TAX FOR THE Owner-Manager

Envision This: Non-Qualifying Amalgamations Clarified

Section 87 of the Act describes certain income tax consequences of an amalgamation that satisfies the conditions in subsection 87(1)--namely, a merger of taxable Canadian corporations into one corporate entity where all of the property and liabilities (other than intercompany shares and liabilities) of the amalgamating corporations become the property and liabilities of the amalgamated corporation, and each shareholder (except a predecessor) receives (or, in the case of a short-form corporation, is deemed by subsection 87(1.1) to receive) shares of the amalgamated corporation. For qualifying amalgamations, subsection 87(2) generally provides that (1) the amalgamated corporation is deemed to be a new corporation for the purposes of the Act, and (2) the tax attributes of the predecessor corporations flow through to the new amalgamated corporation.

If an amalgamation is a non-qualifying amalgamation, the rules in subsection 87(2) do not apply. In the past, it has been unclear whether the tax attributes of a predecessor corporation flow through to the amalgamated corporation in any event under general legal principles. The FCA's recent decision in Envision Credit Union v. Canada (2011 FCA 321), which affirms the TCC's decision (2010 TCC 576), provides clarification.

In *Envision*, in an effort to fall outside the scope of section 87, the predecessor corporations purported to transfer their interests in certain properties to a subsidiary at the same moment that the amalgamation occurred. Thus, one of the conditions in subsection 87(1) arguably was not satisfied. The amalgamated corporation (Envision) took the position that its undepreciated capital cost (UCC) was equal to the original capital cost of the depreciable property of the predecessor corporations, on the basis that paragraph 87(2)(d) did not apply to require UCC continuity.

The TCC held that the amalgamation in Envision was not a qualifying amalgamation, since not all of the property of the predecessor corporations became the property of Envision by virtue of the merger. The court then considered the SCC's decision in R v. Black & Decker Manufacturing Co. ([1975] 1 SCR 411), and observed that the relevant corporate law provisions in Envision were similar. Accordingly, the court concluded that the predecessor corporations "continued without subtraction" under general legal principles, thereby resulting in the tax attributes of the predecessors flowing through to Envision. Envision therefore was entitled only to a reduced UCC balance.

The FCA agreed that tax attributes would flow through on a non-qualifying amalgamation under general legal principles (provided that it was the type of amalgamation contemplated in Black & Decker), but it did not agree that the amalgamation in Envision was a non-qualifying amalgamation. The court adopted a very broad view in its determination that certain properties had become the property of Envision "by virtue of the merger." Essentially, the court considered it sufficient to be able to directly trace all of the property owned by Envision immediately after the amalgamation to all of the property owned by the predecessors immediately before the amalgamation.

Although *Envision* dealt with the amalgamation of credit unions, the decision should be relevant in the context of corporate amalgamations generally. In particular, the following observations may be distilled from the FCA's conclusions.

First, it may be difficult for taxpayers to plan into a non-qualifying amalgamation, given the court's conclusion that the amalgamation in Envision was a qualifying amalgamation based on a tracing concept. Second, contrary to the CRA's published administrative position (see CRA document no. 9229580, November 25, 1992), it appears to be settled that the tax attributes of a predecessor flow through to the amalgamated corporation on a non-qualifying amalgamation that occurs pursuant to corporate law that provides for a "continuation" model of amalgamation. Third, if a non-qualifying amalgamation can be attained, the court's confirmation that Black & Decker applies to certain non-qualifying amalgamations may allow predecessors to flow their tax attributes through to the amalgamated corporation in situations where section 87 otherwise would preclude such a result. Finally, notwithstanding the Envision decision, various income tax consequences of a non-qualifying amalgamation will continue to be unclear. Therefore, taxpayers will often prefer to structure an amalgamation as a qualifying amalgamation to achieve greater certainty under the detailed rules in section 87.

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