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Contents

DEFINED BENEFIT PENSION PLANS: THE TEMPORARY FUNDING RELIEF MEASURES WILL LIKELY BE EXTENDED!

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Since the financial crisis of 2008, defined benefit pension plans have been confronted with a major problem, that is the problem of solvency deficiencies. Over the last two years, this problem has been raised on several occasions by various news media. Due to the historically low long-term interest rates and the decline of stock markets, numerous defined benefit pension plans are currently showing substantial solvency deficiencies. Because the rules provided for in the *Supplemental Pension Plans Act* (the "**SPPA**") require most employers to eliminate these deficiencies over a 5-year period by paying additional contributions, many businesses are forced to use a significant part of their assets for the payment thereof.

To help certain employers catch their breath, temporary funding relief measures were established in 2009. These measures included, in particular, the extension of the amortization period to eliminate solvency deficiencies.

The employer had the choice of availing itself of one or more of these temporary measures and could make his choice at the time of the first actuarial valuation after December 30, 2008. Furthermore, certain conditions also had to be met, including the condition relating to minimum contributions, to make sure that the employer's contributions were not less than those that he would have had to pay had there not been the financial crisis of 2008.

The temporary funding relief measures will expire next December 31st, while the problem of defined benefit plans' solvency deficiencies is still far from being solved.

On October 20, 2011, Mr. Denys Jean, President and Chief Executive Officer of the Régie des rentes du Québec (the "**Régie**") stated that the Minister of Employment and Social Solidarity, Mrs. Julie Boulet, will soon be proposing that the Quebec government extend the temporary funding relief measures for a period of two to three years.

Based on the information provided, we understand that during such an extension, the Régie would try to find a more permanent solution to the problem of defined benefit plans' solvency deficiencies. This exercise by the Régie might result in a less restrictive solution for employers. According to Mr. Jean, Minister Boulet is aware of the prospective issues on the future of supplemental pension plans and she has established a work plan in conjunction with the Régie.

On November 15, 2011, the Quebec government announced that it intends to extend the temporary fundig relief measures for a period of two years, thus until December 31, 2013.

When exactly will the temporary funding relief measures be extended? Will the Quebec government take the opportunity to add new temporary funding relief measures in order to help employers breathe easier? We will likely have answers to these questions in the near future.

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On the other hand, as regards the changes that the Régie might propose to attempt to settle the problem of defined pension plans' solvency deficiencies in a more permanent way, we will probably have to keep waiting for several months, or even a few years. ◂

1 Under An Act to amend the *Supplemental Pension Plans Act* and other legislative provisions in order to reduce the effects of the financial crisis on plans covered by the Act, S.Q. 2009, c. 1 and the Regulation respecting measures to reduce the effects of the financial crisis on plans covered by the *Supplemental Pension Plans Act*, (2009) 141 G.O. part II, 5316.

A NEW STATUTORY FRAMEWORK FOR FEDERAL NOT-FOR-PROFIT ORGANIZATIONS

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In our December 2009 edition, we informed you of the passing of a new statute, the *Canada Not-for-Profit Corporations Act* (the "**Act**"), by the federal Parliament, to replace Part II of the *Canada Corporations Act* (the "**CCA**"). Since then, the necessary regulations have been enacted and the Act along with the regulations have been put into force on October 17, 2011 by a governmental decree.

To take advantage of this new and more modern legislation, not-for-profit organizations ("**NFPs**") subject to Part II of the CCA must be continued under the Act because it does not automatically apply to them. NFPs that do not make this transition by October 17, 2014 at the latest will be dissolved.

The first step in the process of continuing an NFP is to review its letters patent and supplementary letters patent; a copy can be obtained from Corporations Canada. Then, articles of continuance must be prepared in the form provided by Corporations Canada. They contain information comparable to the information contained in the articles of incorporation of a corporation, but with a few additions specific to the regime governing NFPs, like the statement of the purpose of the corporation in which the objects of the organization must be described, and the statement concerning the distribution of the property remaining at the time of liquidation in which it must be clearly stated how such distribution will be made. An NFP may take the opportunity during the course of the transition to change its name and may even use a designating number provided, however, that the number assigned by Corporations Canada is followed by the word "Canada" and the term "Association", "Centre", "Foundation" or "Institute". If an NFP has the status of registered charity ("**RC**"), it is strongly recommended to consult the Charities Directorate at the time of the transition process, to avoid having to file amendments afterwards or, even worse, compromising its tax status as an RC.

The by-laws of the NFP must also be reviewed to determine whether they are compatible with the provisions of the Act and be amended, if necessary. It is imperative that the by-laws, as provided under the Act, contain:

a) the conditions for being a member of the NFP; and

b) the rules respecting the giving of notice to meetings of the members.

In addition, the by-laws can modify certain rules set out in the Act. Indeed, it affords an NFP a certain flexibility to adapt those rules to its own reality.

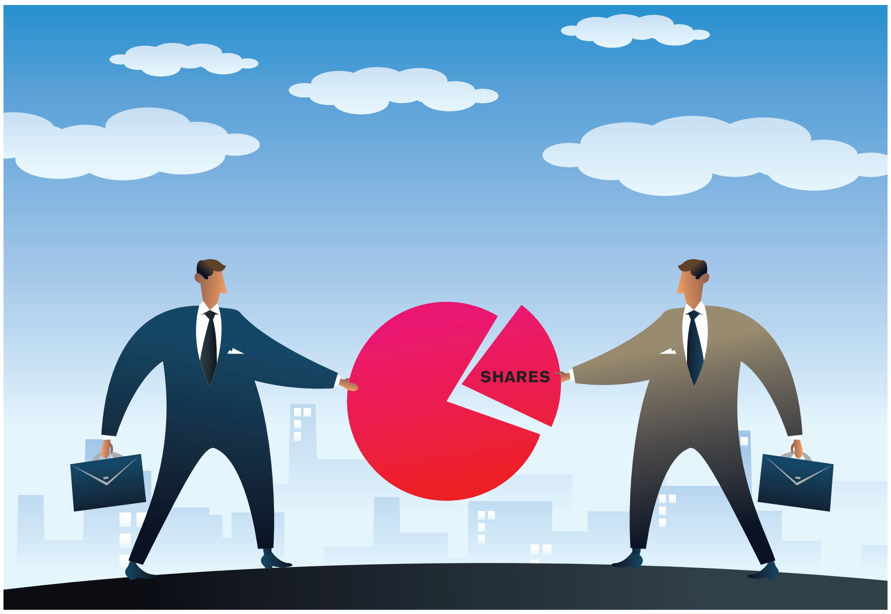
A meeting of the members must be then called and held in accordance with the rules of the CCA and the current by-laws of the NFP, in order to approve the articles of continuance. During that meeting, the current general by-laws may be repealed and replaced by new by-laws that will come into force on the date of continuance. The articles of continuance and the by-laws must be approved by a special majority (2/3).

Once the members have given their approval, a director or officer signs and files the articles of continuance. Following the filing of the articles of continuance, accompanied by the form setting out the initial address of the registered office and the names of the members of the first board of directors, a certificate of continuance will be issued by Corporations Canada. From then on, the NFP is governed by the Act.

Note: There is no longer a need to have the by-laws approved by the Minister of Industry, but they must be filed within the twelve (12) months following their approval by the members.

NFPs subject to the *Act respecting the legal publicity of enterprises* (Quebec) shall complete the transition process by notifying the enterprise registrar of their continuance by filing an updating declaration. ◂

CONVERSION OF DEBT INTO SHARES BY A CORPORATION IN FINANCIAL DIFFICULTY; PAY ATTENTION TO THE TAX CONSEQUENCES!



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In the context of the restructuring of the debt of a corporation in financial difficulty, one of the possibilities that presents itself is to convert its debt into shares of the corporation. Various rules provided for in section 80 of the *Income Tax Act* (Canada) must then be analyzed. Generally, section 80 provides that, at the time of the settlement of a debt for an amount that is less than its principal, the difference between the principal amount of the debt and the amount actually paid or deemed to be paid must be applied to reduce certain tax attributes of the debtor corporation, such as business and capital losses. Ultimately, and to the extent that the value of these tax attributes is insufficient, an inclusion in the income of the debtor corporation may occur.

Where a debt is converted into shares, section 80 provides that the amount deemed to be paid by the corporation is equal to the fair market value (hereinafter the "FMV") of the shares issued. The FMV of the shares issued may lead to problems in the context of the conversion of a debt of a corporation in financial difficulty. Indeed, it is probable that the shares of such a corporation in fact have no value or have a greatly reduced value. Therefore, section 80 will apply if the FMV of the shares issued at the time of the conversion of the debt is less than its principal amount.

To the extent that the FMV of the shares is insufficient to cover the principal amount of the debt due to a decline in the value of the debtor corporation, it will be possible to resort to another rule provided for under section 80. This rule provides that when the debtor corporation is a wholly-owned subsidiary of the creditor, the increase in the FMV of the shares held by the latter in the debtor corporation further to the extinguishment of the debt shall be deemed to be an amount paid at that time in settlement of the debt. For instance, if Aco holds all of the shares of Bco as well as a debt in the amount of $1M in Bco, and the value of Bco is also equal to that amount, the pure and simple extinguishment of the debt, even without consideration, will result in the value of the shares of Bco held by Aco increasing by an amount corresponding to the debt. The value of Bco will thus be increased to $2M. In this case, extinguishment of the debt without payment will not cause section 80 to apply as regards Bco, because Bco will be deemed to have repaid the debt in full. However, in order for this exception to apply, the assets of the debtor corporation must have a value equal to or greater than all of its liabilities, so that extinguishment of the debt can be considered as having led to an increase in the FMV of the corporation's shares.

Other techniques may also be used in order to restructure the debt of a corporation in financial difficulty while minimizing the impact of section 80.

It is essential to pay particular attention to this provision so as to avoid tax consequences likely to make the financial situation of a corporation even worse. Appropriate tax planning makes it possible to avoid the pitfalls of section 80 and thus preserve the tax attributes of a corporation in financial difficulty. ◂

CONFLICTING RIGHTS OF HYPOTHECARY CREDITORS AND TENANTS

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The relationship between the hypothecary creditor of an immovable and the tenant begins when the tenant negotiates his commercial lease, because it contains provisions which, in principle, are intended to satisfy the requirements of a possible hypothecary creditor. The tenant's top priority is to ensure that the creditor cannot terminate the lease if he exercises his hypothecary recourses against the immovable. For it is only when the creditor exercises his recourses that he and the tenant will have a direct relationship as well as rights and obligations toward each other.

Knowing that he can be bound by a lease published in the land register, the creditor will seek to avoid having his borrower sign a lease, or an amendment to a lease, that might have a negative impact on the realizable value of the immovable. In order to do so, the creditor will require an undertaking from his borrower not to amend the leases and not to enter into any new leases without his consent. However, such stipulation cannot be enforced against the tenant since he is not a party to the financing contract made between the lender and the landlord.

That being so, the lender can nevertheless take steps to exercise rights against the tenant. The best solution, but not necessarily the easiest to put in place, is to obtain, directly from the tenant, an undertaking not to amend his lease without the prior consent of the creditor. The tenant may be reluctant to sign this kind of undertaking which gives rise to obligations of the tenant to the hypothecary creditor of the landlord. Thus, this technique is used especially in cases where all or a major part of the immovable is leased to a single tenant, since the risk associated with an unfavorable amendment to the lease is much greater.

If a direct undertaking cannot be obtained from the tenant, the lender can always serve notice on the tenant that the owner has undertaken toward the lender not to amend the leases for the immovable without the prior consent of the latter. Indeed, although in principle a contract binds only the parties who have signed it, it may nevertheless be enforced against a third party who knowingly participates in a breach of the contract. Thus, if a tenant signs an amendment to the lease with the owner of the immovable, knowing that this act constitutes a breach of the loan agreement between the creditor and the landlord, the tenant runs the risk of a claim for damages being filed by the injured creditor.

In fact, it is not so much the prospect of a claim in damages against a tenant that the creditor is seeking, but rather that a tenant, once he has been informed of the landlord's undertaking not to sign an amendment to the lease without the creditor's consent, comply with this requirement and inform the creditor before signing an agreement with the landlord for fear of being sued in damages by the creditor. ◄