THE "GOING PRIVATE" TRANSACTION — SOME INCOME TAX AND CORPORATE ASPECTS OF A PUBLIC COMPANY BECOMING PRIVATE

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I. INTRODUCTION

Over the past three years, many shareholders have been compelled to sell their shares in Canadian public or reporting companies at less than adjusted book or going-concern value when these companies have "gone private".[1] Consequently, going private has been described as "unfair, disgraceful and a perversion of the whole financing process".[2]

The phrase, "going private" is a recent addition to the vocabulary of the corporate practitioner. It refers to a transaction in which the controlling shareholders,[3] who are instrumental in the management of a "public" company (the issuer), seek to terminate public participation and return the firm to the status of a closely held entity in the belief that the firm is no longer suitable for public ownership.[4]

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[1] Alain, *Le droit des valeurs mobilières et le retour des compagnies publiques au statut de compagnie privée*, 20 CAHIERS DE DROIT 539 (1979); Hansen & Iacobucci, *Acquisition of Minority Shares Under the CBCA*, 4 CAN. BUS. L.J. (1980) [forthcoming]; Taves, *Corporate Buy-Backs*, in PRAIRIE PROVINCES TAX CONFERENCE 93 (1979); Glover & Schwartz, *Going Private in Canada*, 3 CAN. BUS. L.J. 3 (1979); Glover & Schwartz, *"Going Private" Fever Cools Off*, Financial Post, Nov. 11, 1978, p. 40, col. 1; Pitch, *Going Private: The Silent Minority is No Longer Silent*, 3 CAN. LAWYER, 1, Feb. 1979, at 12; Campbell & Steele, *What Price Minority Shares?*, 111 CA MAGAZINE, Oct. 1978 at 28; Potter, *Acquisition of Minority Held Shares Through Arrangements*, L.E.S.A. BANFF CONFERENCE PAPERS (1977); Hansen, *Minority Squeeze-outs*, in REPORT OF THE THIRTIETH TAX CONFERENCE 408 (1980) [hereinafter cited as [year] CONFERENCE REPORT]; Dey, *Protecting Minority Shareholders in Public Corporations*, CAN. B. ASS'N. UPDATE '79, at 1 (1979); Palmer, *Amalgamations and Winding Up*, 1978 CONFERENCE REPORT; Magnet, *Shareholders' Appraisal Rights in Canada*, 11 OTTAWA L. REV. 98 (1979); Coleman, *Securities Legislation — Where We Have Been and Where We Are Going*, in NEW SECURITIES LEGISLATION 237 (1979); Scace, *Going Private and Deconglomeration*, 1977 CONFERENCE REPORT 569; Ward, *Arm's Length Acquisitions Relating to Shares in a Public Corporation*, in CORPORATE MANAGEMENT TAX CONFERENCE 1978, at 108 (C. Frost ed. 1978); Baillie, *Developments in Securities Regulations Affecting Corporate Acquisitions*, in CORPORATE MANAGEMENT TAX CONFERENCE 1978, at 177.

[2] A. Sommer, Going Private: A Lesson in Corporate Responsibility, Law Advisory Council Lecture, Notre Dame Law School, Nov. 14, 1974; Sommer, Further Thoughts on "Going Private", Second Annual Securities Seminar, Detroit Institute for Continuing Legal Education, Mar. 14, 1975; Baillie, *supra* note 1; Securities and Exchange Commission [hereinafter cited as SEC], Matter of Beneficial Ownership, Takeovers and Acquisitions by Foreign and Domestic Persons, 39 Fed. Reg. 33,385 (1974) *as amended by* 39 Fed. Reg. 41,223 (1974). *See also* Salter, *"Going Private". Issuer Bids — Insider Bids — Squeeze-Outs* (memorandum to O.S.C., May 17, 1978).

[3] Shareholders who control the company may hold either greater than 50% of the voting equity or have *de facto* control through control of the proxy machinery of the company ("the controllers").

[4] The Draft Ontario Business Corporations Act, s. 188 [hereinafter cited as Draft OBCA], s. 163 of the regulations under The Securities Act, 1978, S.O. 1978, c. 47 *as amended* [hereinafter cited as OSA], and SEC, "Going Private" Rule 13e-3 (42 Fed. Reg. 60,090 (1977) (now adopted by Release 33-6100, August 6, 1979)), contain definitions of a "going private transaction" which outline some of its objectionable features. S. 163 of the OSA Regulations states that a

More importantly, the term "going private" has come to serve as proper justification in the eyes of corporate management and some

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> "going private transaction" means an amalgamation, arrangement, consolidation or other transaction proposed to be carried out by an insider of an issuer as a consequence of which the interest of the holder of a participating security of the issuer in that security may be terminated without the consent of that holder and without the substitution therefor of an interest of equivalent value in a participating security of the issuer or of a successor to the business of that issuer or of another issuer that controls the issuer but does not include the purchase of participating securities pursuant to a statutory right of acquisition;

S. 188(1) (*b*) of the Draft OBCA states that a

> "going private transaction" means an amalgamation, arrangement, consolidation or other transaction carried out under this Act by a corporation that would cause any participating security of the corporation to be an affected security, but does not include a redemption, or other compulsory termination of the interest of the holder in a security, if the security is redeemed or otherwise acquired,
> (i) in accordance with the terms and conditions attaching thereto, or
> (ii) under a requirement of the articles relating to the class of securities or of this Act;

S. 188(1) (*c*) of the Draft OBCA states that a

> "participating security" means a security issued by a corporation other than a security that is, in all circumstances, limited in the extent of its participation in earnings and includes,
> (i) a security currently convertible into such a security, and
> (ii) currently exercisable options and rights issued by the corporation and entitling the holder to acquire such a security or such a convertible security.

An "affected security" is defined in s. 188(1) (*a*) as

> a participating security of a corporation in which the interest of the holder would be terminated by reason of a proposed transaction without the consent of the holder other than an acquisition under section 186, and without the substitution therefor of an interest of equivalent value in a security that is,
> (i) a participating security and has no restriction on its participation rights, and
> (ii) issued by the corporation, an affiliate of the corporation or a successor corporation;

SEC, s. 13e-3(*a*) (4) terms the going private transaction as a "Rule 13e-3 transaction which has a reasonable likelihood or a purpose of producing, either directly or indirectly, such effects as the delisting of shares from a National Exchange or termination of the registration of the issuer . . . ". For a list of the effects, *see* s. 13e-3(*a*) (4) (ii). The specified transactions are: (a) a purchase of any equity security by the issuer of such security or by an affiliate of such issuer; (b) a tender offer or request or invitation for tenders of any equity security made by the issuer of such class of securities or by an affiliate of such issuer; or (c) a solicitation or distribution subject to Regulation 14A [ss. 240.14a-1 to 240.14a-103] or Regulation 14C [ss. 240.14c-1 to 14c-101] in connection with certain corporate events. The corporate events include: a merger, consolidation, reclassification, recapitalization, reorganization or similar corporate transaction by an issuer or between an issuer (or its subsidiaries) and its affiliates; a sale by the issuer of substantially all of its assets to its affiliate; or a reverse stock split of any class of equity securities of the issuer involving the purchase of fractional interests.

courts[5] for the squeeze-out of minority shareholders. If a company is thought to be no longer suitable for public ownership, it has been viewed as legally acceptable and bona fide in the best interests of the company to provide the minority shareholder with cash or redeemable securities in lieu of their existing shares.

Evidencing their displeasure at the ability of controlling shareholders of the issuer to time their departure, to dictate the amount of compensation they are to receive and to regulate the amount of disclosure which would otherwise enable them to judge the adequacy of the price at which each share is to be surrendered,[6] shareholders in Canada[7] and the

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[5] In Gregory v. Canadian Allied Property Invs. Ltd., 11 B.C.L.R. 253, at 264-65, [1979] 3 W.W.R. 612, at 620 (C.A.), Carrothers J.A. states:

> We are not to be concerned with the motivation behind the desire to acquire the minority shareholding unless it is abusive of or unfair to the minority. Certainly there is no presumption of abuse to be derived merely from the majority position of the acquiring company. We must assume, until the contrary be shown, that the objective or motivation of the acquiring company is proper. There are many legitimate reasons for eliminating a minority shareholding and if we are to speculate about that motivation I would prefer to contemplate these. A controlling shareholder can then make business decisions, particularly long-term ones, without concern for conflicts of interest with the minority shareholders and without having to worry about adverse effects on the trading price of shares on the market. To obtain full share control would eliminate the administrative burden and expense of maintaining status as a reporting company with shares listed on stock exchanges. Future financing obtained through the controlling shareholder's resources would be facilitated by that controlling shareholder having all the voting and participating shares in the subject company. Originally the small public shareholding here served as a balancing and leavening influence on the two equal controlling shareholders (who were both well established and renowned as long-term investors but were strangers to this business community) and introduced a local short-term interest to be considered and served by the subject company's directors. That equal control has gone and so perhaps have the other reasons for the minority shareholding.

[6] "Going private" transactions have particularly annoyed shareholders who have been forced to sell their shares when the market value is far lower than the amount they once paid. Consequently, they have objected to the ability of the controlling shareholders to solicit public funds when the market value of shares is high and subsequently to coerce investors to sell when the market value has dropped. For further discussion of the problem arising in shareholder squeeze-outs and more particularly in "going private" transactions, *see* Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978); Brudney, *A Note on Going Private*, 61 VA. L. REV. 1019 (1975); Note, *Going Private*, 84 YALE L.J. 703 (1975); Borden, *Going Private — Old Tort, New Tort or No Tort*, 49 N.Y.U.L. REV. 987 (1974); Salter, *supra* note 2.

[7] *See* Carlton Realty Ltd. v. Maple Leaf Mills, 22 O.R. (2d) 198, 4 Bus. L.R. 300 (H.C. 1978); Alexander v. Westeel-Rosco Ltd., 22 O.R. (2d) 211, 4 Bus. L.R. 313 (H.C. 1978); Neonex Int'l Ltd. v. Kolasa, 3 Bus. L.R. 1, 84 D.L.R. (3d) 446 (B.C.S.C. 1978); In the Matter of Cablecasting Ltd., [Feb., 1978] BULL. O.S.C. 37; *In re* The Acquisition of Quegroup Inv. Ltd. of all the common shares of Queenswear (Canada) Ltd.: Quegroup Inv. Ltd. and Robert S. Vineberg, [1976] C.S. 1458; *Canadian Allied Property*, *supra* note 5; Nasgovitz v. Canadian Merril Ltd. (unreported, Que. S.C.,

United States[8] have chosen to criticize the going private transaction on either of two grounds. On the one hand, they have objected to being forced to give up their shareholdings at even the fairest price, claiming in effect a vested right to remain as shareholders of the issuer.[9] Alternatively, assuming that the applicable corporate statute[10] or constating documents of the company[11] would permit shareholder squeeze-outs, they have complained of being deprived of procedural safeguards which would better ensure the making of an informed investment decision.

This article discusses the different tax consequences flowing from the use of various acquisition techniques and the possibility of minimizing tax liability by the selective use of squeeze-out strategies. In addition, the article highlights various corporate and securities considerations of which the practitioner plotting a shareholder squeeze-out must be aware. Excluded from the present discussion, however, is any examina-

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Dec., 1979); Jepson v. Canadian Salt Co., 17 A.R. 460, [1979] 4 W.W.R. 35 (S.C.); *In Re* Canadian Hidrogas Resources Ltd., [1979] 6 W.W.R. 705 (B.C.S.C.); Ruskin v. All Canada News Radio, 7 Bus. L.R. 142 (Ont. H.C. 1979); *Re* Ripley Int'l Ltd., 1 Bus. L.R. 269 (Ont. H.C. 1977).

[8] Most particularly, *see* Singer v. Magnavox, 380 A.2d 969 (Del. 1977). For a review of all the case law on the subject, *see* Borden & Messmar, *Going Private. A Review of Relevant Considerations*, in ELEVENTH ANNUAL INSTITUTE ON SECURITIES REGULATION 427-550 (1979).

[9] There is some suggestion by Steele J., in *Maple Leaf Mills*, *supra* note 7, that shareholders should not be forced to give up their shares even at the fairest price. The "vested rights" theory is not now recognized as a feature of Canadian corporate law and may never have been, in spite of the comments of the authors of the PROPOSALS FOR A NEW BUSINESS CORPORATIONS LAW (Vol. I, para. 344, p. 114). The introduction of statutory appraisal rights and the requirement for shareholders to approve motions by "special resolution" rather than unanimously exemplify the increasing movement towards flexibility in corporate law. It is then the task of provincial securities acts to safeguard the interests of shareholders. *See* Gibson, *How Fixed are Class Shareholder Rights?*, 23 LAW & CONTEMP. PROB. 283 (1958), and Alain, *supra* note 1.

For discussion of the concept of "vested rights" in the going private context, *see* Johnson, *Delaware Reverses Its Trend in Going Private Transactions: The Forgotten Majority*, 11 LOY. L.A. L. REV. 567, at 601 (1978).

[10] There may be an express provision in the Companies Act authorizing expropriation such as the "compulsory acquisition" provision. *See* text at 76, *infra*. There is still some question whether or not the arrangement or amalgamation sections may be used to squeeze out the minority. This may depend in part on whether the statute also contains a compulsory acquisition provision.

[11] The constating documents may expressly provide for the expropriation of minority shareholders. *See* Phillips v. Manufacturers Sec., 116 L.T. 290 (1917). The shareholders have no cause to complain about expropriation in this case because they accept the terms of the share contract upon purchasing the share. This fact has been recognized in the definitions of "going private" referred to *supra* note 4. However, it is questionable whether controlling shareholders may amend the articles to include an expropriation provision. *See* Brown v. British Abrasive Wheel Co., [1919] 1 Ch. 390, [1918-19] All E.R. Rep. 308; Greenhalgh v. Arderne Cinemas Ltd., [1951] Ch. 286, [1950] 2 All E.R. 1120 (C.A.); Allen v. Gold Reefs of West Africa Ltd., [1900] 1 Ch. 656, [1900-03] All E.R. Rep. 746 (C.A.); Shuttlesworth v. Cox Bros., [1927] 2 K.B. 9, [1926] All E.R. Rep. 498 (C.A.); Dafen Tinplate Co. v. Llanelly Steel Co., [1920] 2 Ch. 124, 89 L.J. Ch. 113 (C.A.).

tion of the remedies available to the aggrieved minority shareholder[12] and of the objectionable features of shareholder squeeze-outs such as coercion or the payment of inadequate consideration.

II. The Transformation of a Company From Public to Private

A. *Companies and Securities Considerations*

Companies and securities legislation designates a company as public[13] or private.[14] A company is classified as public when it offers its

[12] Shareholders who try to enjoin a going private transaction have a number of remedies at their disposal, even when there has been strict compliance with corporate and securities procedural formalities. Shareholders may avail themselves of: 1. the appraisal remedy (text at 114, *infra*); 2. the oppression remedy (*see* Companies Act, S.B.C. 1973, c. 18, s. 221, *as amended* [hereinafter cited as BCCA]; Canadian Business Corporations Act, S.C. 1974-75-76, c. 33, s. 234, *as amended* [hereinafter cited as CBCA]; The Corporations Act, S.M. 1976, c. 40, s. 234, *as amended* [hereinafter cited as MCA]; The Business Corporations Act, 1977, R.S.S. 1978, c. C-23, s. 234, *as amended* [hereinafter cited as SBCA]; Draft OBCA, s. 246, and s. 13.11 of Draft Federal Securities Act (Proposals for a Securities Market Law for Canada, 1979)). *See also Ruskin*, *supra* note 7, and *Westeel*, *supra* note 7); 3. a personal action (*Re* Loeb v. Provigo Inc., 20 O.R. (2d) 497, 4 Bus. L.R. 272 (H.C. 1978)); or, 4. a derivative action on the basis that the directors have committeed a breach of fiduciary duty by sitting and voting on the Boards of both companies involved in the squeeze-out.

There are also a number of remedies created by the courts. There has been a suggestion that controlling shareholders owe a fiduciary duty to the minority (*Westeel-Rosco*, *supra* note 7; and *Maple Leaf Mills*, *supra* note 7) based on such American cases as Jones v. H. F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464 (S. Ct. 1969), though there seems to be little difference between this and the equitable restraint on shareholders to vote their shares "bona fide in the best interests of the company" and not to commit a "fraud on the minority". *See* Greenhalgh v. Arderne Cinemas Ltd., *supra* note 11; Allen v. Gold Reefs of West Africa, *supra* note 11; Rights & Issues, Inv. Trust Ltd. v. Stylo Shoes Ltd., [1965] 1 Ch. 250, [1964] 3 All E.R. 628. Moreover, there has been some hint that there must be some "proper business reason" for the transaction. *See Alain*, *supra* note 1, at 557-62, and note 315, *infra*.

The Ontario Securities Commission Policy 3-37, [Oct., 1977] Bull. O.S.C. 253, and Section 188 of the Draft OBCA set out guidelines for the regulation of Ontario shareholder squeeze-outs. They do not prohibit such transactions but require the issuer to provide a detailed valuation and disclosure. In certain circumstances at least a majority, and possibly up to 2/3 of the independent minority shareholders, must vote in favour of the squeeze-out. For a discussion of this policy, *see* In the Matter of the Securities Act, R.S.O. 1970, chapter 426, and Amendments thereto, and In the Matter of M. Loeb Ltd., and In the Matter of Loebex Ltd., [Dec., 1978] Bull. O.S.C. 333.

[13] Very few statutes use this precise term. It is found in The Companies Act, R.S.A. 1970, c. 60, s. 2(1) 28, *as amended* [hereinafter cited as ACA]; The Securities Act, R.S.A. 1970, c. 333, s. 2(1) 20, *as amended* [hereinafter cited as ASA]; and the Companies Act, R.S.P.E.I. 1974, c. C-15, s. 1(*f*), *as amended* [hereinafter cited as PEICA]. Other statutes use an assortment of terms for what is generally regarded as a "public" company. *See*, *e.g.*, BCCA, s. 1(1) ("reporting company"); Securities Act, 1967, S.B.C. 1967, c. 45, s. 2(1), *as amended* [hereinafter cited as BCSA] ("reporting company"); The Business Corporations Act, R.S.O. 1970, c. 53, s. 1(9), *as amended*

securities for sale to investors who have so little knowledge of the operating affairs of the issuer that they are unable to make an informed and fully rational purchase. Consequently, it must comply with assorted disclosure requirements.[15] Shareholders of a public company are also generally free to alienate their shares without restriction. In contrast, a private company is not subject to as rigorous disclosure or procedural requirements as a public company because of the nature of its ownership. It is generally perceived as a closely held entity. For example, a private company must refrain from distributing its shares to the public[16] or from having its shares listed on a recognized stock exchange.

In some provinces, an issuer might attempt to qualify as a private company to avoid reporting requirements or to take advantage of exemptions available to private companies making take-over or issuer

[hereinafter cited as OBCA] ("corporation offering its shares to the public"); CBCA, s. 121(1) ("distributing corporation"); OSA, s. 1(1) (38) ("reporting issuer"); Securities Act, L.R.Q. 1977, c. V-1, s. 1(1) [hereinafter cited as QSA] ("security issuer"); Securities Act, R.S.P.E.I. 1974, c. S-4, s. 1(*j*), *as amended* [hereinafter cited as PEISA] ("security issuer"); Security Frauds Prevention Act, R.S.N.B. 1973, c. S-6, s. 1, *as amended* [hereinafter cited as NBSFPA] ("security issuer"). *See also*, The Securities Act, 1979 (Manitoba, Bill 49, 1st reading May 22, 1979) [hereinafter cited as Bill 49] ("reporting issuer"); The Securities Act, 1978 (Alberta, Bill 76, 1st reading Nov. 1, 1978) [hereinafter cited as Bill 76]; Draft OBCA, s. 1(1) (26) ("offering corporation"). *See also* the concept of "registering issuers" in s. 4 of the Draft Federal Securities Act, 1979.

[14] The expression "private company" is found in the following: ACA, s. 2(1) 26; PEICA, s.1(*e*); Companies Act, R.S.N.B. 1973, c. 13, s. 38(2), *as amended* [hereinafter cited as NBCA]; The Companies Act, R.S.N. 1970, c. 54, s. 265(*h*), *as amended* [hereinafter cited as NCA]; OSA, s. 1(1) (31); The Securities Act, 1967, R.S.S. 1978, c. S-42, s. 2(1) (*p*), *as amended* [hereinafter cited as SSA]; Securities Act, R.S.M. 1970, c. 250, s. 1(1) (17), *as amended* [hereinafter cited as MSA]; Securities Act, R.S.N.S. 1967, c. 280, s. 1(1) (i), *as amended* [hereinafter cited as NSSA]; QSA, s. 1(13); Bill 49, s. 1(1) (34), NBSFPA, s. 1; Bill 76, s. 1(1) (o.1). *See also* the exemption for "securities of issuers with fewer than fifty shareholders" in s. 3.01 of the Draft Federal Securities Act, 1979.

[15] The requirements include the provision of a prospectus, information circulars to investors, publication of shareholder lists, audited financial statements and insider trading reports. The OSA, s. 74(1), Bill 49, s. 74(1), and Bill 76, s. 72(1), require continuous disclosure of material changes in the company's affairs. Even though private companies do not have to make detailed disclosure, QSA, s. 20(i), states that the Commission may, in its discretion, make such companies subject to the Act for such purposes.

[16] For a definition of "the public", *see* Nash v. Lynde, [1929] A.C. 158, 98 L.J.K.B. 127 (H.L. 1928); Regina v. Empire Dock Ltd., 55 B.C.R. 34 (Cty. Ct. 1940). *See also* L. Loss, SECURITIES REGULATION 655-56 (2d ed. 1961, Supp. 1969); Johnston, *Public Offering Companies and Non-Public Offering Companies Under The Ontario Business Corporations Act*, 5 OTTAWA L. REV. 1, at 1-4 (1970); D. JOHNSTON, CANADIAN SECURITIES REGULATION 148-55 (1977). The OSA and Bills 49 and 76 do away with the concept of "the public". *See generally* Emerson, *Vendor Beware: The Issue and Sale of Securities Without A Prospectus Under The Securities Act, 1978 (Ontario)*, 57 CAN. B. REV. 195 (1979).

bids.[17] The constating documents of the issuer must then contain share transfer restrictions;[18] any invitation to the public to subscribe for its securities is prohibited; and the number of its shareholders must be limited to not more than fifty.[19] For these reasons, the elimination of a sufficient number of publicly-owned securities may enable the company to shed its designation as "public" and become "private" as defined by all applicable company and securities statutes.[20]

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[17] *See, e.g.*, OSA, s. 88(2)(*b*), (3)(*e*), Bill 49, s. 88(2)(*b*), (3)(*e*), Bill 76, s. 86(2)(*b*), 3(*e*). A takeover bid for the shares of a private company or an issuer bid made by a private company are exempt bids. *See also* BCSA, s. 78(*b*)(iii); MSA, s. 80(1)(*b*)(iii); SSA, s. 87(*b*)(iii); MSA, s. 80(1)(*b*)(iii); QSA, s. 131(*f*)(iii). The private company distinction is also important when secondary trades are made of previously exempt securites of a company that has ceased to be a private company (OSA, s. 71(5); Bill 49, s. 71(5) and Bill 76, s. 69(5)). If securities are distributed by a "private company" it will not be required to file a prospectus or to comply with registration requirements.

Because there is no uniformity in the use of certain terms, the securities of companies otherwise presumed not to require regulation may fall subject to Manitoba or Alberta securities legislation, assuming the Draft Acts are passed in their present form. They each contain exemptions for sales of securities of a "private company". There is no such "classification" of companies under the BCCA, for example. When a British Columbia non-reporting company proposes to issue shares to Manitoba or Alberta residents, this will qualify as a "distribution". Even though the B.C. company may not be a "private company" as defined in Bills 49 or 76, the issuer may still use the private placement exemption to forego complying with prospectus and registration requirements.

However, on a secondary distribution of these securities, difficulties may arise. Assuming this is a further "distribution" (sale from a control block or no subsequent exemption within the "closed system"), there will be no further exemptions under Bill 49, s. 71(1), or Bill 76, s. 69(4), because the B.C. company is not a reporting issuer. Barring the use of a private placement exemption, disclosure and registration will be required unless an exemption order is obtained from the securities commission.

The OSA Regulations have been recently amended to resolve this problem. S. 17(*a*) states:

> The exemptions contained in paragraph 10 of subsection 2 of section 34 of the Act, subsection 5 of section 72 of the Act and clause a of subsection 1 of section 72 of the Act apply to and are available to a company incorporated but not continued under The British Columbia Companies Act, S.B.C. 1973, c. 18, as amended, which is not a reporting company within the meaning of section 2 of The British Columbia Securities Act, S.B.C. 1967, c. 45 as if such company were a private company as defined under the Act, but only if the securities thereof are not offered for sale to the public.

[18] The wording of ACA, s. 2(1) (26), would appear to permit a company to restrict the right of transfer on only some of its shares and yet still remain private.

[19] Under ACA, s. 2(1) (26), when calculating the 50 persons, one must not include persons who are in the employ of the company or who were employees and continue to hold shares. In addition, persons registered as joint owners of shares are counted as one shareholder.

[20] It is often necessary for a company to satisfy the requirements of an administrative body or official. *E.g.*, under ACA, ss. 46, 47, the conversion of a company from "public" to "private" occurs when the Registrar issues the appropriate certificate and not upon the filing of the conversion resolution. Under BCCA, s. 1(1), the Registrar of Companies may order a company to become a reporting company. The Registrar of Companies issued a notice outlining the guidelines used to make this determination on Sept. 26, 1978. This is reported in B.C. CORP. L. GUIDE 583 (CCH).

B. *Income Tax Considerations*

The Income Tax Act also uses the terms "public corporation"[21] and "private corporation".[22] While definitions of these expressions roughly correspond to those found in securities and companies legislation, there are some discrepancies because the drafters of the Income Tax Act are evidently more concerned with the promotion of socio-economic objectives[23] than with the need by investors to receive information about the affairs of the company. Classification of a company as private or public is significant because the tax treatment a company receives is largely based on these designations.[24]

1. *The "Public Corporation"*

A "public corporation" must be resident in Canada[25] and have a class or classes of shares listed[26] on a prescribed[27] stock exchange in

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[21] The Income Tax Act, S.C. 1970-71-72, c. 63, s. 89(1)(*g*), *as amended* [hereinafter cited as ITA].

[22] ITA, s. 89(1)(*f*).

[23] *See, e.g.*, text accompanying note 27, *infra*, regarding the failure to treat a corporation which would otherwise be classified as "public" for securities and company law purposes as "public" because it is not controlled by Canadians.

[24] *See* p. 62, *infra*.

[25] For the residency requirements of corporations, *see* ITA, ss. 2(1), 250(4). Anglo-Canadian law indicates that the residence of a corporation for tax purposes is where its central control and management actually reside. *See* DeBeers Cons. Mines Ltd. v. Howe, [1906] A.C. 455, 5 T.C. 198, 95 L.T. 221 (H.L.); *see also* Unit Constr. Ltd. v. Bullock, [1960] A.C. 351, [1959] 3 All E.R. 831 (H.L.).

[26] For listing requirements, *see* Alberta Stock Exchange Bylaws, Part XIX, in CAN. SEC. L. REP. 15,720 (CCH); Montreal Stock Exchange, Rule V, s. 9053, in CAN. SEC. L. REP. 16,759-63 (CCH). There are different listing requirements for senior industrials, junior industrials and mines and oils. *See also* Toronto Stock Exchange Bylaws, Part XIX, in CAN. SEC. L. REP. 17,268 (CCH); Policy Statement, June, 1971. All industrial and investment companies must make a distribution of at least 200,000 issued shares to at least 300 public shareholders each holding a board lot or more. Listing may be permitted where there are between 200 and 300 public shareholders each holding a board lot or more if there is a total of 450 or more public shareholders. Oil and gas companies must make a public distribution of one million shares to a minimum of 300 shareholders. The corporation must also meet a number of solvency tests. *See also* Vancouver Stock Exchange Rules 900-13 in CAN. SEC. L. REP. 17,734-5 (CCH). There is no specification of the listing requirements. The listing requirements for the Vancouver Curb Exchange, in CAN. SEC. L. REP. 18,305 (CCH), specify that the company must have at least 100 shareholders on record, exclusive of vendors, promoters, directors and insiders. A public primary distribution of at least 250,000 shares must also be made by the company. For the Winnipeg Stock Exchange requirements, *see* CAN. SEC. L.REP. 18,799 (CCH).

[27] Income Tax Regulations, C.R.C., c. 945, s. 3200, prescribes the Alberta, Montreal, Toronto, Vancouver and Winnipeg Stock Exchanges.

Canada.[28] In addition, a corporation resident in Canada at any time after June 18, 1971, may elect to be public so long as it complies with prescribed conditions contained in the Regulations.[29] The Minister of National Revenue may also designate a corporation as public once he gives it written notice at least thirty days before the date of designation and the corporation has fulfilled the conditions set out in the Regulations.[30]

2. *Cessation of "Public" Status*

A corporation continues to be a public corporation until it elects to be otherwise by complying with the provisions found in the Regulations.[31] The Minister may also designate a corporation "not to be public" if he first gives at least thirty days written notice to the corporation and the corporation meets those conditions prescribed in the Regulations.[32]

3. *The "Private Corporation"*

A "private corporation" is a Canadian resident corporation which is not a public corporation. It cannot be controlled directly or indirectly[33]

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[28] Note that a Canadian resident corporation with shares listed only on a U.S. exchange may not qualify as a "public corporation".

[29] ITA, s. 89(1) (*g*) (ii) (A), (B). Part XLVIII of the Income Tax Regulations outlines the prescribed conditions:

1) A class of the capital stock must be qualified for distribution to the public. A distribution to the public occurs only if a prospectus, registration statement or similar document has been filed with, and where required by law, accepted for filing by, a public authority in Canada, pursuant to and in accordance with the law of Canada or of any province, *and* there has been a lawful distribution to the public of shares of that class in accordance with that document. S. 4800(1) (*a*) and s. 4802(2) (*a*).

2) There shall be no fewer than 150 persons who hold "equity" shares of the class distributed to the public or 300 persons in any other case. Each of these amounts excludes the "insiders" of the corporation. In both cases, each person must hold not less than 1 block of shares. The shares of the class distributed to the public must have an aggregate fair market value of not less than $500. S. 4800(1) (*b*) and s. 4802(1), (3).

3) Insiders of the corporation shall not hold more than 80% of the issued and outstanding shares of that class (s. 4800(1) (*c*)). Under s. 4802(1), "insider" has the meaning that would be assigned by Canada Corporations Act, R.S.C.1970, c. C-37, s. 100 (replaced by CBCA), and it deems certain employees to be insiders as well. The definition of "insiders" under this act is not as broad as in OSA, s. 1(1) 17, or CBCA, s. 121(1).

[30] ITA, s. 89(1) (*g*) (ii) (A).

[31] ITA, s. 89(1) (*g*) (iii) (A).

[32] ITA, s. 89(1) (*g*) (iii) (B).

[33] It appears that *de facto* control through the existence of a demand note or other indebtedness or a management agreement will not suffice without actual *de jure* control over the voting shares. *See* Buckerfields Ltd. v. M.N.R., [1964] C.T.C. 504, 64 D.T.C.

by a public corporation. A corporation may thus meet the definition of a public or private corporation without being a Canadian corporation, provided that it is resident in Canada. Therefore, a non-resident corporation will not qualify either as a public or private corporation.[34] Furthermore, a Canadian resident corporation that is wholly owned by an American resident corporation whose shares are listed on the New York Stock Exchange would not be controlled by a public corporation and could qualify as a private corporation. This corporation, however, would be denied the tax benefits accorded to Canadian controlled private corporations.[35]

III. THE ECONOMIC JUSTIFICATIONS FOR "GOING PRIVATE"[36]

There are a variety of reasons which might prompt controlling shareholders to take the issuer private. Generally, the information circular sent to shareholders lists both tax and non-tax factors which have caused the company to feel that it is no longer suitable for public ownership.

A. *Non-Tax Considerations*

In today's securities markets, shares of a company may fail to reflect the underlying book value of the assets or the potential earning capacity of the enterprise.[37] In such cases, it is a good investment of surplus funds to acquire shares of the minority.[38] A squeeze-out of minority shareholders relieves the issuer of compliance with disclosure requirements and the payment of related costs,[39] and provides it with enhanced

5301 (Ex.). *But see* Himley Estates Ltd. v. Commissioners of Inland Revenue, [1933] K.B. 472, 102 L.J.K.B. 383, 148 L.T. 319 (C.A. 1932).

[34] ITA, s. 89(1) (*f*), (*g*).

[35] *See* ITA, s. 125(6) (*a*), and the discussion at p. 63, *infra* concerning s. 125(1) and the small business deduction.

[36] For a more detailed discussion, *see generally* Campbell & Steele, *supra* note 1; Borden, *supra* note 6; Note, *supra* 6; Glover & Schwartz, *supra* note 1; Swanson, *The Elimination of Public Shareholders: Going Private*, 7 CONN. L. REV. 609 (1975); Salter, *supra* note 2; and the reasons of Carrothers J.A. in *Canadian Allied Property*, *supra* note 5.

[37] This may have been caused by a number of factors: failure of the corporation to pay dividends because of a substantial reduction in retained earnings for the fiscal year; little or no demand by institutional investors or broker dealers for securities of the corporation distributed to the public; inefficient use of the assets of the corporation; unawareness of the true value of the assets by the directors; inefficient corporate capital structure; or the existence of substantial tax losses. *See* M. WEINBERG, TAKE-OVERS AND MERGERS 22-36 (3d ed. 1971).

[38] Hansen, *supra* note 1.

[39] *Supra* note 15.

economies of scale[40] and increased corporate flexibility.[41] Following a going private transaction, the controlling shareholders are usually the sole shareholders of a company. They can then conduct the business of the company free from public scrutiny; for example, they can hold meetings whenever they see fit,[42] or allot a sizeable portion of the profits to whomever they wish without any threat of a derivative action being brought by a distant and disgruntled minority shareholder.[43] In fact, it is

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[40] An amalgamation may result in synergy or trade advantage. Savings leading to economies of scale could occur from administrative savings associated with shareholder servicing costs. *See* WEINBERG, *supra* note 37.

"Synergy" often is a benefit available to controlling shareholders, and perhaps should be taken into account through valuation when compensation is paid to minority shareholders. *See* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974); Lorne, *A Reappraisal of Fair Shares in Controlled Mergers*, 126 PENN. L. REV. 955 (1978); Toms, *Compensating Shareholders Frozen Out in Two Step Mergers*, 78 COL. L. REV. 546 (1978); Brudney & Chirelstein, *supra* note 6.

[41] *E.g.*, CBCA, s. 97(2), states that corporations which distribute their shares to the public must have a minimum number of directors. BCCA, s. 133, states that the election of the directors of a "reporting company" must take place in a particular fashion. Both BCCA, s. 202, and CBCA, ss. 152, 157, state that a private corporation need not appoint an auditor.

The private corporation is able to make business decisions on the basis of long-range objectives and opportunities without concern for the possible adverse effect on the trading price of its shares. Its officers and directors are able to manage without fear of sanctions imposed at the instance of minority shareholders over conflicts of interest. In some jurisdictions, debt financing costs are cheaper because private corporations do not need to use a trust indenture. *See, e.g.*, BCCA, s. 95; CBCA, s. 77(2); OBCA, s. 57(2). BCCA, s. 163, permits the shareholders of a non-reporting company to transact the business of its annual general meeting by unanimous written resolution.

For a discussion of the main differences between public and private companies in Alberta, *see* ALBERTA COMPANIES MANUAL, Vol. B, at 6006 (CCH), and F. IACOBUCCI, M. PILKINGTON & J. PRICHARD, CANADIAN BUSINESS CORPORATIONS 63-65 (1977).

[42] *See, e.g.*, BCCA, s. 163.

[43] A private corporation may be permitted to give financial assistance to shareholders, directors or employees to enable them to purchase shares of the Corporation. *See* OBCA, s. 17; ACA, s. 14; NBCA, s. 38.

However, PEICA, s. 69, and QCA, s. 110, prohibit all companies from providing financial assistance. BCCA, s. 125, prohibits such assistance unless there are "reasonable grounds for believing . . . [it] is in the best interests of the company". CBCA, s. 42, MCA, s. 42, SBCA, s. 42, and Draft OBCA, s. 20, prohibit loans when there are reasonable grounds to believe such loans would render the company insolvent or would result in the company's net realizable assets, exclusive of the loans, being less than the aggregate of the company's liabilities and stated capital. If directors, and in certain jurisdictions, officers, authorize unlawful loans they will be jointly and severally liable to the company for any losses occasioned. *See* CBCA, s. 113(2) (*d*); BCCA, s. 150(1) (*d*); ACA, s. 14(3), (4); SBCA, s. 113(2) (*d*); MCA, s. 113(2) (*d*); OBCA, s. 146; Draft OBCA, s. 129(2) (*d*); QCA, s. 110; NBCA, s. 100; PEICA, s. 69.

for these reasons that one court has acknowledged that a decision to go private in certain economic circumstances is "*bona fide* in the best interests of the Company" and, as such, is a proper ground for squeezing out shareholders.[44]

In contrast, the benefits of going public[45] are no longer as readily apparent. The depressed market for the shares of many companies has blunted the effectiveness of using these shares as a form of executive compensation and as a tool in the acquisition of new businesses.

B. *Income Tax Considerations*

1. *Benefits to the Issuer*

Both public and private corporations pay tax on taxable income at a rate of 46%.[46] Depending upon the province in which the permanent establishment of the corporation is located,[47] the rate can be as high as 51%.[48]

However, income of a private corporation derived from certain sources attracts less tax. Investment income of a private corporation is only taxed at rates up to 34% because the Income Tax Act provides a tax refund of 16 2/3% of that income, net of foreign tax credits from the refundable dividend tax on hand account, when the corporation pays it out by way of dividends to shareholders.[49]

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[44] *Canadian Allied Properties*, *supra* note 5. *See also* the comments of Laycraft J. in *Jepson*, *supra* note 7.

[45] For statistical details and practical tips about how to "go public", *see* D. Berman, Going Public: A Practical Handbook of Procedures and Forms (1974); G. Robinson & K. Eppler, Going Public (1971); Israels & Duff, When Corporations Go Public (1979); Going Public—Advanced Techniques (Sargent ed. 1979); Going Public Workshop (A. Sommer & S. Friedman eds. 1970); D.K. Shaw, *The Costs of Going Public in Canada*, U.W.O. School of Business Administration, June 6, 1974; Address by D.H. Brown, Going Public, O.I.C.A., 1970; P. McQuillan, Going Public in Canada: The Facts and Fads (1971).

[46] ITA, s. 123(*e*). In their Dec. 11, 1979, Budget, the Conservatives proposed to enact a temporary corporate surtax of 5% to be effective until Dec. 12, 1981. The surtax would have applied to the Federal Part I tax otherwise payable before the deduction of the tax credits for investments, employment, foreign taxes and political contributions and would have been calculated after the deduction of the provincial tax abatement in ITA, s. 124. Ways and Means Motion #52.

[47] The rules for determining where the permanent establishment is located can be found in Part IV of the Income Tax Regulations.

[48] This is the case in British Columbia and is possible in Manitoba. The latter imposes a 2% surtax on taxable income not subject to the small business deduction. For a listing of the provincial income tax rates, *see* ITA, s. 124n. (H. Stikeman ed. 1979).

[49] ITA, s. 129(1), permits a private corporation a refund equal to the lesser of (a) 1/4 of all taxable dividends paid by it on shares of its capital stock, and (b) its refundable dividend tax on hand account (RDTOH account). ITA, s. 129(3), lists the contents of the RDTOH account.

If a private corporation qualifies as a "Canadian controlled private corporation", up to $150,000 of the active business income earned by the corporation[50] in the year will be taxed, to a maximum of 27% because of the small business abatement.[51] This factor may not be crucial in helping the controllers to determine whether or not the issuer should become "private" because the earnings from active business of most public corporations are in excess of $150,000 a year and quickly surpass the "total business limit" of $750,000 permitted by the Income Tax Act.[52]

There is one drawback to private status. Portfolio income received from another Canadian corporation in the form of dividends passes free of Part I tax to either a private or public corporation. However, a private corporation may also be required to pay a 25% refundable Part IV tax on this income,[53] depending upon the degree of ownership the recipient corporation has in the payer corporation, whether the payer corporation is "connected" with the recipient corporation,[54] whether the payer

[50] The terms "active business" and "income of the corporation for the year from an active business" are now defined in ITA, s. 135(6) (*d*), (*e*). An "active business" is defined as:

> the business of manufacturing or processing property for a sale or lease, mining, operating an oil or gas well, prospecting, exploring or drilling for natural resources, construction, logging, farming, fishing, selling property as a principal, transportation or any other business carried on by the corporation other than a specified investment business or a non-qualifying business.

For an analysis of the case law dealing with active business income, *see* Lahey, *Active Business as a Technique of Source Discrimination in the Formulation of Corporate Tax Policy*, 16 OSGOODE HALL L.J. 35 (1978).

[51] ITA, s. 128(1). A Canadian controlled private corporation receives a credit of up to 21% depending on whether or not it is carrying on a "specified investment business" (defined in s. 125(6) (*h*)) or a non-qualifying business (NQB; defined in s. 125(6) (*f*)). The effect of carrying on a NQB is to subject all of the corporation's active business income to a credit of 12 2/3% rather than the larger 21% credit (s. 125(1.1)). Income earned by a "specified investment" corporation is not subject to the s. 125 abatement but will prompt the application of the refundable tax provisions in s. 129.

For an extensive review of this area, *see* Kellough, *An Analysis of the 1979 Amendments to the Small Business Deduction*, 1979 CONFERENCE REPORT [forthcoming].

[52] ITA, s. 125(2), defines these terms. S. 125(1) permits the abatement of 21% of tax otherwise payable on the lesser of (i) the aggregate of the corporation's net income from active businesses, (ii) the taxable income of the corporation less certain foreign tax credits, (iii) the corporation's business limit for the year, (iv) the corporation's total business limit less the preceding year's cumulative deduction account.

[53] ITA, s. 186(1).

[54] To avoid payment of Part IV tax, under ITA, s. 186(4), the corporation must be "connected" with the payer. "Connected" may mean "controlled", as defined by s. 186(2) (more than 50% of the issued share capital having full voting rights under all circumstances belonging to the other corporation, to a person with whom the payee corporation does not deal at arm's length, or to both), or that the payee corporation owns more than 10% of the voting shares of the payer and these shares constitute more than 10% of the fair market value of all the issued shares.

corporation gets a refund on the dividends paid out to the recipient corporation,[55] and whether the recipient corporation elects to pay Part IV tax even though it may not be obliged to do so.[56]

2. *Benefits to the Controlling Shareholders*

Controlling shareholders benefit from the lower amount of tax which the issuer might pay on certain types of income, once it has gone private. As the remaining shareholders of the issuer, they alone share in the greater after-tax profits of the corporation. The absence of public scrutiny on corporate conduct also enables this group to take advantage of income split or estate freeze possibilities; for example, the spouses of the controlling shareholders might receive salaries or dividends[57] from the corporation, and any future growth in the value of the shares of the issuer might be passed on to family members by means of a reorganization of capital without complaint from other shareholders.

Controlling shareholders might also use the private company as a holding company for securities purchased with their own funds and as a vehicle through which to funnel investment income when their personal tax rate is greater than the corporate rate.[58] This will result in a tax deferral while earnings remain in the corporation and an eventual small tax saving once the money is paid out to the shareholders.

3. *Benefits to the Minority Shareholders*

There are two ways in which minority shareholders can profit from being squeezed out. First, they receive either cash or redeemable preference shares of the issuer in return for their investment, which may no longer be marketable because of thin trading or depressed market value. Secondly, the acquiror of shares might use a squeeze-out technique which provides minority shareholders with tax treatment more favourably suited to their marginal rates than they would have received

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[55] ITA, s. 186(1) (*b*) (i), (iii).

[56] ITA, s. 186(1) (*b*.1) states that the payee corporation may elect to pay Part IV tax to the extent taxable dividends are received by individuals from a payer corporation connected to but not controlling the payee corporation. Note that s. 186(1) (*b*.1) requires that taxable dividends be distributed in the same year, otherwise, the opportunity to pay Part IV tax on that particular contribution will be lost forever. For further discussion, *see* Kellough, *supra* note 51.

[57] A spouse earning no other income may receive up to approximately $33,000 of dividends tax-free because of the operation of the dividend tax credit. *See* Eddy, *The Incorporation of Business Income and the 1977 Budget Changes*, 1977 CONFERENCE REPORT 114.

[58] This is due to the imperfections in the present tax system resulting primarily from the application of provincial tax rates to the operation of the dividend tax credit. *See* Fenwick, *Incorporation of Investment Income*, 1977 CONFERENCE REPORT 141.

had they themselves disposed of their shares without coercion. For example, proceeds from the sale of their shares may be treated, for tax purposes, as a dividend rather than as a capital gain. Capital gains treatment is preferable only to investors who earn taxable income in excess of approximately $59,000 because they will pay a combined federal and provincial tax of only 30% on capital gains as compared to 39% on dividends they receive.[59]

IV. Going Private Transactions and Related Methods of Acquisition

A. *The Domestic Transaction*

A domestic going private transaction is one in which the issuer itself seeks to reacquire securities held by shareholders other than the controllers. Any method of acquisition used is initiated by the controlling group or the directors of the issuer. Methods of acquisition available to the issuer in most jurisdictions are: (1) purchase of shares by an issuer or take-over bid, and by open market purchase; (2) share reclassification by shareholders resolution or by arrangement; (3) share consolidation by shareholder resolution or by arrangement; and (4) reduction of capital.

The issuer usually makes a bid for the minority shares first because this enables the shareholders to sell their shares voluntarily.[60] If 100% of the minority do not accept the terms of the issuer bid, the issuer may "mop up" the remaining shares by reclassification or consolidation. In some jurisdictions, an issuer which owns 9/10 of its shares of one class following an issuer bid, may compel the minority to sell the remainder at fair value. This procedure is known as compulsory acquisition.

B. *The Non-Arm's Length Transaction*

A non-arm's length transaction refers to the acquisition of minority shares by controlling shareholders, an associate or affiliate of the controlling shareholders or any affiliate of the issuer. An associate of the controllers is generally defined as any company in which the controllers, their partners, any relatives (including spouses who share the same home), or any trust or estate in which the controllers have a substantial

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[59] Cronkwright, Dart & Lindsay, *Corporate Distributions and the 1977 Tax Changes*, 1977 CONFERENCE REPORT 279, at 283, 356-58.

[60] This, of course, presumes that the purchase of shares is permitted by the companies legislation of the jurisdiction and is not prohibited or restricted by provisions found in the constating documents of the company.

interest or to which they serve as trustees, own greater than 10% of the voting rights attached to all voting securities.[61]

Definitions of "affiliate"[62] are drafted in a complex manner to catch transactions which would otherwise circumvent provisions of companies and securities legislation through the use of a network of companies. One company is deemed to be affiliated with another if one of them is the subsidiary[63] of the other, or both are subsidiaries of the same company, or if each is controlled[64] by the same person.[65] A company is deemed to own beneficially securities owned by its affiliates,[66] while a person is deemed to own beneficially securities beneficially owned by a company controlled by him or by an affiliate of such a company.[67]

The drafters of the Income Tax Act are of the belief that persons who do not deal at arm's length are "bent on creating mischief for the fiscal authorities".[68] Subsection 251(1) states that "related persons"[69] are deemed not to deal with each other at arm's length[70] and "it is a question of fact[71] whether persons not related to each other were at a particular time dealing with each other at arm's length".[72] This paper will not

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[61] CBCA, s. 2(1); BCCA, s. 2(1); SBCA, s. 2(1) (*d*); MCA, s. 1(1) (*d*); Draft OBCA, s. 1(1) (4); BCSA, s. 2(1); ASA, s. 2(1) (1); SSA, s. 2(1) (*a*); MSA, s. 1(*l*) 1; Bill 49, s. 1(1) (2); OSA, s. 1(1) (2); Bill 76, s. 1(1) (*a*.1).

[62] CBCA, s. 2(1); BCCA, s. 1(1); ACA, s. 2(4); SBCA, s. 2(1) (*b*); MCA, s. 1(1) (*b*), (2); OBCA, s. 1(4); Draft OBCA, s. 1(4); ASA, s. 2(2); BCSA, s. 2(1); SSA, s. 2(2); MSA, s. 1(2); Bill 49, s. 1(2); OSA, s. 1(1) (2); Bill 76, s. 1(2).

[63] CBCA, s. 2(5); BCCA, s. 1(3); ACA, s. 2(2); SBCA, s. 2(5); MCA, s. 1(5); OBCA, s. 1(2); Draft OBCA, s. 1(2); ASA, s. 2(4); BCSA, s. 2(3); SSA, s. 2(4); MSA, s. 1(4); Bill 49, s. 1(4); OSA, s. 1(4); QSA, s. 2.3; Bill 76, s. 1(4).

[64] CBCA, s. 2(3); BCCA, s. 1(4); ACA, s. 2(5); SBCA, s. 2(3); MCA, s. 1(3); OBCA, s. 1(5); Draft OBCA, s. 1(5); BCSA, s. 2(4); ASA, s. 2(3); SSA, s. 2(3); MCA, s. 1(3); Bill 49, s. 1(3); OSA, s. 1(3); QSA, s. 2.2; Bill 76, s. 1(3).

[65] CBCA, s. 2(2); BCCA, s. 1(2); ACA, s. 2(4); SBCA, s. 2(2); MCA, s. 1(2); OBCA, s. 1(4); Draft OBCA, s. 1(4); BCSA, s. 2(2); ASA, s. 2(2); SSA, s. 2(2); MSA, s. 1(2); Bill 49, s. 1(2); OSA, s. 1(2); QSA, s. 2.6; Bill 76, s. 1(2).

[66] BCCA, s. 1(7); ACA, s. 81(2) (*c*); SBCA, s. 122(1) (*d*); Draft OBCA, s. 137(2) (*d*); BCSA, s. 2(6); ASA, s. 2(7); SSA, s. 2(7); MSA, s. 1(7); Bill 49, s. 1(6); OSA, s. 1(6); QSA, s. 2.6; Bill 76, s. 1(6).

[67] BCCA, s. 1(6); ACA, s. 81(2) (*b*); SBCA, s. 122(1) (*g*); Draft OBCA, s. 137(2) (*c*); BCSA, s. 2(7); ASA, s. 2(6); SSA, s. 2(6); MSA, s. 1(6); Bill 49, s. 1(5); OSA, s. 1(5); QSA, s. 2.5; Bill 76, s. 1(5).

[68] Kellough, *Acquisition of Shares in a Non-Arm's Length Transaction*, CORPORATE MANAGEMENT TAX CONFERENCE 1978, *supra* note 1, 186, at 187. *See also* Couzin, *Of Arm's Length and Not Dealing Thereat*, 26 CAN. TAX J. 271 (1978).

[69] ITA, s. 251(2)-(6). *See also* the extended definition, ITA, s. 84.1(2) (*b*), (*c*), and the recent amendment to s. 84.1(2) (*c*) which deems a person to beneficially own the shares of his spouse, of an *inter vivos* trust of which he, his spouse, or a corporation controlled by him, his spouse, or the trust, is a beneficiary, for purposes of determining whether he is "a member of a group of less than 6 persons". ITA, s. 212.1(3), also contains a definition of non-arm's length which has been similarly amended. *See also* ITA, s. 15(2).

[70] ITA, s. 251(1) (*a*).

[71] *See* Hansen, *Factual Non-Arm's Length Relationships in Canadian Business Statutes*, 2 CAN. BUS. L.J. 278 (1978), as to what relationships this phrase may capture.

[72] ITA, s. 251(1) (*b*).

canvass this or other provisions such as sections 69[73] or 256,[74] which are designed to prevent tax evasion.

In a non-arm's length transaction, controlling shareholders themselves do not usually purchase the minority shares. They create an "associate" corporation to which they transfer their interest in the issuer in return for complete share ownership in the associate. This transfer constitutes a "disposition" for income tax purposes[75] and may give rise to a capital gain if the fair market value of the shares of the associate received as proceeds of disposition exceeds the adjusted cost base of the shares of the issuer.[76] In order to defer tax consequences, the transferor may elect to dispose of the shares of the issuer in accordance with the procedure outlined in subsection 85(1).[77] To prevent the application of

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[73] ITA, s. 69(1) (*a*), states: "where a taxpayer has acquired anything from a person with whom he was not dealing at arm's length at an amount in excess of the fair market value thereof at the time he so acquired it, he shall be deemed to have acquired it at that fair market value".

ITA, s. 69(1) (*b*), correspondingly provides that "where a taxpayer has disposed of anything to a person with whom he was not dealing at arm's length for no proceeds or for proceeds less than the fair market value thereof at the time he so disposed of it, . . . he shall be deemed to have received proceeds of disposition therefor equal to that fair market value."

[74] ITA, s. 256, defines the term "associated corporations". In order to prevent a corporation from setting up affiliates to maximize the availability of the small business deduction under s. 125, s. 256 deems corporations to be associated if the conditions outlined in the section are met. S. 125(3) then permits the allocation of the total and annual business limit to one or more of the associated corporations.

[75] ITA, s. 54(*c*), (*i*), (*h*).

[76] ITA, s. 40. Ways and Means Motion #33 of the Dec. 11, 1979, Budget proposed to restrict tax-free transfers of property to "taxable Canadian corporations" to prevent transfers to tax-exempt corporations which would ultimately dispose of the property without tax liability.

[77] A s. 85(1) rollover is permitted if:

(a) There is a disposition of "capital property" which is defined in ITA, ss. 248, 54(*b*). A Canadian taxpayer may also transfer inventory (other than real property), eligible capital property or resource property.

(b) The disposition is made to a "Canadian corporation" as defined in ITA, s. 89(1) (*a*).

(c) The consideration for each item transferred includes at least one share. It can also be a fraction of a "share" as defined in s. 248(1). *See* Information Circular 76-19R, *Transfer of Property to a Corporation under Section 85*.

(d) The taxpayer and the corporation have jointly elected on prescribed form T2057 (T2058 if the taxpayer is a partnership).

Once these conditions are satisfied the parties may elect an amount at which the eligible property may be transferred. The elected amount becomes the proceeds of disposition to the transferor and the adjusted cost base to the transferee. There are certain provisions which prevent choosing any figure whatsoever for the elected amount (s. 85(1) (*b*), (*c*), (*c*.1), (*d*), (*e*), (4)) without any tax liability arising. S. 85(1) (*f*), (*g*), (*h*) discusses the allocations of cost bases to the forms of consideration received by the transferor. One must also beware of the operation of s. 85(1) (*e*.2) when the fair market value of the consideration taken back by the transferor is less than the fair market value of the asset transferred. This "indirect gift" rule causes a bump in the elected amount to the extent of the amount which "can reasonably be regarded as a gift".

sections 84.1,[78] 212.1[79] and possibly subsection 247(1),[80] the transferor must take back the shares of the associate with a paid-up capital equal to

Note that when a non-resident disposes of his shares to a corporation under s. 85, all the shares of the capital stock of the Canadian corporation received by him as consideration shall be deemed to be "taxable Canadian property" of the corporation (s. 85(1) (*i*)). One must also be careful of the consequences resulting from the transfer of pre-1972 capital property. If the controllers owned the shares of the issuer on Valuation Day (V-Day) and the value of the share on V-Day exceeds their current value, the cost base of the shares of the issuer on V-Day will be reduced to current value upon the transfer according to Income Tax Application Rules, 1971, S.C. 1970-71-72, c. 63, s. 26(5) (*c*) (ii), (5.2) [hereinafter cited as ITAR]. In addition, the tax-free zone will be available to the transferee but not to the controllers in respect of shares of the transferee received in return for the shares of the issuer.

[78] ITA, s. 84.1, is intended to prevent taxpayers from stripping out from the corporation a tax-free amount equal to the difference between the adjusted cost base and the paid-up capital of the shares which they owned after 1971, or which they acquired from a party with whom they were not dealing at arm's length and who owned the shares on that date. S. 84.1 will apply if the following circumstances are present:

(a) A taxpayer (other than a corporation) who resides in Canada,
(b) Disposes of shares that are capital property,
(c) The shares disposed of must be shares of a corporation resident in Canada ("the subject corporation"),
(d) The shares are acquired by another corporation,
(e) The taxpayer and the acquiring corporation do not deal at arm's length,
(f) Immediately after the share disposition the "subject corporation" is connected to the acquiring corporation within the meaning of s. 186(2) of the Act.

Note that s. 84.1(2) broadens the definition of "non-arm's length" persons. A transfer of pre-1972 shares by the controllers of the issuer would seem to fall within the scope of s. 84.1. The receipt of non-share or non-debt consideration by the controllers in excess of the paid-up capital of the shares will result in an immediate capital gain, while the adjusted cost base of the debt or share consideration received by the tranferor will be reduced to the level of the paid-up capital of the shares transferred, assuming that the share of debt consideration received in return is in excess of the paid-up capital.

[79] S. 212.1 applies to non-residents who sell their shares to non-arm's length corporations. The section prevents the non-resident from obtaining a step-up in the paid-up capital of the shares he receives in exchange for those of the issuer which he transferred. To avoid the application of the section, the non-resident should receive shares of the transferee corporation with a paid-up capital equal to the paid-up capital of the shares of the issuer being transferred. Otherwise, if the non-resident receives non-share consideration as partial or whole payment for the shares of the issuer from the transferee, he will realize an immediate capital gain equal to the difference between the value of such non-share consideration and the paid-up capital of the share of the transferee given in return. If the non-resident receives from the issuer *non-share* consideration as payment for the shares transferred, he will realize an immediate deemed dividend equal to the difference between the value of such non-share consideration and the paid-up capital of the shares so transferred. Glover & Schwartz, *supra* note 1, at 22 n. 21, suggest that the provisions of tax treaties exempting non-residents from tax on capital gains override s. 212.1 because the deemed dividend includes a capital gain. S. 212.1(4) provides an exemption where the shares of a Canadian corporation are transferred by a non-resident corporation to another Canadian corporation which controlled the non-resident corporation immediately before the transfer. *See generally* Cronkwright, Dart & Lindsay, *supra* note 59, at 298-303.

[80] ITA, s. 247(1), states that the Minister has the discretionary power to include amounts in income where acquisition or conversion of the shares of the corporation,

the paid-up capital[81] of the issuer. Furthermore, the operation of subsection 15(1) can be avoided where the associate corporation does not give back consideration of a value which is in excess of the fair market value of the property transferred.[82]

Initially, the associate corporation usually makes a take-over bid for the minority interest. Alternatively, it might purchase minority shares on the open market. If the corporation cannot acquire all outstanding shares in this fashion, it may eliminate them by: (1) an amalgamation with the issuer in which the minority is given either redeemable preference shares or cash; (2) purchase of the assets of the issuer followed by a winding up of the issuer from which the minority receives cash for its shares; (3) compulsory acquisition; (4) share reclassification by shareholder resolution or arrangement; or (5) share consolidation by shareholder resolution or arrangement.

C. *The Arm's Length Transaction*

A going private transaction may be classified as arm's length when the acquiror or its beneficial owners hold less than a 10% interest in the issuer.[83] While the acquiror might be an individual, a trust, an estate or a partnership, it will usually be a corporation. The corporation, however, must not be public, because, upon being acquired by a public corporation, the issuer would remain public for income tax purposes, even if it had gone private in accordance with relevant companies and securities provisions.

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assuming that one of the purposes of the transaction is to effect a substantial reduction or disappearance of, the assets of the corporation in a manner in which "the whole or any part of any tax that might otherwise have been or become payable under this Act" has been or will be avoided. It is conceivable that even if the controlling shareholders can circumvent the operation of ss. 84.1 or 212.1, but just fall outside the sections (for example, if the taxpayer is one of a group of seven persons and not six as required under s. 84.1(2) (*b*)), there may still be a Ministerial direction under s. 247(1).

[81] Under the CBCA, s. 24(1), MCA, s. 24(1), SBCA, s. 24(1), and Draft OBCA, s. 22(1), the issuance of par value shares is prohibited. All amounts received as consideration constitute "stated capital". CBCA, s. 26(1.1)-(1.5), and Draft OBCA, s. 24(4), permit only a portion of the amount to be designated as "stated capital" in specific circumstances (ITA, s. 85.1, share for share exchange). *See* Ewens, *Meaning of Corporate "Capital" and Distribution of Post-1971 Surplus as Capital Gains*, in CORPORATE MANAGEMENT TAX CONFERENCE 1978, *supra* note 1, 49, at 52; Bowden, *The Significance of Paid-Up Capital in Income Tax Law*, in BRITISH COLUMBIA TAX SEMINAR (1978).

[82] Where the corporation has conferred a benefit or advantage on a shareholder, s. 15(1) requires the inclusion of this amount into income.

[83] I choose 10% as the dividing line because of the corporate definition of "associate" and because of the 10% rule used for "connected" corporation and the Part IV tax.

In the course of taking the issuer private, an acquiror might purchase shares of the controlling group for an amount in excess of market value.[84] It may also be necessary to acquire the shares of the minority at the same price, depending on whether there is any provision in applicable companies or securities legislation requiring *pro rata* repurchase and prohibiting the payment of a premium.[85]

Once the acquiror has obtained control of the issuer, it can mop up the outstanding shares by compulsory acquisition, share reclassification, share consolidation, amalgamation or purchase of assets followed by a winding up.

V. The Income Tax, Corporate and Securities Considerations Involved in the Methods of Acquisition

Against the background of the preceding outline of the three types of transactions, the discussion now turns to the income tax considerations involved in using the methods of acquisition outlined. Relevant aspects of companies or securities law which might influence the choice of method in certain jurisdictions will be noted,[86] although a detailed examination is beyond the bounds of this paper.[87]

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[84] The acquiror may also try to make a private agreement with the controllers in order to circumvent the prohibition relating to the sale of a control premium found in OSA, s. 91(3), Bill 49, s. 91(3), and Bill 76, s. 89.

[85] *Supra* note 7. *See also Re* R.J. Jowsey Mining Ltd., [1969] 2 O.R. 549, at 556-7, 6 D.L.R. (3d) 97, at 104-5 (C.A.); Farnham v. Fingold, [1973] 2 O.R. 132, 33 D.L.R. (3d) 156 (C.A.), *rev'g on other grounds* [1972] 3 O.R. 688, 29 D.L.R. (3d) 279 (H.C.). In the Matter of Consolidated Manitoba Mines Ltd., [Dec., 1966] Bull. O.S.C. 5; Perlman v. Feldmann, 219 F. 2d 173 (D.C. 1955). *See generally* Gibson, *The Sale of Control in Canadian Company Law*, 10 U.B.C.L. Rev. 1 (1976).

At common law, those persons who receive a premium are liable to the other shareholders for the premium. Statutory provisions state that it is necessary for the acquiror to make a follow-up offer on the same terms within a short period of the private agreement. If an exempt bid is made whereby both the offeror and offeree are "control persons", then a control premium could be paid without triggering a follow-up obligation.

[86] One must also consider the possible effects of the Foreign Investment Review Act, S.C. 1973, c. 46. *See generally* Glover & Schwartz, *supra* note 1.

[87] For an excellent review of the corporate considerations involved in corporate reorganizations, *see* Ewens, *Company Law Considerations Relating to Corporate Actions and Reorganizations*, 1976 Conference Report 224.

A. *Purchase of Shares*

1. *Take-over Bids*

(a) *The Domestic Take-over or Issuer Bid*

(i) *Non-Tax Considerations*

The domestic take-over, or issuer bid, is an offer made by the issuer to its shareholders to purchase their shares in the company. In order to remain as sole shareholders, the controlling group does not tender its own shares; only the shares of the minority are acquired.

While most jurisdictions permit a corporation to repurchase its shares,[88] subject to certain restrictions,[89] few statutes regulate the use of an issuer bid.[90] In these jurisdictions the issuer must provide shareholders with sufficient time and information to evaluate the terms of the bid and may be required to file insider trading reports.[91] In addition, an issuer wishing to repurchase its shares from individuals resident in Ontario must comply with guidelines designed by the Ontario Securities Commission (Policy 3-37) and with section 163 of the Ontario Securities Act Regulations to ensure that shareholders are given adequate disclosure and a fair evaluation of their shares.[92]

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[88] BCCA, ss. 256-8; ACA, s. 41.1(1); SBCA, s. 37(5); MCA, s. 37(5); OBCA, s. 39(2); Draft OBCA, s. 30; QCA, ss. 48, 58; NBCA, ss. 59(2), (3), 60(1), (2); NSCA, ss. 47(1) (*f*), (4), 48; NCA, s. 101; CBCA, s. 37(1), (5). *See generally* Phillips, *The Concept of a Corporation's Purchase of Its Own Shares*, 15 ALTA. L. REV. 324 (1977); Getz, *Some Aspects of Corporate Share Repurchases*, 9 U.B.C.L. REV. 9 (1974).

[89] *E.g.*, the purchase of shares must not render the issuer insolvent. OBCA, s. 39(5), sets out the procedure for repurchasing common and special shares. CBCA, s. 32, leaves the procedural steps to be determined by the shareholders and inserted in the articles or by-laws.

[90] OSA, ss. 88-100; CBCA, ss. 187-98; Bill 49, ss. 89-100; Bill 76, ss. 87-98. The SBCA, ss. 187-88, speaks of a take-over bid by the purchase of its own shares in the context of compulsory acquisition.

[91] An issuer may be an insider of itself. For a definition of "insider", *see* CBCA, s. 121(1); BCCA, s. 1(1); ACA, s. 41.31; SBCA, s. 121(1) (*b*); MSA, s. 125(1) (*a*); Bill 49, s. 1(1)18(v); OSA 1(1)17(iv); Draft OBCA, s. 137(1) (*b*) (i); Bill 76, s. 1(1) (*h*.1) (iv).

There is no requirement for filing under the BCCA, MCA, SBCA, or Draft OBCA. Under these acts an issuer, who is deemed to be an insider of itself, will be liable for damages only if it misuses inside information.

[92] [Oct., 1977] BULL. O.S.C. 253. The O.S.C. will grant exemptions in certain cases. *See* [Nov., 1978] BULL. O.S.C. 323. The definition of "going private transaction" in the Draft OBCA contains no reference to a take-over bid, though the phrase "or other transaction" is used. According to the remaining portion of the definition the interest of the security holder must be terminated without his consent. It is certainly arguable that in certain circumstances the take-over bid does just this because the shareholder has no choice but to surrender his shares for fear of being left holding a security for which there are few ready buyers. An issuer would then be required to comply with the s. 188 provisions:

(a) A valuation must be prepared by a qualified and independent valuer.

Directors of the issuer who do not dissent from the resolution authorizing a purchase which contravenes restrictions in the constating documents or companies legislation are liable to the issuer to the extent of the amount paid to repurchase the shares.[93] Furthermore, it is conceivable that minority shareholders might challenge the authority of the directors on the basis that the directors have acted for an improper purpose by demonstrating that the reacquisition of the shares of the issuer was designed to strengthen the position of the directors as controlling shareholders.[94]

(ii) *Income Tax Considerations*

The income tax consequences for minority shareholders whose shares are acquired are straightforward. On an issuer bid, the *company* is making a bid to repurchase shares. Consequently, any amount which a shareholder receives in excess of the paid-up capital of his shares is deemed by the Income Tax Act to be a dividend.[95] In addition, a capital gain will result if the shareholder receives proceeds of disposition in excess of the adjusted cost base of his shares.[96]

For example, shareholder X owns one share with a paid-up capital of $5 and an adjusted cost base of $6. He tenders his share to the issuer and receives $10. The deemed dividend to X is $5 while his capital gain is $4. To prevent double taxation of the same proceeds, the Income Tax Act permits a shareholder to subtract the amount of a deemed dividend from what normally would be considered his proceeds of disposition.[97]

(b) The valuation must consider going concern or liquidation assumptions without discounting the shares' value because they are held by the minority and must evaluate the sufficiency of the consideration offered for the shares.
(c) The valuation must be made not later that 120 days prior to the announcement of the transaction and all material intervening events must be detailed.
(d) A summary of the valuation and other details relating to the transaction must be sent in an information circular to each within 40 days of the meeting at which the squeeze-out is to occur.
(e) The transaction must be approved by a majority or in certain cases, two-thirds of the independent votes cast by holders of the affected security at a meeting of the members of the class affected.

[93] CBCA, s. 113(2)(*a*); BCCA, s. 150(1)(*a*); ACA, s. 41.21(1); SBCA, s. 113(2) (*a*); MCA, s. 113(2) (*a*); OBCA, s. 135(1); Draft OBCA, s. 129(2) (*a*).

[94] *See* IACOBUCCI, PILKINGTON & PRICHARD, *supra* note 34, at 297-300; Birds, *Proper Purposes as a Head of Director's Duties*, 37 MOD. L. REV. 580 (1974).

[95] ITA, s. 84(3). S. 84(4) (substituted by S.C. 1977, c. 1, s. 38(1)) would not apply because it deals with a reduction of capital "otherwise than by way of a redemption acquisition or cancellation". Presumably, when the corporation repurchases shares on an issuer bid, one of these three consequences occurs.

[96] ITA, s. 40(1).

[97] *See* ITA, s. 54 (*h*) (x). One must also take account of the provisions of s. 112 if a capital loss occurs. S. 112(3) states that if a *corporation* owns a share that is capital property and receives a taxable dividend or capital dividend in respect of that share, the

Therefore, his proceeds of disposition are \$5 rather than \$10 and there is a capital gain of only \$1.

The deemed dividend is taxable to its recipient.[98] However, the liability may vary. An individual resident in Canada receives the benefit of the dividend gross-up and tax credit.[99] These mechanisms effectively reduce the amount of tax which an individual must pay on the income he receives by way of dividend from a corporation resident in Canada.[100]

A Canadian public corporation pays no Part I tax on any deemed dividend it receives. To prevent double taxation the Income Tax Act permits inter-corporate dividends to pass tax-free. A Canadian private corporation may be required to pay a Part IV tax of 25% which is refunded once taxable dividends are paid to its shareholders.[101] If the recipient is a non-resident, a 25% withholding tax is imposed, subject to reduction of this amount by any bilateral tax treaty between Canada and the foreign country in which the shareholder is resident.[102]

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amount of loss of the corporation arising from transactions with reference to the share on which the dividend was received will be the loss as otherwise determined less the aggregate of all taxable dividends received by the corporations on the share that were deductible under s. 112(1) and all capital dividends received on the share. This rule will not apply if the corporate shareholder owned the share for at least one year before the capital loss arose *and* the corporation did not own more than 5% of the issued shares of any class of stock of the corporation paying the dividend.

In addition, where shares in respect of which the capital loss was realized were acquired in exchange for other shares of the corporation under a transaction to which s. 51 applied, the amount of the reduction in the capital loss will include taxable or capital dividends received on the shares that were given up on the exchange.

There may be some doubt as to the treatment of shares which are inventory to the taxpayer. It is clear that a deemed dividend may arise. However, does the trader also have to include an amount in his income computed in accordance with the rules for determining income from the disposition of inventory found in ss. 9, 10, 23? It is only where the shares are "capital property" that s. 54(*h*) (x) subtracts the amount of the deemed dividend from the proceeds of disposition to prevent double taxation.

[98] ITA, s. 12(1) (*j*), (*k*).

[99] ITA, s. 82, *as amended by* S.C. 1977-78, c. 1, s. 36; s. 121 *as amended by* S.C. 1977-78, c. 1, s. 58. The \$1,000 dividend deduction in s. 110.1 is not available to minimize tax liability created by deemed dividends under s. 84. For a critique of this proposal, *see* Gould & Laiken, *Dividends vs. Capital Gains Under Share Redemptions*, 27 CAN. TAX J. 161 (1979).

[100] In British Columbia, *e.g.*, a shareholder who pays tax at a marginal rate of 62.78% is required to pay at a rate of only 39.37% due to the dividend tax credit.

[101] *See* text accompanying notes 53-56, *supra*.

[102] ITA, s. 212(2). Canada has tax treaties which provide for a reduction of withholding tax on dividends from 25% to 15% with the United States, United Kingdom, Australia, Belgium, Denmark, Finland, France, Ireland, Israel, Japan, The Netherlands, Norway, Pakistan, The Philippines, Sweden, Switzerland and Trinidad and Tobago. *See also* Coulombe, Johnston, Hausman & Peterson, *Canada's New Tax Treaties*, 1976 CONFERENCE REPORT 290.

Once acquired, shares of the minority are either cancelled or held as treasury shares.[103] The resale of treasury shares, however, does not constitute a disposition for income tax purposes and no capital gain or loss results.[104] Similarly, no tax consequences are incurred when shares are cancelled, even though a reduction of capital is classified as a disposition.[105]

(b) *The Non-Arm's Length/Arm's Length Take-over Bid*

(i) *Non-Tax Considerations*

The take-over bid is a cash offer made by a third party to acquire the outstanding shares of the issuer. Companies[106] and securities[107] legislation regulate the conduct of the offeror. They contain provisions, for example, specifying the required contents of information circulars and the length of time a bid must remain open.[108] The Ontario Securities Commission presently requires extensive disclosure and independent valuations before "bids which could result in the squeeze-out of the minority" are to take place in order to discourage the minority shareholder from selling his shares without first making a rational assessment of the compensation offered.[109] In addition, those restrictions

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[103] The treatment of the reacquired shares varies. Some statutes require a corporation to cancel its shares following repurchase: CBCA, s. 37(5); Draft OBCA, s. 35(6); SBCA, s. 37(5); MCA, s. 37(5); QCA, s. 58; NBCA, s. 59(3); NSCA, s. 46(4) (redemption of preference shares); PEICA, s. 34(3) (special shares only); OBCA, s. 38(2) (special shares only). OBCA, s. 40(2), provides directors with a choice with respect to *common* shares. ACA, s. 41.11(3), states that shares which have been issued by a company and purchased by it shall be restored to the status of authorized but unissued shares. BCCA, s. 259, states that a company may cancel shares it has repurchased or keep them as treasury shares. NCA, s. 49(3), requires the cancellation of redeemed preference shares without decreasing authorized capital, yet permits, under s. 49(4), the reissue of new shares in its place without an increase in the issued capital.

[104] ITA, s. 54(*c*) (vii).

[105] ITA, s. 54(*c*) (ii) (A), (vii).

[106] CBCA, ss. 187-89. A bid may be exempt from regulation when it is made through the stock exchange or in the over-the-counter market (*see also* CBCA Regulations, s. 58) or it is an offer to fewer than 15 shareholders to purchase shares by way of separate agreements or to purchase shares of a corporation that has fewer than 15 shareholders, two or more joint holders being counted as one shareholder. An interested person may also apply to a court having jurisdiction in the place where the offeree corporation has its registered office for an order exempting a take-over bid from regulation. The court may make an exemption order on such terms as it thinks fit provided the exemption does not unfairly prejudice a shareholder of the offeree corporation.

[107] BCCA, ss. 78-97; ASA, ss. 80-99; SSA, ss. 87-106; MSA, ss. 80-99.1; Bill 49, ss. 88-100; OSA, ss. 88-100; QSA, ss. 131-56; Bill 76, ss. 86-88.

[108] For a detailed review, *see* P. ANISMAN, TAKEOVER LEGISLATION IN CANADA 147-80 (1974).

[109] Often, minority shareholders realize that they will be squeezed out on the second step by amalgamation, for example, and consequently may accept the take-over

on directors mentioned in connection with the issuer bid apply equally when a take-over bid is used.

(ii) *Income Tax Considerations*

A common form of take-over bid involves a straight cash offer made by the acquiror to the shareholder. If the shareholder disposes of capital property, a capital gain or loss results, depending on whether or not the proceeds of the disposition exceed the adjusted cost base of the shares. There is no deemed dividend to the shareholder because the acquiror is not the company which originally issued the shares.

In certain arm's length, share for share, take-over bid situations, section 85.1 may be available to all shareholders to permit a tax-free disposition.[110] The provisions of this section apply automatically without the necessity to file any election form.[111] A shareholder will be deemed to have disposed of his shares of the target company at their adjusted cost base and to have acquired the shares of the purchasing company (the offeror) at a similar cost if all of the following conditions are met:

1. The target company shares constitute capital property of the vendor shareholder.
2. The vendor shareholder and/or purchasing company deal at arm's length immediately prior to the acquisition.
3. The vendor shareholder and/or persons with whom he does not deal at arm's length must not control the purchasing company immediately after the acquisition.
4. The vendor shareholder and/or persons with whom he does not deal at arm's length must not own shares of the capital stock of the purchasing company having a fair market value of more than 50% of the fair market value of all its outstanding shares.
5. Shares of the target company may only be exchanged for shares of one class of the purchasing company.

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bid offer. This effect was referred to by former SEC Commissioner Sommer as the "whipsaw effect": "Faced with the prospect of a merger or a market reduced to 'glacial activity and the liquidity of the Mojave Desert, how real is the choice of the shareholder confronting the offer of Management to acquire his shares?'" *Supra* note 2. *See* discussion in Note, *supra* note 6; Brudney & Chirelstein, *supra* note 6; Stumpf, *SEC Proposed "Going Private" Rule*, 4 DEL. J. CORP. L. 184, at 186 (1978); Salter, *supra* note 2.

[110] *See* Ward, *supra* note 1; Gould & Laiken, *supra* note 99.

[111] The vendor and purchasing company may nullify the application of s. 85.1 by making an election under s. 85, or a particular vendor may nullify the rollover by reporting a gain or loss for the year in which the exchange occurs.

[112] *See* McNamara, *Note on Compulsory Acquisition of Shares*, 10 WESTERN ONT. L. REV. 141 (1971); Flisfeder, *Compulsory Acquisition of the Interest of a Dissenting Minority Shareholder*, 11 ALTA. L. REV. 87 (1973); English, *Corporate Acquisitions—General Considerations*, in STUDIES IN CANADIAN COMPANY LAW 603 (J. Zeigel ed. 1967); Hansen, *supra* note 1; ANISMAN, *supra* note 108; REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT (Greene, Chairman, cmd. 2657, 1925-26).

The cost base of the target company shares to the purchasing company depends on both the number and value of the shares acquired. If shares with more than 10% of the value and votes are acquired, the cost of the shares will be their fair market value. Otherwise, their adjusted cost base will be nil. This 10% ownership requirement can be met at any time after the exchange and before the shares are sold. Once 10% are acquired, all shares purchased prior to the date the threshold is reached will be deemed to have a cost equal to fair market value at their time of acquisition.

Section 85.1 is of limited use in going private transactions because usually the vendor and purchaser do not deal at arm's length as a result of the take-over bid transaction. However, this provision may be of use when the take-over bid is the first step to a two-step squeeze-out transaction and the offeror is not able to purchase sufficient shares on the bid to acquire *de jure* control.

(c) *The Compulsory Acquisition*[112]

(i) *Non-Tax Considerations*

In most Canadian provinces,[113] it is more advantageous to use a take-over bid than any other technique. Once an offeror obtains tenders of at least 90% in value of those shares[114] which he did not otherwise hold or have held on his behalf before the bid,[115] either directly or indirectly

Whether or not controlling shareholders will be permitted to squeeze out the minority, by amalgamation or arrangement, will depend in part on whether the courts view the enactment of a compulsory acquisition provision as the only means of expropriation the legislature condones. Consequently, in the absence of such a provision, is an amalgamation squeeze-out permissible? In Ontario, under the OBCA, squeeze-outs by arrangement have been permitted (*Re Ripley Int'l, supra* note 7; *Re* P.L. Robertson Mfg. Co., 7 O.R. (2d) 98, 54 D.L.R. (3d) 354 (H.C. 1974)), and amalgamations have been recently prohibited (*Maple Leaf Mills, supra* note 7, and *Westeel-Rosco, supra* note 7). In order to answer this question, it is necessary to determine the reason for the enactment of the compulsory acquisition provision. Was it intended to facilitate mergers and business combinations and to rid the company of an obstreperous minority or did the legislature contemplate the use of the technique as a means of aggrandizing shareholdings without any "business reasons" for doing so? It is beyond the scope of this paper to examine this question fully. For brief comments, *see* Flisfeder, *id.*, at 90-95, and the comments of the Privy Council in Blue Metal Indus. Ltd. v. R.W. Dilley, [1969] 3 W.L.R. 357 *aff'g* 111 C.L.R. 445 (Aust. H.C. 1966-67).

[113] CBCA, s. 199(2); BCCA, s. 276(1); SBCA, s. 188; ACA, s. 153(1); QCA, s. 48(1); NSCA, s. 119(1). *See also* Draft OBCA, ss. 185-87.

[114] It is 90% in value and not 90% in number. *See, e.g.*, Australian Consol. Press Ltd. v. Australian Newsprint Mills Holdings Ltd., 105 C.L.R. 473 (Aust. H.C. 1960).

[115] The 90% must be computed on the basis of shareholders independent of the offeree. This is a statutory requirement under the CBCA, MCA, SBCA, BCCA and Draft OBCA, and was the position of the court in *Re* Bugle Press Ltd., [1961] Ch. 270, [1960] 1 All E.R. 768 (C.A.), and Esso-Standard Ltd. v. J.W. Enterprises Inc., [1963]

through associates[116] or affiliates, he may compel the remaining minority to surrender its shares within five months after the making of an offer. The offeror must supply these shareholders with compensation equal to the original offer price.

However, a court, on application by a shareholder to whom notice of expropriation was given, may "order otherwise"[117] within two months from the date of the notice. On such an application, the shareholder may object not only to the price offered for his shares, but also to the manner in which his shares are being acquired.[118]

S.C.R. 144, 37 D.L.R. (2d) 598. It is presumably possible to acquire 90% of the independently held shares even where the offeror already holds 90%. *See* Lewis Emmanuel & Sons v. Lombard Australia Ltd., [1963] N.S.W.L.R. 38, and Hansen & Iacobucci, *supra* note 1.

[116] The BCCA makes no reference to the term "associate" but uses the term "nominee". For a discussion of the expression, *see* the outstanding judgment of the South African Court of Appeal in Sammel v. President Brand Gold Mining Co., [1969] 3 S.A. 629; *Canadian Allied Property*, *supra* note 5; and most recently, Jefferson v. Omnitron Inv. Ltd., (unreported, B.C.S.C., Dec. 4, 1979) (*per* Meredith J.). Note that a joint bid is not permitted unless expressly authorized as in the CBCA, s. 187. *See Blue Metal*, *supra* note 112.

[117] There have been few successful "orders otherwise"; *see Re* Bugle Press, *supra* note 115, and *Esso-Standard*, *supra* note 115. These orders were made on grounds of lack of independence when computing the 90% of shares affected. Many applications in which unfairness of price was alleged have been brought to court. *See Re* Hoare & Co., [1933] All E.R. Rep. 105, 150 L.T. 374 (Ch. D.); *Re* Evertite Locknuts Ltd., [1945] Ch. 220, [1945] 1 All E.R. 40 (Ch. D.); *Re* Press Caps Ltd., [1949] Ch. 434, [1949] 1 All E.R. 1013 (C.A.); *Re* Western Mfg. (Reading) Ltd., [1956] Ch. 436, [1955] 3 All E.R. 733 (Ch. D.); *Re* Sussex Brick Co., [1961] Ch. 289, [1960] 1 All E.R. 772 (Ch. D.); *Re* Grierson, Oldham & Adams Ltd., [1968] Ch. 17, [1967] 1 All E.R. 192 (Ch. D.). Nonetheless, the onus to prove unfairness is on the dissenting shareholders because, as the B.C. Court of Appeal pointed out in *Canadian Allied Property*, *supra* note 5, there are many legitimate reasons for permitting the applications, and, as Maugham J. pointed out in *Re Hoare*, *id.*, over 90% of the shareholders have voted in favour of the scheme.

[118] One must look at the statutory provisions of each jurisdiction to determine the grounds upon which to ask for an order otherwise. For example, in B.C., a court has the power to vary the price and to fix terms as it sees fit as well as the discretion to order otherwise. For discussion of the procedural aspects, *see Canadian Allied Property*, *supra* note 5; In the Matter of Pacific Enterprises Ltd. and In the Matter of the Companies Act, Section 276, (unreported, B.C.S.C., May 10, 1979) (*per* Esson J.). Strict compliance with each procedural provision is required. Otherwise, the court may "order otherwise" in order to ensure that investors are given time to make a rational decision. *See* Rathie v. Montreal Trust, [1953] 2 S.C.R. 204, [1953] 4 D.L.R. 289; *Re* John Labatt & Lucky Lager Breweries Ltd., 29 W.W.R. 323, 20 D.L.R. (2d) 159 (B.C.S.C. 1959). *See generally* Bird, *Corporate Mergers and Acquisitions in Canada*, 18 U.N.B.L.J. 16 (1968). Note also that in British Columbia, for example, there must be a scheme or contract (*Canadian Allied Property*, *supra* note 5) and proper notice must be given to the shareholders (*Re John Labatt*, *id.*).

If the Companies Act of the incorporating jurisdiction does not contain a compulsory acquisition provision, a company may choose to continue its existence in a jurisdiction which does.[119]

(ii) *Income Tax Considerations*

Only issuers in jurisdictions which classify issuer bids as take-over bids have compulsory acquisition at their disposal.[120] Consequently, a deemed dividend and capital gain or loss could result when the issuer compels a minority shareholder to dispose of his shares.

2. *The Open Market Purchase*

(a) *The Domestic Transaction*

(i) *Non-Tax Considerations*

The issuer can acquire shares "in the manner they would normally be purchased by any member of the public" instead of purchasing them pursuant to tenders. This is known as an open market purchase. While the most common forum for this is the stock exchange, the open market purchase may also be made in the over-the-counter market, provided that it is done through an independent middleman who acts between two principals unknown to each other.[121]

Even though a purchase of shares through an exchange is exempt from the application of securities and company law provisions,[122] it is subject to rules prescribed by that body.[123] In Ontario, Policy 3-37 and the Ontario Securities Act also impose valuation and disclosure requirements on an issuer which intends to circumvent take-over bid

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[119] This assumes that the statute of incorporation permits the export of a corporation and that the jurisdiction in which continuance is desired has the statutory power to import a corporation. *See, e.g.*, CBCA, ss. 181-82; BCCA, s. 37A-B; ACA, ss. 157-59; SBCA, ss. 181-82; MCA, ss. 181-82; OBCA, ss. 198-99; Draft OBCA, ss. 178-79; NBCA, s. 26 (import provision only); NSCA, s. 119A (import provision only).

[120] *See* CBCA, s. 187; SBCA, s. 187(*g*). In Draft OBCA, s. 186, the expressions "issuer bid" and "takeover bid" are used.

[121] *See Purchase of Own Shares by a Corporation*, INTERPRETATION BULLETIN IT-300, n. 3 (Apr. 2, 1976); Ward, *supra* note 1.

[122] CBCA, s. 187(*b*); OSA, s. 88(2) (*a*); Bill 49, s. 88(3) (*c*); Bill 76, s. 86(3) (*c*). *See also* O.S.C. Policy Statement No. 3-42, in [Oct., 1979] BULL. O.S.C. 285.

[123] *See* Toronto Stock Exchange Bylaws, Part XXIII in CAN. SEC. L. REP. 17,281-27 (CCH); Vancouver Stock Exchange Rule 975, in CAN. SEC. L. REP. 17,737 (CCH); Montreal Stock Exchange Rule VIII, in CAN. SEC. L. REP. 16,825 (CCH). *See also* "*Re*: Current Procedure for Take-Over Bids, Issuer Bids and Insider Bids Through the Facilities of the Toronto Stock Exchange", TSE Notice to Members No. 1999, Nov. 7, 1979, in CAN. SEC. L. REP. 70,123 (CCH).

provisions by making a "creeping acquisition" of the shares of the minority.[124]

Companies and securities statutes attempt to redress the inequality of bargaining powers between the parties in an open market purchase where the vendor may not be aware that the issuer is purchasing his shares. To prevent abuse, the issuer may be liable for damages if it misuses specific confidential information when purchasing these shares.[125]

(ii) *Income Tax Considerations*

Prior to March 31, 1977, a corporation that purchased its shares[126] on the open market was required to pay a 25% Part II tax on the amount by which the purchase price exceeded the lesser of the paid-up capital of the shares acquired and the paid-up capital limit. If the shareholder received proceeds of disposition in excess of the adjusted cost base of the shares he owned he would pay only capital gains tax.[127] It was intended that a shareholder not pay tax on any deemed dividend which might arise because he had no knowledge of the identity of the purchaser.[128]

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[124] This only applies if the issuer intends to purchase 5% or more of its own shares within the following year. The 5% per 12 month exemption would most commonly be used for purchases through stock exchanges not recognized by the Commissions or for purchases in the over-the-counter market. OSA, s. 88(3) (*d*), Bill 40, s. 88(3) (*d*), and Bill 76, s. 86(3) (*d*), state that an issuer bid is exempt if the issuer publishes a Notice of Intention that it will not purchase in aggregate more than 5% of securities of the class within 12 consecutive months. The exemption is not available if there is a published market (as defined in OSA, s. 88(1) (*j*), and OSC Policy No. 3-42, *supra* note 122) for the voting securities *and* the purchase is effected above the market price plus brokerage ("market price" is defined in OSA, s. 88(1) (*e*), and s. 162(3) of the Regulations). The OSA has recently been amended so that the 5% rule will not include securities relying on other s. 88(2) exemptions.

[125] CBCA, s. 125(5); BCCA, s. 152; ACA, s. 85; SBCA, s. 124; MCA, s. 125(5); Draft OBCA, s. 139(5); BCSA, s. 111; SSA, s. 120; MSA, s. 111; ASA, s. 112; QSA, s. 169. For a discussion of the phrase, *see* Green v. Charterhouse Group Canada Ltd., 12 O.R. (2d) 280, 68 D.L.R. (3d) 592 (C.A. 1976); In the Matter of Harold P. Connor, [June, 1976] BULL. O.S.C. 149. Note that OSA, s. 131, Bill 49, s. 131, and Bill 76, s. 129, use the phrase "knowledge of a material fact . . . that has not been generally disclosed". *See* Buckley, *How to Do Things with Inside Information*, 2 CAN. BUS. L.J. 343 (1977). *See also* Anisman, *Insider Trading Under the Canadian Business Corporations Act*, in MEREDITH MEMORIAL LECTURES 151 (1975); IACOBUCCI, PILKINGTON & PRICHARD, *supra* note 41, at 341 *et seq.*; Yontef, *Insider Trading*, in 3 PROPOSALS FOR A SECURITIES LAW FOR CANADA 625 (1979).

[126] ITA, s. 181, *repealed by* S.C. 1977-78, c. 1, s. 81. The section stated that the share could be common or preferred. S. 182, *repealed by* S.C. 1977-78, c. 1, s. 82(1), applied only to the redemption shares on the open market when the maximum amount payable upon redemption or acquisition had not been increased since either Feb. 19, 1953, or June 18, 1971. In such cases, a certain percentage of tax was imposed on the premium paid over par value.

[127] ITA, s. 84(6), states that s. 84(3) does not apply to issuer open market purchases; thus there is no deemed dividend.

[128] For a more complete discussion, *see* Kellough, *Some Income Tax Effects of a Company Purchasing or Redeeming Its Own Shares*, 32 THE ADVOCATE 14 (1974).

After March 31, 1977, the Part II tax was repealed. A transaction in which a taxpayer sells shares on the open market is now subject only to the provisions of subdivision C of Part I. Consequently, the shareholder who incurs a capital gain or loss following the sale of his shares is the only person required to pay tax. This is true even though a deemed dividend occurs in effect when the shareholder receives proceeds from the issuer in excess of the paid-up capital of his shares. Presumably, by repealing the Part II tax and keeping subsection 84(6) in the Income Tax Act, the Federal government is no longer worried that a taxpayer can structure a transaction in order to receive the amount as a dividend or a capital gain.[129]

Taxpayers who dispose of their shares to the issuer on the open market have their proceeds treated as a capital gain rather than as a deemed dividend. This, however, is not preferred by many shareholders in low tax brackets. Such persons cannot make use of the dividend tax credit which would substantially reduce the amount of tax they are required to pay on taxable dividends. On the other hand, persons earning in excess of $59,000 will wish to make an open market sale because of the favourable treatment given to capital gains in that tax bracket.[130] To accommodate all its shareholders, the issuer can make purchases through intermediaries and by issuer bid. In jurisdictions where the use of an issuer bid is authorized and when it wishes to use only one technique, the issuer may be undecided about which to employ. This decision should not prove difficult for issuers in jurisdictions where compulsory acquisition is available following an issuer bid.

(b) *The Non-Arm's Length Transaction*

(i) *Non-Tax Considerations*

An open market purchase made by a corporation using either type of transaction is free of companies or securities regulation,[131] subject to possible compliance with Policy 3-37 or the Ontario Securities Act when

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[129] *Supra* note 59.

[130] *Id.*

[131] CBCA, s. 187(*b*); BCSA, s. 78(*b*) (ii); Bill 49, s. 88(2) (*a*); Bill 76, s. 86(2) (*a*); OSA, s. 88(2) (*a*). Note that ASA, s. 80(*b*) (ii), MSA, s. 80(*b*) (ii), and QSA, s. 131(*f*) (ii), also exempt purchases of shares in the over-the-counter market, provided that the purchaser has filed an insider trading report in accordance with ASA, ss. 109, 109.1, MSA, ss. 109, 109.1, or QSA, s. 179. SSA, s. 87(*b*) (ii), also exempts over-the-counter purchases without the requirement that insiders file reports on their additional share acquisitions.

An acquiror might also circumvent the take-over rules by offering to purchase the shares of fewer than 15 shareholders by private agreement. This private agreement is considered an exempt bid by corporate and securities legislation. *See* CBCA, s. 187(*a*); BCSA, s. 78(*b*) (ii); QSA, s. 131(*f*) (i); ASA, s. 80(*b*) (i); SSA, s. 88(*b*) (i); MSA, s. 80(1) (*b*) (i); Bill 49, s. 88(2) (*c*); OSA, s. 88(2) (*c*); Bill 76, s. 86(2) (*c*). Barring any

Ontario shareholders are affected.[132] There are two reasons for this. First, a seller in the open market, at least where the market is operating fairly, is not under the same pressures as an offeree in a take-over bid nor subject to uncertainty whether the conditions of a bid will be met.[133] Secondly, the market price will presumably vary as the purchaser seeks control and the market itself can thereby give some protection to the shareholder.[134] Nonetheless, the shareholder often lacks the necessary information to make a reasoned decision whether to sell. To assist shareholders, companies and securities legislation attempts to prevent an acquiror from benefiting from its dominant position by holding it in breach of insider trading provisions if it makes use of specific confidential information when acquiring its own shares.[135]

(ii) *Income Tax Considerations*

The open market purchase triggers a capital gain or loss provided the vendor is not in the business of selling securities.[136] As a vendor of shares will experience similar tax consequences regardless of whether he has surrendered them through an open market purchase or take-over bid,[137] the issuer will decide on the mode of acquisition once it has considered such non-tax factors as the availability of compulsory acquisition, the degree to which each transaction is regulated and the amount of legal, accounting and brokerage costs.

B. *Amalgamation*

An amalgamation can be used in a non-arm's length or arm's length going private transaction. When Company A and the issuer amalgamate,

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prohibition at common law, the acquiror will then be able to pay shareholders a premium for their shares, particularly if it is purchasing control of the corporation in an arm's length transaction. *But see* OSA, s. 91; Bill 49, s. 91; Bill 76, s. 89, and *supra* notes 84, 85.

[132] *See* note 147 *infra*. The O.S.C. may choose to exempt transactions under certain circumstances. *See* note 92 *supra*.

[133] *See* ANISMAN, *supra* note 108, at 51.

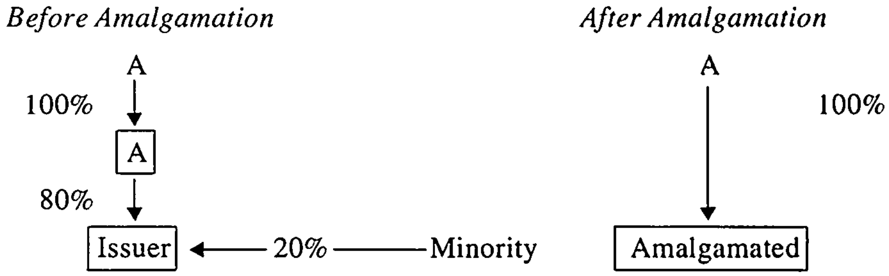
[134] IACOBUCCI, PILKINGTON & PRICHARD, *supra* note 41, at 461.

[135] *See* note 125 *supra*. For a description of the Consolidated Building-Bovis deal, *see* Ward, *supra* note 1, at 116. Note that a shareholder who makes a private agreement and is treated differently from others would not have the protection of Draft OBCA, s. 188(1) (*a*).

[136] Recall that under ITA, s. 248(1), "business" also includes "an adventure or concern in the nature of trade". *See also* M.N.R. v. Taylor, [1956-60] Ex. C.R. 3, [1956] C.T.C. 189, and the discussion of income in A. SCACE, THE INCOME TAX LAW OF CANADA 38 (1979).

[137] CBCA, ss. 175-80; BCCA, ss. 268-72; ACA, s. 156; SBCA, ss. 175-80; MCA, ss. 175-80; OBCA, ss. 196-97; Draft OBCA, ss. 172-77; QCA, s. 18, NBCA, s. 31; NSCA, s. 120; PEICA, s. 77; NCA, s. 30. The PEICA, the NBCA and the NCA only permit the amalgamation of companies with the same or similar objects.

the controlling shareholders of Company A, or of the issuer, receive common shares of the amalgamated corporation, and minority shareholders are given cash or some other security, generally a non-voting, non-participating preference share.



1. *Non-Tax Considerations*

Amalgamations are regulated by provisions in the companies[137] and securities[138] acts of every jurisdiction in Canada. Companies cannot, however, amalgamate unless they have been incorporated in the same jurisdiction. Some acts permit the export or import (continuance) of one company into the jurisdiction of the other so that amalagamation is possible.[139] The companies must then enter into an amalgamation agreement which prescribes the terms and conditions of the amalgamation and the mode of bringing the amalgamation into effect.[140] Whether or not the agreement is to provide for the cancellation of shares of one amalgamating company held by the others is determined by the companies statute affecting the amalgamating companies.[141]

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[138] While companies legislation sets out procedural steps which companies must follow to amalgamate, securities acts regulate trading in securities made in connection with a statutory amalgamation. Shareholders who distribute their shares to the public or trade in securities in these circumstances are exempt from both prospectus (or registration statement) and registration requirements. *See* BCSA, ss. 21(1) (*i*), 55(1); ASA, ss. 19(1)9, 58; SSA, ss. 20(1) *j*, 65; MSA, ss. 19(1)10, 58(1) (*b*); Bill 49, ss. 34(1)15, 71(1) (*i*); OSA, ss. 34(1)15, 71(1) (*i*); QSA, ss. 28, 69, 70; NBSFPA, ss. 7(*h*), 12(12); PEISA, ss. 2(3) (*f*), 13(*a*); NSSA, ss. 4(*f*), 19(*f*); NSA, ss. 5(*g*), 20(*g*); Bill 76, ss. 32(1) (*o*) (i), 69(1) (*i*) (i).

[139] *Supra* note 119.

[140] The amalgamation agreement usually contains:

(1) The terms and conditions of the amalgation;

(2) The manner of carrying the amalgation into effect;

(3) The memorandum and the articles (articles and by-laws) of the amalgamated company;

(4) The names, addresses and occupations of the directors of the amalgamated company;

(5) The requirement that each company must adopt the agreement;

(6) The manner in which the issued and unissued shares of each amalgamated company will be exchanged for those of the amalgamated company.

[141] CBCA, s. 176(2); BCCA, s. 269(3); ACA, s. 156(3) (*f*); SBCA, s. 176(2); MCA, s. 176(2); OBCA, s. 196(3); Draft OBCA, s. 173(2); QCA, s. 18(2); NBCA, s. 31(2); NSCA, s. 120(3) (*g*), (*h*); PEICA, s. 77(2); NCA, s. 30(2) (*i*), (*j*).

Once an agreement is concluded and is approved of by the Boards of Directors of the amalgamating companies,[142] shareholders of each amalgamating company receive an information circular.[143] They must then approve the business combination by special resolution.[144] In British Columbia and Alberta, court approval is also required.[145] The constating documents of the amalgamated company are then filed with the appropriate government authority. This authority then issues a certificate

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[142] The agreement must be approved by the Board of Directors of each amalgamating company. If a person sits on the Board of each amalgamating company, he should declare his possible conflict of interest and refrain from voting on the matter.

[143] The information circular need not contain much information. *See Re* Ardiem Holdings Ltd., 67 D.L.R. (3d) 253 (B.C.C.A. 1976), and the comments in Hansen, *Annual Survey of Canadian Law: Corporation Law*, 10 OTTAWA L. REV. 617, at 714 (1978).

[144] CBCA, s. 177(5), SBCA, s. 177(5), and MCA, s. 177(5), all require approval by a special resolution of the shareholders (not less than two-thirds majority of shareholders who voted in respect of the resolution: CBCA, s. 2(1); SBCA, s. 2(1) *(ff)*; MCA, s. 1(1) *(gg)*). The OBCA, s. 196(4), and the Draft OBCA, s. 174(4), require the passage of a special resolution which includes a directors' resolution, in addition to a shareholders' resolution passing by a two-thirds majority of the votes cast (OBCA, s. 1(1)27; Draft OBCA, s. 1(1)42). The QCA, s. 18(4), states that two-thirds in value of the shares represented at the meeting of each amalgamating company must approve of the transaction.

Other jurisdictions require that the resolution be passed by three-fourths of the votes cast at the meeting of each amalgamating company. ACA, s. 156(4); NBCA, s. 31(3); NSCA, s. 120(4); PEICA, s. 77(3); NCA, s. 30(3).

Note that there is a requirement for class voting in certain jurisdictions. CBCA, s. 177(4); SBCA, s. 177(4); MCA, s. 177(4); BCCA, s. 269(4) *(b)*; OBCA, s. 196(5); Draft OBCA, s. 174(3). Moreover, the minority may also be treated by the court as a separate class based on commercial principles and a lack of community of interest with the controlling shareholders. *See Re* Hellenic and General Trust, [1975] 3 All E.R. 382, [1976] 1 W.L.R. 123 (Ch. D.) (*per* Templeman J.). Whether or not Canadian courts should adopt the *Re Hellenic* decision as binding will depend on the protection afforded to minority shareholders in the companies statute of each jurisdiction. For example, under the OBCA, shareholders have no recourse to dissent or oppression proceedings. In addition, there is no requirement for the court to approve the amalgamation. Therefore, it is not surprising that Steele J., in *Maple Leaf Mills*, *supra* note 7, suggested that the doctrine may be applicable in Ontario. Contrast this with the position in British Columbia where shareholders are able to ask for relief in one of three ways when they do not agree with the terms of an amalgamation. It is suggested that the court in British Columbia should not adopt the *Re Hellenic* test. It is also surprising that Montgomery J. in *Westeel-Rosco*, *supra* note 7, suggested that there be separate approval by the minority on an amalgamation under the CBCA because shareholders may bring a dissent or oppression application if they do not approve of the business combination. For a case in which the courts might have used *Re Hellenic*, but did not, *see Re* Simco Ltée, 3 B.L.R. 318 (Que. S.C. 1978).

[145] BCCA, s. 270; ACA, s. 156(6), (7). In Newfoundland (NCA, s. 30(4)) and Nova Scotia (NSCA, s. 120(5)), the amalgamating companies may apply for a court order.

In Triad Oil Holdings Ltd. v. Provincial Sec'y for Manitoba, 59 W.W.R. 1 (Man. C.A. 1967), the court permitted the squeeze-out of minority shareholders on an amalgamation and overturned the order of Nitikman J., who had refused to approve the amalgamation pursuant to a provision in a previous Manitoba Companies Act which provided for this procedure. Hall J., speaking for the court, stated that:

of amalgamation, which thereafter constitutes the charter of the amalgamated company.[146]

Ontario shareholders must receive added disclosure because the provisions of Policy 3-37 apply to amalgamation squeeze-outs.[147] In addition, an issuer may be required to file disclosure documents with a stock exchange when its shares are to become delisted as a result of the amalgamation.[148]

The amalgamation of a private company with a public company does not enable the latter to shirk its statutory obligations to disclose material information. For example, the new Ontario Securities Act and both the British Columbia Companies Act and Securities Act state that the amalgamated company will be designated a "reporting issuer" following an amalgamation with another reporting issuer even though it was not subject to such regulation prior to the acquisition.[149]

> The mere fact that some shareholders dissent or deem their interest adversely affected is not sufficient to preclude the Court from approving the amalgamation. It is the function of the Court to examine the material and if it is satisfied that all parties, including creditors and dissentient shareholders are being fairly dealt with, to approve the agreement . . . .

Quaere whether the court was possibly affected by the repeal of the previous Manitoba statute containing a compulsory acquisition provision. There followed the enactment of a new Companies Act which for the first time permitted combination by amalgamation.

Generally, courts will not question the adequacy of consideration on the presumption that a large number of shareholders have agreed to the amalgamation. However, courts will insist on strict compliance with procedural requirements dealing with disclosure, notice of meetings and time limits.

[146] What is the effect of the amalgamation certificate? In Ruskin v. Canada All-News Radio Ltd., *supra* note 7, the court ordered the respondent in an oppression action to return the certificate of amalgamation (for cancellation) which the respondent had caused to be issued during the day of the hearing on the injunction application pursuant to s. 234 of the CBCA. The applicant had applied to enjoin a proposed amalgamation following which he would have been squeezed out. *See also Shareholders of Rio Algom, Preston Appraise Company Merger*, GLOBE & MAIL, Jan. 31, 1980, p. B-13, col. 1. *Cf.* Wingold v. Minister of Consumer and Corporate Relations, (unreported, Ont. H.C., July 9, 1979) (*per* Galligan J.); Norcan Oils Ltd. v. Fogler, [1965] S.C.R. 36, 46 D.L.R. (2d) 630 (1964), *rev'g* 47 W.W.R. 257, 43 D.L.R. (2d) 508 (Alta. C.A. 1964); *Re* Gibbex Mines Ltd. (N.P.L.) and Int'l Video Cassettes Ltd., [1972] 2 W.W.R. 10, 49 D.L.R. (3d) 731 (B.C.S.C.).

[147] Disclosure Standards—Takeover Bid Circulars—Information Circulars—Material Information, [Dec., 1977] BULL. O.S.C. 273. *See also* Draft OBCA, s. 188, which would also regulate amalgamation squeeze-outs. Note that the definition of a "Going private transaction" excludes the purchase of participating securities pursuant to statutory rights of purchase. It is presumed that a shareholder who purchases shares with a redeemability feature recognizes that the company may repurchase its shares upon the exercise of this right.

[148] Toronto Stock Exchange Bylaws, s. 19.16; r. 912 of the Vancouver Stock Exchange; Alberta Stock Exchange Bylaws, s. 19.16; Montreal Stock Exchange Rules, s. 9155.

[149] OSA, s. 1(1)38 (v), Bill 49, s. 1(1)41 (v), and Bill 76, s. 1(1) (*t*) (iv), state that a "reporting issuer" includes companies continuing from a statutory amalgamation, provided one of the amalgamating companies has been a reporting issuer for at least 12 months. An issuer may be a "reporting issuer" if it is an issuer of voting securities

There are a number of advantages in using an amalgamation as opposed to compulsory acquisition following a take-over bid:

1. The acquiring group will be uncertain as to its chances for success for the period of up to five months when compulsory acquisition is used. However, an amalgamation requires only preparation, time and notice periods appropriate for special resolutions, and court approval which takes on the order of six weeks.

2. Approval of an amalgamation is required by only a majority of not less than three-fourths of the votes[150] cast by members of the company entitled to do so by proxy or in person. A condition precedent to compulsory acquisition is the purchase of at least 90% of all the issued shares.

3. No funds are required to acquire the preferred shares of a minority shareholder issued on an amalgamation squeeze-out in accordance with the companies act until such time as those shares are redeemed. By contrast, the acquiring company on a take-over bid will probably need to borrow a large sum of money to finance a take-over and will thereby incur a sizeable interest expense. The fact that this interest expense is deductible does not detract from the fact that no such expense will be incurred if amalgamation is used.

However, it may be disadvantageous to proceed by way of amalgamation in certain provinces because there is case law to the effect that amalgamations should not be used as a means to squeeze out minority shareholders.[151]

2. *Income Tax Considerations*

(a) *Interjurisdictional Amalgamation: Continuance*

A ruling published by Revenue Canada indicates that continuance of a company in another jurisdiction triggers either a disposition by shareholders of their shares or by the company of its assets.[152] In some

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through a prospectus or exchange take-over bid circular, it has filed such documents, its securities have been listed and posted for trading on any recognized stock exchange in Ontario after the new act has come into force, or it is subject to the provincial corporation act and is offering its securities to the public. Emerson, *supra* note 16, at n. 39, points out that an issuer whose securities are listed after the OSA came into force (Sept. 1, 1979) and are subsequently delisted will continue to be a reporting issuer until it obtains an order deeming it to have ceased being one. *See* BCCA, s. 1(1) ("reporting company"); BCSA, s. 2(1) ("reporting company").

[150] *Supra* note 144.

[151] *See Maple Leaf Mills*, *supra* note 7; *Westeel-Rosco*, *supra* note 7; *cf. Triad Oil*, *supra* note 145. *See also Canadian Merril*, *supra* note 7; *Neonex*, *supra* note 7; *Jepson*, *supra* note 7. The recent introduction of the amalgamation provision into most Canadian companies statutes begs the question whether it was intended that this procedure be used to expropriate minority shares. For a review of the advantages and disadvantages of using the amalgamation, *see* Hansen, *supra* note 1.

[152] *Exporting a Corporation—Whether a Disposition—Effect on Incorporation Date*, TR-1 (June 24, 1974); *Sale of Assets, Amalgamation*, TR-49 (Mar. 7, 1977).

jurisdictions, however, shareholders may receive a deemed dividend. Under the federal, Manitoba and Saskatchewan corporations acts, the concept of par value and non-par value shares has been abolished.[153] All amounts received by corporations incorporated in these jurisdictions fall into a stated capital account. If continuance into one of these jurisdictions is to occur, one must ensure that any contributed surplus which arose on the sale of shares by the corporation for amounts in excess of par value is shown on the balance sheet as contributed surplus and not as stated capital.[154] Otherwise there will be a deemed dividend to the shareholder equal to the amount of the contributed surplus that has been capitalized.[155]

(b) *The Act of Amalgamation*

(i) *The Issuer as an Amalgamating Corporation*

An amalgamating corporation triggers either income or capital gains consequences when it disposes of its assets to a new corporation.[156] The Income Tax Act, however, permits the corporation to defer tax liability by disposing of assets and liabilities for proceeds equal to their adjusted cost bases.[157]

Section 87 will apply to a transaction if:

1. Two or more predecessor corporations merge to form one new corporate entity;
2. The predecessor corporations are taxable Canadian corporations;[158]
3. All the property of the predecessor corporations becomes the property of the new corporation;
4. All the liabilities of the predecessor corporations become liabilities of the new corporations; and
5. All of the shareholders, except predecessor corporations, receive shares of the new corporation.

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[153] CBCA, s. 24(1); SBCA, s. 24(1); MCA, s. 24(1); and *supra* note 81.

[154] Glover & Schwartz, *supra* note 1, at 12 n. 5, point out that this is permitted by s. 26(2) of the CBCA which states that s. 26(1.1) does not apply where the shares are issued prior to the continuation. *See also* SBCA, s. 26(2); MCA, s. 26(2); Draft OBCA, s. 24(5).

[155] ITA, s. 84(1). The definition of "paid-up capital" in s. 89(1) (*c*) no longer includes contributed surplus. *Repealed by* S.C. 1977-78, c. 1, s. 44(3).

[156] ITA, ss. 54(*c*), 40.

[157] ITA, s. 87. S. 87(2) details the rollover treatment of all assets and liabilities disposed of. The tax-free zone is not lost for amalgamating corporations with pre-1972 acquired capital property provided certain conditions are met.

[158] ITA, s. 248(1), defines a "taxable Canadian corporation" as a corporation, that, at the time the expression is relevant, is a Canadian corporation, which is not exempt from tax under Part I by virtue of a statutory provision.

(ii) *The Shareholders of the Amalgamating Corporations*

On an amalgamation, a shareholder may receive cash, debt or shares from the amalgamated corporation in exchange for shares in an amalgamating corporation.[159] Capital gains liability might then arise because the Income Tax Act regards this transaction as a disposition.[160] Subsection 87(4), however, provides that shareholders may acquire new shares at the adjusted cost base of the old shares[161] if the shares of the predecessor corporation are capital property[162] of shareholders who receive no consideration other than shares of the new corporation.

The consideration received by shareholders of the issuer dictates the tax consequences of the amalgamation. Persons who pay tax at greater than a 50% rate or who have accumulated a large capital loss carry-forward want to receive cash in order to trigger capital gains.[163] To provide them with cash, though, would destroy the rollover for the amalgamating companies and for the other shareholders.[164] Shareholders who wish any gain to be treated as a dividend rather than as a capital gain want the amalgamated corporation to issue them redeemable preference shares with the same paid-up capital as their old shares and with redemption value equal to the fair market value of the old shares. Upon redemption[165] of the preference shares, the shareholders would receive a

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[159] Whereas the BCCA, for example, requires the amalgamated company to issue shares as consideration for shares of an amalgamating company, the CBCA, MCA, SBCA and Draft OBCA state that money is an acceptable alternative. *See, e.g.*, CBCA, s. 176(1) (*d*), (*e*), and Draft OBCA, s. 173(1) (*b*) (i), (ii).

[160] ITA, s. 54(*c*) (ii) (C).

[161] ITA, s. 87(4) (*a*). ITAR 26(21) permits the flow-through of the tax-free zone for shareholders who held their shares on V-Day, even if the current fair market value is less than the V-Day value, provided that the shareholder takes back shares of only one class. There is no adjustment to the pre-1972 capital surplus account under s. 88(2.1) upon the disposition of shares.

[162] ITA, ss. 248(1), 54(*a*).

[163] *Supra* note 59.

[164] Glover & Schwartz, *supra* note 1, at 23, point out that in the *Neonex* case, *supra* note 7, minority shareholders received cash for their shares, and the s. 87 rollover was not available. Solicitors of the corporation apparently received an advance ruling that no adverse tax consequences would occur. Minority shareholders were indifferent to the result because they would have incurred the same gain or loss had they received redeemable preference shares. The only difference was that the gain or loss arose immediately on the amalgamation rather than shortly thereafter on the redemption. However, the controlling shareholders would have been able to realize a capital loss immediately rather than at a later time had redeemable preference shares been issued and the amalgamation qualified for s. 87 treatment.

Note that *Amalgamation—Fractional Interests in Shares*, INTERPRETATION BULLETIN IT-192 (Dec. 23, 1974), states that the Department of National Revenue will not deny shareholders or their corporations the application of the s. 87 rules merely because one or more shareholders received a fraction of a share or received cash (not in excess of $200) in lieu of a fraction of a share or other consideration.

[165] There are a number of corporate formalities which must be observed on redemption:

1) The company must have the authority to create redeemable shares. CBCA,

deemed dividend to the extent that the proceeds from redemption exceeded the paid-up capital of the shares.[166]

For example, shareholder X owns a share of the issuer with a paid-up capital of $5, an adjusted cost base of $5 and a fair market value of $50. On amalgamation he has the choice of receiving either a share of the amalgamated corporation or cash. If he chooses a new share which is subsequently redeemed at $50 by the amalgamated corporation, a deemed dividend of $45 and no capital gain or loss result.[167] The receipt of cash triggers a capital gain of $45 yet destroys the section 87 rollover for the other shareholders.

In order to please all shareholders of the amalgamating corporations and to satisfy the subsection 87(1) requirements, the amalgamated corporation might issue two classes of redeemable preference shares. While the paid-up capital of Class A shares would be equal to the paid-up capital of the old shares, Class B shares would have a lower paid-up capital than the old shares and a redemption price equal to their fair market value. A capital gain or loss would result from the redemption of a Class A share, while a deemed dividend and possible capital gain or loss would occur upon redemption of a Class B share.

For example, shareholder X owns a share of the issuer with a paid-up capital of $5, an adjusted cost base of $5 and a fair market value of $50. He is given a choice of a Class A share with a paid-up capital of $5 and a fair market value of $50 or a Class B share with a paid-up capital of 1¢ and a redemption value of $50. If he elects Class A, a capital gain of $45 would result from redemption. The redemption of a Class B share provides the shareholder with a deemed dividend of $49.99 and a capital loss of $4.99.[168]

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ss. 2(1), 34(1); BCCA, ss. 22, 256; ACA, s. 69(1); SBCA, ss. 2(1) (*y*), 34(1); MCA, ss. 2(1) (*y*), 34(1); OBCA, ss. 27(1) (*f*), 34(1); Draft OBCA, ss. 1(1)32, 32(1); QCA, s. 48(1) (*d*); NBCA, s. 59(2); NSCA, s. 46(1); PEICA, s. 86 (*as amended by* S.P.E.I. 1976, c. 28); NCA. s. 49(1).

2) In certain jurisdictions the redemption price or a formula to calculate the amount must be stated in the constating documents. CBCA, s. 34(1); BCCA, s. 256(*a*); ACA, s. 70(7); SBCA, s. 34(1); MCA, s. 34(1); OBCA, s. 27(2); Draft OBCA, s. 32(1); NSCA, s. 46(3); PEICA, s. 86; NCA, s. 49(2).

3) The redemption must not render the corporation insolvent. CBCA, s. 34(2); BCCA, s. 257; SBCA, s. 34(2); MCA, s. 34(2); OBCA, s. 38(1); Draft OBCA, s. 32(2).

4) The redemption must not be made with capital. ACA, s. 70; QCA, s. 48(13); NSCA, s. 46(1) (*a*); NCA, s. 49(1) (*a*).

5) Under BCCA, s. 258, there must be a *pro rata* redemption if not all shares of the class are to be redeemed, provided that the memorandum and articles do not state otherwise.

[166] This scheme was used in the Beaver Engineering and Y & R Properties transactions. For commentary on the latter, *see* Gould & Laiken, *supra* note 99, at 163 *et seq*.

[167] There is no capital gain because the proceeds of disposition are $5 ($50 reduced by the deemed dividend of $45) and the adjusted cost base is $5.

[168] The capital loss is $4.99 because the proceeds of disposition are 1¢ ($50 less deemed dividend of $49.99) and the adjusted cost base is $5.

The amalgamation agreement must specify that an election made by the shareholder some time after the amalgamation is retroactive to the date of the transaction. Failure to choose within a specified period will leave the shareholder with a deemed election of Class A shares. Revenue Canada, however, may question this procedure, and it is prudent for the issuer to defer the period of election until after shareholder approval of the scheme.[169]

The amalgamated corporation might wish to please only those shareholders earning more than $59,000 per year by converting apparent dividends into capital gains. To do so, controlling shareholders of one amalgamating corporation would purchase additional shares from the corporation, thereby injecting capital which is subsequently allocated to redeemable preference shares of the amalgamated corporation.[170] To prevent the occurrence of a deemed dividend, shareholders must inject sufficient capital so that the paid-up capital of the redeemable shares equals the redemption price.[171]

Revenue Canada does not look favourably upon this scheme or upon the indiscriminate use of redeemable preference shares to minimize tax liability.[172] Apparently, the Department is prepared to apply section 55 where it feels shareholders have been able to dictate the terms of an amalgamation to provide the shareholders with dividends rather than

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[169] Glover & Schwartz, *supra* note 1, at 33, suggest that one obtain an advance ruling because this procedure could be considered in substance to be the issue of Class A shares followed by the conversion of such shares into Class B by those who elect. If so, the desired intention of giving a shareholder dividend treatment may not result because, on a conversion, the paid-up capital of Class A shares by law becomes paid-up capital of the Class B shares.

This is one example of what is referred to by American tax planners as a "step transaction". The Internal Revenue Service assesses the tax consequences of business transactions by their substance and not by their form. Two steps must not be used to produce a specific tax result when the use of another technique which would render less favourable tax consequences is better suited to the circumstances. For further details, *see* Silver, *Step Transactions*, 22 CAN. TAX J. 213 (1974); Magnet, *supra* note 1, at 146-50; Sapienza, *Tax Considerations in Corporate Reorganizations and Mergers*, 60 NW. U.L. REV. 765 (1966); Vesaly, *"A" Reorganizations—Statutory Mergers and Consolidations*, 19 CASE W. RES. L. REV. 975 (1968); Levin & Bowen, *Taxable and Tax-Free Two Step Acquisitions and Minority Squeezeouts—The Tax Aspects*, 36 N.Y.U. INST. ON FED. TAX. 865 (1978); Lederman, *Two-Step Acquisitions and Minority Squeezeouts—The Securities Law Aspects*, 36 N.Y.U. INST. ON FED. TAX. 941 (1978).

[170] If the injection of capital is deferred until after the amalgamation that amount would be allocable to a specific class of shares and could not be spilled over to the redeemable preference shares. *See* Glover & Schwartz, *supra* note 1, at 25.

[171] Consequently, there will be no deemed dividend but a capital gain or loss will result depending on the adjusted cost base of the shares.

[172] *See* Silver, *Section 55 and Subsection 247(1)*, 1978 CONFERENCE REPORT 626; Robertson, *A Departmental Perspective on Recent Developments in Federal Taxation*, *id.* at 52. *See also* Robertson, *An Update on A Departmental Perspective on Recent Developments in Federal Taxation*, 27 CAN. TAX J. 428 (1979).

capital gains.[173] Paradoxically, a resident shareholder who arranges to receive post-1971 retained earnings of a corporation as a capital gain rather than as a taxable dividend will not be penalized.[174]

(iii) *The Amalgamated Corporation*

Section 87 places the new corporation in the tax shoes of the predecessor corporations. All accounts of the predecessor corporations are aggregated and carried forward into the amalgamated corporation.[175] For example, the paid-up capital of the shares of the amalgamated corporation must equal the paid-up capital of the shares of the predecessor corporations,[176] while non-capital or net capital losses of the amalgamating corporations continue to be deductible by the amalgamated corporation to the extent that they would have been to the amalgamating corporations.[177]

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[173] S. 55 applies where a taxpayer has disposed of property under circumstances where he is considered to have artificially reduced the amount of his gain or created or increased the amount of his loss from the disposition. The gain or loss from the disposition is then computed as if such reduction, creation or increase had not occurred. For further discussion of the possible applications of s. 55, *see* Silver, *supra* note 172. Robertson, *An Update, supra* note 172, at 428, states that "capital gains stripping" should not be encouraged and that Revenue Canada was concerned about the transaction involving "dispositions of shares of a corporation before, on, or subsequent to which the corporation . . . pays or is deemed to pay a dividend free of Part IV tax which represents the capital gain which otherwise would have been realized on a sale of the shares". He indicates that the redemption or repurchase of shares in this situation will be seen as an artificial or undue reduction of capital gains that otherwise would have been suffered by the shareholder, to the extent that he or his holding company received a deemed dividend in excess of the "tax retained earnings" of the payer corporation.

"Tax retained earnings" is not a term of art used in s. 55, nor is it defined anywhere in the Income Tax Act. In the opinion of Revenue Canada, this expression refers to the retained earnings of the payor corporation computed in accordance with Generally Accepted Accounting Principles to the extent that such retained earnings are reflected for tax purposes. In effect, s. 55 will be used to impose a form of "designated surplus" tax on the taxpayer.

Reflecting Revenue Canada's position, the Dec. 11, 1979, Budget contained a provision intended to stop capital gains stripping (Ways & Means Motion #21). It was the stated intention of the Government to enact rules to ensure that where it could reasonably be considered that one of the main reasons for the payment of tax-free intercorporate dividends was to reduce the proceeds on the disposition of shares, the capital gain otherwise determined would be adjusted to reflect the extent to which aggregate tax-free dividends exceeded post-1971 tax retained earnings of the payer corporation.

[174] Robertson, in 1978 CONFERENCE REPORT, *supra* note 172.

[175] ITA, s. 87(2).

[176] ITA, s. 87(3).

[177] ITA, ss. 87(2.1), 87(2) (*w*), 111. *See also* s. 256(7), regarding presumptions as to control of the corporation following an amalgamation, and *Net Capital and Non-Capital Losses on the Acquisition of Control of a Corporation*, INTERPRETATION BULLETIN IT-302R (Nov. 26, 1979).

The new corporation is also deemed to begin its first taxation year at the time of the amalgamation[178] and is permitted to forego paying tax instalments until its second year.[179]

(iv) *Timing of the Amalgamation*

Timing of the amalgamation is important. The amalgamating corporations will have a short fiscal period if the transaction occurs prior to their year-end. It follows that:

1. Capital cost allowance for most classes of depreciable property must be prorated.[180]
2. The 3% inventory allowance must be prorated.[181]
3. Certain carry-forwards (losses, foreign business tax credits, investment tax credits) are affected because the short year counts as one year of the carry-forward period.
4. The time period for repayment of shareholder loans might be accelerated.
5. The inclusion or imputation of partnership income and foreign accrual property income is accelerated.[182]

Shareholders of the issuer might prefer the amalgamation to take place close to their own taxation year-end. Therefore, the squeeze-out might be structured so that a take-over bid and amalgamation occur in different taxation years.[183] For example, Company X makes a take-over bid for the shares of the issuer in December, 1980, but announces that it will amalgamate with the issuer in February, 1981, and eliminate those shareholders who do not tender their shares. At that time, it will issue redeemable preference shares with a redemption value equal to the amount the shareholders are given on the take-over bid. Shareholder X owns 1,000 shares and also has a large loss carry-forward. If 1980 is the last year of the carry-forward period, or if shareholder X anticipates that his income will be greater in 1981, he will choose to tender his shares in 1980. Any capital gains which result will then soak up the losses before the expiration of the carry-forward period.

[178] ITA, s. 87(2)(*a*).

[179] ITA, s. 157.

[180] Income Tax Regulations, s. 1100(1)(*a*).

[181] ITA, s. 20(1)(*gg*).

[182] ITA, ss. 95, 96. These consequences resulting from a short year-end are quoted from Glover & Schwartz, *supra* note 1, at 26.

[183] The International Land Corporation information circular (Oct. 5, 1978) pointed out this fact to shareholders.

C. *Alteration of the Capital Structure of the Corporation by Shareholder Resolution or by Arrangement*

Minority shareholders are often forced to surrender their shares through a reorganization of the capital structure of the issuer.[184] Shares may be either bought for cash and cancelled upon a selective reduction of capital, or they may be reclassified. Alternatively, a consolidation of the existing shares of the issuer may leave minority shareholders with fractional shares for which they are subsequently given cash. The use of most of these techniques, however, must be authorized by shareholders.[185] Court approval is also required when controlling shareholders wish to reorganize the capital structure by means of an arrangement[186] and it may be refused if the provisions of the companies legislation are not strictly followed.[187]

There are a number of advantages and disadvantages in using an arrangement as opposed to an amalgamation or compulsory acquisition. The primary disadvantage of an amalgamation is that it requires that both

[184] Some jurisdictions outside Canada are faced with eliminating the problem of having corporations circumvent take-over bid rules through capital reorganization techniques in order to eliminate shareholders. For the positions in Australia and South Africa respectively, *see* Macgregor, *Take-overs Revisited*, 95 S.A.L.J. 329 (1978); Pliner, *Arranging a Take-over—A Scheme Around the Code?*, 7 AUST. BUS. L.J. 51 (1979).

[185] Shareholders must approve the transaction by special resolution. *See* note 144 *supra*. Strict compliance with class and, in certain jurisdictions, series voting provisions is required. When an arrangement is used, it may be necessary to secure approval of shareholders who own three-fourths of the shares *in value* and *in number*. *See Re* Dorman Long & Co., [1934] Ch. 635, 103 L.J. Ch. 316.

[186] An arrangement is a scheme through which the rights of shareholders may be adjusted or modified. It is used primarily under extraordinary circumstances; *e.g.*, it may be used either where the capital structure of the corporation is inconvenient, or where new capital is required and is only obtainable on condition that the existing rights of the shareholders are modified or their interest in the corporation reduced. The procedure for effecting an arrangement involves the submission of a scheme at the meeting of the shareholders, or, where the holders of more than one class are affected, at separate meetings of the classes of shareholders concerned. Once shareholder approval is obtained, the court must determine whether the scheme was fair and equitable to the shareholders and whether the position of the creditors has been adequately considered.

Once the court has approved a scheme, the corporation must deliver documents evidencing amendments to the constating documents to a governmental regulatory agency which issues a certificate, the effect of which is to amend the constating documents in accordance with the provisions of the arrangement. *See* CBCA, s. 185.1; BCCA, ss. 273-75; ACA, s. 154; SBCA, s. 186; MCA, s. 185.1; Draft OBCA, ss. 180-81; QCA, ss. 49-50; NBCA, s. 48; NSCA, ss. 117-19; NCA, ss. 131-33.

Note that the reorganization of capital by means other than an arrangement may also require approval of the court as well as the passage of a special resolution. *See* ACA, s. 38.

[187] For a recent example, *see Re* Upper Canada Resources Ltd., 20 O.R. (2d) 100 (H.C. 1978).

companies be governed by the same statute, whereas this is not a prerequisite to an arrangement. With an arrangement, all that is required is that the target company be subject to an act which makes provision for it. In addition, whereas courts have not frowned upon the use of arrangements as squeeze-out techniques, some have recently prohibited the use of an amalgamation for this purpose.[188]

The advantages of an arrangement over compulsory acquisition are more significant than the advantages over amalgamation and can be summarized as follows:[189]

1. A lower level of shareholder approval is required for an arrangement than in the case of a compulsory acquisition. For compulsory acquisition, it is necessary to get 90% of the outstanding independently held shares whereas, for an arrangement, the requirement is 75% of those present in person or by proxy and voting at the meeting.

2. Arrangements can be done more expeditiously than compulsory acquisitions because, in the latter case, the offer must remain open for at least four months and the take-over cannot be completed for at least another month. An arrangement in most jurisdictions can probably be done in about two months pending court approval.

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[188] A summary of advantages and disadvantages is also found in WEINBERG, *supra* note 37, at 63-65, later quoted in Potter, *supra* note 1, and Hansen, *supra* note 1.

[189] *See Re Ripley Int'l*, *supra* note 7; *Re* P.L. Robertson, *supra* note 112; *Re* National Bank Ltd., [1966] 1 All E.R. 1006, [1966] 1 W.L.R. 819 (Ch.D.). *But see Re* Hellenic & General Trust Ltd., *supra* note 144, and most recently, *Re* Canadian Hidrogas Resources Ltd., *supra* note 7.

The fact that Ontario courts have permitted arrangement squeeze-outs and not amalgamation freeze-outs may be attributable to the lack of a requirement for court approval under the OBCA. This may be a hollow distinction. As L. GOWER, MODERN COMPANY LAW 712 (4th ed. 1979) points out:

> [T]o suggest that the courts adopt quite the same *laissez-faire* attitude as they apply to reductions [of capital] would be unfair. In practice they investigate the scheme as closely as they are able and regard the initial onus as being on the company to establish its prima facie fairness. The trouble is that English High Court procedure is ill-adapted to the inquisitorial role thus thrust upon the judges. The company will have set the stage for the scheme and will have little difficulty in establishing its prima facie fairness—indeed, the mere fact that it has been passed with the requisite majority is sufficient to raise a strong inference of fairness, an inference which the objectors are rarely able to rebut.

For a discussion of the duties of the court, *see* the comments of Maugham J. in *Re* Dorman Long & Co., *supra* note 185. *See also* the comments of Southey J. in *Re Ripley Int'l*, *supra* note 7; Houlden J. in *Re* P.L. Robertson Mfg. Co., *supra* note 112; Hutcheon J. in *Re* Canadian Hidrogas Resources Ltd., *supra* note 7.

1. *Share Reclassification*

(a) *Non-Tax Considerations*

Share reclassification requires alteration of the attributes of the issuer's shares. Generally, minority shareholders are left with some form of security which is subsequently redeemed by the issuer.

To ensure that all minority shares are acquired, controlling shareholders sometimes employ schemes[190] more elaborate than simply passing a resolution which appends the attribute of redeemability to the shares. For example, Company X has an existing class of shares (Class A). The shareholders of the company first authorize the creation of a new class of shares (Class B), and then pass a resolution providing for the redeemability of the existing class by the issuer at any time. Afterwards, the controlling shareholders exercise the conversion right, while most of the minority shareholders do not. Subsequently, the issuer redeems the Class A minority shares. If any of the minority convert to Class B to escape redemption, the controllers convert back to Class A and reclassify the shares of the new class as redeemable. Before the minority is able to convert its shares back to Class A, its shares are redeemed by the issuer.[191]

This scheme leaves the impression that controlling shareholders may act with abandon. However, in passing the special resolution authorizing a modification of share attributes,[192] they must act "bona fide in the best interests of the company".[193] Even then, any classes of shareholders affected by the modification are required to approve the share reclassifi-

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[190] *E.g.*, *Cablecasting Ltd.*, *supra* note 7. For commentary, *see* Hansen, *supra* note 143, at 711, and Campbell & Steele, *supra* note 1.

[191] In *Re* Canadian Hidrogas Resources Ltd., *supra* note 7, the applicant company had approximately 735 shareholders holding 3 million common shares. The company proposed to convert these shares into Class "A" non-voting redeemable shares at a ratio of 5 to 1. The new shares could then be converted, within 30 days of the first conversion, to Class "B" voting shares at the ratio of 1 Class "A" share to 5 Class "B" shares. At the meeting, only two shareholders representing a majority of the outstanding shares were present. Hutcheon J. held that there were 733 persons who had no knowledge of the proposal and who would have no knowledge beyond the terms of conversion proposed once the arrangement was approved. He concluded that there "lurked the danger of unfairness in the arrangement" because "it is obvious that those shareholders who fail to take advantage promptly of the arrangement will see their investment decline in value significantly with the decline reflected as an enhancement in value of the shares which are altered in accord with the arrangement". *Id.* at 709.

[192] CBCA, ss. 37(4), (7), 167(1) (*f*); BCCA, ss. 246, 251; ACA, s. 38(1) (*a*); SBCA, ss. 167(1) (*f*), 37(7); MCA, ss. 29(3), 37(7), 167(1) (*e*); OBCA, s. 189(1) (*j*); Draft OBCA, s. 166(1) (*f*); QCA, s. 48(5)-(8); NBCA, ss. 62(3), 65; PEICA, ss. 34(6), 86; NCA, ss. 39, 40, 131(2); NSCA, s. 47(1) (*c*), (*g*), (*j*).

[193] *See* note 11 *supra*; GOWER, *supra* note 189; Magnet, *supra* note 1, at 152; WEINBERG, *supra* note 37, at 86-87; Flisfeder, *supra* note 112.

cation.[194] In some jurisdictions, the minority may be treated as a separate class when only one class of shares has been issued.[195] Consequently the approval of a "majority of the minority" would be required.

Even though they are not required to comply with registration or prospectus provisions for engaging in a reclassification,[196] issuers which squeeze out Ontario shareholders by this technique must observe the valuation and disclosure guidelines outlined by the Ontario Securities Act.[197]

(b) *Income Tax Considerations*

(i) *Attachment of Conversion and Redemption Provisions to an Existing Class of Shares*

When the attributes of a share have been fundamentally changed, a shareholder has, in effect, disposed of his old shares and acquired new ones. However, it is unclear at what point the addition of attributes sufficiently alters the shares to trigger tax liability. Policy statements issued by Revenue Canada suggest that a disposition occurs only when there is a *substantial* change in the entire bundle of rights of the shareholder.[198] For example, Interpretation Bulletin 146-R2 states that the addition of a right to common shares with identical attributes other than the right to receive tax-deferred dividends on the shares is not a

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[194] Most jurisdictions in Canada provide for class voting rights when a class of shareholders is adversely affected by fundamental changes in the corporate constitution. *See* CBCA, s. 170; BCCA, ss. 247, 249, 251(2); ACA, ss. 38, 69; SBCA, s. 170; MCA, s. 170; OBCA, s. 189(4); Draft OBCA, s. 168.

Note that when a reclassification is done by arrangement under NCA, s. 131, class voting requirements must be observed. Note also that the interests of other classes affected by share reclassification are considered by the court approving a scheme of arrangement. *See supra* note 144.

[195] *Re* Hellenic & General Trust Ltd., *supra* note 144.

[196] *Supra* note 138. In order for an issuer to qualify for the exemption in British Columbia, Saskatchewan, Alberta, New Brunswick, Nova Scotia, Newfoundland and Prince Edward Island, the share reclassification must be considered a "reorganization", which is not defined by the securities legislation of these jurisdictions. In OSA, s. 193(1)(*b*), and MSA, s.193(1)(*b*), the share reclassification must be performed by arrangement. *Quaere* whether exemptions are available in Quebec because of the wording of QSA, s. 28(*f*): "the exchange by one company of securities issued by it for the securities of *another* company . . . for the purpose of reorganizing one of them."

[197] Disclosure Standards—Takeover Bid Circulars—Information Circulars—Material Information, *supra* note 147. *See also* OSA Draft Regulations, s. 163, and Draft OBCA, s. 188(1)(*b*), which designates the share reclassification as a going private transaction through the phrase "by arrangement . . . or other transaction . . . that would cause any participating security of the corporation to be an affected security . . . ". *See* note 4 *supra*. If so, the issuer must observe those requirements set out *supra* note 92.

[198] *Changing Par Value to No Par Value Shares—Whether a Disposition*, TR-2 (June 24, 1974); *Reduction of Paid-up Capital—Whether a Disposition by Shareholder*, TR-9 (Jan. 27, 1975); *Estate Freeze By Way of a Corporate Reorganization*, TR-36 (Aug. 2, 1976).

disposition. However, the Bulletin does suggest that "only in specific circumstances does the addition of a right of exchange not constitute a disposition of shares"[199] and that a change in the rights attaching to a class of shares may constitute a disposition.

It is best to regard the addition of conversion and redemption rights as "insubstantial changes" because of potential valuation and administrative problems.[200] Consequently, there is no change in the adjusted cost base of a shareholder's common shares following the modification of share attributes. Yet, if Revenue Canada views the addition of these rights as a disposition, the taxpayer may wish to make use of section 86 of the Income Tax Act to escape immediate tax liability.[201]

(ii) *The Exercise of Conversion Rights by Shareholders*

It is more likely that Revenue Canada will view the exercise, rather than the addition of conversion rights, as a disposition.[202] Although a capital gain will result if shares of the new class have a fair market value in excess of the adjusted cost base of shares of the old class, sections 51 and 86 of the Income Tax Act enable a shareholder to defer tax liability.

Section 51 states that an exchange of shares is deemed not to be a disposition and the cost base of the shares to the taxpayer is deemed to be

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[199] *Shares Entitling Shareholders to Choose Taxable or Subsection 83(1) Dividends*, INTERPRETATION BULLETIN IT-146R2.

[200] Ewens, *supra* note 87, at 254-55, points out that serious valuation problems would be involved in attempting to compute the portion of the adjusted cost base of the share that is reasonably attributable to the deleted right when a right is removed from a share and no new right is added, thus giving nil proceeds. It would also be almost impossible for Revenue Canada to provide advance rulings in response to ingenious variations in share attributes. Ewens, *id.* at 254-57, gives a general discussion of the addition or deletion of rights triggering a "disposition".

[201] Even if the addition of a right is substantial enough to constitute a disposition, s. 86 will not be available if there is no "reorganization of capital" and may not technically apply because there is no receipt of "property (other shares) from the corporation". As Ewens, *supra* note 87, at n. 220, indicates, the articles of amendment merely change the shareholders' rights with new share certificates being issued and old ones being cancelled.

[202] ITA, s. 54(*c*), does not expressly include this act as a disposition. However, it may fall within either s. 54(*c*) (i) or s. 54(*c*) (ii) (A). Under the former provision, the event must entitle the taxpayer to proceeds of disposition. S. 54(*h*) does not include the receipt of a share following conversion as a proceeds of disposition though the list contained in the section is not exhaustive. It may also be possible to classify the exercise of conversion rights under s. 54(*c*) (ii) (A) as "any transaction or event by which any property of a taxpayer that is a share . . . or similar property, or an interest therein, is redeemed in whole or in part or is cancelled". When this right is exercised, the issuer redeems the shares and issues other shares as consideration.

his adjusted cost base of the convertible property immediately before the exchange[203] where:

1. shares held by the shareholder are capital property;
2. the capital property is a share, bond or debenture of the corporation;
3. the terms of the shares confer upon their holder the right to make the exchange; and
4. the taxpayer receives no consideration other than shares of one class of the capital stock of a corporation.[204]

Section 86 provides a shareholder with a rollover[205] if:

1. the taxpayer *disposes* of *all* his shares of the class;
2. the disposition occurs in the course of a reorganization of capital;[206]
3. the shares of the taxpayer are capital property; and
4. the taxpayer receives property that includes other shares of the corporation as consideration for the shares he surrenders.

Sections 51 and 86 apply in different circumstances and are mutually exclusive. If the exercise of conversion rights constitutes a disposition, the taxpayer must use section 86. However, this provision is available only on a reorganization of capital and upon the disposition of all of the taxpayer's shares. Assuming that the exercise of conversion rights is not a disposition, the taxpayer may use section 51, provided that he receives only shares of one class of the capital stock of the company. If cash is given back, one must use section 86 to defer tax liability. Still, the taxpayer will realize a capital gain to the extent that the fair market value of the non-share consideration he receives exceeds the adjusted cost base of the old shares.

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[203] *See generally* Cronkwright, *Amalgamation and Share for Share Exchanges*, 1973 CONFERENCE REPORT 53, at 65; *Estate Freeze*, TR-66 (July 11, 1977). ITAR, s. 26(24), permits a flow-through of the tax-free zone for shareholders who held their shares on V-Day, provided such taxpayers have acquired only one class of the capital stock of the corporation. There is also no adjustment by corporate shareholders to the pre-1972 CSOH account.

[204] *See Fractional Interests in Shares*, INTERPRETATION BULLETIN IT-115R (Sept. 15, 1975), which states that a taxpayer may receive cash to a maximum of $200 for a fractional share received from a company on a s. 51 exchange.

[205] ITAR, s. 26(27), permits a flow-through of the tax-free zone for shareholders who held their shares on V-Day provided they take back only shares of one class of the capital stock of the corporation. There is no adjustment to pre-1972 CSOH. *See generally* Witterick, *Section 86, A Slumbering Giant*, 23 CAN. TAX J. 89 (1975).

[206] The term "reorganization" is not defined by the ITA, nor is it a term of art. Therefore courts have chosen to give a wide reading to the word. *See* Regina v. Santiago Mines Ltd., [1946] 3 W.W.R. 129, 86 C.C.C. 357 (B.C.C.A.); MacLaren v. M.N.R., [1933] Ex. C.R. 13, [1928-34] C.T.C. 135; M.N.R. v. Merritt, [1942] S.C.R. 269, [1942] 2 D.L.R. 465; Smythe v. M.N.R., [1969] C.T.C. 558, 10 D.L.R. (3d) 73 (S.C.C.).

(iii) *The Possibility of a Deemed Dividend on Conversion or Redemption*

Upon conversion of shares of one class into another, shareholders of the issuer are deemed to receive a dividend to the extent that the paid-up capital of the new shares exceeds the paid-up capital of the shares surrendered.[207] When the issuer exercises the redemption right attached to shares of the minority, a deemed dividend and possible capital gain or loss will arise.[208]

2. *Consolidation or Reverse Stock Split*[209]

(a) *Non-Tax Considerations*

Shares are said to be "consolidated" when they are replaced by a greater or lesser number of shares of the same class in the same proportion for all shareholders. For example, controlling shareholders of the issuer wishing to eliminate the minority may propose that a consolidation take place on a ratio of one for 5,000. A shareholder who owns ten shares is then entitled to 1/500 of a share. He is given a fractional certificate in bearer form which the issuer subsequently repurchases for cash pursuant to statutory authority[210] or to a provision in the constating documents of the company.[211]

Those corporate[212] and securities[213] provisions available to protect shareholders on a reclassification also apply on a consolidation.[214]

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[207] ITA, s. 84(1). To avoid the deemed dividend a shareholder should take back shares of the new class with the same paid-up capital as shares of the old class.

[208] *See* p. 89 *supra*.

[209] *See* Dykstra, *The Reverse Stock Split—That Other Means of Going Private*, 53 CHI.-KENT L. REV. 1 (1976); Lawson, *Reverse Stock Splits: The Fiduciary's Obligations Under State Law*, 63 CALIF. L. REV. 1226 (1975); Magnet, *supra* note 1, at 157. *See, e.g.*, *supra* note 112.

[210] CBCA, s. 33(1) (*b*); MCA, s. 33(1) (*b*); SBCA, s. 33(1) (*b*); BCCA, s. 262(2); OBCA, s. 39(1); Draft OBCA, s. 31(1) (*b*); QCA, s. 55(3); NBCA, s. 62(2). All permit repurchase and resale within two years. Draft OBCA, s. 35(6), CBCA, s. 37(5), SBCA, s. 37(5), and MCA, s. 37(5), require the cancellation of fractions unless the articles limit the number of authorized shares. OBCA, s. 40(1), requires cancellation. *See also* CBCA, s. 45(12)-(15), for the rights of shareholders holding fractional shares and scrip certificates.

[211] *See, e.g.*, *Re Ripley Int'l*, *supra* note 7; *Re* P.L. Robertson Mfg. Co., *supra* note 112. For commentary, *see* Campbell & Steele, *supra* note 1; Alain, *supra* note 1.

[212] Most jurisdictions require the passage of a special resolution. CBCA, s. 167(1) (*g*); MCA, s. 167(1) (*f*) and SBCA, s. 167(1) (*g*), state that the resolution must be passed by a majority of not less than two-thirds of the votes cast by the shareholders who voted in respect of that resolution. The OBCA, s. 189(1) (*f*), QSA, s. 55(2), PEICA, s. 34(1) and NBCA, s. 62(1), all require the passage of a director's resolution as well as shareholder approval. QSA, s. 63, and PEICA, s. 34, require approval of two-thirds in value of shareholders represented by shareholders present at the meeting. *See also* OBCA and Draft OBCA provisions, *supra* note 144. The NBCA requires approval of two-thirds of the votes cast at the special general meeting. Note that QSA, s. 55(2), and

(b) *Income Tax Considerations*

(i) *The Consolidation as a Disposition*

Upon reading the Income Tax Act one might conclude that a consolidation is a disposition.[215] Revenue Canada, however, has stated that a disposition does not occur where there is no change in the interests, rights or privileges of the shareholders and there are no concurrent changes in the capital structure of the corporation or the rights and privileges of other shareholders.[216]

A shareholder then will acquire his new shares at the cost of the old ones. For example, shareholder X owns a share with an adjusted cost base of $5. Following a one for 1,000 consolidation, the cost of each new share is $5,000 with the adjusted cost base of the fractional share of shareholder X remaining at $5.

(ii) *The Purchase of Fractional Interests*

A deemed dividend and possible capital gain or loss result to the extent that the shareholders receive consideration in excess of the paid-up capital of the fractional shares surrendered.[217] For example, shareholder X owns a share with a paid-up capital of $5 and an adjusted cost base of $5. Following a consolidation he has a fractional interest, with a paid-up capital of $5 and adjusted cost base of $5. The repurchase of the share by the issuer for $10 leaves the shareholder with a deemed dividend of $5 but no capital gain or loss.[218]

NBCA, s. 62(1), permit consolidation only when the par value of the existing shares is less than $100 each and no share is consolidated over a par value of $100. NCA, s. 131(2), permits consolidation by arrangement with the requirement that a special resolution by passed be three-fourths of the votes cast in person or by proxy by members of the company at a meeting called for that purpose (s. 111). Note that NCA, s. 39, requires every company that has consolidated its shares to give notice of those shares consolidated to the Registrar of Companies. *See also* NSCA, ss. 17, 42(1) (*b*), or s. 21 and article 60 of Table A; ACA, ss. 38(1) (*a*) (*i*), 2(1)32 (Court approval); BCCA, ss. 1(1), 251(1) (*c*) (majority of three-fourths of votes of those entitled to vote).

[213] Unlike the reclassification, the consolidation is expressly covered by the prospectus and registration exemptions in Saskatchewan, Nova Scotia, P.E.I, British Columbia, Alberta, New Brunswick and Newfoundland. In Ontario and Manitoba, it is necessary to use an arrangement while in Quebec, no exemption appears. *See* notes 138, 196 *supra*. Ontario shareholders are protected by Policy 3-37, [Aug., 1978] BULL. O.S.C. 231, as well as by OSA Regulations, s. 163, and Draft OBCA, s. 188. There is probably also a need to report the consolidation squeeze-out to the stock exchange authorities if this will result in the delisting of shares. *See supra* note 148.

[214] *See* pp. 94-95 *supra*.

[215] ITA, s. 54(*c*) (ii) (A). *See supra* note 202.

[216] *Stock Splits and Consolidations*, INTERPRETATION BULLETIN IT-65 (Sept. 8, 1972).

[217] ITA, s. 84(3).

[218] His proceeds are $5 ($10 less deemed dividend of $5) and his adjusted cost base is $5.

3. *Reduction of Capital*

(a) *Non-Tax Considerations*

The companies legislation of most jurisdictions in Canada permits companies to repurchase, redeem or cancel their own shares in spite of the common law prohibition in *Trevor v. Whitworth*.[219] This "reduction of capital", often prompted by particular economic circumstances,[220] is accomplished by the passage of a special resolution.[221] Other formalities which may be required include court approval,[222] notice to creditors,[223] as well as an obligation on the shareholders at the general meeting to act "bona fide in the best interests of the company".[224] In addition, every company whose securities are listed on a stock exchange is required to notify that body promptly of any corporate action that results in the cancellation, in whole or in part, of any of its listed securities.[225]

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[219] 12 App. Cas. 409, 57 L.J. Ch. 28 (H.L. 1887).

[220] These circumstances are: 1) the extinguishment or reduction of a liability in respect of an amount unpaid on any share. ACA, s. 38(1) (*b*) (i); CBCA, s. 36(1) (*a*); BCCA, s. 253(1) (*a*); SBCA, s. 36(1) (*a*); MCA, s. 36(1) (*a*); QSA, s. 58(1); NCA, s. 87; NSCA, s. 52(1) (*a*); Draft OBCA, s. 34(1) (*a*); 2) the reduction of stated or paid-up capital by an amount that is not represented by available or realizable assets. CBCA, s. 36(1) (*c*); BCCA, s. 253(1) (*b*); ACA, s. 35(1) (*b*) (ii); SBCA, s. 36(1) (*c*); MCA, s. 36(1) (*c*); Draft OBCA, s. 34(1) (*b*) (ii); QSA, s. 58(3); NCA, s. 87; NSCA, s. 52(1) (*b*); 3) repayment of an amount in excess of the wants of the company. BCCA, s. 253(1) (*c*); CBCA, s. 36(1) (*b*); ACA, s. 38(1) (*b*) (iii); MCA, s. 36(1) (*c*); Draft OBCA, s. 34(1) (*b*) (i); QSA, s. 58(3); NCA, s. 87; NSCA, s. 52(1) (*c*). Note that both the NBCA, s. 64, and the PEICA, s. 33, permit directors to pass a by-law for the reduction "to any amount they consider advisable and sufficient for the due carrying out of the undertaking". Generally, the reduction of capital must neither render the company insolvent nor be done when it is already insolvent. *See also* OBCA, s. 189(1) (*d*).

[221] CBCA, s. 36(1); BCCA, s. 253; ACA, s. 38(1) (*b*); SBCA, s. 36(1); MCA, s. 36(1); OBCA, ss. 189(1) (*d*), 189(2); Draft OBCA, s. 34(1); QCA, s. 63; NCA, s. 86; NBCA, s. 65; NSCA, s. 52(1); PEICA, s. 34(1). There may also be requirements for separate class votes (*see supra* note 144), and for the passage of a directors' resolution authorizing the reduction (Ont., P.E.I., N.B., and Que.).

[222] BCCA, s. 253; OBCA, s. 190(3); ACA, s. 38(1); NCA, s. 89; NSCA, ss. 52, 53. Even though the courts may try to ensure that creditors' rights are respected, some creditors may be ignorant of the proceedings. If no money remains to pay off these debts, shareholders of the company may be liable. *See* CBCA, s. 36; NCA, s. 96; ACA, s. 41; PEICA, s. 34; QSA, s. 60; MCA, s. 36; SBCA, s. 36; Draft OBCA, s. 35(5).

[223] The court may exercise its discretion to dispense with such notice. *See, e.g.*, BCCA, s. 254.

[224] *See* British & American Trustee Corp. v. Couper, [1894] A.C. 399, 63 L.J. Ch. 425 (H.L.); *Re* Fraser, [1951] C.S. 394 (Ct. Sess.); *Ex parte* Westburn Sugar Refineries Ltd., [1951] S.C.R. 190, *rev'd* [1951] A.C. 625 (P.C.); *In re* Saltdean Estate Co., [1968] 3 All E.R. 829, [1968] 1 W.L.R. 1844 (Ch. D.); *In re* Fowlers Vacola Mfg. Co., [1966] V.R. 97 (S.C. 1965); *cf. In re* Holders Inv. Trust Ltd., [1971] 2 All E.R. 289, [1971] 1 W.L.R. 583 (Ch. D. 1970). *See also* GOWER, *supra* note 189, at 636-39.

[225] *Supra* note 148.

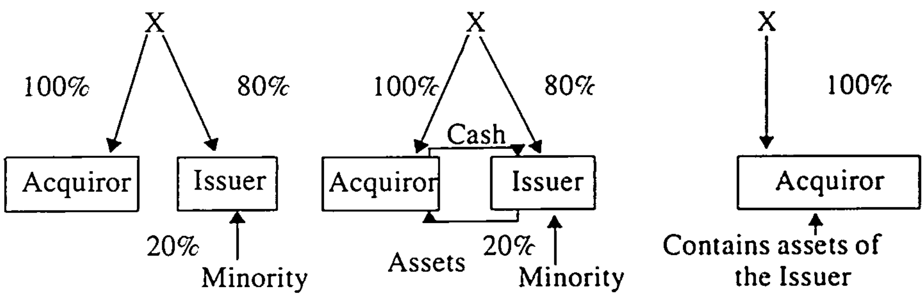
(b) *Income Tax Considerations*

If minority shares are acquired by the issuer through a reduction of capital, a deemed dividend[226] and possibly a capital gain or loss will result.[227]

D. *Sale of Assets and Winding Up*

Controlling shareholders who favour this technique must use two steps to squeeze out the minority. They must first vote in favour of the sale of the issuer's assets to an acquiring corporation[228] for which the issuer receives substantial non-share consideration. Subsequently, they must pass a special resolution authorizing the winding up and dissolution of the issuer.[229] While both the minority and controlling shareholders receive cash for their shares on the winding up, the latter group can continue to carry on the business of the issuer in the acquiring company without the need to account to the minority.

Before the Squeeze-Out *Purchase of Assets* *After the Winding Up*



[226] The deemed dividend will equal any amount by which the sum paid by the issuer on the reduction of paid-up capital exceeds the amount the paid-up capital of the shares of the class has been reduced. Note that ITA, s. 84(4.1), applies only to a public corporation.

[227] *See* p. 72 *supra*; *supra* note 105.

[228] The sale must be of all or substantially all of the property other than in the ordinary course of business. For the corporate requirements, *see* CBCA, s. 183; BCCA, s. 149; SBCA, s. 183(2)-(9); MCA, s. 183(2)-(7); OBCA, ss. 15(2), 17; Draft OBCA, s. 182(7), (8); NCA, s. 131(4). ACA, QSA, NSCA and PEICA do not have such requirements. In certain jurisdictions, approval of the sale is subject to class voting rights. *See* CBCA, s. 183(6); SBCA, s. 183(6); MCA, s. 183(6); Draft OBCA, s. 182(7). Note that in certain jurisdictions, the issuer may first be put into liquidation, before assets are sold, following the passage of an ordinary resolution. *See* OBCA, s. 214(1); Draft OBCA, s. 202(1); P.E.I. Winding Up Act, s. 19; N.S. Winding Up Act, s. 20. BCCA, s. 310, ACA, s. 249, and NCA, s. 234, require a special resolution.

[229] CBCA, s. 204(3); BCCA, s. 288; ACA, s. 237; SBCA, s. 204(3); MCA, s. 204(3); OBCA, s. 203(1) (majority of votes cast at a general meeting duly called for that purpose unless the articles provide otherwise); Draft OBCA, s. 191(1) (*see* OBCA); Que. Winding Up Act, s. 3; N.B. Winding Up Act, s. 3(*a*); P.E.I. Winding Up Act, s. 4(1) (*b*) ("resolution"); NCA, s. 244(*b*); N.S. Winding Up Act, ss. 3(*b*), 1(*e*).

1. *Sale of Assets*

(a) *Non-Tax Considerations*

Parties to an agreement of purchase and sale must first value the assets being acquired and subsequently allocate a portion of the total purchase price to each asset. Each party must also warrant to perform certain tasks. For example, the purchaser may be required to confirm the title of the assets while the vendor may be obliged to verify that each asset has been assigned or transferred by the appropriate document and has been properly registered.[230] Depending on the terms of the agreement, one of the parties will be required to pay retail sales tax,[231] or land transfer tax,[232] and account for any liability arising under the Bulk

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In certain jurisdictions, the holders of each class of shares must approve of winding up (liquidation) and dissolution. *See* CBCA, s. 204(3); MCA, s. 204(3); SBCA, s. 204(3).

A corporation may be dissolved once all is liquidated, if the company by ordinary resolution or its directors by statutory declaration request the Registrar to strike it off. *See, e.g.*, BCCA, s. 279. Even if all affairs have not been wound up, the Registrar may strike the corporation off the Register if it is in default for one year in sending any fee, notice or document required by the Companies Act to the Director of Companies in Ministry of Corporation and Consumer Affairs or the equivalent. *See* CBCA, s. 205(1) (*c*); *cf.* BCCA, ss. 277-78; MCA, s. 205(1) (*c*); SBCA, s. 206 (application to court); ACA, s. 188; OBCA, s. 251; Draft OBCA, s. 238; NBCA, s. 35; NCA, s. 24; NSCA, s. 122.

[230] For example, when acquiring property one should check the registration and priority of leases, obtain mortgage statements, review surveys, search executions, ensure compliance with zoning and building by-laws, search liens for unpaid taxes, conditional sales and assignment of book debt registrations (for personal property), and loans pursuant to s. 88 of the Bank Act.

[231] Retail sales tax is generally a tax imposed on the purchaser of tangible personal property which is to be used for consumption within a province. In most jurisdictions, an exemption is available when a parent or subsidiary (95% or more of its assets are owned by the parent) purchases tangible personal property and pays tax and then sells it to the other. The following is a list of liability and exemption provisions: Social Services and Education Tax Act, R.S.N.B. 1973, c. S-10, s. 4 (8%), and Regulations, s. 13; Retail Sales Tax Act, S.N. 1978, c. 36, s. 3 (11%), and Regulations, s. 26(3); Health Services Tax Act, R.S.N.S. 1967, c. 126, s. 3 (8%), and Regulations, s. 13(2); Revenue Tax Act, R.S.P.E.I. 1974, c. R-14, s. 4 (8%), and Regulations, s. 21; Revenue Tax Act, R.S.M. 1970, c. R-50, s. 3(5), and Regulations, s. 16; The Education and Health Tax Act, R.S.S. 1978, c. E-3, s. 5 (5%), and Rulings, s. 9(*a*); Social Services Tax Act, R.S.B.C. 1960, c. 351, s. 3 (5%), and Regulation 3-14; Retail Sales Tax Act, R.S.O. 1970, c. 415, s. 2, *as amended by* S.O. 1973, c. 23, s. 2 (7%), and Regulation 785(19); Retail Sales Tax Act, R.S.Q. 1964, c. 71, s. 6, *as amended by* S.Q. 1966-67, c. 34, s. 2 (8%), and Regulation 13. Alberta imposes no retail sales tax. *See generally* J. BROWN & J. DRAFFIN, PROVINCIAL RETAIL SALES TAX HANDBOOK (1979).

[232] *E.g.*, the Land Transfer Tax Act, R.S.O. 1970, c. 235, s. 2, *as amended by* S.O. 1977, c. 14, s. 2, provides that any person registering a conveyance of land shall pay a tax of 3/10 of 1% on the first $35,000 of the value of the consideration and 6/10 of 1% on the balance. Provinces throughout Canada impose such fees on the conveyance of land.

Sales Act,[233] the Foreign Investment Review Act[234] or the Combines Investigation Act.[235]

The management of the vendor and purchaser companies must also observe certain corporate formalities.[236] When the issuer sells all or substantially all of its property, its shareholders must approve the sale by special resolution. In some jurisdictions, directors of the vendor must also consent to the sale[237] and obtain the release or consent of holders of debt securities or secured liabilities of the company, assuming the assets are specifically encumbered or are subject to a floating charge. In addition, directors of the vendor who also sit on the board of the acquiring company must beware of a conflict of interest and will usually be required to refrain from voting on resolutions authorizing the purchase or sale of assets.[238]

(b) *Income Tax Considerations*

The complexity of conveyancing procedures, and the tax consequences involved in the purchase and sale of assets, should discourage an acquiror from using this method. There is a conflict of interests between the parties to an asset purchase. When determining the allocation of the purchase price among the assets, the vendor generally prefers to allocate high values to his non-depreciable assets (land) and low amounts to depreciable property (plant or equipment). This enables him to avoid recapture of capital cost allowance which comes fully into his income,[239]

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[233] The Bulk Sales Act is intended to protect creditors of a business whose assets have been sold in bulk. If the purchaser does not fall outside the application of the Act, he may be required to pay a minimum amount for deposit, to demand (from the vendor) a list of creditors whom he may be required to pay immediately or, in certain circumstances, on whose behalf he will deposit money with a trustee. Every province in Canada has bulk sales legislation. Quebec legislation is found in the QUEBEC CIVIL CODE, Art. 1569 *a-e*.

[234] This legislation will apply if the acquiror is a "non-eligible person who is acquiring control of a Canadian business enterprise". *See generally* Hayden & Burns, *The Canadian Foreign Investment Review Act*, 21 PRAC. LAW 55 (1975).

[235] *See* Combines Investigation Act, R.S.C. 1970, c. C-23, s. 33, which reads: "Every person who is party to or privy to or knowingly assists in, or in the formation of, a merger or monopoly is guilty of an indictable offence."

[236] In certain jurisdictions in which the *ultra vires* rule has not been abolished, the vendor and the purchaser must have powers to dispose of and to acquire assets. *See* ACA, s. 20(1)1, (1)3, (1)7, (1)12; QSA, s. 31(*a*), (*h*); NSCA, s. 24(3) (*a*), (*b*); NBCA, s. 14(1) (*a*), (*m*); PEICA, s. 13(1) (*a*), (*b*), (*m*).

[237] Ontario, Quebec, New Brunswick and British Columbia. *See* note 228 *supra*.

[238] CBCA, s. 115; BCCA, s. 143; ACA, s. 78; SBCA, s. 115; MCA, s. 115; OBCA, s. 134; Draft OBCA, s. 131; QCA (no provision); NBCA (no provision); NSCA (no provision); NCA, Table A, s. 57. Even if the directors do commit a breach of their fiduciary duty, they are permitted to ratify the wrong in their capacity as shareholders absent fraud or oppressive conduct. *See* North W. Trans. Co. v. Beatty, 12 App. Cas. 589, 56 L.J.P.C. 102 (1887).

[239] ITA, s. 13(1).

while paying tax on only half of any gain from the disposition of non-depreciable capital property. The purchaser, however, is eager to allocate a significant amount to depreciable property because the larger his capital cost, the larger his continuing deduction for capital cost allowance.[240]

This problem might be corrected in two ways. In a non-arm's length going private transaction any transfer of assets is subject to the operation of section 69. Therefore, if a non-arm's length acquiror purchases assets for consideration in excess of fair market value, its adjusted cost base of the assets is lowered to fair market value.[241] In addition, section 68 permits the Minister of National Revenue to make a reasonable allocation of the purchase price among the assets. This is done from the point of view of the vendor, notwithstanding the form or effect of the contract or agreement, and is binding on the purchaser. However, the effectiveness of this provision is dubious because the Minister apparently will only exercise his power when he believes the agreement is structured solely on the basis of tax considerations.

There are a number of other potential tax problems resulting from a sale of assets. Breach of warranties given by either party might lead to additional tax costs.[242] The purchaser must be aware of problems arising from the sale of assets by a non-resident issuer[243] and the inability to transfer prior years' losses suffered by the vendor in carrying on the business.

Once the asset purchase is complete, the acquiror can begin to operate the business of the issuer. The shareholders of the issuer, however, will be faced with the problem of withdrawing the proceeds of sale from the corporation. In order to extract these funds, the shareholders might vote to wind up the company.

2. *Winding Up of the Issuer*

(a) *Non-Tax Considerations*

Winding up is the process by which the assets of the company are liquidated and the affairs of the company are brought to a halt.[244] For this to occur, most jurisdictions require the passage of a special resolution.[245]

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[240] ITA, s. 20(1) (*a*), and Income Tax Regulations, s. 1100.

[241] ITA, s. 69(1) (*a*). Yet if the property is acquired for less than fair market value, there is no bump in the cost base to the purchaser even though ITA, s. 69(1) (*b*), deems the vendor to have received proceeds of disposition equal to fair market value.

[242] ITA, s. 42, states that if either party pays out money pursuant to the legal obligation, there will be a capital loss.

[243] If the asset is "taxable Canadian property" as defined by ITA, s. 248(1), and it is not "excluded property," as defined by ITA, s. 116(6), then ITA, s. 116(5), imposes tax liability on the purchaser even if he was unaware that the vendor was a non-resident.

[244] *Meaning of Winding Up*, INTERPRETATION BULLETIN IT-126R (Feb. 3, 1975).

[245] *Supra* note 229.

A liquidator may then be appointed to distribute the assets,[246] following which the company is dissolved.[247] It is also possible for the company to request that the Registrar strike it off the register. This may be done either by ordinary resolution or by filing with the Registrar a copy of the resolution and a statutory declaration of two or more directors proving that the company has made a disposition of its assets and that it no longer has debts or liabilities.[248]

(b) *Income Tax Considerations*

On a winding up, the issuer re-acquires the shares of its shareholders. Consequently, shareholders are deemed to receive a "winding up dividend"[249] equal to the excess of the proceeds distributed to them over the amount by which the paid-up capital of the class of shares affected is reduced on the distribution. For example, if the issuer distributes $1,000 and the paid-up capital of the shares was $500, there is a deemed dividend of $500 which is prorated among the shareholders, according to the number of shares each held.

Not all of the deemed dividend is taxable to its recipient. Subsection 88(2) of the Income Tax Act permits shareholders to receive as a tax-free dividend that amount which could have been paid out tax-free by the company had it disposed of all its property and actually declared the relevant dividends.[250] As such, the amount of deemed dividend which is taxable to the shareholders of a private corporation is reduced by the balance in the capital dividend account[251] and the pre-1972 capital

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[246] CBCA, s. 213(1); BCCA, s. 291; ACA, s. 241; SBCA, s. 213(1); MCA, s. 213(1); OBCA, s. 203(2); Draft OBCA, s. 199; Que. Winding Up Act, s. 5; N.B. Winding Up Act, s. 9; P.E.I. Winding Up Act, s. 9(*c*); N.S. Winding Up Act, s. 8; NCA, s. 203. Note that the CBCA, MCA and SBCA do not require the appointment of a liquidator.

[247] *Supra* note 229.

[248] *Supra* note 229. *See, e.g.*, BCCA, s. 279; CBCA, s. 205; OBCA, s. 248.

[249] ITA, s. 84(2), deems a shareholder to receive a winding up dividend when funds or property of a corporation resident in Canada have, or has, been distributed or otherwise appropriated in any manner for the benefit of the shareholders of any class of shares on winding up. *See Winding Up Dividend*, INTERPRETATION BULLETIN IT-149R (Nov. 15, 1979).

[250] S. 88(2) only applies if the issuer is a Canadian corporation and all or substantially all of its property was distributed to its shareholders immediately before a particular time in the course of the winding up.

[251] ITA, s. 89(1) (*b*), states that the capital dividend account (CDA) contains the non-taxable half of the capital gains, dividends from the capital dividend accounts of other corporations, and the excess of eligible capital amounts as defined by s. 14(1) payable in a period over the aggregate of cumulative eligible capital at the beginning of the period and 1/2 of the eligible capital expenditures of the corporation incurred in the period. The CDA also includes life insurance proceeds net of the adjusted cost base of the policy immediately before death.

surplus on hand (pre-1972 CSOH).[252] An issuer that is designated as "public" prior to the winding up may only have the winding up dividend reduced by the amount in its pre-1972 CSOH account.

To illustrate the operation of subsection 88(2), it is convenient to continue with the earlier example. If there is $100 in the pre-1972 CSOH account, only $400 of the $500 winding up dividend is taxable[253] and subject to the dividend gross-up and tax credit. Each shareholder is then deemed to receive his *pro rata* share of the dividend.[254]

Shareholders may also realize a capital gain or loss upon the disposition of their shares. Their proceeds of disposition consist of the amounts which they receive on the winding up less the deemed dividend.[255] For example, shareholder X has a share with a paid-up capital of $5 and an adjusted cost base of $5. In 1980, he receives $10 as his share of the winding-up dividend. If the amount in the pre-1972 CSOH account is $3, his taxable winding up dividend[256] is $2 and his capital gain is nil.[257]

The issuer may also trigger capital gains or losses when it disposes of its capital properties. Paragraph 69(5) (*a*) deems the corporation to sell each property immediately before the winding up and to receive its fair market value at that time.

The use of a sale of assets and winding up is not common because an issuer can go private with fewer tax costs and less trouble.[258] This

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[252] ITA, s. 88(2) (*b*) (i), (ii). Determination of pre-1972 CSOH is found in s. 88(2.1). Generally, it consists of a corporation's 1971 CSOH on Dec. 31, 1978, and any pre-system gains realized by the corporation when disposing of pre-1972 acquired capital property after 1978. *See* the chart in Levitt, *Determination and Methods of Realization of 1971 Surpluses*, in CORPORATE MANAGEMENT TAX CONFERENCE 1978, *supra* note 1, at 12. S. 88(2) (*a*) sets out three rules which deal with time limits and the year-end of the corporation. They deem the corporation to realize all potential pre-1972 CSOH so that any dividend or deemed dividend that is distributed to the shareholders on the winding up can be paid from these surpluses. The time limits are considered in Geer, *Section 88 and Part IV Changes*, 1977 CONFERENCE REPORT 558.

[253] ITA, s. 88(2) (*b*) (iii).

[254] ITA, s. 88(2) (*b*) (iv).

[255] Even though ITA, s. 54(*h*)(x), reduces the proceeds of disposition by the amount of the deemed dividend, s. 54(*h*) (ix) states that one must not subtract the amount of the pre-1972 CSOH from the proceeds.

[256] $10 less the $5 paid-up capital and the $3 pre-1972 CSOH.

[257] His proceeds of disposition are $5 ($10 less the deemed dividend of $5) and his adjusted cost base is $5. The $5 proceeds include the $3 pre-1972 CSOH as indicated by s. 54(*h*) (*ix*).

[258] The Nachurs-Can West squeeze-out is a variation of the scheme. A Delaware subsidiary of Can West purchased the assets of Nachurs which consisted of shares held in its subsidiaries. In return Nachurs received sufficient consideration to enable it to distribute $8.50 to its shareholders on a subsequent liquidation. Given that the paid-up capital of each of the Nachurs shares was 42¢, a shareholder would realize a deemed dividend of $8.08 on the liquidation as well as a capital loss, the size of which depended on the adjusted cost base of the shares he purchased. In order to give Nachurs shareholders a choice of tax treatment, Can West also made a take-over bid through the facilities of the Toronto Stock Exchange to purchase the shares of Nachurs. Consequently, Nachurs shareholders could realize either a capital gain or loss or a

technique, however, can provide shareholders with alternate tax treatment in much the same way as the amalgamation does.[259] Prior to the winding up, a corporate planner can ensure that there are two classes of shares in existence, each having a right of conversion. One class should have a low paid-up capital, the other a high paid-up capital. Shareholders may then convert shares of one class to the other in order to trigger either a dividend or capital gain.

VI. OTHER CONSIDERATIONS IN A GOING PRIVATE TRANSACTION

A. *Concerns of the Acquiror*

1. *The Issuer as a Wholly Owned Subsidiary*

(a) *Non-Tax Considerations*

Following a non-arm's length going private transaction, the acquiring company owns all the shares of the issuer and might subsequently wish to terminate the existence of its new subsidiary. The combination of the two companies can eliminate possible conflicts of interests for the directors, create certain trade advantages and avoid duplicity of accounting, auditing and legal fees. To obtain these benefits, the acquiror may either wind up or amalgamate with the issuer. Certain jurisdictions permit the amalgamation of a wholly owned subsidiary with its parent (horizontal) or with another wholly owned subsidiary of the parent (vertical) by directors' resolution without shareholder approval.[260] Companies using the "short-form amalgamation"[261] are still obliged to notify their creditors of the date of the amalgamation, and to continue making the disclosure required by statute.

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deemed dividend and capital gain or loss on the disposition of their shares. *Quaere* whether Policy 3-37, the OSA Regulations and the Draft OBCA apply to the sale of assets and winding up. If not, there may be some merit in using the scheme. *Compare* SEC, Rule 13e-3, *supra* note 4.

[259] *See* text at pp. 87-89 *supra*.

[260] CBCA, s. 178; SBCA, s. 178; MCA, s. 178; Draft OBCA, s. 175. Note that s. 156(1) of the ACA provides for the amalgamation of an Alberta company with an extraprovincial company if the extraprovincial company is authorized to amalgamate with an Alberta company by the laws of the jurisdiction in which the extraprovincial company is incorporated and either of them is the wholly owned subsidiary of the other.

[261] For the American position, *see* Magnet, *supra* note 1, at 118-19; Note, *The Short-Form Merger Statute*, 32 U. CHI. L. REV. 596 (1964-65). In the United States, short-form amalgamations are permitted even though the subsidiary is not wholly owned. The parent must own between 90 and 99% of the shares of the subsidiary, depending on the state corporations law which governs the transaction. The articles of incorporation of the amalgamated corporation are those of the parent in the vertical amalgamation and of one of the amalgamating subsidiaries in the horizontal amalgamation. *See* CBCA, s. 178(1) (*b*) (i), (ii); SBCA, s. 178(1) (*b*) (i), (ii); MCA, s. 178(1) (*b*) (i), (ii); Draft OBCA, s. 175(1) (*b*) (ii), (2) (*b*) (ii).

(b) *Income Tax Considerations*

(i) *The Short-Form Amalgamation*

Those tax considerations discussed in the context of the amalgamation apply equally to the short-form amalgamation. If the conditions set out in section 87 are met, no capital gain will result for either the amalgamating corporations or their shareholders. On a short-form amalgamation, however, the section 87 rollover may not be available, at first glance, because shareholders of one amalgamating corporation do not receive new shares of the amalgamated corporation.

To enable the amalgamating corporations to use the section 87 rollover, subsection 87(1.1) deems any uncancelled shares of the amalgamating corporations to be shares of the new corporation received as consideration for shares of the amalgamating corporations.

(ii) *Winding Up of the Issuer*

On the winding up of a wholly owned subsidiary, the subsidiary disposes of its assets to the parent and the parent disposes of its shares in the subsidiary. Subsection 88(1) of the Income Tax Act defers any capital gains liability which might arise from these transactions by deeming the issuer to dispose of its capital properties to the parent at their "cost amounts".[262] This subsection applies when both the parent and the subsidiary are "Taxable Canadian Corporations",[263] the parent beneficially owns all the issued shares of this subsidiary,[264] and a winding up has taken place.[265] Certain timing considerations must also be observed in order to preserve the rollover.[266] For example, the issuer must not dispose of property before the completion of the winding up, *i.e.*, between the passage of the winding up resolution and the satisfaction of all liabilities. Otherwise, this might trigger income or capital gains or losses.

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[262] ITA, s. 88(1) (*a*) (iii). S. 88(1) (*a*) (i), (ii), deals with the proceeds received on the disposition of resource property (nil) and eligible capital property (twice the cost amount). *See generally* Nitikman & Eriks, *Subsection 88(1) and Macbeth*, 24 CAN. TAX J. 1 (1976).

[263] *See* note 158 *supra*.

[264] Ways & Means Motion #35 in the Dec. 11, 1979, Budget would have changed this rule. It would only have been necessary for the parent to own 90% of each class of outstanding shares of the subsidiary.

[265] A winding up need not be completed for the subsection to apply. INTERPRETATION BULLETIN IT-126R, *supra* note 244, states that where there is substantial evidence that the actual winding up will be completed within a short period of time, it will be deemed to be a winding up.

[266] *See* note 252 *supra*.

The parent acquires these properties at a cost equal to the deemed proceeds of disposition of the issuer.[267] If the tax-free zone has applied to assets of the subsidiary, it also becomes available to the parent.[268] The parent may also elect to increase the cost base of certain non-depreciable properties if the adjusted cost base of its shares of the issuer immediately before the winding up exceeds the net value of the properties of the issuer.[269] However, the parent may increase the cost base by an amount necessary to bring its cost up to the fair market value of the property determined as of the date on which the parent last acquired control of the subsidiary. The increment in the cost base must also not be greater than the excess of the adjusted cost base of the subsidiary's shares to the parent over the lesser of the paid-up capital of the shares of the subsidiary and the net value of its properties.[270]

The parent is also deemed to dispose of its shares of the subsidiary, on the winding up, for proceeds at least equal to the adjusted cost base of the shares to the parent immediately before the winding up.[271] A capital gain will result when both the paid-up capital of the shares of the subsidiary and the net asset value of its tax properties exceed the adjusted cost base of the shares.[272]

Subsection 88(1) also provides for a flow through of the subsidiary's pre-1972 CSOH account[273] as well as the refundable dividend tax on hand, and the capital dividend and cumulative deduction accounts which may have come into existence following the designation of the issuer as a private corporation.[274] The parent may also use any losses which were

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267 ITA, s. 88(1) (*c*). *See* s. 88(1) (*f*) for the special rules used in computing the capital cost to parent and the undepreciated capital cost of depreciable property for purposes of capital cost allowance and recapture.

268 ITA, s. 88(1) (*c*).

269 ITA, s. 88(1) (*d*). The "net value" equals the "cost amount" to the subsidiary of all its properties immediately before the winding up plus any cash it has on hand at the time *less* all debts owned by the subsidiary immediately before the winding up and any reserves taken by the subsidiary in the year it distributes its property (excluding reserves under ss. 40(1) (*a*) (iii), 20(1) (*n*), 64(1) or (1.1)).

270 ITA, s. 88(1) (*d*) (ii), (iii).

271 ITA, s. 88(1) (*b*). The formula can be schematized:

A = Paid-up capital of the subsidiary shares.
B = Net Value of the assets of the subsidiary.
C = (Lesser of A and B).
D = Adjusted Cost Base of shares.
Proceeds = Greater of C and D

272 This will occur when both the paid-up capital of the subsidiary and the net asset value of its property as calculated in s. 88(1) (*d*) exceed the adjusted cost base of the shares to the parent. The proceeds of disposition will then be the lesser of the paid-up capital and the net asset value.

273 On the disposition of capital assets acquired before 1972, the subsidiary need not adjust its pre-1972 CSOH account because s. 88(1) (*a*.1) deems no disposition of assets to occur on a winding up. The parent continues to use this account following the winding up and will only make adjustments when it actually disposes of the assets.

274 ITA, s. 88(1) (*e*.2), (*e*.3), (*e*.5).

available to the subsidiary, subject to those restrictions found in the Income Tax Act.[275]

(c) *Amalgamation or Winding-Up?*

It is advantageous to use the winding up rather than the amalgamation in certain circumstances:

1. Paragraphs 88(1) (*c*) and (*d*) provide a potential cost "bump" for non-depreciable capital assets which is not available on an amalgamation.

2. When a subsidiary's goodwill is acquired by the parent on a winding up, the ITAR subsection 21(1) transitional treatment, available only if the goodwill relates to a business carried on by the parent since 1971, is not applicable to an amalgamation.

3. No transfer of capital cost allowance entitlement is possible on an amalgamation because an amalgamation ends the predecessor company's taxation year. There is no such problem on a winding up.

4. It is uncertain whether section 80 of the Income Tax Act will be applicable only on an amalgamation.[276]

By contrast, there are also advantages to using an amalgamation in certain cases:

1. If the issuer is a loss company, it should amalgamate with the parent because, following the amalgamation, the parent will be permitted to use these losses immediately. On completion of the amalgamation, the year-end of the issuer is deemed to be reached.[277] The non-capital losses of the issuer of that year are then available to the parent, subject to that year being the last of the issuer's five-year carry-forward period.[278]

Following a winding up, however, the parent might be unable to use losses incurred by the issuer in its last year of existence until the following taxation year, depending on the time of year at which the winding up takes place. Subsections 88(1.1) and (1.2) permit the

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[275] ITA, s. 88(1.1), (1.2), (1.3).

[276] S. 80 provides that where a debt or other obligation of a taxpayer has been settled or extinguished after 1971 without any payment thereon, or by the payment of an amount less than the principal amount thereof, the taxpayer's gain on the transaction shall be applied to reduce any loss carry-forward which he has available. To the extent that the gain exceeds deductible losses in previous years, such excess may be applied by the Minister to reduce the capital cost of depreciable capital property and adjusted cost base of non-depreciable capital property. *See also* ITA, s. 53(2) (*g*); Income Tax Regulations, s. 5400; *Settlement of Debts on the Winding Up of a Corporation*, INTERPRETATION BULLETIN IT-142R (Sept. 25, 1978).

[277] ITA, s. 87(2)(*a*). It is deemed to have ended immediately before the amalgamation.

[278] ITA, s. 87(2.1). *See* Arnold & Poynton, *Tax Treatment of Losses on Amalgamation and Winding-Up*, 26 CAN. TAX J. 444 (1978); Hirsch, *Intercorporate Transfer of Losses—Practical Uses and Limitations*, PRAIRIE PROVINCES TAX CONFERENCE 369 (1979).

flow-through of non-capital and net capital losses to the parent if they were not deductible to the subsidiary in any year but would have been in the first taxation year *beginning after the commencement of the winding up*,[279] assuming the subsidiary had a subsequent taxation year and had sufficient income in that year to use these losses.[280] Therefore, if the year-end of both the parent and the subsidiary is December 31st, 1980, and the winding up commences on January 1st, 1981, any losses incurred by the subsidiary in 1980 are not deductible by the parent until 1982 because that is the first taxation year of the subsidiary which begins after the commencement of the winding up.

2. In British Columbia, for example, Land Title fees are only payable on a winding up.[281]

3. On a winding up there may be a "short-fall" problem when the parent is unable to add to the cost base of its capital non-depreciable assets the full amount of the potential capital loss under paragraph 88(1) (*d*). For example, Company X pays $70,000 for the shares of the subsidiary when its underlying assets have an adjusted cost base of $50,000 and a fair market value of $60,000. Under paragraph 88(1) (*d*) Company Y will only be permitted to add $10,000 to the cost base of the assets (up to fair market value) rather than $20,000.

4. As the amalgamation creates a new corporation for tax purposes, the corporation will not be required to make instalment payments in its first taxation year.

2. *Financing*

To squeeze out the minority, an acquiror can obtain the funds it requires from borrowings and, to a limited extent, from its tax-free accounts. In non-arm's length or arm's length transactions, it may also make use of the retained earnings of the issuer it receives through inter-corporate dividends or through winding up or amalgamation with the issuer. A corporation might also finance the acquisition of minority

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[279] Most company acts state that winding up is deemed to commence at the time of the resolution requiring the winding up. *See*: BCCA, s. 290; ACA, s. 239; OBCA, s. 207; Draft OBCA, s. 195; Que. Winding Up Act, s. 3; P.E.I. Winding Up Act, s. 5; N.S. Winding Up Act, s. 5(*a*); NCA, s. 142. The CBCA, SBCA, MCA and N.B. Winding Up Act are silent on this matter.

[280] ITA, s. 88(2.1), restricts the ability of the parent to deduct non-capital losses of the subsidiary if control of the parent or the subsidiary was acquired before the parent's year-end by a person or persons who did not, at the end of the subsidiary's loss-year, control the parent or the subsidiary *and* the parent was not carrying on the business of the subsidiary. Net capital losses are non-deductible if control of the parent or of the subsidiary has been acquired before the end of the parent's year by a person or persons who did not, at the end of the subsidiary's loss-year, control the parent or the subsidiary. *See also* INTERPRETATION BULLETIN IT-302, *supra* note 177.

[281] S. 187 of the Land Titles Act, S.B.C. 1978, c. 25, deems an amalgamation to be a change of name and not a transfer. *See also* note 232 *supra*.

shares with its own retained earnings.[282] However, other sources of funds are preferable for the purpose because they do not involve the use of after-tax dollars.

(a) *Borrowings*

Borrowing money from banks, mortgage lenders or finance companies necessitates payment of interest. This expense is deductible to the acquiror if the money is used to repurchase shares on a take-over bid or to redeem shares following an issuer bid, amalgamation, share reclassification or consolidation.[283] However, the deduction must be reasonable, and it is not available if the borrowed money is used to acquire property which generates "exempt income".[284]

The deductibility of interest may be further restricted when the issuer borrows money from non-resident controlling shareholders or a foreign affiliate. Once the amount of an "outstanding debt owing to specified non-residents" exceeds three times the equity of the corporation, any portion of the interest payable which can be attributed to such excess is disallowed.[285] Interest paid by a Canadian business to a non-resident is subject to withholding tax.[286] However, there is no such liability where a corporation pays interest to an arm's length party on a debt issued after June 23, 1975, and before 1983, as long as it is not necessary to repay more than 25% of the principal within five years.[287]

The corporate tax planner must determine whether controlling shareholders of the issuer or a corporation controlled by them should incur the interest expense and claim it as a deduction against other income.[288] Even though a corporation is most suitable for squeezing out

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[282] S. 61 of the PEICA states that a company may not acquire shares of any other corporation from its retained earnings, unless expressly authorized by by-law confirmed at a general meeting.

[283] ITA, s. 20(1) (*c*); *Interest on Money Borrowed to Redeem Shares or to Pay Dividends*, INTERPRETATION BULLETIN IT-80 (Nov. 27, 1972); *Interest Expense Incurred for the Purpose of Winding Up or Amalgamation*, INTERPRETATION BULLETIN IT-315 (May 10, 1976).

[284] ITA, s. 248(1).

[285] ITA, s. 18(4). S. 18(5) states that an outstanding debt payable to a specified non-resident is one which is payable to:

(i) a non-resident shareholder which owns, either alone or together with persons with whom it does not deal at arm's length, at least 25% of the issued shares of *any class* of the corporation; or

(ii) a non-resident person which does not deal at arm's length with shareholders who hold at least 25% of the issued shares of any class.

[286] ITA, s. 212(1) (*b*).

[287] ITA, s. 212(1) (*b*) (vii). This provision may apply when an arm's length acquiror initiates a going private transaction.

[288] The controlling shareholders borrow the money and then advance it to the company in return for more shares. It is debatable whether the interest expense would be deductible in this case. For further discussion, *see* Kellough, *supra* note 68, at 206.

minority shareholders because of the greater number of acquisition techniques at its disposal, it might have insufficient taxable income to make full use of the interest deduction.[289] Nonetheless, if a corporation other than the issuer borrows funds and can deduct only part of the interest expense, it has the option of combining with the issuer by amalgamation or liquidation in order that the income of the issuer offset the remaining portion of the expense.

(b) *Tax-Free Accounts*

It is now difficult for a company to finance the acquisition of minority shares from its surplus accounts because only a private corporation may pay out proceeds of its capital dividend account tax-free to its shareholders.[290] Moreover, while dividends out of tax-paid undistributed surplus of 1971 capital surplus are still available to shareholders of a very limited number of companies,[291] tax-free dividends out of pre-1972 capital surplus on hand are payable only on a winding up.[292]

(c) *Retained Earnings of the Issuer*

Now that the Part VII tax of 25% on "designated surplus" and related provisions have been repealed,[293] a non-arm's length or arm's length acquiror may receive the retained earnings of the issuer tax-free, thus enabling it to meet those financial obligations it incurred to make the acquisition of minority shares. Consequently, directors of the issuer may declare large dividends which pass to the acquiror free of Part I[294] and possibly of Part IV tax,[295] or the acquiror may either wind up or amalgamate with the issuer, using one of the rollovers prescribed by the Income Tax Act.

There are, however, a number of possible restrictions on this mode of financing. First, some jurisdictions do not permit a corporation to give financial assistance to its shareholders,[296] save in exceptional cir-

[289] This is particularly true when a corporation has been incorporated solely to acquire minority shares. If it has no income, a loss carry-forward will accumulate and expire within five years unless utilized.

[290] ITA, s. 83(2).

[291] ITA, s. 83(1), (6).

[292] ITA, s. 88(2.1).

[293] ITA, ss. 192-96. For a discussion of debt limit, paid-up capital deficiency, designated surplus and control period earnings, *see* McDonnell, *In the Labyrinth. Paid-Up Capital, Paid-Up Capital Deficiency and Debt Limit*, in CAN. BAR ASS'N: ONTARIO BRANCH, INCOME TAX—1976, at 1 (1976).

[294] ITA, s. 112(1).

[295] *See* text at p. 63 and notes 53-56 *supra*.

[296] *See supra* notes 43, 282.

cumstances.[297] Secondly, Revenue Canada has frowned upon the use of inter-corporate dividends in acquisitions where the recipient of the dividend is not liable for the payment of Part IV tax.[298] Thirdly, the recent decision of the New Zealand Court of Appeal in *Coleman v. Myers* suggests that directors of the issuer may be committing a breach of fiduciary duty if they do not disclose to minority shareholders that the acquisition of their shares is to be financed by retained earnings of the issuer.[299]

In response to the growing belief that shareholders of the issuer should be told that they are to be eliminated from participating any further in the growth of the corporation with the very funds in which they might have shared,[300] the Ontario Securities Act now requires disclosure, to shareholders whose interests will be acquired, of how the transaction will be financed.[301]

B. *Concerns of the Shareholders: The Dissent Remedy*

1. *Non-Tax Considerations*[302]

The dissent or appraisal remedy is a statutory right available to shareholders[303] in most Canadian jurisdictions.[304] It permits a share-

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[297] *Supra* note 43. It is crucial that the issuer be designated as a private company before it begins to pay out inter-corporate dividends to the parent company. Consequently, there will be no restriction on the provision of financial assistance to a company which owns at least 90% of its shares, provided that a special resolution is first passed. *See also* CBCA, s. 42(1) (*c*); SBCA, s. 42(1) (*c*); MCA, s. 42(1) (*c*).

[298] *Supra* notes 172, 173. Note that the ITA, s.15(1), benefit might also be attributed to the shareholder. *See* Perrault v. The Queen, [1976] 1 F.C. 339, [1976] C.T.C. 65, 76 D.T.C. 6021 (Trial D.).

[299] [1977] 2 N.Z.L.R. 298 (C.A.), *rev'g* [1977] 2 N.Z.L.R. 225 (S.C. 1976). For commentary on the trial judgment, *see* Rider, *Percival v. Wright—per Incuriam*, 40 MOD. L. REV. 471 (1977); Hetherington, *Financing an Insider Take-over*, 4 AUST. BUS. L. REV. 220 (1976); Paterson, *A Role for Civil Liability in Canadian Securities Regulation? Remedies for Breach of the Take-over Bid Disclosure Requirements of the Securities Act 1967*, 12 U.B.C.L. REV. 32 (1978).

[300] [Aug., 1978] BULL. O.S.C.; Sommer, *supra* note 2.

[301] [Aug., 1978] BULL. O.S.C.; OSA Regulations, s. 163.

[302] The article by Magnet, *supra* note 1, examines the mechanics of and policy considerations behind the existing dissent provisions. *See also* Manning, *The Shareholders' Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 233 (1962-63). The significance of the dissent remedy cannot be understated. To conclude whether minority shareholder squeeze-out should be permitted, it is necessary to determine whether this right of dissent affords sufficient protection to shareholders who are coerced into giving up their investments. Consideration of this topic, however, is beyond the scope of this paper.

[303] The OBCA limits the right to shareholders in private companies. *See also* Magnet, *supra* note 1, at 104 n. 28.

[304] CBCA, s. 184; BCCA, s. 228; ACA, s. 249; SBCA, s. 184; MCA, s. 184; OBCA, s. 100; Draft OBCA, s. 183.

holder[305] who does not vote in favour of particular changes in the structure of the corporation to demand that the corporation purchase his shares at a negotiated price.[306] Changes which trigger the dissent remedy include sale of all or substantially all the assets of the corporation,[307] amalgamation, alteration of any restriction upon the business which can be carried on, extra-jurisdictional continuance, alteration or removal of any restriction or constraint on the issue or transfer of shares, and amendment of the articles of incorporation to convert a corporation with share capital into a corporation without share capital and vice versa.[308] If the shareholder and the corporation cannot agree on the value of a share, either party may apply to the court[309] for a determination of the matter. The court may subsequently appoint an independent appraiser to calculate the "fair value" of the shares.[310]

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[305] In Manitoba Sec. Comm'n v. Versatile Cornat Corp., [1979] 2 W.W.R. 714, 97 D.L.R. (3d) 45 (Man. Q.B.), Hewak J. held that "shareholder" did not mean a shareholder who owned shares as of the date of the triggering transaction but who sold them before he received notice of the resolution advising him of his dissent right.

[306] For commentary on the procedure to be followed, *see Jepson, supra* note 7; Neonex, *supra* note 7; Bruun & Lansky, *The Appraisal Remedy for Dissenting Shareholders in Canada: Is it Effective?*, 8 MAN. L. J. 583 (1978); Magnet, *supra* note 1.

[307] The BCCA, s. 310, also includes a sale of assets followed by a voluntary winding up. S. 125 permits a dissent application when financial assistance is given by the corporation to a person who wishes to acquire at least 90% of the ownership of a non-reporting company.

[308] This is peculiar to the MCA. The Draft OBCA, s. 183, grants a dissent right if the corporation proposes to carry out a going private transaction as defined in s. 188. In McConnell v. Newco Financial Corp. (unreported, B.C.S.C., Aug. 7, 1979) (*per* Esson J.), the court held that a consolidation of shares did not result in "the amendment of the articles to add, change or remove any provisions restricting or constraining the issue or transfer of shares". The shareholder was therefore not entitled to bring a dissent application under s. 184 of the CBCA.

[309] The OBCA states that the dissenting shareholder should apply. For conflicting views as to who should bear the burden of proof, *compare Neonex, supra* note 7, *with* Robertson v. Canadian Canners Ltd., 4 BUS. L.R. 290 (Ont. H.C. 1978).

[310] It is uncertain what the term "fair value" means. In *Re* Wall & Redekop Corp., [1975] 1 W.W.R. 621, 50 D.L.R. (3d) 733 (B.C.S.C.), MacFarlane J. suggested three alternatives: (a) market value by reference to the stock exchange; (b) net asset or liquidation determination; or (c) the investment value of shares based on a capitalization of earnings. No preference for any method was expressed. For a discussion of the merits of each, *see* Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453 (1966).

Should dissentients share in any benefits which may result from the consummation of the transaction to which they disssented? The very fact of dissent implies that the shareholder made a rational assessment of the merits of the triggering transaction and decided that he wished to be paid the "fair value" of his shares prior to the transaction; that is, he wished no part of any benefits resulting from the triggering transaction. In this respect, the determination of "fair value" on a dissent application should differ from the calculation required on compulsory acquisition or upon a court making a decision whether the amendment of the constating documents is "bona fide in the best interests of

2. *Income Tax Considerations*

A deemed dividend and capital gain or loss may result when the issuer repurchases the shares of a dissentient. The availability of deemed dividend treatment may prompt shareholders to decide whether or not it would be wiser to surrender their shares through dissent or through one of the acquisition techniques.

For example, shareholder X owns a share of the issuer with a paid-up capital of $1 and adjusted cost base of $3. The acquiring company, Company Y, is wholly owned by the controlling shareholders of the issuer. It has announced that it will pay $5 to shareholders for each of their shares which they tender on a take-over bid. If some shareholders refuse to tender, they will be squeezed out for $5 a share when Companies X and Y amalgamate. Shareholder X then has a number of choices. He can accept the take-over bid offer which will leave him with a capital gain of $2. Alternatively, he can dissent prior to the amalgamation and hold out for a "fair value" of, say, $7. This would result in a deemed dividend of $6 and a capital loss of $2. Finally, he can surrender his shares on the amalgamation and trigger either a capital gain of $2, or a deemed dividend[311] of $4 and a capital loss of $2, depending upon whether he received cash or redeemable preference shares from the amalgamating corporation.

It is clear from this example that a shareholder must evaluate the tax consequences of each technique very carefully. More importantly, unfavourable tax consequences may prevent shareholders from bringing dissent applications. For example, a shareholder who prefers to have the proceeds from the disposition of his shares taxed as a capital gain may likely accept a take-over bid offer, because of the favourable tax consequences it promises, and despite his belief that the amount he is being offered is far below the "fair value".

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the company as a whole", *i.e.*, that one party has not received greater compensation than the other as a result of the transaction (discrimination). In the latter two cases, shareholders are compelled to surrender their shares when they might have otherwise wished to remain as shareholders of the company and partake of the benefits of continued participation. They then should be compensated in some approximate fashion for the benefits in which they will not share but to which they would have been otherwise entitled. Whether or not entitlement to specific benefits is only an incident of "control" and whether minority shareholders should by analogy share in the premium paid for sale of control is too broad a topic to be canvassed here.

However, the dissent provisions now fail to recognize the distinction mentioned. In December, 1978, the CBCA was amended and the phrase directing the court to ignore any change in the value of the shares which is reasonably attributable to the anticipated adoption of the resolution was deleted. S. 228 of the BCCA merely states that any appreciation or depreciation in anticipation of the vote on the relevant resolution should be taken into account, but does not go so far as to take into account "benefits to controllers" as Bouck J. in *Neonex*, *supra* note 7, suggested that it might.

[311] This assumes that the shareholder receives shares with the same paid-up capital back from the amalgamated company.

VII. Conclusion: The Importance of Income Tax Consequences in a Going Private Transaction

Many companies do not find it economical to remain public under present economic conditions. They must incur significant costs and often do not receive those substantial benefits expected in return. Therefore, it is likely that minority shareholder squeeze-outs will not abate, and the phrase "going private" will continue to colour information circulars as justification for the elimination of the minority. Generally speaking, courts will permit the expropriation of minority-held shares if the minority is given adequate compensation for its shares.[312] In determining what is "fair value" or adequate, courts do not appear to tolerate controlling shareholders receiving a disproportionate share of the benefits which result from the issuer going private.[313]

It is in this context that the income tax consequences in a minority shareholder squeeze-out, and more particularly in a going private transaction, become important. In calculating the fair value of minority shares following compulsory acquisition or, perhaps mistakenly, in a dissent application, a company may be required to take into account that the controllers will acquire sizeable tax benefits as a consequence of the elimination of the minority.[314] Similarly, for a squeeze-out to be "bona fide in the best interests of the Company", the acquiror may have to

[312] This is the implication in *Neonex*, *supra* note 7, and *Re Ripley Int'l*, *supra* note 7, for example. This is also one of the bases upon which the court determines whether to approve an amalgamation or arrangement. However, as pointed out throughout this paper, this type of inquiry is not one in which the courts attempt to involve themselves to any great degree, often deferring to the decisions of management or the majority of shareholders.

[313] *See Re Ripley Int'l*, *supra* note 7; *Neonex*, *supra* note 7. *Cf. Re Grierson*, *supra* note 117. *See also* the case law mentioned *supra* note 11, especially the decision in Greenhalgh v. Arderne Cinemas Ltd. which interpreted the meaning of the phrase "bona fide in the best interests of the company as a whole". For a general discussion, *see* Knetch & Borcherding, *Expropriation of Private Property and the Basis of Compensation*, 29 U.T.L.J. 237 (1979), and *supra* note 40. For a recent decision on "fair value" and the Consolidated Building squeeze-out referred to *supra* note 135, *see Shareholder's Hunt for Fair Value Teaches a Lot About Appraisal*, GLOBE & MAIL, Feb. 4, 1980, p. B-2, col. 4.

[314] Note the distinction made between compulsory acquisition and dissent valuation, *supra* note 310. In *Ruskin*, *supra* note 7, the availability of tax losses following the proposed amalgamation was of great concern to the controlling shareholders. *See also Re Ripley Int'l*, *supra* note 7, and *Re Grierson*, *supra* note 117.

quantify these benefits and include a portion thereof in the total consideration offered.[315]

Consequently, corporate and tax planners must not only be vigilant for any benefits which might be available to controlling shareholders following going private transactions, they must also heed the preferences of the minority as well!

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[315] *But see* the comments of Montgomery J. in *Westeel-Rosco*, *supra* note 7, at 216, who implies that favourable tax consequences for the minority will not be regarded as a proper business reason for a squeeze-out. *Quaere* whether the absence of a "proper business reason" would be adequate justification for enjoining a squeeze-out even where the minority was paid a substantial amount of money for its shares, far in excess of even the most generous valuation of their worth. *See also*, for the American judicial viewpoint on the same subject, Scott, *Going Private: An Examination of Going Private Transactions Using the Business Purpose Standard*, 32 S.W.L. J. 64 (1978); Borden & Messmer, *supra* note 8; Young v. Valhi Inc., 382 A. 2d 1371 (Del. Ch. 1978); Kemp v. Angel, 381 A. 2d 241 (Del. Ch. 1977). It is hoped that Canadian courts will not adopt the approach of Montgomery J. in *Westeel*. If they do, will they introduce those considerations which have surfaced in connection with the "business purpose test" in income tax law? *See, e.g.*, O'Keefe, *The Business Purpose Test—Who Needs It?*, 25 CAN. TAX J. 139 (1977); Ware, *The Business Purpose Test and Sham Transactions*, 1976 CONFERENCE REPORT 602.