
Tax Issues for Commercial Practitioners - Mergers of Corporations -

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Mergers of Corporations



- *Amalgamations*
- *Wind-Ups*
- *Tax Considerations in Business Acquisitions*

Mergers of Corporations

BRITISH COLUMBIA

DUPLICATE Number:

**CERTIFICATE
OF
AMALGAMATION**

BUSINESS CORPORATIONS ACT

I Hereby Certify that , incorporation number , and LML
company under the name , incorporation number were amalgamated as one
Pacific Time. on January 10, 2013 at 02:37 PM

Issued under my hand at Victoria, British Columbia
On January 10, 2013

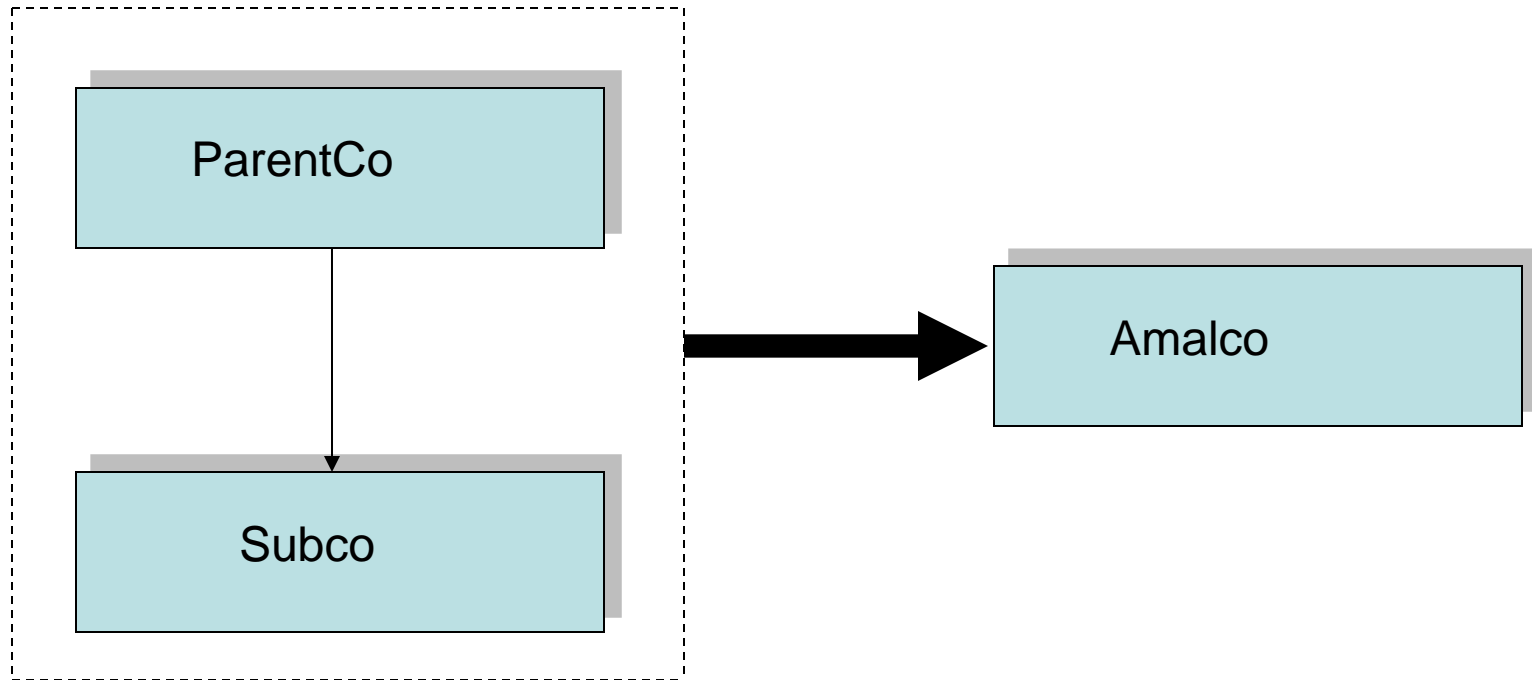
Carol Prest
CAROL PREST
Registrar of Companies
Province of British Columbia
Canada



Amalgamations (s. 87(1) ITA)

Amalgamations

Vertical Short Form Amalgamation: ParentCo and Subco are amalgamated under corporate law to form Amalco



Note: Today's discussion, will focus on vertical short form amalgamations (not horizontal amalgamations or triangular amalgamations)

Amalgamations

Qualifying Amalgamation (s. 87(1) ITA):

- ▶ Merger of two or more **taxable Canadian corporations** under corporate law to form one corporate entity
- ▶ All **assets and liabilities** of the predecessor corporations become assets and liabilities of the merged corporation
- ▶ All shareholders of the predecessor corporations must **receive shares** in the amalgamated corporation except:
 - ▶ Shareholders who are also predecessor corporations (i.e. vertical short form amalgamations)
 - ▶ Shareholders who receive cash under statutory dissent rights or in lieu of fractional shares (CRA: ITF S4-F7-C1 pgh 1.5)

Amalgamations

Tax Aspects of Qualifying Amalgamations:

- ▶ **New Corporation:** For tax purposes, Amalco is considered to be a new corporation (different than corporate law)
 - ▶ Amalco can elect to assume the tax accounts of either predecessor corporation by sending letter to the CRA
- ▶ **Tax Deferred Transfer:** Assets of predecessor corporations transfer to Amalco on a tax deferred basis
- ▶ **Tax Losses:** In a vertical amalgamation:
 - ▶ Tax losses of predecessor corporations can be carried forward and deducted against Amalco income and gains
 - ▶ Tax losses of Amalco can be carried back and deducted against income and gains of ParentCo only (s. 87(2.11) ITA)

Amalgamations

Tax Aspects of Qualifying Amalgamations :

- ▶ **Watch out for Inadvertent Capital Gain**: If the paid-up capital or “PUC” of Subco’s shares exceeds their adjusted cost base or “ACB” to ParentCo, ParentCo will realize a capital gain on the amalgamation (s. 87(11) and 88(1)(b) ITA)
 - ▶ If this is a problem, consider effecting a reduction of stated capital in Subco (without any payment of distribution) immediately prior to the amalgamation
- ▶ **Deemed Year-End**: Each amalgamating company is deemed to have a taxation year-end immediately prior to the “time of amalgamation” (s. 87(2)(a) ITA)

Amalgamations

Time of Amalgamation:

- ▶ CRA (Income Tax Folio S4-F7-C1 pgh 1.15): The time of amalgamation is the earliest moment on the day of amalgamation unless either:
 - ▶ a specific time is specified on the certificate of amalgamation or
 - ▶ the series of transactions supports a different time of amalgamation
- ▶ B.C.: All Certificates of Amalgamation are time stamped
- ▶ Canada (federal), Alberta and Ontario: Certificates of Amalgamation are not time stamped

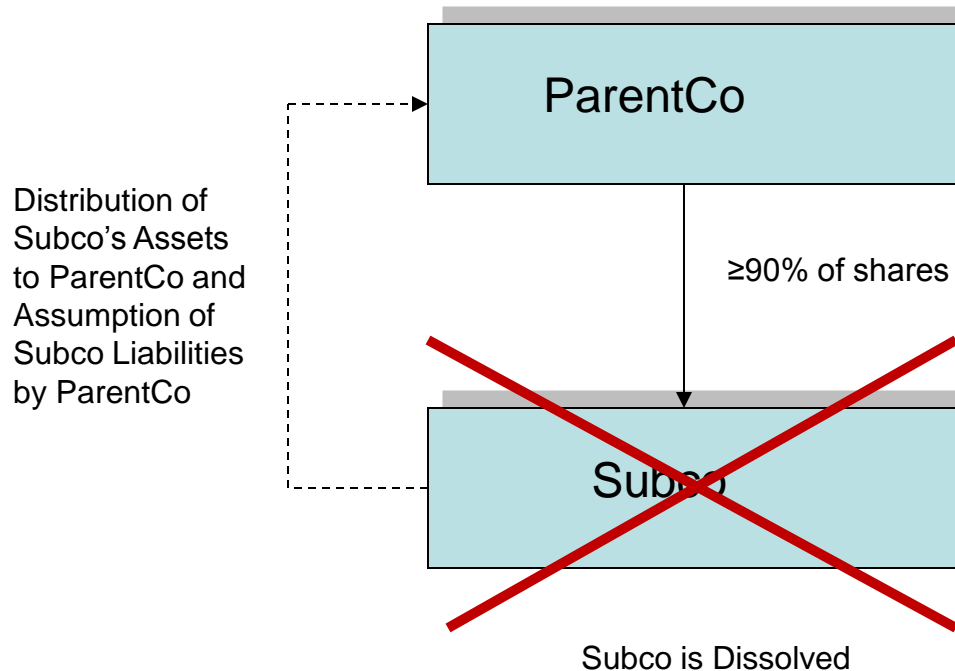
Mergers of Corporations



Wind-Ups (s. 88(1) ITA)

Wind-Ups of Subsidiaries

Wind-Up: Subco's Assets and Liabilities are transferred to ParentCo after which Subco is dissolved



Wind-Ups of Subsidiaries

Qualifying Wind-Up (s. 88(1) ITA):

- ▶ ParentCo owns at least 90% of each class of shares of Subco (s. 88(1)ITA)
- ▶ Either:
 - ▶ Subco has commenced procedures for winding-up and dissolution under applicable corporate legislation; or
 - ▶ Subco has been dissolved
- ▶ If formal dissolution of Subco has not been completed, substantial evidence exist that the corporation will be dissolved within a short period of time

Wind-Ups of Subsidiaries

“Substantial Evidence”:

- ▶ CRA accept wind-up has occurred if Subco has not been dissolved due to outstanding litigation provided that (IT-126R2 Archived):
 - ▶ All assets and liabilities of Subco (other than liabilities under litigation) have been distributed to ParentCo
 - ▶ Sole reason for dissolution delay is the outstanding litigation
 - ▶ Subco carries on no activity after distribution
 - ▶ Subco is formally dissolved within a reasonable time following resolution of the outstanding litigation
- ▶ Post-acquisition dissolution sometimes deferred for 8 months to qualify distribution of assets for related party PST exemption

Wind-Ups of Subsidiaries

Tax Aspects of Qualifying Wind-up:

- ▶ **Tax Deferred Transfer:** Assets of Subco transfer to ParentCo on a tax deferred basis
- ▶ **No Deemed Taxation Year-End Triggered**
- ▶ **Tax Clearance Certificate:** Must be obtained from CRA prior to Subco distributing its property to ParentCo, otherwise Subco directors are personally liable for Subco's taxes (s. 159(2) ITA)
 - ▶ Common practice is to not obtain clearance certificate and for ParentCo to agree (i) to assume all tax liabilities of Subco and (ii) to indemnify the directors of Subco should any tax liabilities trace to them

Wind-Ups of Subsidiaries

Tax Aspects of Qualifying Wind-up:

- ▶ **Tax Losses:** On a wind-up:
 - ▶ Tax losses of the Sub generally deductible by the Parent but only for taxation years of the Parent commencing after the wind-up (s. 88(1.1) and 88(1.2) ITA)
 - ▶ To deduct tax losses (other than net capital losses) Subco must be formally dissolved (s. 88(1.1) ITA)
 - ▶ To deduct net capital losses, “substantial evidence” test applies but formal dissolution not required

Wind-Ups of Subsidiaries

Tax Aspects of Qualifying Wind-up:

- ▶ Watch out for Inadvertent Capital Gain: If the paid-up capital or “PUC” of Subco’s shares exceeds ParentCo’s adjusted cost base or “ACB” in those shares, ParentCo will realize a capital gain on the wind-up (s. 88(1)(b) ITA)
 - ▶ If this is a problem, consider effecting a reduction of stated capital in Subco (without any payment or distribution) immediately prior to the wind-up

Tax Considerations in Business Acquisitions



- *\$800,000 QSBC Capital Gains Exemption*
- *Change of CCPC Status*
- *Acquisition of Control*
- *Post-Acquisition Merger of Companies*
- *88(1)(d) “Bump”*
- *Managing Multiple Year-Ends*
- *Purchase and Sale Agreements*
 - *Tax Warranties, Covenants and Indemnities*
 - *Earn-Outs*
 - *Non-Compete Covenants*
 - *Non-Resident Vendor Issues (s. 116 Certificates, Withholding Tax on Interest)*
 - *Purchase Price Allocation*
 - *Section 22 Election*
 - *GST/ PST Issues*

Business Acquisitions



\$800,000
QSBC Lifetime
Capital Gains
Exemption

\$800,000 QSBC Exemption

To Qualify must be a “Qualified Small Business Corporation” or QSBC:

- ▶ Sale of Shares of a “Canadian-controlled private corporation”
- ▶ At time of sale, 90% of Assets used in Active Business in Canada (can purify)
- ▶ Throughout past 24 months, CCPC with 50% of Assets used in Active Business in Canada
- ▶ Shares held for 24 months by individual vendor or related persons (exceptions if issued for the transfer of shares or a business) – newly issued shares deemed held by non-related person (s.110.6(14)(f))

Business Acquisitions



***Change in
“CCPC”
Status***

Change in CCPC Status

What is a CCPC?

- ▶ “Canadian controlled private corporation”
- ▶ A private corporation that is not controlled, directly or indirectly by a combination of one or more:
 - ▶ Non Resident Person(s)
 - ▶ Public Companies
- ▶ Note: Does not have to be “controlled” by a Canadian resident person

Change in CCPC Status

Some Benefits of being a CCPC:

- ▶ Small Business Deduction (in B.C., 13.5% rate on first \$500k vs 26%)
- ▶ Potential Qualification for QSBC Exemption on sale of shares
- ▶ Potential ABIL Treatment (Allowable Business Investment Loss) on sale of shares
- ▶ Favourable treatment for Stock Options
- ▶ Capital Dividend Treatment
- ▶ Enhanced Tax Credits for Scientific Research and Experimental Development (SRED)

Change in CCPC Status

- Deemed Taxation Year-End immediately before either becoming or ceasing to be a CCPC (s. 249(3.1) ITA)
- A purchase and sale transaction may trigger change of CCPC status if control of the company moves from Canadian residents to non-residents and/or public companies....or vice versa.
- Change in CCPC status triggered immediately upon signing of the Purchase and Sale Agreement (i.e. at the time an enforceable right to acquire control exists)
- **Simultaneous sign and close transaction** – only one year-end triggered upon the acquisition of control, not upon change of CCPC status (see carve-out language s. 249(3.1) ITA)

Business Acquisitions



***Acquisition
of
Control***

Acquisition of Control

Loss Carry-forward and Carry-back Rules:

- ▶ Non-Capital Losses (i.e. Business Losses) can be carried back 3 years or forward 20 years
- ▶ Capital Losses can be carried back 3 years or forward indefinitely
- ▶ Where an “acquisition of control” occurs with respect to a corporation with loss carry-forwards, various restrictions are imposed on the corporation’s ability to utilize the losses

Acquisition of Control

Implications of an “Acquisition of Control”:

- ▶ A deemed year-end is triggered at the beginning of the date of closing (s. 256(9) ITA) (unless election is filed) which results in the aging of losses by one year
- ▶ Accrued unrealized losses on property held by the corporation are deemed to be realized and thus become subject to loss restrictions
- ▶ All capital loss carry-forwards expire
- ▶ Non-capital losses can only be applied going forward:
 - *if carry on loss generating business with a **reasonable expectation of profit**; and*
 - *against income derived from a “same or similar” business*

Business Acquisitions



***Post-Acquisition
Merger of
Companies***

Post-Acquisition Merger

When to consider Post-Acquisition Merger (some examples):

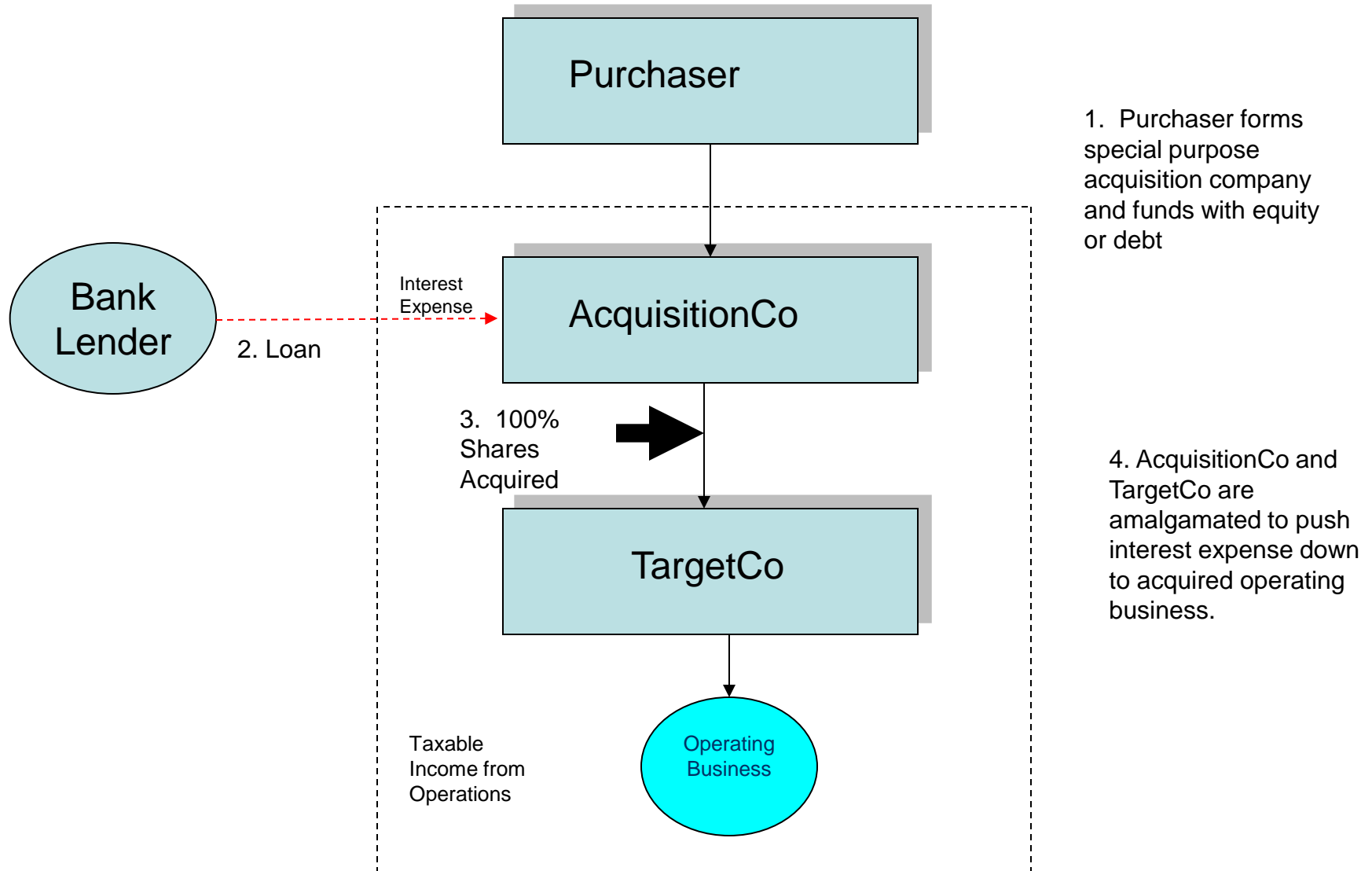
- ▶ Purchaser is acquiring shares of TargetCo; and
- ▶ Either:
 - ▶ Debt Financed Acquisition and want interest expense charged against operating income;
 - ▶ Non-Resident Purchaser that would like to convert TargetCo to a ULC structure OR would like full paid-up capital or PUC in shares in new Canadian subsidiary;
 - ▶ Purchaser would like to “wrap” TargetCo’s business into its existing business; or
 - ▶ Purchaser would like to utilize the s 88(1)(d) “bump”
 - ▶ Purchaser would like to access tax losses in TargetCo

Post-Acquisition Merger

When to Consider Amalgamation:

- ▶ In most cases, amalgamation is the preferred option
- ▶ Assets and liabilities transfer to Amalco by operation of law without having to assign and/or transfer each asset
- ▶ In most jurisdictions, a PST exemption applies to assets transferring on amalgamation

Post-Acquisition Amalgamation



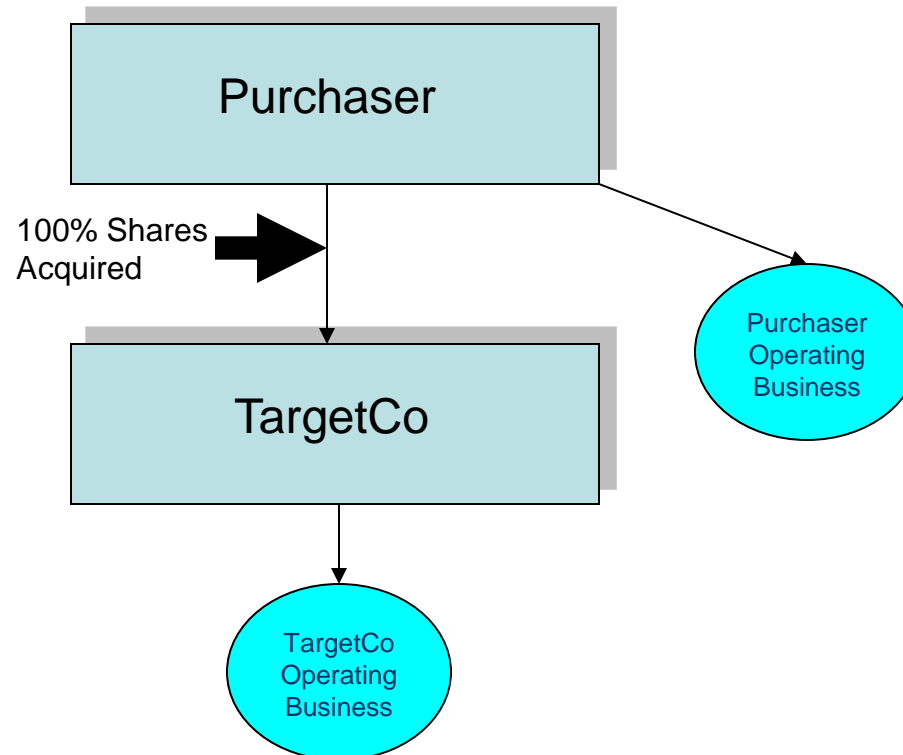
Post-Acquisition Merger

When to Consider Wind-Up:

- ▶ Purchaser wants to wrap TargetCo's business into Purchaser's business (but amalgamation will trigger consent requirements under Purchaser's lending or other contracts); and
- ▶ Either PST on transfer is immaterial or can qualify for PST exemption

Post-Closing Amalgamation

Purchaser wants to wrap TargetCo business into its own business



Consider either amalgamating Purchaser and TargetCo OR winding up TargetCo into Purchaser if amalgamation is too difficult.

Business Acquisitions



*The s.88(1)(d)
“Bump”*

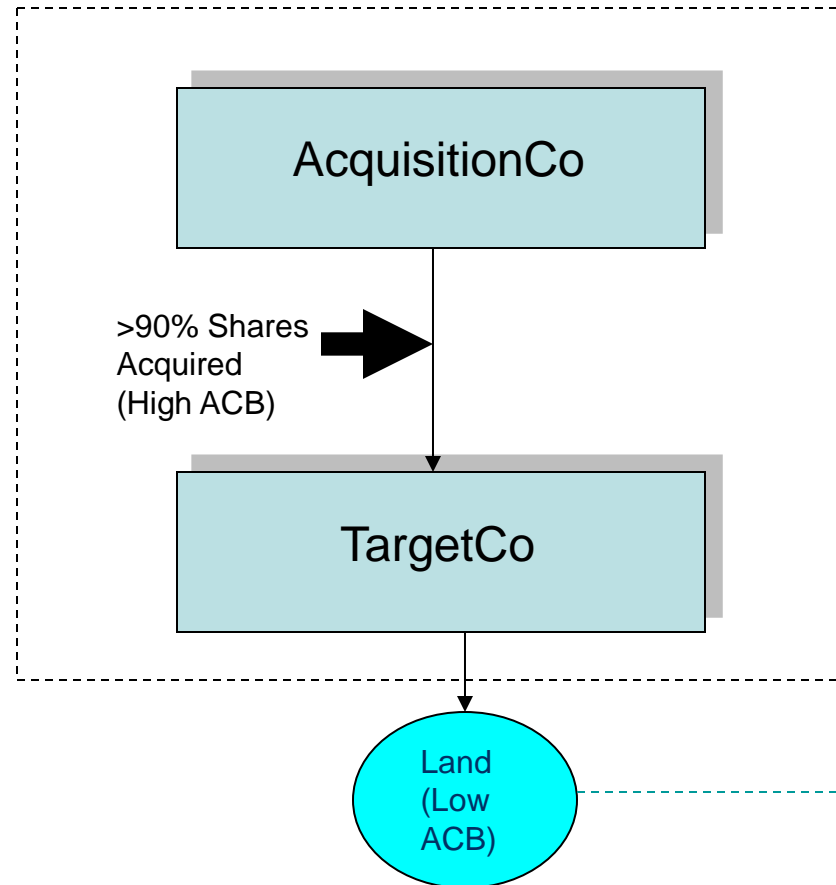
Section 88(1)(d) “Bump “

Wind-up / Amalgamation:

- ▶ Achievable under either a qualifying amalgamation (s. 87(11)(b) ITA) or a qualifying wind-up (s. 88(1)(d) ITA) provided that certain criteria are met
- ▶ If qualify, can elect to push-down ACB of shares in TargetCo to TargetCo’s non-depreciable capital properties (up to a maximum amount equal to the fair market value of such properties)

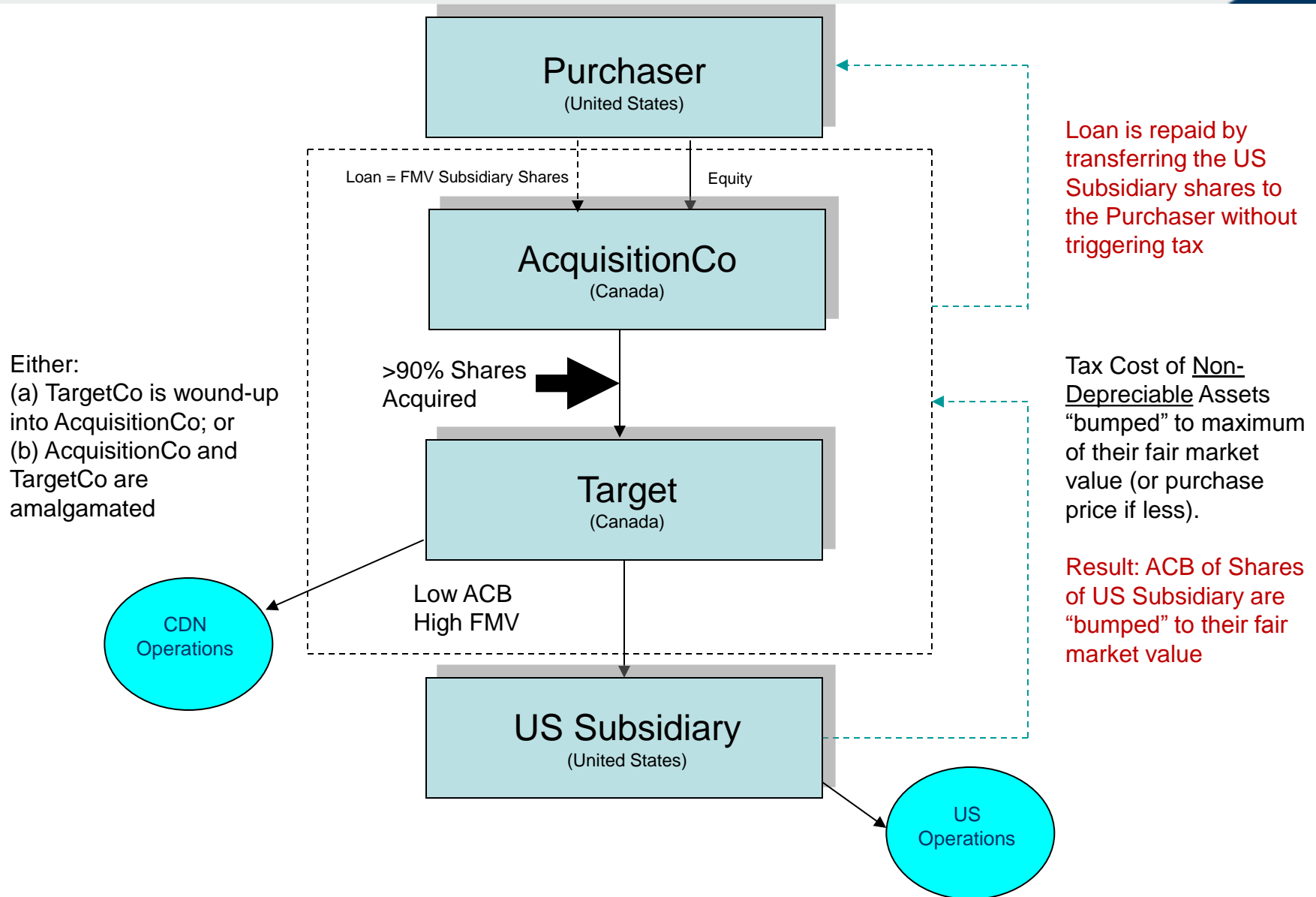
“Bump” Example #1

Either:
(a) TargetCo is wound-up into AcquisitionCo; or
(b) AcquisitionCo and TargetCo are amalgamated



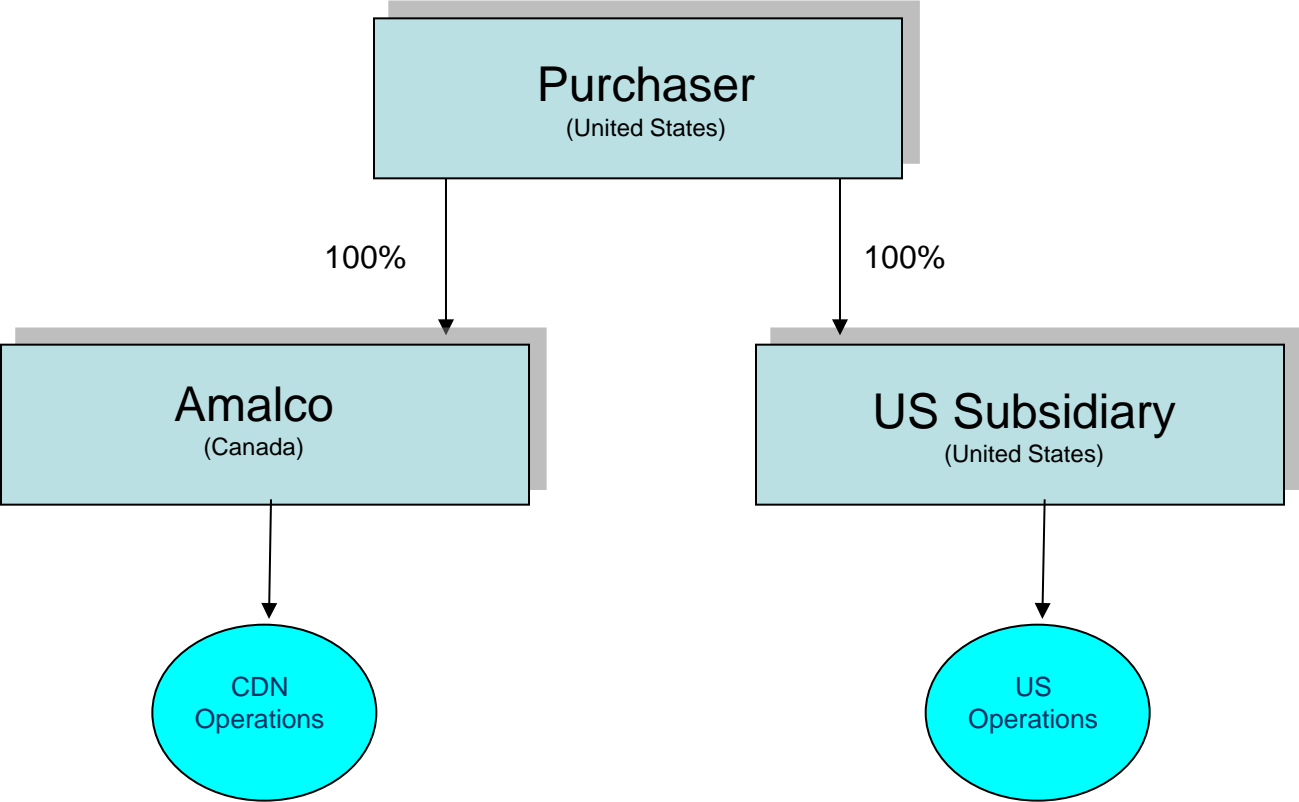
Tax Cost of Non-Depreciable Land Assets “bumped” to maximum of their fair market value (or ACB of shares in TargetCo if less). Following bump, Amalco can sell land at FMV triggering lower or no taxes (e.g. in a sale-leaseback transaction etc.)

“Bump” Example #2



“Bump” Example #2

End Result



Business Acquisitions



***Managing
Multiple
Year-Ends***

Managing Multiple Year-Ends

3 Potential Deemed Year-Ends on the Sale of a Corporation:

- ▶ **Change of CCPC Status** – year-end immediately prior to signing of purchase and sale agreement (s. 249(3.1) ITA)
- ▶ **Acquisition of Control** – year-end at the very last moment of the day prior to the Acquisition of Control unless elect to have the change of control occur at the actual time of closing (s. 256(9) ITA)
- ▶ **Amalgamation** - year-end immediately prior to the “time of amalgamation” (s. 87(2)(a) ITA)

Managing Multiple Year-Ends

Simultaneous Sign and Close:

- ▶ Avoids triggering year-end on change of CCPC status
- ▶ Year-end on Acquisition of Control deemed to occur at the very last moment of the day prior to closing
- ▶ If amalgamation certificate is not time stamped, CRA view is that amalgamation will not trigger an additional year-end (Income Tax Folio S4-F7-C1, pgh 1.19)
- ▶ CRA administrative position doesn't apply in B.C. given that amalgamation certificates are time stamped (results in an additional year-end)

Managing Multiple Year-Ends

Escrowed Sign and Close (in B.C.):

- ▶ Escrow terms provide for closing immediately prior to the post-closing amalgamation
- ▶ Avoids triggering year-end on change of CCPC status
- ▶ Elect under s. 256(9) ITA to have the acquisition of control year-end occur at the actual time of closing
- ▶ Second taxation year triggered on the amalgamation should be of only an instantaneous period of time such (i.e. a nil return)

Business Acquisitions



**Purchase and Sale
Agreements
- Tax Considerations -**

Purchase and Sale Agreements - Tax Considerations -

- ▶ Tax Warranties
- ▶ Tax Covenants
- ▶ Tax Indemnities
- ▶ Earn-Outs
- ▶ Non-Compete Covenants
- ▶ Non-Resident Vendor Issues (s. 116 Certificates, Withholding Tax on Interest)
- ▶ Purchase Price Allocation
- ▶ Section 22 Election
- ▶ GST/ PST Issues

Purchase and Sale Agreements - Tax Warranties -

Definitions

▶ “Tax”

- Define broadly to cover all taxes at various levels of government (domestic or foreign), including interest & penalties paid on such taxes

Note: See Presentation Supplement for sample definitions and tax clauses for Purchase and Sale Agreements

Purchase and Sale Agreements - Tax Warranties -

Fundamental Tax Warranties

- ▶ All Returns have been filed and all Taxes have been paid
- ▶ All Assessments, Reassessments and tax appeals have been disclosed to purchaser
- ▶ All Withholding Taxes have been withheld and remitted (Income Tax, CPP contributions, EI premiums, non-resident withholding taxes)

Purchase and Sale Agreements

- Tax Warranties -

Informational Tax Warranties

- ▶ Details of all Prior Elections filed (ITA or ETA)
- ▶ No prior acquisitions from non-arm's length party by target corporation
 - *ITA s. 160 – joint and several liability for tax owing to the extent that target corporation paid less than fair market value for property*
 - *Similar liability for GST under excise tax act*
- ▶ Tax Accounts and attributes (should be scheduled)
 - *Loss carry forwards, non-capital losses, net-capital losses*
 - *Paid Up Capital of Shares*
 - *UCC/ CEC/ACB of Assets*
 - *Capital Dividend Account and RDTOH Balances*

Purchase and Sale Agreements - Tax Warranties -

Survival of Tax Reps and Warranties and Indemnities

- ▶ Standard for tax warranties and indemnities is statute of limitations provided in ITA s. 152:
 - For individuals and CCPC's – 3 years from original tax assessment provided to taxpayer by CRA.
 - For non-CCPC's – 4 years from original tax assessment provided to taxpayer by CRA.
 - Indefinite where fraud, misrepresentation or negligence (for this reason, should not limit survival to above reassessment periods)

Purchase and Sale Agreements - Tax Covenants -

Tax Covenants

- ▶ Allocates responsibility for preparing and filing tax returns for year of acquisition (typically Purchaser who possess all records following closing – but reviewed and approved by Vendor)
- ▶ Payments of taxes owing within prescribed time
- ▶ File Elections (sections 85 ITA, 56.4 ITA, 167 ETA etc.)

Purchase and Sale Agreements - Tax Indemnities -

Background

- ▶ Obtaining a stand alone tax indemnity for any and all taxes up to closing has been standard practice in U.K. and U.S. transactions for many years
- ▶ Over the past 15 years or so has become standard practice in Canadian transactions as well

Purchase and Sale Agreements - Stand Alone Tax Indemnity -

Why Special Treatment for Taxes?

- ▶ Voluntarily reported liability
- ▶ Significant time lag between filing and final determination
- ▶ Not easily verifiable unless CRA audit has occurred
- ▶ Subject to potential abuse

Purchase and Sale Agreements - Stand Alone Tax Indemnity -

Tax Indemnity – Purchaser’s Perspective:

- ▶ Should seek stand alone tax indemnity when acting for purchasers in both share purchases and asset purchases
- ▶ Vendor indemnifies Purchaser for any and all Tax liabilities arising up to and including closing
- ▶ Normal tax statute of limitations survival period applies to Tax Indemnity

Purchase and Sale Agreements - Stand Alone Tax Indemnity -

Tax Indemnity – Vendor’s Perspective:

- ▶ Typical for Vendors to seek indemnity carve-outs in Purchase Agreements for tax liabilities:
 - ▶ already taken into account in purchase price determination
 - ▶ attributable to changes in taxation laws following closing
 - ▶ attributable to voluntary acts of Purchaser following closing (except such acts as are required by law)
 - ▶ Attributable to Purchaser failing to file returns or changing filing practice
- ▶ When acting for the Vendor, should also seek a covenant requiring the Purchaser to pay over any tax refunds for pre-closing period

Purchase and Sale Agreements

- Earn-Outs -

Earn Outs

- ▶ Portion of purchase price determined based on post-closing performance of acquired business
- ▶ e.g. Purchase Price = \$X plus % of EBITDA in years 1, 2 and 3

Purchase and Sale Agreements

- Earn-Outs -

Earn Outs – (CRA Position)

- ▶ Earn-Out Payments are fully taxable as income (not capital gains) under s.12(1)(g) ITA.*
 - **Note: Could argue that s. 12(1)(g) is N/A for share sales. If this is the case, CRA take the position that earn-out must be valued and reported as proceeds in year of closing (tough to do)*
- ▶ **Exception #1:** If satisfy CRA's Cost Recovery Method criteria, can treat earn-out payments as capital gains and not income
- ▶ **Exception #2:** Structure as a Reverse Earn-Out??? (Recent CRA technical interpretation may make reverse earn-outs less appealing)

Purchase and Sale Agreements

- Earn-Outs -

Cost Recovery Method Criteria (IT-426R):

- ▶ Vendor is Canadian resident
- ▶ Vendor and Purchaser deal at arm's length
- ▶ Gain or loss on sale of property for cash would clearly be capital in nature
- ▶ Earn-Out amount reasonably relates to underlying goodwill that cannot be valued at closing
- ▶ Earn-Out does not extend beyond 5 years
- ▶ Vendor must submit letter requesting “cost recovery method” with tax return for year of closing

Purchase and Sale Agreements - Reverse Earn-Out Alternative-

Reverse Earn Out:

- ▶ Historically considered where IT-426R criteria cannot be met
- ▶ Vendor and Purchaser agree on maximum purchase price
- ▶ Reverse Earn-Out portion paid by promissory note
- ▶ Purchase Price reduced if performance targets not met
- ▶ Refund of purchase price effected by set-off against promissory note
- ▶ ACHILES HEAL: CRA Admin position is no capital gains reserve for unpaid amounts under reverse earn-outs (CRA technical interpretation 2013-0505391E5 F)

Purchase and Sale Agreements - Restrictive Covenants -

Non-Compete / Non-Solicitation Covenants:

- ▶ Irrespective of any tax issues involved, purchasers of a business will virtually always insist on non-compete and non-solicitation covenants from Vendors
- ▶ *Fortino* (1999) and *Manrell* (2003) held amounts received for personal non-compete covenants were tax free
- ▶ In response to those cases, Minister of Finance introduced draft section 56.4 in October 2003 (finally enacted in June 2013)

Purchase and Sale Agreements - Restrictive Covenants -

Tax Implications of s. 56.4:

- ▶ **General Rule:** Amounts received as consideration for non-compete covenants are fully taxable as income in the recipient's hands (s. 56.4(2) ITA)
- ▶ **Potential Issue:** s. 68(c) ITA permits CRA to re-allocate part of sale consideration to restrictive covenants (such that s. 56.4(2) ITA could apply)
 - ▶ Can avoid s. 68(c) ITA if certain criteria met (including that **no proceeds** received or receivable by the vendor for the non-compete covenant) (s. 56.4(7) ITA)
 - ▶ Concern as to enforceability of non-compete if the purchase agreement states that **no consideration** has been given for the non-compete covenant

Purchase and Sale Agreements - Restrictive Covenants -

Tax Implications of s. 56.4:

- ▶ **CRA Administrative Position:** Now accept that “\$1.00 and other good and valuable consideration” will satisfy the no proceeds requirement provided that no more than a \$1 worth of consideration" is conveyed by the purchaser for the restrictive covenant (CRA technical interpretation 2014-0547251C6).

Purchase and Sale Agreements - Restrictive Covenants -

Tax Implications of s. 56.4:

- ▶ **Election to Treat as Proceeds:** Where the non-compete covenant is given by a Vendor in conjunction with the sale of shares to an arm's length Purchaser, the Vendor and the Purchaser can generally elect to have the non-compete proceeds included in the sale proceeds for the shares (s. 56.4(3)(c) ITA).
- ▶ **Form of Election:** No prescribed form – election made by way of a joint letter to the CRA (see <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/lf-vnts/sllng/rstrctv/lctn-eng.html> for what has to be included in the letter)

Purchase and Sale Agreements - Restrictive Covenants -

Typical Practice in SPAs:

- ▶ Allocate nil or nominal consideration in the SPA to non-compete / non-solicit covenants
- ▶ Include a provision in the SPA requiring the parties to file a s. 56.4(3)(c)(vii) joint election if the CRA later determine that the consideration received for the non-compete / non-solicit covenant is a greater than the amount allocated under the SPA

Purchase and Sale Agreements - Non-Resident Issues -

Section 116 Clearance Certificate:

- ▶ must be considered if:
 - *Vendor is a non-resident of Canada*
 - *Property sold is “taxable Canadian property”*
 - real property in Canada
 - property used in a business carried on in Canada
 - certain insurance property
 - private corporation shares if 50% of the FMV is or has within the last 5 years been derived from real property, resource or timber property, etc. or options related to those types of property
 - Public corporation shares if the taxpayer and non-arm's length persons hold 25% thereof

Purchase and Sale Agreements - Non-Resident Issues -

Section 116 Clearance Certificates:

- ▶ If Vendor is Canadian resident, cover off with Canadian residency warranty in Agreement
- ▶ If Vendor is a non-resident:
 - ▶ First determine if property being sold is “taxable Canadian property”
 - ▶ If “taxable Canadian property”, Purchaser must either:
 - *Receive a s. 116 Clearance Certificate from Vendor at closing;*
 - *Withhold 25% of gross proceeds and remit to CRA within 30 days of month-end (50% in the case of certain Canadian resource properties); or*
 - *Satisfy itself that treaty exemption from s. 116 applies*

Purchase and Sale Agreements - Non-Resident Issues -

Section 116 Exemption Qualification:

- ▶ To rely on the treaty exemption, the Purchaser must:
 - *Conclude, after “reasonable inquiry”, that the Vendor is resident in a tax treaty country,*
 - *Conclude that the Vendor would qualify for exemption from s.116 withholding under the tax treaty, and*
 - *Provide appropriate notice to CRA within 30 days of the purchase.*
- ▶ If Purchaser fails to do any one of the above, then liable for the amounts that should have been withheld.

Purchase and Sale Agreements

- Non-Resident Issues -

Problems with Section 116 Certificate Process :

- ▶ CRA is slow in processing certificate requests— rare that certificate received prior to closing
 - *Practice is to escrow 25%/50% withholding amount until Vendor delivers either:*
 - S. 116 Clearance Certificate; or
 - Comfort letter from CRA instructing Purchaser/Escrow Agent to continue to hold funds pending CRA instructions
 - *If Vendor fails to deliver by remittance due date, escrowed funds are remitted to CRA on the due date*

Purchase and Sale Agreements - Non-Resident Issues -

Withholding Taxes on Interest:

- ▶ Interest paid by Purchaser to arm's length non-resident Vendor on Vendor take-back debt consideration is exempt from Canadian withholding tax, regardless of country of residence of recipient
- ▶ Similar exemption applies to interest paid to arm's length lenders that finance the acquisition
- ▶ Interest paid to non-arm's length persons generally subject to Canadian withholding tax unless exemption applies under applicable tax treaty (e.g. US – Canada Tax Treaty)

Purchase and Sale Agreements

- Purchase Price Allocation -

Purchase Price Allocation (Asset Sale):

- ▶ Important if different types of assets being sold
- ▶ ITA does not require that a purchase price allocation be agreed to by the parties
- ▶ If fail to allocate, CRA can allocate on a reasonable basis pursuant to section 68 ITA
 - *Very difficult for CRA to challenge allocation agreed to by arm's length parties in a negotiated deal*
 - *Attaching purchase price allocation schedule to Agreement will provide certainty*

Purchase and Sale Agreements

- Section 22 Election -

Section 22 Election (Asset Sale):

- ▶ Election for accounts receivable transferred under an Asset Sale
 - *Only available if all or substantially all of the property used in the business (90% or more) is sold*
- ▶ Failure to elect
 - *Vendor has to include in income prior doubtful debts*
 - *Purchaser denied a deduction for accounts receivable that are not collectable in the future*

Purchase and Sale Agreements - GST Considerations -

GST – Share Sale

- ▶ GST Not applicable on share transfers as shares constitute an exempt financial instrument
- ▶ If using AcquisitionCo/Amalgamation structure, register AcquisitionCo for GST in advance of closing to support recovery of GST paid on professional fees etc. (s. 240(3)(d) Excise Tax Act)

Purchase and Sale Agreements - GST Considerations -

GST – Asset Sale

- ▶ Section 167 Election exempts transfers of assets comprising a business or part of a business that is capable of being carried on as a business
- ▶ Transfers of employees supports the transfer of a business requirement
- ▶ Joint election must be made by vendor and purchaser (Form GST 44)
- ▶ Election Form typically tabled at closing

Purchase and Sale Agreements - PST Considerations-

British Columbia PST (Asset Sale):

- ▶ Only applies in Asset sales
- ▶ 7% B.C. Provincial Sales Tax (or “PST”):
 - *Applies to sales of “tangible personal property” and software in BC and supplies of some services (e.g. legal services)*
 - *Does not apply to intangible assets (e.g. shares, bonds, other securities, goodwill) or to real property*
- ▶ In asset sales, completed PST return (FIN 426) typically tabled at closing along with cheque from purchaser for PST payable

Purchase and Sale Agreements

- PST Considerations -

PST - Bulk Sales Requirement:

- ▶ Subsection 187(1) of PSTA
 - *Vendor who disposes of inventory, software, tangible personal property or an interest in a business through a “sale in bulk” must obtain tax clearance certificate*
- ▶ Purchaser receives a duplicate copy of Clearance Certificate obtained by Vendor
- ▶ Purchaser liable for unremitted PST if fails to obtain Certificate from the Vendor

Purchase and Sale Agreements - PST Considerations-

PST – Some Exemptions:

- ▶ Inventory (raw materials, work-in-progress and finished goods)
- ▶ Production Machinery and Equipment
- ▶ Specific forms required to avail of these exemptions (consult with tax advisor)

Tax Issues for Commercial Practitioners - Mergers of Corporations -

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Thank You!

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