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MAJOR RELIEF FOR NON-RESIDENTS OF CANADA

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The *Income Tax Act* (federal) provides very restrictive measures for non-residents of Canada who dispose of investments that are "taxable Canadian property," as defined in Section 248 of the Act, such as shares of Canadian private corporations or interests in trusts or partnerships resident in Canada.

In general, pursuant to the provisions of Section 116 of the *Income Tax Act* (federal), non-residents of Canada who dispose of taxable Canadian property must first obtain a certificate of compliance from the Canada Revenue Agency ("CRA") by either making a payment to cover the resulting tax payable, providing an acceptable security or demonstrating to the CRA that the gains are exempted under a specific treaty.

The measures provided in the *Taxation Act* (Quebec) are similar to the measures provided in the federal Act with regard to the disposition of "taxable Quebec property."

In order to ensure that the non-residents to whom the Act is applicable respect the administrative procedures, both the *Income Tax Act* (federal) and the *Taxation Act* (Quebec) provide that, when a certificate of compliance is not obtained within the prescribed time limit, the purchaser of a property is liable to pay the tax authorities, on the behalf of the non-resident, an amount equal to a percentage of the purchase price.

Based on the federal budget of March 4, 2010, the Canadian government introduced Bill C-9 on March 29, 2010, which proposes a significant change to the current definition of a "taxable Canadian property."

Under this Bill, shares in private Canadian corporations as well as interests in trusts and partnerships will no longer be "taxable Canadian property" provided that the value of the shares does not directly or indirectly derive (at any time during the 60-month period that starts before and ends at the time of disposition) from real or immovable property situated in Canada, or from Canadian resource property or timber resource property.

Thus, non-residents of Canada, regardless of their country of residence, will no longer be subject to the procedures enacted by Section 116 of the *Income Tax Act* (federal) and will be exempt of Canadian tax on the disposition of the above-mentioned property. Consequently, purchasers will be relieved of any potential liability prescribed in the current legislation with regard to property that falls under the new measures.

The new provisions set forth in this Bill will apply to the disposition of property acquired after March 4, 2010, provided that they are sanctioned in their current form.

The Quebec Finance Minister announced in the tabling of the provincial budget on March 30, 2010 that Quebec's legislation will be harmonized with the new measures enacted by the federal Bill. ◂

A NEW ACT ON LEGAL PUBLICITY

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Since the *Business Corporations Act* was adopted on December 1, 2009, the Quebec legislator has continued to work towards the modernization of corporate law by introducing Bill 87.

The Bill consolidates into a single Act, entitled *An Act respecting the legal publicity of enterprises*, a number of provisions from both *An Act respecting the legal publicity of sole proprietorships, partnerships and legal persons* (which set in motion the register of sole proprietorships, partnerships and legal persons, commonly known as the French acronym CIDREQ) and *An Act respecting the enterprise registrar*.

Some of the innovations included in Bill 87 should nevertheless be noted. For example, we will no longer refer to an annual declaration but rather to an updating declaration. In addition, a legal person that files an income tax return in Quebec, and whose information in the register is up to date, will meet its annual updating obligation simply by declaring in its income tax return that the information is up to date.

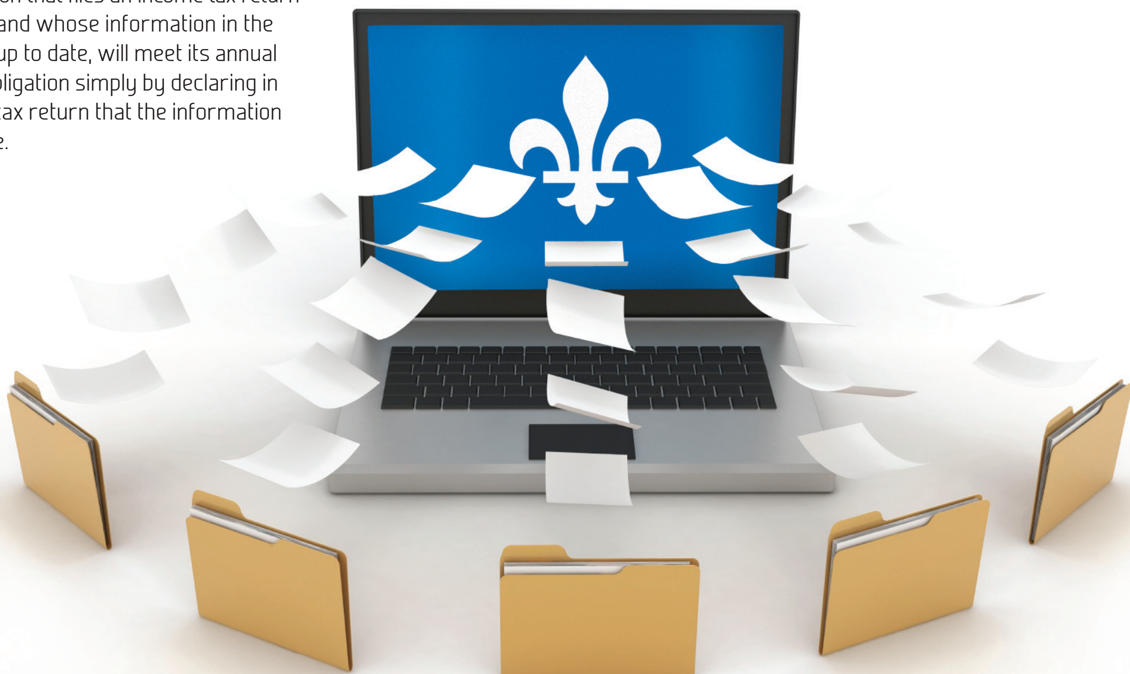
Furthermore, an enterprise subject to Bill 87, which is declared bankrupt within the meaning of the *Bankruptcy and Insolvency Act*, must file a declaration to that effect without delay. Said enterprise is therefore exempt from filing an updating declaration and from the obligation to pay an annual registration fee. However, the trustee in bankruptcy must file a declaration of striking off after having been discharged.

As prescribed by the *Business Corporations Act*, the registration declaration for a legal person must indicate the existence of a unanimous shareholder agreement that restricts or withdraws all powers from directors. Enterprises subject to the Act must also state the date of entry into office of the directors.

Lastly, an updating declaration will need to be filed within thirty (30) days after the date on which any change has occurred instead of the current deadline to file an amending declaration within fifteen (15) days.

Furthermore, under this Bill, trusts will not be obligated to register and will not be able to register voluntarily. This situation may seem incongruous given that a number of trusts are in fact actual businesses.

Before the Bill comes into force, either a new computer system will be implemented or improvements will be made to the current system in order to process the information added to the registrar to allow declarations to be filed online. The Minister of Revenue projects that this new or improved system will come into operation by the beginning of 2011. ◂



STOCK OPTIONS CAN BE ADVANTAGEOUS, BUT BE CAREFUL!

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Notwithstanding some criticism voiced by financial analysts, the issue of stock options to employees remains popular in both private and public corporations. The federal *Income Tax Act* contains specific rules that apply to such options and their exercise. These rules have undergone numerous amendments in the past and are the subject matter of new amendments in the budget tabled by Canada's Finance Minister last March 4th.

Generally, these amendments are as follows:

▸ **Hybrid plans**

Before the proposed amendments, it was possible for the employer to claim a deduction in computing its income for the amounts paid to the employee to acquire stock options held by the latter, whereas the employee could benefit from an advantageous tax rate on the gain realized upon the disposition of his or her options. The possibility of claiming this double tax benefit ended on March 4, 2010.

▸ **Tax deferral for public company employees**

This advantageous relief for employees has ended for all the rights covered by an agreement to sell or issue securities that are exercised after last March 4th.

▸ **Deductions at source**

From now on, the employer will have to pay its withholding and remittance obligations to taxation authorities on the benefit resulting from the issue of shares to an employee or from the repurchase of options held by him or her. Given the cash flow difficulties that such an employer obligation might entail for employers as well as for employees, this measure risks resulting in practical implementation difficulties.

▸ **Hardship relating to the loss of value of shares acquired by the employee**

In the past, several employees having purchased shares of their employer's capital stock for an amount less than the fair market value of these shares at the time of issue, had to contend with an undue tax hardship when these shares lost value. In such case, the taxable benefit realized by the employee when the shares were subscribed for could not be offset by the subsequent capital loss realized at the time of the disposition of the shares. This hardship that obliged certain employees to declare bankruptcy was pointed out to Canada's Department of Finance on several occasions in the past but the act was never amended in this respect.

The March 4, 2010 federal budget offers some relief to this hardship that is not easily explained from the fiscal policy perspective but this relief is quite limited. In fact, the proposed relief only applies to certain public company employees having made the now repealed tax deferral election. The application of this proposed relief should be significantly broadened in the amendments to the act that will eventually be ratified.

Quebec's Finance Minister has announced that he would ensure harmonization with the foregoing proposed amendments.

Notwithstanding these amendments to the taxation system applicable to stock options, this method to remunerate and reward employees remains fiscally advantageous as long as it is used carefully. ◂

ADOPTION OF IFRS AND RECENT GAAP CHANGES: THE IMPACT ON CREDIT AGREEMENTS

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Insofar as finance and accounting are concerned, businesses are currently juggling either with changes to generally accepted accounting principles ("GAAP") that apply since December 2009 to companies that are not publicly traded or with the International Financial Reporting Standards ("IFRS") that will become mandatory as of January 1st, 2011 to publicly traded companies in Canada.

In addition to being concerned about the impact of these new rules or standards on their financial statements, businesses also have to remember that most of the credit agreements signed with a financial institution contain the following clause:

> *"Unless otherwise defined herein, each accounting term used in this Agreement has the meaning ascribed to it under the generally accepted accounting principles, consistently applied and as established, specified and updated in the Canadian Institute of Chartered Accountants Handbook. The financial calculations, audits, audit reports and financial statements (and their different items) referred to herein or pertaining to the Borrower's business shall be made or prepared in accordance with such accounting principles applied on a consistent basis and in accordance with the normal practice in the Borrower's industry."*

At first glance, there is no problem. Actually, both the IFRS and the changes to GAAP recently adopted for closed companies form part of GAAP in Canada. But, what about "applied on a consistent basis"?

It shall not be forgotten that financial institutions have established control measures for surveying the financial health of their debtors, especially in requiring the compliance with certain financial ratios, and base them on the accounting principles used in the financial statements initially provided by the debtor.

When a business, in all good faith, adopts a new accounting standard, it could certainly be argued that it is straying from "consistently applied rules." You will no doubt, and with reason, argue that the business had no other choice but to adopt this new standard. It remains nonetheless that this reference in the credit agreement calls for a disclosure of this change to the financial institution and possibly a demonstration of its effect or lack of effect on the accounting computations outlined in the contract.

Therefore, do not be surprised if, in the course of negotiating new lending agreements, financial institutions require additional provisions to further define the scope of the information that must be disclosed to them when any such changes are made.

In light of the foregoing, a review of your credit agreements may certainly prove useful. ◂

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