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The Joint Committee on Taxation of
The Canadian Bar Association
and

Chartered Professional Accountants of Canada

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March 26, 2024

Robert Demeter
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Tax Legislation Division
Tax Policy Branch
Department of Finance Canada
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Dear Mr. Demeter:

Subject: Proposed Part II.2 Tax – Tax on Repurchases of Equity – "Reorganization Transaction"

We are writing in regard to the "Tax on Repurchases of Equity" provisions in Part II.2 of the *Income Tax Act* (Canada) (the "**Act**")¹, as proposed to be enacted by Bill C-59. Under proposed Part II.2, the redemption, acquisition or cancellation of equity of a "covered entity" may result in a tax under proposed subsection 183.3(2) (the "**Share Buyback Tax**"). Proposed paragraph 183.3(2)(a) includes a carve-out for equity that is redeemed, acquired or cancelled in a "reorganization transaction" (as such term is defined in proposed subsection 183.3(1)). Members of the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada (the "**Joint Committee**") have identified certain technical issues arising in the definition of "reorganization transaction", which may have significant adverse impacts on *bona fide* acquisition transactions involving Canadian public corporations.

The issues identified by the Joint Committee are best illustrated by examples. Each example involves a situation where a taxable Canadian corporation ("**Acquisitionco**") acquires all of the issued and outstanding shares in the capital of a taxable Canadian corporation ("**Targetco**") at a time when the Targetco shares are listed on a designated stock exchange such as the Toronto Stock Exchange. Targetco is not a mutual fund corporation.

¹ Unless otherwise noted, all statutory references herein are to the provisions of the Act.

Example 1: Amalgamation of Acquisitionco and Targetco

Following the acquisition by Acquisitionco of Targetco, it is often the case that Acquisitionco and Targetco will immediately amalgamate to form one corporation ("**Amalco**"), with the amalgamation being governed by subsections 87(1) and 87(11). Such an amalgamation may be implemented for a number of legitimate commercial and tax planning reasons; for example, providing the lenders to Acquisitionco with direct security against the assets of Targetco, permitting a tax cost "bump" under paragraph 88(1)(d), or effecting a direct consolidation of the Targetco income and the interest expense on Acquisitionco's acquisition debt. Commercial objectives and tax planning often require the amalgamation of Acquisitionco and Targetco to be implemented as soon as possible after the acquisition; for example, it may be preferable for shares of foreign affiliates of Targetco to be distributed out of Canada (to the ultimate non-resident shareholder of Acquisitionco) as soon as possible after the acquisition in order to minimize the risk of any value appreciation (including as a result of currency fluctuations) between the time of the acquisition and the distribution. We note that, in most cases, an amalgamation is preferred to a wind-up as an amalgamation avoids numerous commercial issues associated with the transfer of property of Targetco on a wind-up (particularly where such property is comprised of operating assets).

It is our understanding that such an amalgamation is not, from a policy perspective, intended to be subject to the Share Buyback Tax, as there is no change in the ownership interest of the ultimate shareholders nor a distribution of corporate funds to shareholders. A technical analysis, however, indicates that the Share Buyback Tax may apply to such an amalgamation.

Under the definition of "covered entity" in proposed subsection 183.3(1), Targetco may constitute a "covered entity" at the time of the amalgamation, because shares of Targetco will often continue to be listed on a designated stock exchange² for several days after the acquisition. The continued listing of the shares of Targetco means that Targetco may constitute a "covered entity" at the time of the amalgamation (even if the shares are de-listed prior to the amalgamation).

The particular concern that arises is that the amalgamation of Acquisitionco and Targetco will not qualify as a "reorganization transaction" under proposed paragraph (b) of the definition of reorganization transaction, which is as follows:

reorganization transaction means a redemption, acquisition or cancellation of equity by a covered entity that is made [...]

(b) on an amalgamation of the covered entity with one or more other predecessor corporations to which subsection 87(1) applies if a holder of that equity, immediately before the amalgamation, receives consideration that includes equity (other than substantive debt) of the new corporation (within the meaning of subsection 87(1)) for the disposition of their equity on the amalgamation;

In particular, in order for an amalgamation to qualify as a "reorganization transaction", the equity holder of the covered entity (in our example, Acquisitionco as the holder of Targetco shares) must receive equity

² Please refer to the Joint Committee Submission - Definition of "Public Corporation" dated March 4, 2019. The TSX has recently confirmed that listed shares will normally remain listed for a period of time after an acquisition of the issuer corporation.

of Amalco. This is not the case with a vertical amalgamation, because the Targetco shares are cancelled on the amalgamation for no consideration, and only the Acquisitionco shares become shares of Amalco.

The result – that Targetco continues to constitute a "covered entity" after the acquisition and that the amalgamation of Targetco and Acquisitionco may result in the Share Buyback Tax - is anomalous and inappropriate. Such a result would not have arisen under either the draft legislation released as part of the 2023 Federal Budget nor under the revised draft legislation released in August 2023.³

Recommendation: Paragraph (b) of the proposed definition of "reorganization transaction" should be amended to also apply where equity of the covered entity was owned by another predecessor corporation immediately before the amalgamation, and such equity is cancelled on the amalgamation for no consideration.

Example 2: Wind-Up of Targetco into Acquisitionco

Following the acquisition by Acquisitionco of all of the issued and outstanding shares of Targetco, it may be desirable for Targetco to be wound-up into Acquisitionco. Such a transaction may be implemented as an alternative to the amalgamation of Acquisitionco and Targetco (although it is less common due to additional corporate and commercial complexities). It is our understanding that such a wind-up is not, from a policy perspective, intended to be subject to the Share Buyback Tax, as there is no change in the ownership interest of the ultimate shareholders or distribution of corporate funds to shareholders. A technical analysis, however, indicates that the Share Buyback Tax may apply to such a wind-up where more than 10% of Targetco's assets is comprised of shares or debt of Acquisitionco.

As described above, it may be that Targetco constitutes a "covered entity" at the time of the wind-up into Acquisitionco (because its shares are still listed or were listed earlier in the same taxation year). To avoid the application of the Share Buyback Tax, the wind-up must constitute a "reorganization transaction". Proposed paragraph (c) of the definition of reorganization transaction is as follows:

reorganization transaction means a redemption, acquisition or cancellation of equity by a covered entity that is made [...]

(c) on a winding-up of the covered entity during which all or substantially all of the property owned by the covered entity is distributed to the equity holders of the covered entity;

In order for the wind-up of Targetco to qualify as a "reorganization transaction", all or substantially all (generally 90% or more) of the property of Targetco must be distributed to Acquisitionco (as the equity holder of Targetco). While this typically should not be problematic, issues can arise where more than 10% of Targetco's assets are comprised of debt or equity of Acquisitionco. This can occur where Targetco owned shares or debt of Acquisitionco prior to the acquisition. Such shares or debt will be extinguished by operation of law on the wind-up and may not technically be "distributed" to Acquisitionco.

As above, the result – that Targetco continues to constitute a "covered entity" after the acquisition, and that the wind-up may result in the Share Buyback Tax - is anomalous and inappropriate.

³ The prior draft law referred to any amalgamation of a covered entity governed by subsection 87(1) if holders receive no consideration other than equity.

Recommendation: Paragraph (c) of the proposed definition of "reorganization transaction" should be amended to include any wind-up governed by subsection 88(1).⁴

Example 3: Acquisition of Targetco by Way of Share Exchange

Some public company acquisition transactions are structured such that, in consideration for the acquisition of the Targetco shares, former shareholders of Targetco receive a combination of shares of Acquisitionco and cash. It is our understanding that such a transaction is not, from a policy perspective, intended to be subject to the Share Buyback Tax, as it does not involve a situation where a corporation buys back its own stock from existing shareholders⁵. A technical analysis, however, indicates that the Share Buyback Tax may apply where Acquisitionco is itself a taxable Canadian corporation whose shares are listed on a designated stock exchange.

At the time of the acquisition by Acquisitionco, Targetco is a "covered entity" as a consequence of being a Canadian resident corporation whose shares are listed on a designated stock exchange. The acquisition will constitute a "reorganization transaction" under proposed subparagraph (a)(i) of the definition of reorganization transaction, as there is an acquisition of equity by a covered entity (Acquisitionco) that is made on an exchange of equity by a holder (Targetco shareholders) for consideration that includes equity of the covered entity (Acquisitionco).

If the consideration paid by Acquisitionco for the shares of Targetco was comprised solely of Acquisitionco shares or solely of cash, there would be no effect on the Share Buyback Tax, as the amounts included in Variables A and B of proposed subsection 183.3(2) would both be nil. This is the correct policy result, since there is no acquisition by an issuer of its own shares. However, because the consideration includes both a share and cash component, that cash component is included in Variable B of the formula in proposed subsection 183.3(2). This is because equity of a covered entity (Targetco) is acquired in the taxation year pursuant to a reorganization transaction described in paragraph (a) of that definition and a portion of the consideration received by a holder for the shares of Targetco is not equity consideration described in paragraph (a) or (b) of the definition of reorganization transaction.

The result – that a third-party acquisition of Targetco is subject to the Share Buyback Tax simply because the transaction involves both share and non-share consideration – is anomalous and inappropriate.⁶ Such a result would not have arisen under either the draft legislation released as part of the 2023 Federal Budget nor under the revised draft legislation released in August 2023.

Recommendation: We recommend that the proposed definition of "reorganization transaction" be amended to refer to a redemption, acquisition or cancellation of equity of a covered entity by the covered entity.

⁴ Such an amendment would be similar, in policy terms, to the exception in the foreign affiliate dumping regime for wind-ups in paragraph 212.3(22)(b).

⁵ If Acquisitionco is simply a vehicle to distribute cash of Targetco to its shareholders, and is not a bona fide purchaser, the anti-avoidance rule in draft subsection 183.3(3) should apply.

⁶ That this is an anomalous result is further illustrated by the fact that it is not clear which covered entity – Targetco or Acquisitionco – should pay the tax under proposed Part II.2 as the tax under proposed subsection 183.3(2) applies to "each person ... that is a covered entity".

Tax Payable

We also note that proposed subsection 183.3(2) provides that each person or partnership that is a covered entity for a taxation year shall pay a tax determined by a formula, where Variable B of the formula includes an amount where equity of a covered entity is redeemed, acquired or cancelled pursuant to a reorganization transaction (and a portion of the consideration is not equity). Under a literal reading of this provision, every covered entity would have an amount under Variable B when equity of any other covered entity is redeemed, acquired or cancelled pursuant to a reorganization transaction (and a portion of the consideration is not equity).

Recommendation: Variable B(a) of proposed subsection 183.3(2) should refer to equity of the covered entity (being the covered entity referenced in the preamble to proposed subsection 183.3(2)).

Members of the Joint Committee and others in the tax community participated in the discussion concerning this submission and contributed to its preparation, including:

- Anu Nijhawan – Bennett Jones LLP
- Carrie Smit – Goodmans LLP

We would be pleased to discuss this submission with you in further detail at your convenience.

Yours truly,

Carmela Pallotto

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