Amalgamations Not Governed By Section 87: The *Envision Credit Union* Case

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By K. A. Siobhan Monaghan

Section 87 Amalgamations and Non-Qualifying Amalgamations

An amalgamation is the combination or merger of two or more corporations to form a single corporation. Although the term "amalgamation" is often used to refer to any type of merger or business combination, the rules found in section 87 of the *Income Tax Act* (the "ITA")[1] pertain only to an "amalgamation" as defined in subsection 87(1). In particular, subsection 87(1) states that, for purposes of section 87, an amalgamation means:

> "a merger of two or more corporations each of which was, immediately before the merger, a taxable Canadian corporation (each … a "predecessor corporation") to form one corporate entity (…the "new corporation") in such manner that:
>
> (i) all of the property … of the predecessor corporations immediately before the merger[2] becomes property of the new corporation by virtue of the merger;
>
> (ii) all of the liabilities … of the predecessor corporations immediately before the merger[3] become liabilities of the new corporation by virtue of the merger; and
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> (iii) all of the shareholders … who owned shares of the capital stock of any predecessor corporation immediately before the merger,[4] receive shares of the new corporation because of the merger,

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1 RSC 1985 (5th Supp.) c.1, as amended. Unless otherwise expressly stated, all references to statutory provisions are to provisions of the ITA.

2 Except amounts receivable from or shares of a predecessor, which will be cancelled on the merger.

3 Except amounts payable to a predecessor, which will be cancelled on the merger.

4 Except any predecessor.

> otherwise than as a result of the acquisition of property of one corporation by another corporation or as a result of…the winding-up of the corporation".

Where a particular merger qualifies as an amalgamation as defined in subsection 87(1), the amalgamated corporation is deemed, by paragraph 87(2)(a), to be a new corporation for purposes of the ITA.[5] This is in contrast to Canadian corporate statutes which typically reflect what is often termed a "continuation" theory of amalgamation – that is, the corporation formed by the amalgamation of two or more corporations is not a new corporation, but rather a continuation of all of the predecessors. Section 179 of the *Business Corporations Act* (Ontario)[6] illustrates this principle:

> "the amalgamating corporations amalgamate and continue as one corporation…; …the amalgamating corporations cease to exist as entities separate from the amalgamated corporation."

Notwithstanding paragraph 87(2)(a), the rules in subsection 87(2), which determine the manner in which the tax attributes of the predecessors are carried over to the amalgamated corporation, reflect both the "continuation theory" of amalgamation reflected in the corporate law[7] and the "new corporation theory" reflected in paragraph 87(2)(a).[8] That is, while the amalgamated corporation is a new corporation, to a significant extent the tax attributes of the predecessors carry through the amalgamation as if the two corporations had continued. However, because the amalgamated corporation is a new corporation, if the ITA is silent on a tax attribute, that attribute does not flow through the amalgamation.[9]

Of course, not all amalgamations qualify as an "amalgamation" as defined in subsection 87(1) (a "Section 87 Amalgamation"). For example, a merger of two foreign corporations would not qualify because neither predecessor would be a taxable Canadian corporation. Similarly, an amalgamation of two corporations exempt from tax under the ITA would not qualify.

It has been CRA's long-standing position that the tax consequences of an amalgamation that does not qualify as an amalgamation as defined in section 87 (a "Non-Qualifying Amalgamation") will be determined by the legal consequences under the corporate law governing the amalgamation.[10] Thus, if the governing corporate law provides that only one of the predecessors survives, or that the amalgamated corporation is a new corporation and the predecessors cease to exist, the assets of the non-surviving predecessors are considered disposed of by, and the liabilities of such predecessors are considered assumed by, the amalgamated corporation with the tax consequences flowing from that disposition and acquisition.[11] The surviving corporation is not considered to have disposed of the assets it owned immediately prior to the merger.[12]

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5 Judicial views on this point are varied. See, for example, *Pan Ocean Oil* and *Guaranty Properties, infra* note 23; *CGU Holdings, infra* note 9 and *Dow Chemicals, infra* note 26.

6 See also, for example, section 186 of the *Canada Business Corporations Act*; section 186 of the *Business Corporations Act* (Alberta); section 180 of *The Corporations Act* (Manitoba); section 282 of the *Business Corporations Act* (British Columbia); and section 294 of the *Corporations Act* (Newfoundland and Labrador).

7 For many purposes the amalgamated corporation is to be treated as the same corporation as, and a continuation of each predecessor. See, for example, paragraphs 87(2)(e.3), (e.5), (g.1)-(g.5), (j.2)-(j.95), (l)-(l.4), (m.1), (q), (s.1), (v), (x), (y), (z)-(z.2), (bb.1), (jj), (ll), (mm), (qq), (rr), (ss), (tt), (uu) and (vv) and subsection 87(2.1) and (2.2). See also subsection 87(1.2) and paragraph 87(2)(e.1) which apply the continuation theory provided that the predecessors satisfy certain conditions.

8 The amalgamated corporation is, for example, considered to acquire property from the predecessors (see, for example, paragraphs 87(2)(b), (d), (d.1), and (e)-(e.4)). The amalgamated corporation, as a new corporation, is entitled to choose its own taxation year (see paragraph 87(2)(a)) and its own method for computing income (see paragraph 87(2)(c)).

9 See *CGU Holdings Canada Ltd.* v *The Queen*. 2008 DTC 3347 (TCC), aff'd 2009 DTC 504 (FCA). In that case, while the amalgamation was governed by section 87, section 87 was silent on whether a predecessor's refundable tax account (related to status as a non-resident owned investment corporation) flowed through to the amalgamated corporation. At the Tax Court, Hershfield J stated that by virtue of section 87 the new corporation formed on the amalgamation was not the same corporation as the predecessor so that, absent specific provisions to the contrary, the predecessor's tax accounts would not flow through to the amalgamated corporation.

10 See Q26 CRA 1992 Roundtable in *Report of Proceedings of the Forty-Fourth Tax Conference* (Toronto: Canadian Tax Foundation, 1993) at 54:17.

11 *Ibid.* See also, Q16 1993 Roundtable in *Report of Proceedings of the Forty-Fifth Tax Conference* (Toronto: Canadian Tax Foundation, 1994) at 58:9.

If the governing corporate law provides for a continuation of all predecessors, the assets and liabilities of the predecessors become assets and liabilities of the amalgamated corporation without a disposition of assets being considered to have occurred.[13]

While most Canadian statutes provide that, as a matter of corporate law, the predecessors "amalgamate and continue as one corporation" that "possesses" all of the property, rights and liabilities of the predecessors, it was not entirely clear whether that included tax attributes. CRA's view was that, if the amalgamation was not a Section 87 Amalgamation, predecessors' tax attributes did not flow through to the amalgamated corporation. In CRA's view, to conclude otherwise would render subsection 87(2) redundant because those rules specifically provide for the predecessors' tax accounts to carry through to the amalgamated corporation.[14]

However, CRA's view was not accepted universally. Some commentary suggested that tax attributes could be carried over to the amalgamated corporation if the Non-Qualifying Amalgamation was a continuation-type amalgamation. Subsection 87(2) would not thereby be redundant: it simply would not apply to that amalgamation. Indeed this would appear to be consistent with CRA's position that the corporation that survives an amalgamation that is not a continuation-type amalgamation does not dispose of its assets and liabilities and maintains its taxation year.

The *Envision* Case

This question was addressed in *Envision Credit Union* v *The Queen.*[15] The amalgamation involved two taxable Canadian corporations ("Delta" and "First Heritage") but the amalgamation was designed in an attempt to avoid qualifying as a Section 87 Amalgamation. In particular, the amalgamation agreement provided that, contemporaneous with the amalgamation taking effect, certain surplus assets of the predecessors would be transferred to a new corporation ("619") in consideration for shares of 619. The concept was that because some of the property of the predecessors immediately before the amalgamation (the surplus assets) would not become property of the amalgamated corporation ("Envision"), the amalgamation would not be a Section 87 Amalgamation.[16]

The main issue in *Envision* was whether, in determining the undepreciated capital cost ("UCC") of Envision's depreciable property, the capital cost allowance previously claimed by the predecessors was to be taken into account. In other words, was Envision's base for capital cost allowance purposes the capital cost of the property to the predecessors or the aggregate UCC of the property to the predecessors. If the amalgamation were a Section 87 Amalgamation, there is no doubt the answer would have been the aggregate UCC (rather than the capital cost) of the property to the predecessors.[17] However, the taxpayer argued that because the amalgamation was not a Section 87 Amalgamation, the starting point for Envision's UCC was the capital cost of the property to the predecessors[18] and that amount should not be reduced by total depreciation allowed to the predecessors,[19] because depreciation is neither an asset nor a liability that flows through from the predecessors under the corporate law.

As no capital cost allowance had been previously claimed by Envision, its UCC should be based on the capital cost (not UCC) of property of the predecessors.

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12 See CRA Documents 2000-0023953 and 2000-0034951 dated October 25, 2000.

13 See, for example, Q26 CRA 1992 Roundtable supra note 10; CRA Document 2002-0169775(E) dated April 10, 2003; CRA Document 2010-03879611 dated March 8, 2012 and CRA Document 2005-0142471R3(E) dated January 1, 2006.

14 See CRA Technical Interpretations 5-6034 dated September 30, 1988 and 2000-0003385 dated February 2, 2000.

15 2010 DTC 1399 (TCC), aff'd 2012 DTC 5055 (FCA).

16 The Tax Court accepted that notwithstanding that the governing commercial law expressly stated that "on and after the amalgamation… the amalgamated credit union is seized of and holds and possesses all the property, rights and interests….of each amalgamating credit union…", because it was open to the parties to the amalgamation to specify the manner in which the amalgamation was to be carried into effect, they could agree that the surplus assets would be transferred to a new corporation at the time of the amalgamation.

17 See paragraph 87(2)(d).

18 See A in the definition of undepreciated capital cost in subsection 13(21).

19 Basically, capital cost allowance previously claimed (see subsection 13(21)). This is deducted in computing UCC. See E in the definition of undepreciated capital cost in subsection 13(21).

Tax Court Decision

Webb J agreed that the amalgamation of Delta and First Heritage was not an amalgamation for purposes of section 87, with the result that the rules in section 87 did not apply to determine Envision's UCC. However, Webb J also found that the governing corporate law reflected the continuation theory of amalgamation: that is, no new corporation was created but rather Delta and First Heritage "continued as one credit union" as provided for in the *Credit Union Incorporation Act* (British Columbia). As a result, the principles in *Black & Decker* were found applicable:

> "Whether an amalgamation creates or extinguishes a corporate entity will, of course, depend on the terms of the applicable statute, but as I read the [*Canada Corporations Act*]…it would appear to me that upon an amalgamation under the *Canada Corporations Act* no "new" company is created and no "'old" company is extinguished. … The companies "are amalgamated and continued as one company" which is the very antithesis of the notion that the amalgamating companies are extinguished or that they continue in a truncated state…
>
> …The effect of the statute, on a proper construction, is to have the amalgamating companies continue without subtraction in the amalgamated company, with all their strengths and weaknesses, their perfections and imperfections, and their sins, in sinners they be."[20]

As a result of these principles, in Webb J's view, Delta and First Heritage continued with the amounts that had been allowed to them as capital cost allowance and, as a result, Envision's opening UCC for any particular class of depreciable property was equal to the closing UCC balance of such class to Delta and First Heritage immediately before the amalgamation, the same result that would have ensued had the amalgamation been a Section 87 Amalgamation.

> "In this case since the merger of Delta and First Heritage is not an amalgamation as defined in subsection 87(1) … the principles in Black and Decker, supra, will be applicable to the Appellant. As a result, Delta and First Heritage are continued without subtraction and therefore are continued with the amounts that had been allowed to each of them for depreciation."[21]

Unresolved Issues

It is hard to quibble with the result; it appears to be the right one in policy terms. Nonetheless there is something unsatisfactory about it because it leaves a number of questions unresolved. For example, assume two corporations with a December 31 taxation year amalgamate on May 1 and the amalgamation is a continuation-type amalgamation. If it is a Section 87 Amalgamation, the predecessors would have a taxation year end of April 30. If it is Non-Qualifying Amalgamation, does the amalgamated corporation simply file a tax return for the taxation year ended December 31 showing the combined results of the two corporations.[22] What if one predecessor has a September 30 taxation year and the other a December 31 taxation year?

Moreover, in some cases, the *Envision* approach would seem to potentially lead to a more favourable tax result than would be the case were the amalgamation a Section 87 Amalgamation. This could lead to more attempts to purposely avoid section 87: that is, to avoid the negative aspects of section 87 while nonetheless being able to carry over beneficial tax attributes. For example, returning to the example in the previous paragraph, if losses are incurred by the amalgamated corporation in the period between May 1 and December 31, can they be applied against income from either corporation in the January 1 to April 30 period on the basis that those corporations have not ceased to exist and continue in existence? Can losses also be carried back to prior taxation years on the same basis? Some cases have suggested that even in the context of a Section 87 Amalgamation, the predecessors do not cease to exist, although the new corporation formed by the amalgamation is not a continuation of the predecessors.[23]

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20 *The Queen v. Black & Decker Manufacturing Company Ltd*., [1975] 1 SCR 411 at 422.

21 *Supra* note 15 at para 70. See also para 81 where he said his conclusion "is simply a logical result of finding that the old company[ies] continue [ ] to exist.…".

22 See CRA Document 2000-023953, *supra* note 12, where CRA ruled the surviving corporation in an absorptive merger maintained its existing taxation year.

23 See *The Queen* v. *Guaranty Properties Limited* 90 DTC 6363 (FCA) at 6368 and *The Queen* v *Pan Ocean Ltd.* 94 DTC 6412 (FCA) at 6369 and *CGU Holdings supra* note 9. See also CRA Document 2010-0355941R3 dated 2012 where the terms of the amalgamation expressly stated that the legal existence of one of the predecessors did not cease and that

Other issues expressly addressed by the ITA in the context of Section 87 Amalgamations are similarly unresolved. What if one predecessor has a status for tax purposes that the other does not? What if a provision of the ITA applies only where a particular status is maintained throughout the taxation year?

Federal Court of Appeal Division

It is perhaps out of an appreciation of this resulting uncertainty that, in affirming the Tax Court's decision, the Federal Court of Appeal went further than simply endorsing the Tax Court's conclusion that the UCC of the predecessors' assets flowed through to the amalgamated corporation on the basis of the *Black & Decker* principle. Notwithstanding that it expressly stated that that conclusion was sufficient to dispose of the appeal, the Federal Court of Appeal went on to consider whether the amalgamation was one governed by section 87 because that issue "was thoroughly and ably canvassed by counsel in this Court, and is of some general importance in the profession."

As noted above, Envision's view was that some of the property owned by the predecessors immediately before the amalgamation (i.e., the surplus assets) was not acquired by the amalgamated corporation (i.e., it acquired shares of the company to which the assets were transferred simultaneously with the amalgamation), with the result that the amalgamation did not meet the conditions of subsection 87(1). The Federal Court of Appeal did not agree. In its view, as a result of the transactions all of the property owned by the predecessors became property of Envision by virtue of the merger. Somewhat surprisingly, the Court applied a tracing principle to support this conclusion:

> "The transactions related to the merger thus merely changed the form of the predecessors' property that became property of Envision. That is, instead of becoming the owner of beneficial interest in the surplus assets on amalgamation, Envision became owner of all the issued shares in 619, the value of which was set at the fair market value of the surplus assets. All the property owned by the predecessors immediately before the amalgamation can thus be traced directly to property owned by Envision after the amalgamation.
>
> Hence, the fact that the beneficial interest in the surplus properties was vested in Envision's wholly-owned subsidiary as of the moment of the amalgamation does not warrant a conclusion that the property of the predecessors did not become property of Envision for the purpose of paragraph 87(1)(a)."

Interestingly, this type of tracing was rejected in *Palmer-McLellan (United) Ltd.* v *MNR*.[24] The issue in that case was whether interest borrowed by a predecessor parent to acquire shares of a subsidiary predecessor could be considered interest payable on borrowed money used for the purpose of earning income from a business or property by the amalgamated corporation. In determining the answer was no, Thurlow, J said the following:

> "The appellant from the moment of the amalgamation did have the assets of the [predecessor subsidiary] but these assets were not what the money borrowed … had been used to purchase and *I do not see any way in which these assets can even be regarded as having been acquired in exchange for the shares*….
>
> Nor, on reflection, do I think the assets of the [predecessor subsidiary] can be regarded as representing the capital stock of that company formerly held by [predecessor parent]. *Those assets, as I view the matter, became property of the appellant by virtue of the amalgamation procedure and not, in any legal sense, by reason of [predecessor parent's] ownership of or its giving up of the shares*."[25]
>
> (Emphasis added.)

Conclusions?

So what conclusions can be drawn from this analysis? Both the Tax Court and Federal Court of Appeal agreed that tax attributes of predecessors will flow through an amalgamation that is a Non-Qualifying Amalgamation if it is a continuation-

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predecessor survived the merger while the separate legal existence of the other ceased without it being liquidated or wound up but that both predecessors continued as one corporation, a strange combination of concepts apparently inspired by a desire to both have a Section 87 Amalgamation and qualify for a reorganization rollover under US tax law.

[24] 68 DTC 5304 (Ex.Crt).

[25] *Ibid*., at page 5307.

type amalgamation. How this principle will apply in the context of particular tax attributes remains to be seen. It is possible that a court would conclude that, notwithstanding that the amalgamated corporation is a continuation of the

predecessors, it is nonetheless not the same corporation as the predecessors and thus, for example, losses incurred by the amalgamated corporation could not be carried back to a taxation year of a predecessor.[26] These questions remain unresolved. Moreover, certain provisions of the ITA do not rely on the amalgamation being an amalgamation as defined in subsection 87(1). For example, subsection 256(7), which applies for many provisions of the ITA, contains its own definition of amalgamation. These provisions will apply in the appropriate circumstances without regard to whether the amalgamation is a Section 87 Amalgamation or a Non-Qualifying Amalgamation.

The Tax Court and Federal Court of Appeal disagreed about whether a substitution of the property owned by a predecessor for other property contemporaneously with the effective time of the amalgamation was sufficient to render an amalgamation of taxable Canadian corporations a Non-Qualifying Amalgamation. The Federal Court of Appeal's conclusion on this point would appear to be *obiter* given that it both endorsed the Tax Court's conclusion on the first point and stated that that conclusion was sufficient to dispose of the appeal. Nonetheless, it may be difficult to dismiss it as *obiter* given that the Court addressed this issue specifically because of its importance to the tax community. Thus, to achieve Non-Qualifying Amalgamation status something more may be required, although it is not clear what more would be sufficient. Would a distribution of property to the shareholders contemporaneously with the amalgamation be effective? That issue remains unresolved.

It is understood that Envision has sought leave to appeal to the Supreme Court of Canada. If leave is granted, the Supreme Court decision will undoubtedly be an important one.

If you have any questions regarding the foregoing, please contact K. A. Siobhan Monaghan (416.863.5558), John Ulmer (416.863.5505), Kevin J. Thomson (416.863.5590) or Richard Fridman (416.367.7483) in our Toronto office.

[26] Although it considered a Section 87 Amalgamation, in *The Queen* v. *Dow Chemical Canada Inc.* 2008 DTC 6544 (FCA), the provision of the ITA at issue required the amalgamated corporation to be treated as if it were a predecessor – a continuation concept. The FCA stated that in that context nothing turned on the fact that the amalgamated corporation and the predecessor are otherwise distinct corporations. Similarly, one might postulate that in a Non-Qualifying Amalgamation that is a continuation-type amalgamation, while a predecessor may not cease to exist, the amalgamated corporation is nonetheless a corporation that is distinct from the predecessors.