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LAST CALL: DO YOU HAVE ANY PRIVATE CORPORATION SHARES IN YOUR RRSP?

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The 2011 federal budget, which was tabled June 6, 2011 (after the defeated March 23, 2011 budget), proposed various broad anti-avoidance tax measures to counter the implementation of tax planning strategies involving investments in registered retirement savings plans (**"RRSP"**)[1]. One such anti-avoidance measure targets the shares of certain private corporations held in an RRSP after March 22, 2011. Such shares could now be considered as a "prohibited investment"[2] with the result that the RRSP holder will be subject to severe special tax consequences. With proper planning before the end of 2012, the effects of that special tax could be alleviated.

GENERAL REVIEW OF THE RULES

As a general rule, an individual who deals at arm's length with a particular small business corporation ("**SBC**") and who, alone or with non-arm's length persons, **owns less than 10%** of the shares of any class of the capital stock of that SBC, may hold the shares of that SBC in his RRSP. In that respect, an SBC is a Canadian-controlled private corporation, all or substantially all of whose assets are used primarily in an active business carried on in Canada or are shares or debts of related SBCs.

Before March 23, 2011, an exception to the above rule provided that an individual who, alone or with non-arm's length persons, owned **10% or more** of the shares in a class of the capital stock of an SBC or of a related corporation, could nevertheless hold the SBC's shares in his RRSP if the following conditions were satisfied:

1) **At the particular time** that the RRSP acquired the investments, the RRSP holder, alone or with non-arm's length persons, dealt at arm's length with the SBC; and

2) At that particular time, the RRSP holder, alone or with non-arm's length persons, owned shares in the capital stock of the SBC or of a related corporation, **the total cost of which shares was less than $25,000.**

This exception provided that the applicable conditions had to be satisfied at the time that the RRSP acquired the investments, with the result that all subsequent variations in the value of the shares did not affect the "qualified investment" status of the SBC's shares.

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PROPOSED TAX MEASURE

Effective March 23, 2011, the rule remains unchanged, but the exception is no longer available. Thus, investments in the shares of an SBC in which the RRSP holder, alone or with non-arm's length persons, holds **10% or more** of the shares of a class of the capital stock of that corporation or of a related corporation, **at a particular time**, are now prohibited investments[3].

Consequently, on or after March 23, 2011, these new anti-avoidance measures could have the effect of transforming a qualified RRSP investment into a prohibited RRSP investment. An RRSP holder who, after March 22, 2011, holds a prohibited investment is therefore subject to a special tax for the given calendar year, corresponding to 50% of the fair market value of the prohibited investment at any time in the year when it was acquired or when it became a prohibited investment[4].

[1] Note that the proposed tax measures that are the subject of this article apply equally to registered retirement income funds (**"RRIF"**).

[2] Definition of "prohibited investment" in paragraph 207.01(1) of the *Income Tax Act*, R.S.C. (1985), 5th supp., c. 1 and amendments (the **"ITA"**).

[3] Paragraphs 207.01 (1) and (4) of the ITA.

[4] Paragraphs 207.04 (1) and (2) of the ITA.

However, a number of measures make it possible to eliminate the special tax. Thus, unless the RRSP holder knew or should have known at the time the shares were acquired that they were or would become a prohibited investment, the RRSP holder could obtain a refund of the special tax in question if the prohibited investment is disposed of and is no longer held in the RRSP by the end of the calendar year following the year in which the special tax applied [5]. For example, if on March 23, 2011 a qualified investment became a prohibited investment, the RRSP holder has until **the end of 2012** to dispose of it.

In addition to the above-mentioned special tax, the RRSP holder is subject to a tax equal to 100% of the "advantage"[6], namely the income and capital gain earned by the RRSP on the prohibited investment, that it is reasonable to attribute to the investment in the calendar year [7]. In this regard, the holder may avail himself of a transitional measure allowing him to make a tax election **before December 31, 2012**, (deadline that was recently extended) so that the tax equal to 100% of the "advantage" attributed to a prohibited investment as of March 23, 2011 does not apply, as long as the amount of the advantage is paid to the holder out of the RRSP in the ninety (90) days following the end of the applicable fiscal year [8]. If such tax election is made, incomes made on a prohibited investment as of March 23, 2011 in an RSSP will never be subject to a tax equal to 100% of the "advantage". RRSP holders who do not make such an election will be taxed at 100% of the "advantage" in each calendar year.

An RRSP holder who held a prohibited investment on March 23, 2011 should consider transferring that investment outside the RRSP **before the end of 2012** in order to obtain a refund of the applicable special tax. In that respect, tax planning should be considered in order to reduce the onerous tax consequences that may result from the transfer of an investment held in an RRSP.

If you think you were holding a prohibited investment in your RRSP on or after March 23, 2011, you still have time to implement certain tax planning measures to minimize the tax consequences. We strongly urge you to discuss this with your advisers and to consult a tax professional.

[5] Paragraph 207.04 (4) of the ITA.

[6] Definition of "advantage" in paragraph 207.01 (1) of the ITA.

[7] Paragraphs 207.05(1) and (2) of the ITA.

[8] Section 207.05(4) of the ITA.

PLAN NORD: MAXIMIZE YOUR BUSINESS OPPORTUNITIES

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In May 2011, the Quebec Government unveiled its vision for the sustainable development of the region located north of the 49th parallel, a vision that then took shape in the provincial budget announced on March 20, 2012. Investments of $80 billion projected to span over 25 years should translate into numerous business and financing opportunities for companies operating in a diverse range of industry sectors, including the development of natural resources. Quebec has initiated measures indicating its clear willingness to participate in the future benefits generated by projects launched by investors and promoters under the Plan Nord.

NORTHERN QUEBEC AS A FOCUS FOR LOCAL AND FOREIGN INVESTMENT

In its latest budget, the Quebec Government announced the creation of Ressources Québec. This specialized subsidiary of Investissement Québec could invest up to $1.2 billion in various projects over the next 5 years.

Some would argue that the Quebec Government should be careful to not cede any territory or resources to foreign interests. Thus, projects such as that of Wisco, a Chinese company planning to invest over $13 billion in iron ore extraction at Lac Otelnuk, provide an opportunity for the Government to foster community development while forging business partnerships.

NEW FINANCING POSSIBILITIES

While foregoing the nationalization of major assets in the north, the Government will still enjoy considerable leverage allowing it to preserve certain assets or select projects, or to influence project development. Within the scope of its mandate, Ressources Québec could negotiate three types of investments targeting the most promising projects according to return-on-investment objectives: (i) joint ventures; (ii) equity investments; and (iii) debt investments.

Investment in a project based on a joint venture model will allow for direct participation in the project. The joint venture investor can exercise tight control over the activity and its unfolding. However, the joint venture model comes with its own particular risks and responsibilities given that the investor is

the beneficial owner of the project and that it must ensure that its partner, often the majority holder, exercises its rights of management in an exemplary manner and by consensus.

Equity interests in the form of investments in the capital stock of companies that develop projects provide investors with a flexible investment horizon. In the case of corporations listed on published markets, such investments often provide a liquid market in which investors can dispose of their equity interests. They also give investors in their capacity as shareholders some control over the affairs of the operating company, and they are sometimes accompanied by prerogatives respecting certain transactions which provide the possibility of sitting on the board of directors of the operating company as well as all the usual rights conferred by law to the shareholders of share capital corporations.

However, the investor's control is indirect as the project ultimately remains under the entity that has its own legal personality. Often, the investor's contribution will have little influence over the value of the shares versus the value of the assets constituting the project.

Debt investments, regardless of whether or not they are convertible into equity, can minimize an investor's risks, especially where the loan is secured by certain project-related assets. Without directly sharing the operator's business risks, the lender can obtain a return via interest on the loan. Even if he can require oversight authority respecting certain borrower activities, the lender does not usually play an active role in managing the project. Lastly, if he considers it advisable, the lender could require that its debt be convertible into an equity interest in the corporation with share capital.

THE SOCIÉTÉ DU PLAN NORD

As of August 1, 2012 when a general election was called, the members of the National Assembly were considering a bill aimed at establishing the Société du Plan Nord. Once created, the Société du Plan Nord will act as a guide for investors. It will ensure the coherent development of projects that fall within the framework of the Plan Nord by coordinating, among other things, government investments in strategic infrastructure development and by negotiating the financing arrangements for projects for which it will be responsible. Until such time as Bill 27 creating the Société du Plan Nord becomes law, a transitional office, which was created on July 30, 2012, will, in the short term, oversee the mandates and responsibilities that will eventually be assigned to the Société du Plan Nord.

The recent election of a new government on September 4 could have an impact on the Plan Nord's deployment strategy, including the establishment of the Société du Plan Nord.

CONCLUSION

To summarize, the Quebec Government will have all the necessary tools to generate business opportunities in the territory covered by the Plan Nord, in cooperation with its financial and economic organizations and the government ministries involved. Therefore, this commitment by the Government should result in increased availability of capital for companies wishing to maximize the benefits generated by the development of projects in this territory.

CAN THE REFUSAL TO SIGN A NON-COMPETITION CLAUSE CONSTITUTE A JUST AND SUFFICIENT CAUSE FOR DISMISSAL?

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INTRODUCTION

In *Jean* c. *Omegachem inc.*[1], a recent decision of the Court of Appeal, the Court held that an employee's refusal to sign a non-competition agreement during employment is not a just and sufficient cause for dismissal.[2] Although the employer had discussed the non-competition agreement with the employee at the time of hiring, it had presented it to the employee only three years after he had started working.

THE FACTS

In 2002, Patrick Jean was hired by Omegachem Inc. ("Omegachem"), a company that specializes in organic chemistry and that conducts business with the world's leading pharmaceutical corporations.

When he was hired, Mr. Jean was told that he would have to sign a mandatory confidentiality and non-competition agreement, which was a requirement for all of the employees. However, when he began working, Mr. Jean had only signed a confidentiality agreement. He was asked to sign a non-competition agreement three years later. Initially, the agreement was for 24 months and applicable in Canada, the United States and Europe. Mr. Jean refused to sign the agreement unless he received severance pay equal to 24 months' salary. Omegachem put its draft agreement on hold.

A year and a half later, Omegachem presented Mr. Jean with a revised draft of the non-competition agreement. The

[1] 2012 QCCA 232 (C.A.).

[2] This judgment overrules the two decisions rendered by the Commission des relations du travail (the "CRT") (2009 QCCRT 0076 and 2009 QCCRT 0368) as well as the judgment rendered by the Superior Court of Québec (2011 QCCS 1059 (C.S.) in this case.

proposed agreement was for 12 months but applicable worldwide. Mr. Jean refused to sign it. Omegachem sent him a demand letter demanding that he signs it and alleging that his refusal to do so would jeopardize their relationship of trust. Mr. Jean maintained his refusal to sign the agreement unless Omegachem agreed to compensate him financially. Omegachem refused.

Omegachem dismissed Mr. Jean in April 2007. The following month, Mr. Jean filed a complaint with the Commission des relations du travail ("CRT") under section 124 of the *Act respecting labour standards*.[3]

THE COURT OF APPEAL DECISION

The issue before the CRT and the Superior Court, the two lower-level decision-making authorities, was whether Mr. Jean's refusal to sign the non-competition agreement proposed by Omegachem was a just and sufficient cause for dismissal. The CRT answered that question affirmatively and its decision was upheld by the Superior Court on judicial review. However, the Court of Appeal reversed the Superior Court decision and quashed the two CRT decisions.

When Mr. Jean started working with Omegachem in 2002, no non-competition agreement was presented to him. It was only in 2005 that Mr. Jean was asked to sign such an agreement. The Court of Appeal was of the view that in order to hold, as did the CRT, that Mr. Jean had breached a fundamental condition of his contract of employment, the non-competition agreement must have been submitted to him when he commenced his job, as provided for in his contract of employment. The Court of Appeal explained that because the CRT did not consider these specific facts, its decision was not well-founded.

The Court of Appeal was of the view that the CRT should have also considered the formal requirements of article 2089 of the *Civil Code of Québec*[4] (the "C.C.Q."), which specifically provides that in order to be valid, a non-competition clause must be stipulated in writing and in express terms. Furthermore, according to the law of contracts, for contractual obligations to be valid, they must be determinate or determinable.[5] As such, Mr. Jean could not have legally bound himself without knowing the scope of the obligation to which he would have been subjected. According to the Court, by failing to consider these statutory provisions, the CRT made a "proposition that is unacceptable in law".

Lastly, the CRT should have considered the legality of the non-competition agreement with regards to article 2089 C.C.Q. On its face, the second version of the agreement was problematic regarding the territory it covered, i.e., "everywhere in the world". According to article 2089 C.C.Q., a non-competition clause is valid only if it is limited as to time, place and type of employment. As such, the Court of Appeal, explained that a clause is not limited as to place if it applies to "everywhere in the world". Therefore, the CRT could not reasonably conclude that Mr. Jean's refusal to sign the non-competition agreement constituted a just and sufficient cause for dismissal since its validity was *prima facie* questionable.

Considering that the dismissal of an employee is a serious matter with important consequences, the Court explained that an employer can unilaterally and without prior notice terminate a contract of employment only if it can be shown that it has serious reasons or just and sufficient cause for doing so. However, the decision to dismiss, without notice, an employee who refuses to sign a non-competition clause while employed, which is presented to him for the first time three years after he was hired, is not a just and sufficient cause for dismissal. If Omegachem attached such importance to the non-competition agreement to the extent that it chose to dismiss an employee who refused to sign such an agreement, it could only do so by compensating that employee.

COMMENTS

This Court of Appeal decision highlights a general rule of contract law, which states that a person is not bound to perform an obligation without knowing the terms of that obligation or without the obligation being "determinate or determinable". In addition, when a contract of employment obligates an employee not to do something, that obligation must be reasonably identified. Needless to say, the content of the obligation itself must not be contrary to the law. Omegachem should have presented the non-competition agreement to Mr. Jean at the time of hiring, and not three years later, and the agreement should have respected the parameters established by article 2089 C.C.Q. Lastly, this judgment emphasizes that it is in an employer's best interest to strategically plan its non-competition and non-solicitation agreements.

[3] R.S.Q., c. N-1.1.

[4] S.Q., 1991, c. 64.

[5] Article 1373 C.C.Q..

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