# Tax Aspects of Insolvency and Bankruptcy

October 19, 2020

## Author

Éric Gélinas

Counsel and Lawyer

The current crisis caused by the COVID-19 pandemic has already caused, and will continue to cause, significant liquidity problems for some businesses. Companies whose financial difficulties threaten their very existence will have to restructure in order to avoid bankruptcy, either by availing themselves of the protection of the *Companies' Creditors Arrangement Act*[1] (the "**CCAA**") or by using the proposal mechanism of the *Bankruptcy and Insolvency Act*[2] (the "**BIA**").

**Tax considerations related to an arrangement or a proposal accepted by creditors**

Making use of the provisions of the CCAA or the BIA entails tax considerations for the debtor corporation that directors and owner-operators need to consider. Some of these tax considerations are discussed below.

In the context of the restructuring of a debtor company, creditors may accept a partial settlement of their claim or a conversion of their claim into shares in the debtor company. If a corporation is not bankrupt within the meaning of the *Bankruptcy and Insolvency Act*, the settlement of a debt for an amount less than its principal will have tax consequences for the debtor corporation. For example, certain tax attributes of the debtor corporation such as the balance of loss carryforwards, the undepreciated portion of the capital cost of depreciable property or the adjusted cost base of capital assets will be reduced by the amount of the reduction in the receivable, if any.

In certain cases, if the tax attributes of the debtor corporation are insufficient to absorb the amount of debt forgiven, inclusion in the calculation of its taxable income may occur, creating a tax liability.

Several strategies can be adopted to limit undesirable consequences in the context of a restructuring under the *Companies' Creditors Arrangement Act*.

As mentioned, it may be possible, among other things, to convert the debt into shares of the debtor company without causing adverse consequences, if the fair market value of the shares issued upon conversion of the debt is equal to the principal of the debt.

In some cases, a debt held by a shareholder of the debtor company could be written off without consideration and without the need to issue shares.

Finally, it may be possible, in certain situations, to avoid inclusion in the income of the debtor corporation through the use of certain reserve mechanisms or through tax deductions.

Insolvency is a delicate situation for any business. Proper tax planning will allow the debtor company to maximize the effectiveness of the restructuring process offered by the CCAA.

Our taxation team can help you set up effective planning in this context.

---

1. R.S.C. 1985, c. C-36 and amendments
2. R.S.C. 1985, c. B-3 and amendments