Supreme Court Dismisses Appeal in Amalgamation Case

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Reprinted from Tax Notes Int’l, September 30, 2013, p. 1278
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The Supreme Court of Canada (SCC) on September 26 dismissed the taxpayer’s appeal in Envision Credit Union v. Canada (2013 SCC 48), a case in which two credit union corporations (the predecessors) merged to form a single entity (Envision) under the corporate laws of the province of British Columbia.

Envision took the position that the merger was a taxable transaction that did not constitute a “qualifying amalgamation” (a tax-deferred merger of the two participating entities) under the Income Tax Act (Canada) and therefore, Envision could claim a higher amount of capital cost allowance (CCA), the Canadian tax version of depreciation. All seven SCC justices hearing the case disagreed and found in favor of the Crown.

Background

The merger was undertaken for nontax reasons but was structured with the intention of achieving the most tax-advantageous result. Specifically, SCC Justice Marshall Rothstein characterized Envision’s planning as an “attempt to double claim capital cost allowance and [produce] an enhanced capacity for a lower tax rate on a portion of its income.”1 The parties agreed that the second tax planning objective had not been met, and as such, the case was limited to Envision’s claim for higher CCA.

The ITA provides that in a qualifying amalgamation, the tax attributes and tax history of the predecessor corporations flow through to the amalgamated entity for various tax purposes. It was this flow-through that Envision was attempting to prevent by structuring the merger in such a way as to prevent it from being a qualifying amalgamation under the ITA.

To constitute a qualifying amalgamation, Envision would have had to acquire all of the property and assume all of the liabilities of the predecessor corporations. Envision sought to prevent that by providing in

1 See Envision, 2013 SCC 48, para. 2.
directly to property owned by Envision after the amalgamation. Many in the tax community were distinctly uncomfortable with this reasoning because it effectively looked through the separate existence of the subsidiary, a view that is inconsistent with the manner in which taxation statutes are generally interpreted in Canada.

SCC

The SCC reached the same effective result as the lower courts, but on the basis of simpler and more satisfying reasoning. Rothstein noted the wording of the relevant corporate statute (the Credit Union Incorporation Act, or CUIA) governing the amalgamation:

23. On and after the date of the amalgamation...

(b) the amalgamated credit union is seized of and holds and possesses all the property, rights and interests and is subject to all the debts, liabilities and obligations of each amalgamating credit union . . .

“This language provides that the result of an amalgamation under the CUIA is that the amalgamated credit union is the owner of all the property of its predecessors,” Rothstein held.

Moreover, contrary to the finding of the TCC, the parties could not choose to contract out of that statutory result in the amalgamation agreement or otherwise deviate from it under the CUIA. The only way in which Envision’s predecessors could have amalgamated under the CUIA was for Envision to have acquired all property owned by its predecessors, the SCC said. Allowing amalgamations to occur on any other basis would undermine the statutory scheme and potentially cause the creditors of a predecessor to lose the protection they are intended to have by requiring the amalgamated entity to acquire all property of its predecessors.

As such, the CUIA both required and deemed Envision to own the surplus properties of its predecessors, making the amalgamation a qualifying amalgamation for ITA purposes. By operation of law, Envision simply inherited and immediately fulfilled the sale obligation to 619 under the amalgamation agreement, transferring the surplus properties to 619 in exchange for 619 shares.3

While this finding was enough to dispose of the appeal, the SCC went on to address the FCA’s “approach of tracing the surplus properties through the shares of 619” as a basis for concluding that the merger was a qualifying amalgamation. Rothstein observed that “it is a basic rule of company law that shareholders do not own the assets of the company” whose shares they own. In the absence of an explicit deeming rule to the contrary in the ITA, Envision therefore could not be said to own property that was in fact owned by a wholly owned subsidiary, he said. Therefore, “the tracing approach cannot be used to cause an amalgamation to [be a qualifying amalgamation],” Rothstein held.

Conclusion

The SCC’s decision is significant, not only because it highlights the importance of carefully interpreting nontax (corporate) law to assess the tax consequences of a transaction but also because it so clearly rejected the FCA’s tracing approach.

Left unaddressed, that approach could have cast significant doubt on both the general principle that Canadian tax law applies based on the legal results produced by the taxpayer’s transactions, and indeed on the proper interpretation of taxing statutes generally.

Treating Envision as owning 619’s property or stretching the words of the “qualifying amalgamation” provisions beyond their normal meaning to try and achieve a particular result was not appropriate, the SCC said, and it rightly rejected that approach. The result reverses the uncertainty produced by the lower court decision: a welcome result.

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3 Envision, 2013 SCC 48, para. 52: “At the moment that Envision was created, it was seized of the property and was immediately able to transact in relation to that property. Envision was therefore immediately able to and indeed required to fulfill the obligations of the predecessors, such as the obligation to sell the surplus properties to 619. It follows that the agreements for the sale of the surplus properties were effective.”

4 Envision, 2013 SCC 48, paras. 57-58.