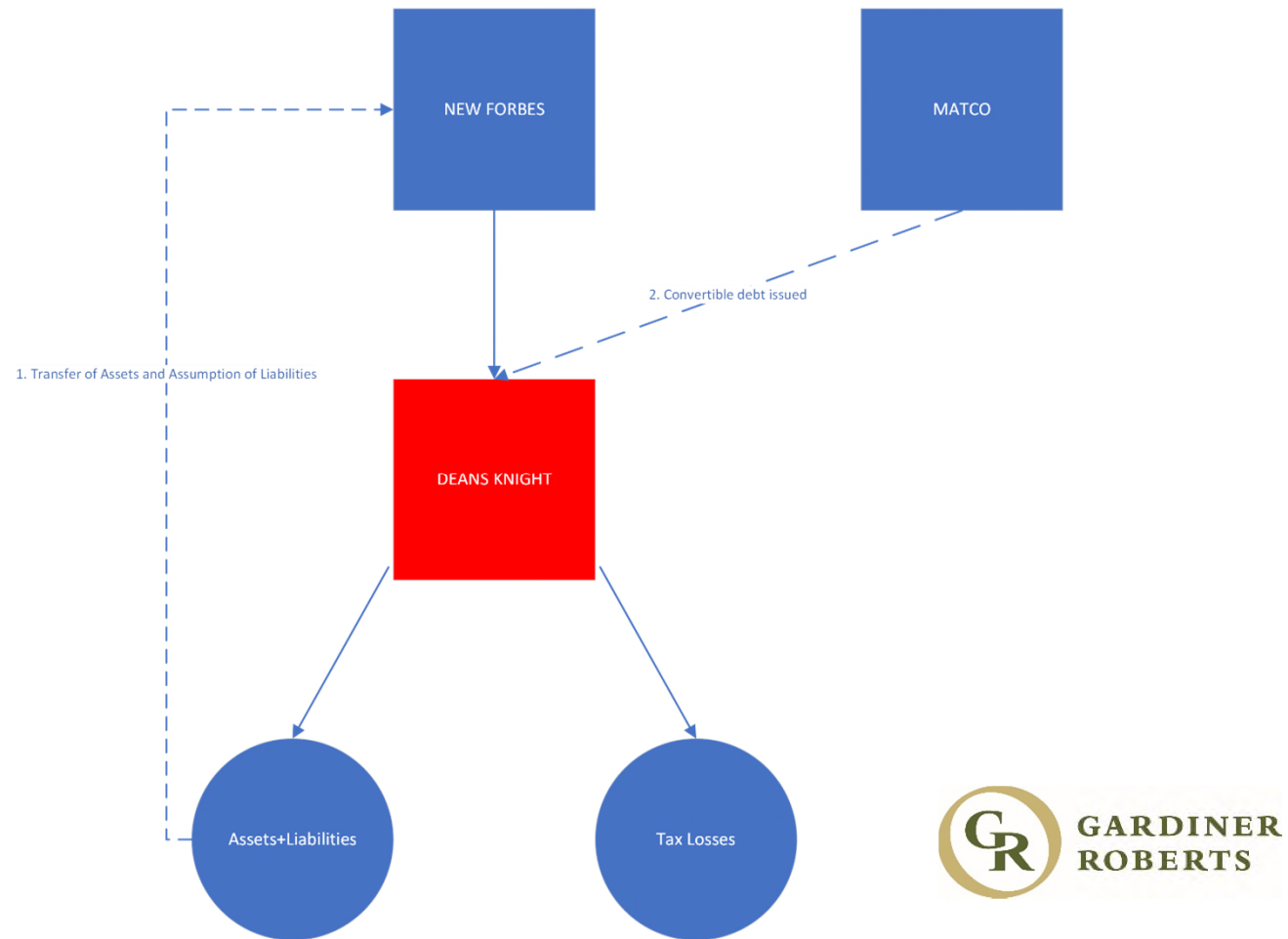
- Deans Knight had \$90m in unused business losses
- Entered into a series of “loss-trading” transactions to shelter income from a new business venture
- MNR denied the deductions
- ITA, ss. 111(5) limits a corporation that has undergone an acquisition of *de jure* control from using previously accumulated business losses in future taxation years
- SCC Majority applied the GAAR to deny the deduction, finding the transaction abused ss. 111(5) even though the corporation did not undergo a change in *de jure* control

Facts

- Deans Knight Income Corporation (formerly, Forbes Medi-Tech Inc.) had \$90m of unused non-capital losses and tax credits
- Deans Knight entered into an Investment Agreement with an arm's length venture capital company, Matco
- Matco was tasked with finding a loss-use opportunity

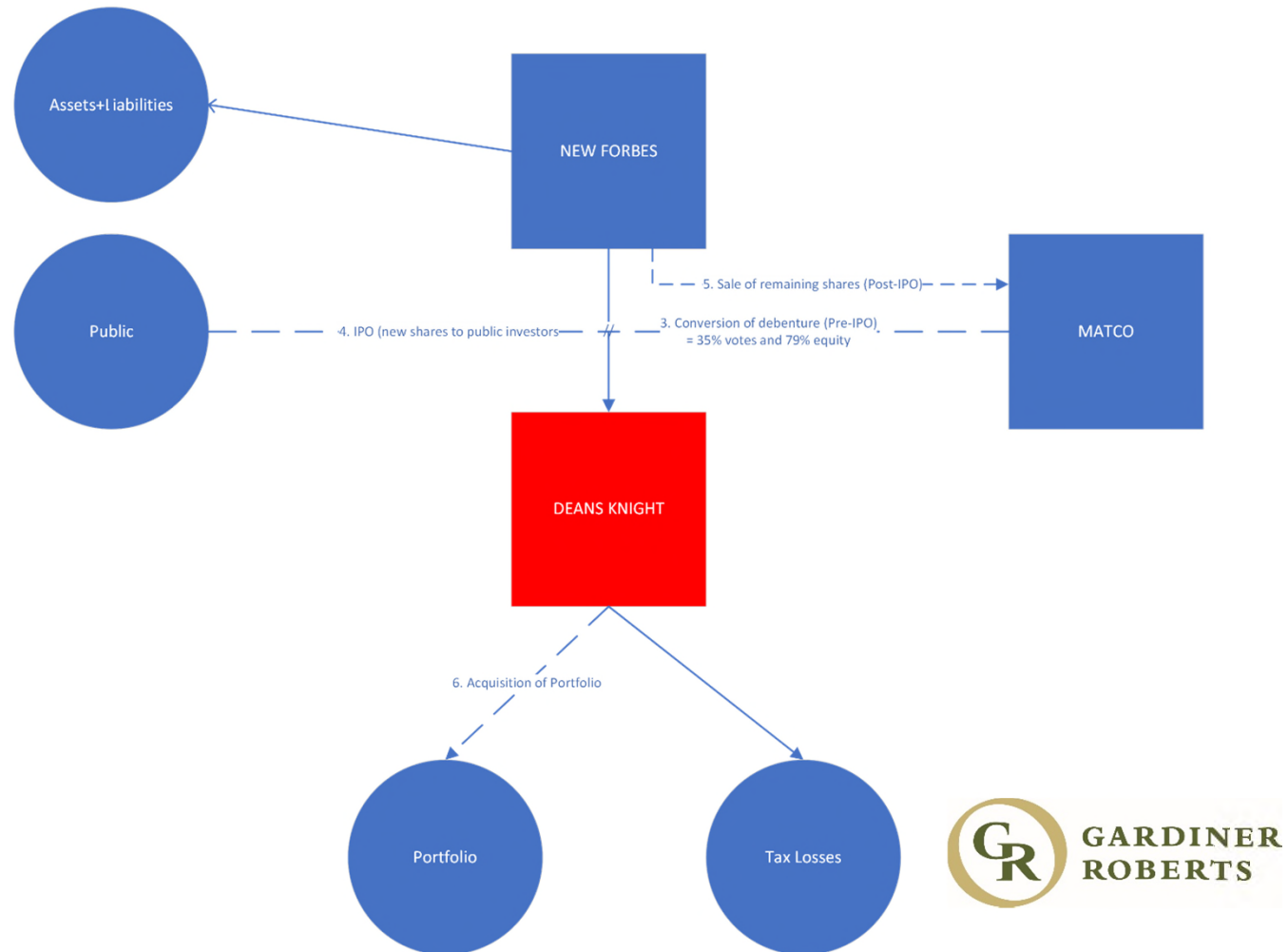
Facts

- Under the Investment Agreement:



Facts

- Under the Investment Agreement:



Facts

- Deans Knights deducted its pre-transaction business losses and tax credits against the investment income earned for its 2009 to 2012 tax years
- MNR denied the deductions as abusive anti-avoidance transactions

Relevant ITA Provisions

1. Specific Anti-Avoidance Rule against loss trading (ITA, s. 111)
2. General Anti-Avoidance Rule (ITA, s. 245)

Specific Anti-Avoidance Rule – Loss Trading

- Loss Carryover Deduction (ITA, para. 111(1)(a))
 - Permits a taxpayer's non-capital losses to be carried back 3 years or forward 20 years to offset income in those years
- Loss Trading Restriction (ITA, ss. 111(5))
 - Restricts a taxpayer's ability to carryover its non-capital losses where control of the corporation has been acquired by a person or group of persons unless, after the acquisition of control, the corporation engages in the same or a similar business
 - "control" = *de jure* control (*Buckerfield's; Duha Printers*)

De jure control versus de facto control

De jure control – legal test:

•[160] “Control” is not defined in the Act. However, courts have considered this concept on a number of occasions and have determined that “control” for the purposes of the Act means *de jure* control. In *Buckerfield’s Ltd. v. Minister of National Revenue*, [1965] 1 Ex. C.R. 299, the Exchequer Court of Canada held that *de jure* control refers to the **ownership of a sufficient number of shares to have a majority of votes in the election of the corporation’s board of directors**.

•[161] The principle established in *Buckerfield’s* was affirmed by this Court in *Duha Printers (Western) Ltd. v. Canada*, [1998] 1 S.C.R. 795. In that case, Iacobucci J. stated that in assessing *de jure* control, one must consider the corporation’s governing statute, the share register of the corporation and any specific or unique limitation on the majority shareholder’s power to control the election of the board of directors, as manifested in either the corporation’s constating documents or a unanimous shareholder agreement. Iacobucci J. also made it clear that **external documents are not relevant to determining *de jure* control** (para. 85). Thus, the voting power attributable to shareholdings, ascertained in light of the corporation’s constating documents and share register, is generally the determinative factor for *de jure* control.

De jure control versus *de facto* control

- *De facto* control is defined in ITA, s. 256
- The use of the phrase “controlled, directly or indirectly in any manner whatever” specifically refers to *de facto* control, which exists when a party has direct or indirect influence over the corporation which can result in control in fact

Specific Anti-Avoidance Rule – Loss Trading

- In *Deans Knight*, parties agreed that there was no acquisition of control (no change in *de jure* control) so loss carryover restriction in ss. 111(5) did not apply
- Only issue was whether GAAR applied to denied the deduction

General Anti-Avoidance Rule (GAAR)

- ITA, s. 245
- Legal Test:
 - 1. There was a tax benefit
 - 2. The transaction giving rise to the tax benefit was an avoidance transaction, meaning one that is not undertaken primarily for a *bona fide* non-tax purpose; and
 - 3. The avoidance transaction was abusive
- To determine whether transaction was “abusive”:
 - 1. Determine the “object, spirit and purpose” (OSP) of the relevant ITA provision by examining its text, context and purpose
 - 2. Determine if the result of the transaction frustrated the OSP

Lower Court Decisions

- Tax Court of Canada
 - OSP of ss. 111(5) – “to target the manipulation of losses of a corporation by a new person or group of persons through effective control over the corporation’s actions”
 - Since Matco did not have “effective control” over Deans Knight, transactions did not frustrate the OSP
 - Held: These were tax avoidance transactions that resulted in a tax benefit but were not abusive

Lower Court Decisions

- Federal Court of Appeal
 - OSP of ss. 111(5) – “to restrict the use of specified losses, including non-capital losses, if a person or group of persons has acquired actual control over the corporation’s actions, whether by way of de jure control or otherwise”
 - Terms of Investment Agreement gave Matco “actual control” over Deans Knight
 - Held: Transactions were abusive and the GAAR applied to deny the tax benefits

SCC Majority (7-1)

- Agreed with lower courts that these were tax avoidance transactions that resulted in a tax benefit
- Issue – whether the transactions were “abusive”
- Test: to determine whether transaction was abusive
 - 1. Determine the “object, spirit and purpose” (OSP) of the relevant ITA provision by examining the text, context and purpose of the provision
 - 2. Determine if the result of the transaction frustrated the OSP
- Must look beyond the text to determine the “underlying rationale” of the provision – look at the “why” in addition to the “how”

SCC Majority (7-1)

- Application to *Deans Knight*
- OSP of ss. 111(5) – to deny loss carryovers when there is a lack of continuity within the corporation, as measured by both the identity of its controlling shareholders and its business activity
- Here, even though there was no acquisition of control, Matco achieved the "functional equivalent" of *de jure* control
 - It fundamentally changed the taxpayer's assets, liabilities, shareholders and business via the Investment Agreement
 - Investment Agreement restricted powers of the board such that any actions taken required Matco's consent

SCC Dissent (Cote)

- Transactions were not abusive
- Parliament intended that the acquisition of *de jure* control be the triggering event for ss. 111(5) to apply
- Where specific anti-avoidance provision is precisely drafted, any gaps left by Parliament must be presumed to be intentional
- Effect of Majority's *ad hoc* approach to determining control is that Minister can use the GAAR to re-write a specific anti-avoidance provision into something broader (i.e. *de facto* control)

Key Takeaways

1. GAAR creates more uncertainty for taxpayers
2. GAAR may still apply even where Parliament has implemented a specific anti-avoidance rule to prevent a particular tax strategy and the taxpayer complies with the text of that rule
3. Even where the objective and applicable legal test is clear from the text, courts may look beyond the text to extrinsic aids, including legislative history, in determining the object, spirit, and purpose of the provisions at issue



Questions?