2015 IFA International Tax Conference
Thursday May 28-Friday May 29, 2015

TELUS Convention Centre
Calgary, AB

Recent M&A and Case Law Update

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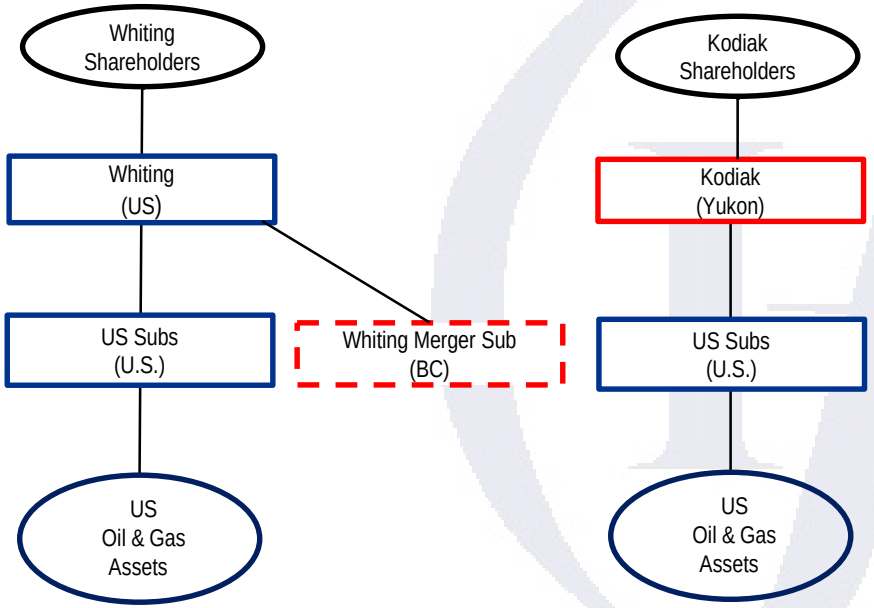
RECENT M&A TRANSACTIONS

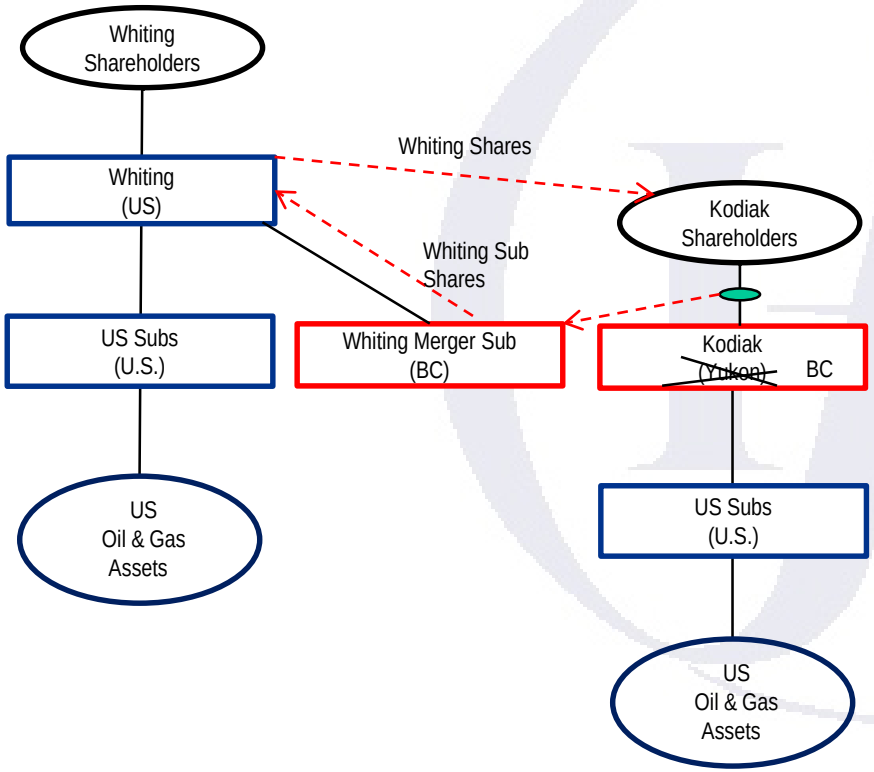
Acquisition of Kodiak Oil by Whiting Petroleum

Overview of Transaction



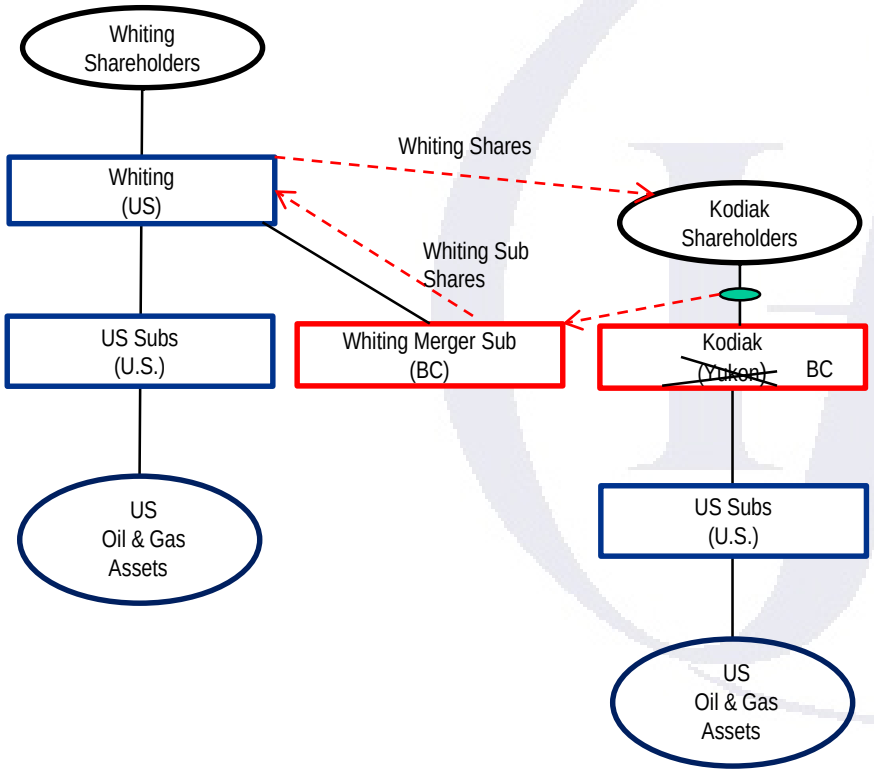
- Whiting Petroleum (a Delaware corporation) listed on the NYSE agreed to acquire all the shares of Kodiak Oil & Gas (a Yukon incorporated company) in a share exchange transaction.

Overview of Transaction



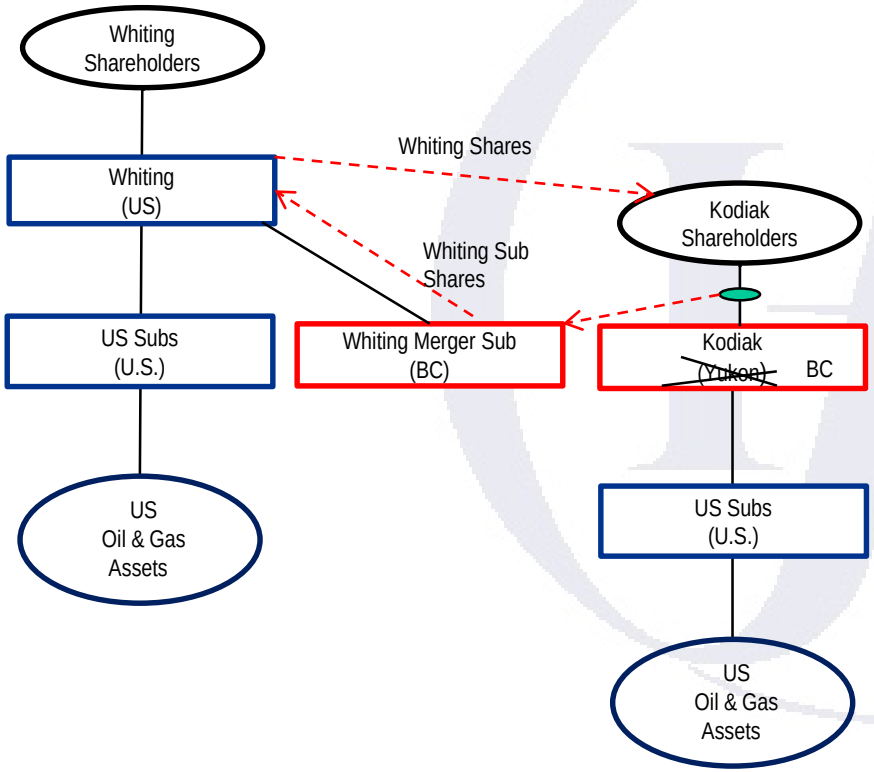
- Kodiak was continued as a corporation under the BCBCA.
- Pursuant to the plan of arrangement, Whiting Merger Sub acquired all of the Kodiak shares in consideration for Whiting shares.
- The Whiting shares were delivered directly by Whiting to Kodiak shareholders and in consideration Whiting Merger Sub issued its shares to Whiting.
- It was important for the purposes of the foreign affiliate dumping rules that Whiting Merger Sub did not acquire the shares of Whiting and then deliver the Whiting shares to Kodiak shareholders as the acquisition of the Whiting Shares by Whiting Merger Sub would have been an “investment” in a foreign affiliate.

Overview of Transaction



- Whiting Merger Sub is a Canadian corporation controlled by a non-resident corporation and, as such, is a CRIC for the purposes of the FA dumping rules.
- An investment by Whiting Merger Sub in a foreign affiliate will result in the reduction of the paid-up capital of its shares to the extent thereof and any excess would be a deemed dividend from Whiting Merger Sub to Whiting.
- For these purposes, the acquisition of the Kodiak shares is treated as a direct acquisition of the shares of the US subsidiaries of Kodiak because the FMV of the foreign affiliates exceeds 75% of the FMV of all assets (see s. 212.3(10)(f)).
- As a result, the paid-up capital of the Whiting Merger Sub shares issued to Whiting was reduced to nil.

FA Dumping



- The issuance of Whiting shares to Kodiak shareholders likely prohibited a s.88(1)(d) bump because the value of Kodiak appears to have represented more than 10% of the total value of the combined company.
- Unless there is no inherent gain in the Kodiak US subs, a tax-efficient exit from Canada will not be available.
- As such, the foreign affiliate dumping rules will have to be managed going forward recognizing that the PUC of White Merger Sub (or its successor by amalgamation) will be nil.

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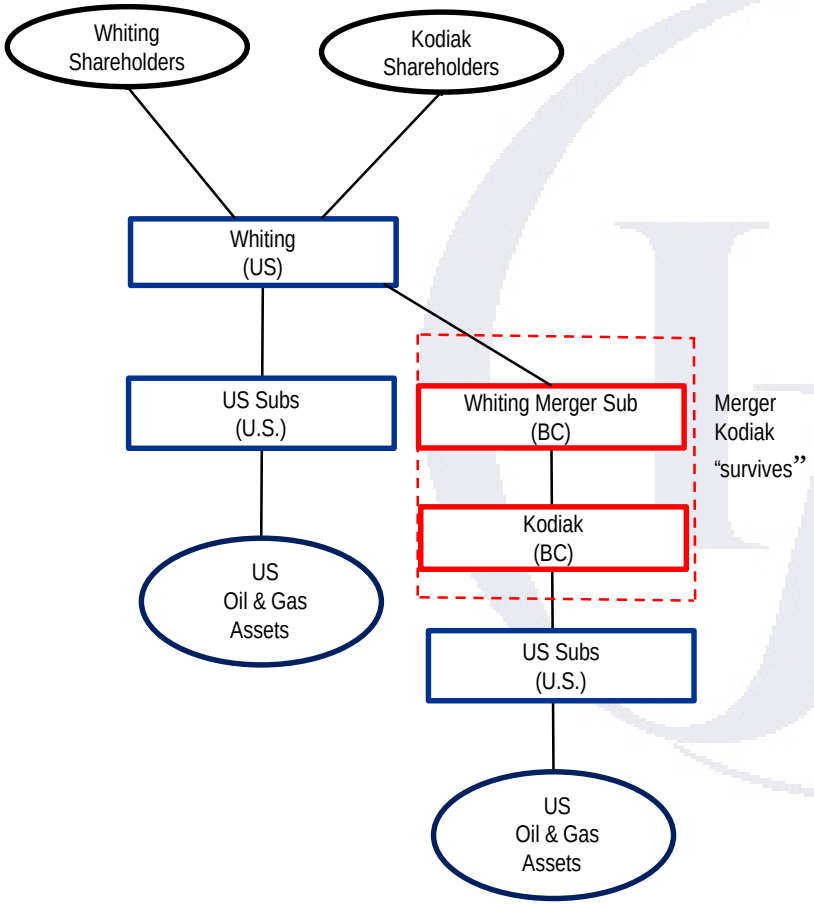
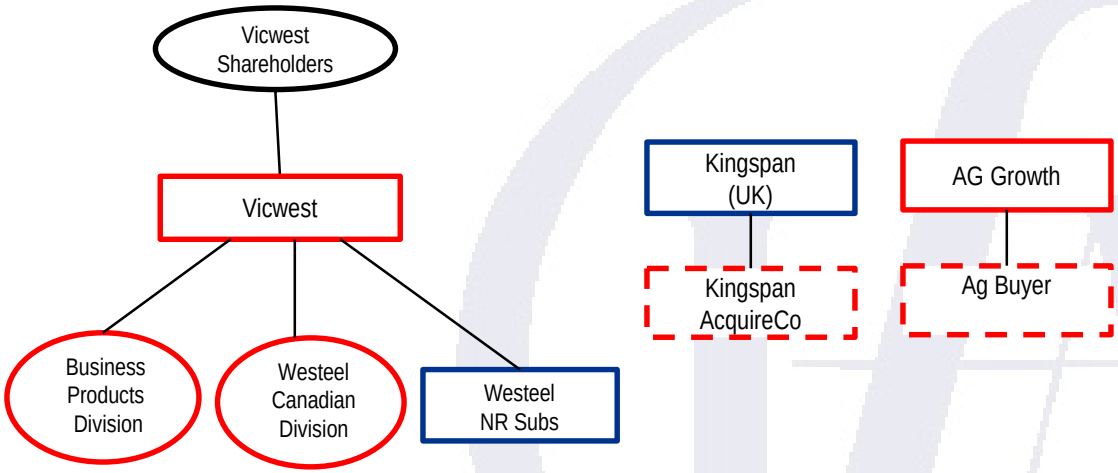
US Style Survivor Amalgamation



- The paid-up capital of the Kodiak shares was reduced to nil to ensure no s.88(1)(b) gain.
- White Merger Sub and Kodiak amalgamated to form one corporate entity with the same effect as a typical amalgamation under the BCBCA except Kodiak is stated to survive the amalgamation and the separate legal existence Whiting Merger Sub is stated to cease without Whiting Merger Sub being liquidated or wound-up.
- Doesn't affect qualification as a s.87 amalgamation – all three conditions still met.
- See CRA Ruling 2006-0178571R3 (parent is the surviving entity) and CRA Ruling 2010-0355941R3 (target is the survivor entity).
- S.212.3(22) applies for the purposes of the FA dumping rules. Consider whether s.87(3.1) election required to clarify that PUC reinstatement in the future can apply.

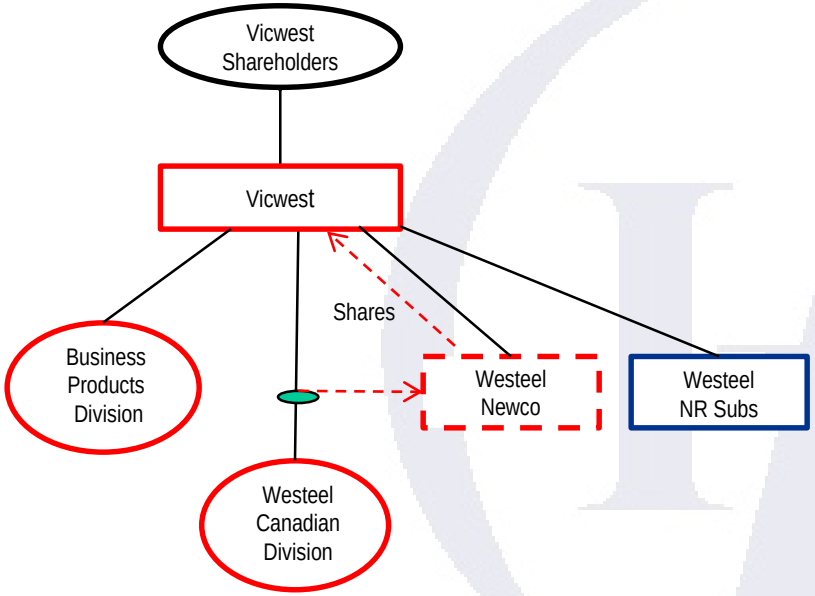
Acquisition of Vicwest by Kingspan and Sale of Vicwest's Westeel Division to AG Growth International

Overview of Transaction



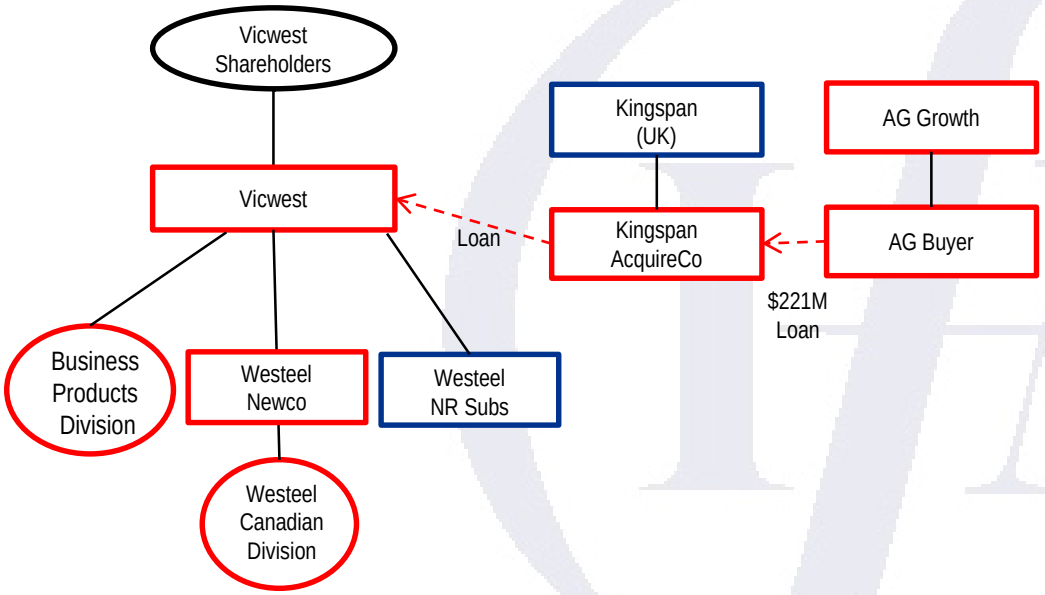
- Vicwest is a Canadian company listed on the TSX.
- Kingspan is a UK public company that wants to buy Vicwest's Business Products Division.
- AG Growth is a Canadian public company that wants to buy the Westeel Canadian Division and the Westeel NR Subs (collectively, the "Westeel Business").
- Transaction to use the s.88(1)(d) bump to split the Vicwest assets between Kingspan and AG Growth on a tax-efficient basis.

Bump Packaging



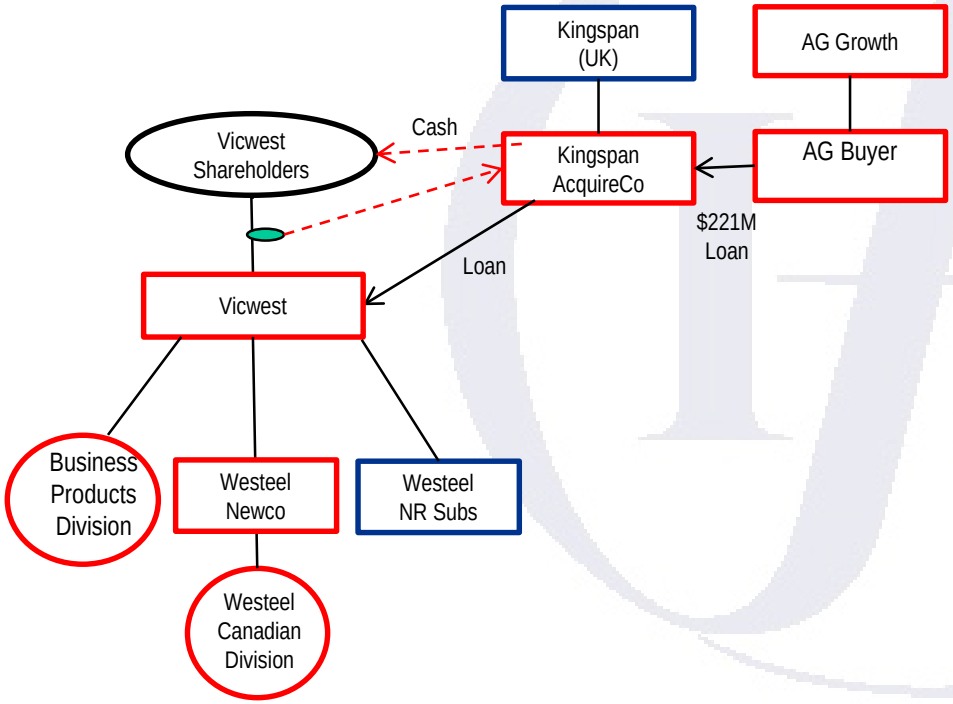
- s.88(1)(d) bump only available in respect of non-depreciable capital property. No longer available in respect of interests in partnerships that hold business assets.
- As such, Vicwest will transfer the Westeel Canadian division to Westeel Newco on a tax-deferred basis under s. 85(1).

Plan of Arrangement Transactions



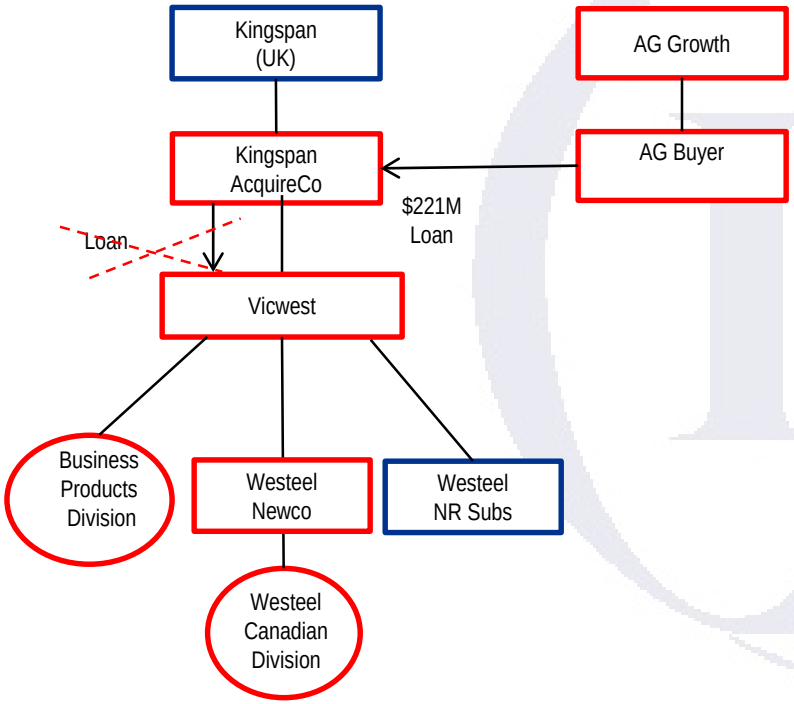
- AG Buyer will make a loan of $221M to Kingspan AcquireCo. This will fund the portion of the purchase price represented by the Westeel Business.
- Kingspan AcquireCo will make a loan to Vicwest to fund the cash out of options & phantom units and the repayment of amounts owed by Vicwest under a credit facility.
- Vicwest will cash-out its options and phantom units.

Plan of Arrangement Transactions



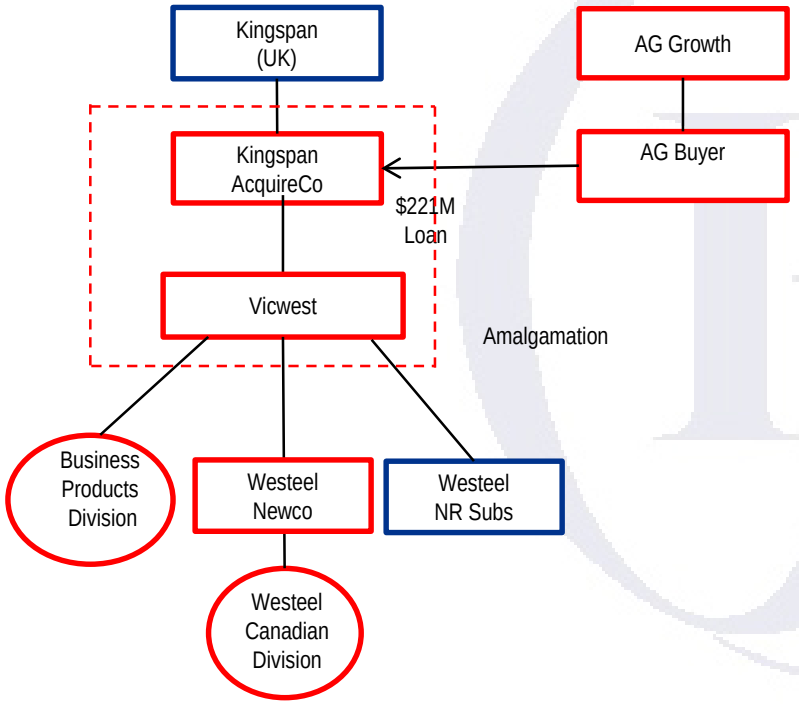
- Kingspan AcquireCo will acquire the Vicwest shares for cash consideration.
- Any dissenters shares are transferred to Kingspan AcquireCo in consideration for a debt claim against Kingspan AcquireCo.
- Intended to ensure dissent rights are specified property for bump purposes as described in s.88(1)(c.4)(ii) – see bump discussion below.

Plan of Arrangement Transactions



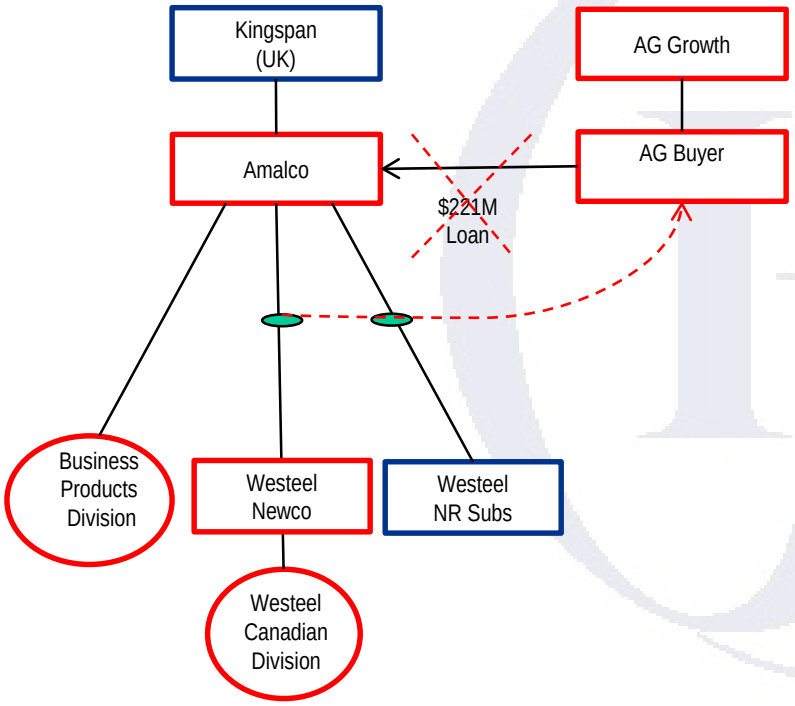
- The loan previously made by Kingspan AcquireCo to Vicwest is settled by way of a capital contribution to Vicwest.
  - Kingspan AcquireCo's tax cost in the Vicwest shares should increase pursuant to s.53(1)(c).
- Vicwest will file an election with the CRA to cease to be a "public corporation" (stated to occur at 9:45am).
  - Under the plan of arrangement, the acquisition of the Vicwest shares is to occur at 9:25am and the amalgamation (see next slide) will occur at 9:55am.
  - It is very likely that the Vicwest shares will still be listed on the TSX until at least the end of the day so Amalco will arguably be deemed to be a public corporation even though the election is filed prior to the amalgamation.

Plan of Arrangement Transactions



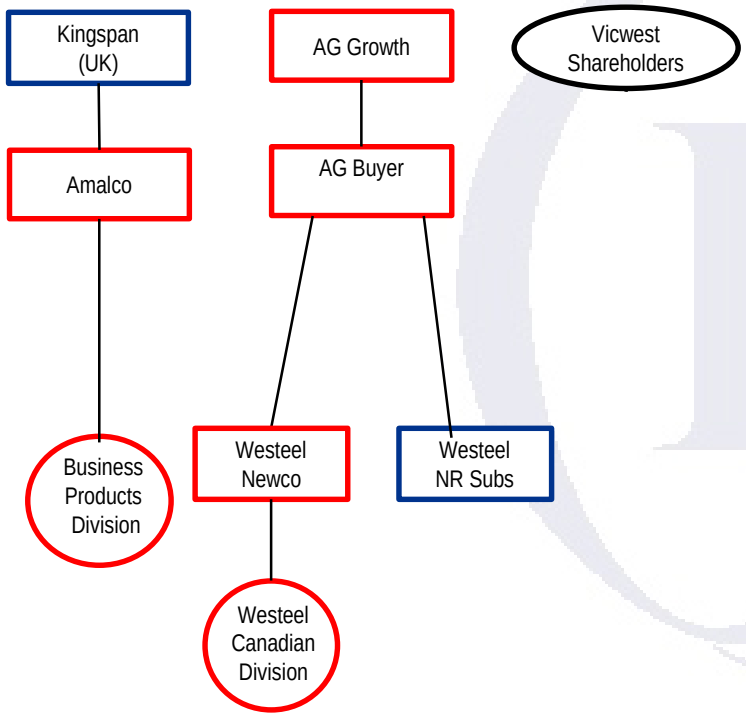
- The stated capital of the Vicwest shares will be reduced to $1.00 without any distribution to ensure no s.88(1)(b) gain.
- Kingspan AcquireCo and Vicwest amalgamate to form “Amalco”.
- Amalco will make a designation under paragraph 88(1)(d) in its return for its first taxation year to bump the tax cost of the shares of Westeel Newco and the Westeel NR Subs to their fair market value (the amount being paid by AG Buyer). (If there is a tax-free surplus balance, the bump room will be reduced and it will be necessary to utilize section 93 elections unless CRA’s position in 2011-0404521C6 is relied on (which is qualified by very limited facts).)

Plan of Arrangement Transactions



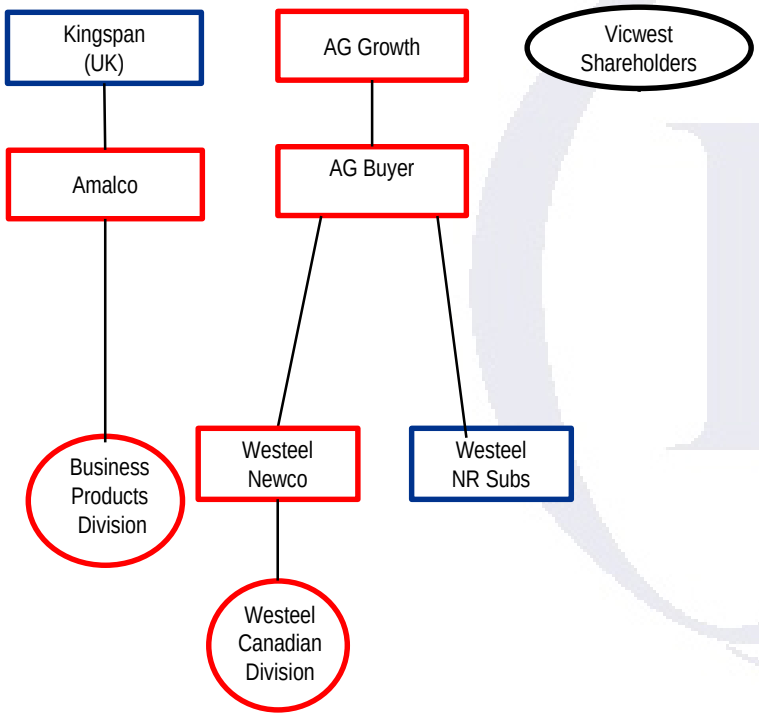
- Amalco will transfer the shares of Westeel Newco and Westeel NR Subs to AG Buyer in repayment of the $221M loan previously advanced by AG Buyer to Kingspan AcquireCo.
- Provided the tax bump in s.88(1)(d) is available (and, if applicable, s.93 elections are utilized), no gain should be realized by Amalco on the disposition of the Westeel Business to AG Buyer.

Final Structure/Bump Denial Rules



- The Bump denial rules are intended to prohibit the use of the bump to effect a purchase butterfly, but the rules are much broader in scope.
- The Bump is denied where prohibited persons acquire prohibited property as part of the series.
- Prohibited persons include target shareholders that collectively held 10% or more of target shares.
- Prohibited property includes
  - any property held by target at the time of the bump transaction (i.e., the wind-up or amalgamation of target) or
  - any property more than 10% of the FMV of which is attributable to property or properties that were held by target at the time of the bump transaction (i.e., the wind-up or amalgamation of target) subject to certain exceptions such as shares and debt of the Canadian buyer (see comment above in respect of dissent rights being a debt claim against Kingspan AcquireCo).

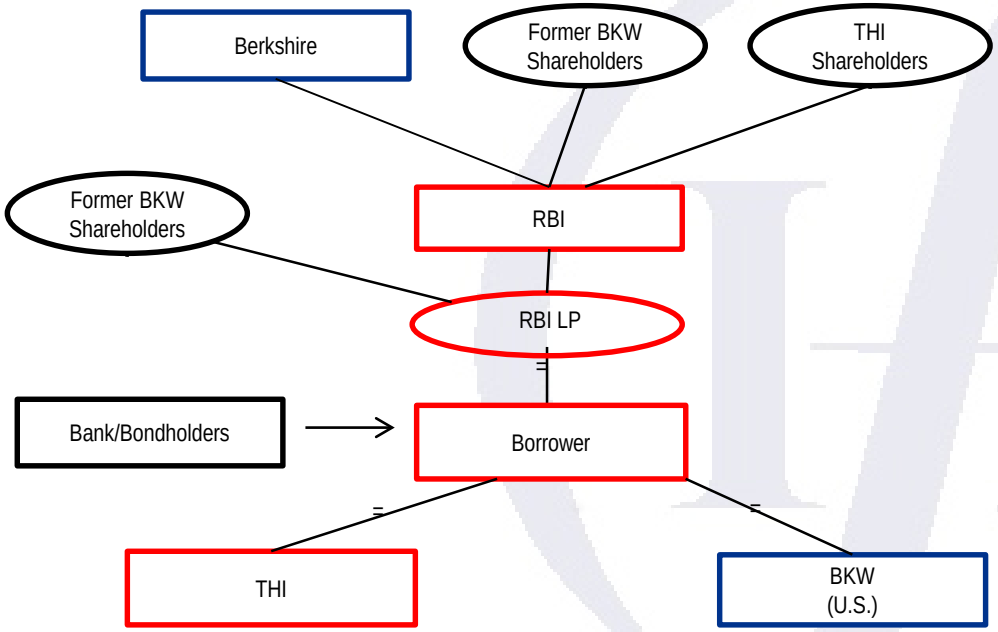
Final Structure/Bump Denial Rules



- Both Kingspan and AG Growth acquired prohibited property but:
  - The Kingspan group are “specified persons”.
  - Presumably AG Growth did not own any shares of Vicwest.
- Kingspan UK’s market cap is approx $4B and value of Business Products Division is approx $125M. As such, securities of Kingspan UK are likely not prohibited property – however timing uncertainties can arise.
- AG Growth’s market cap is currently approx $675M so its securities will be prohibited property. AG Growth issued subscription receipts for common shares and convertible debentures to fund the acquisition. Indebtedness issued solely for money is excepted from prohibited property but the other securities of AG Growth would not be.
- Significant shareholders of Vicwest entered into voting agreements in which they agreed they would not acquire securities of AG Growth, securities of Kingspan UK or any other prohibited property for the period of one year.

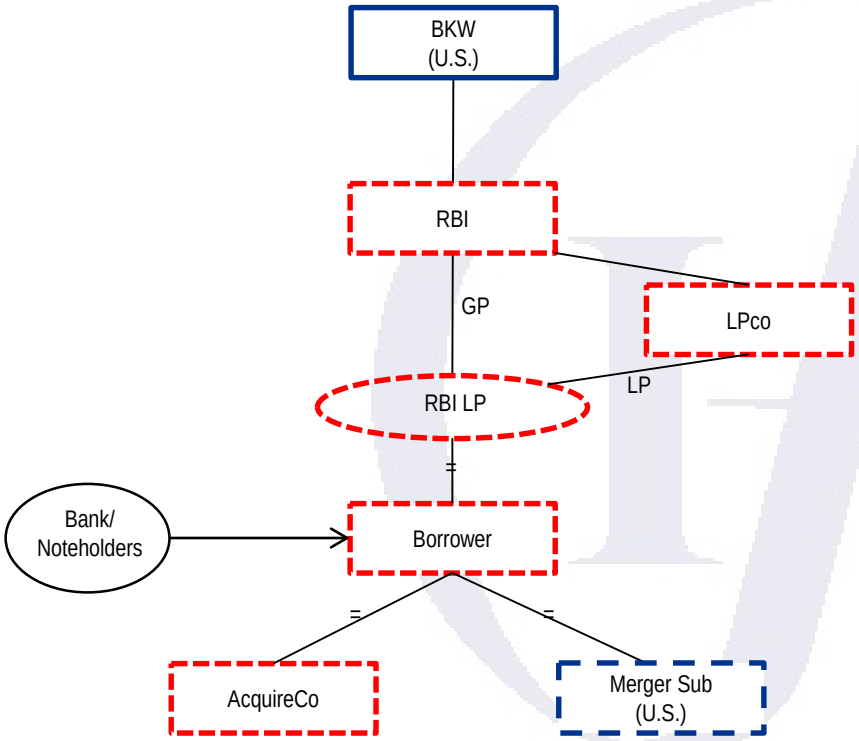
Combination of Tim Hortons and Burger King Worldwide

Combination Overview



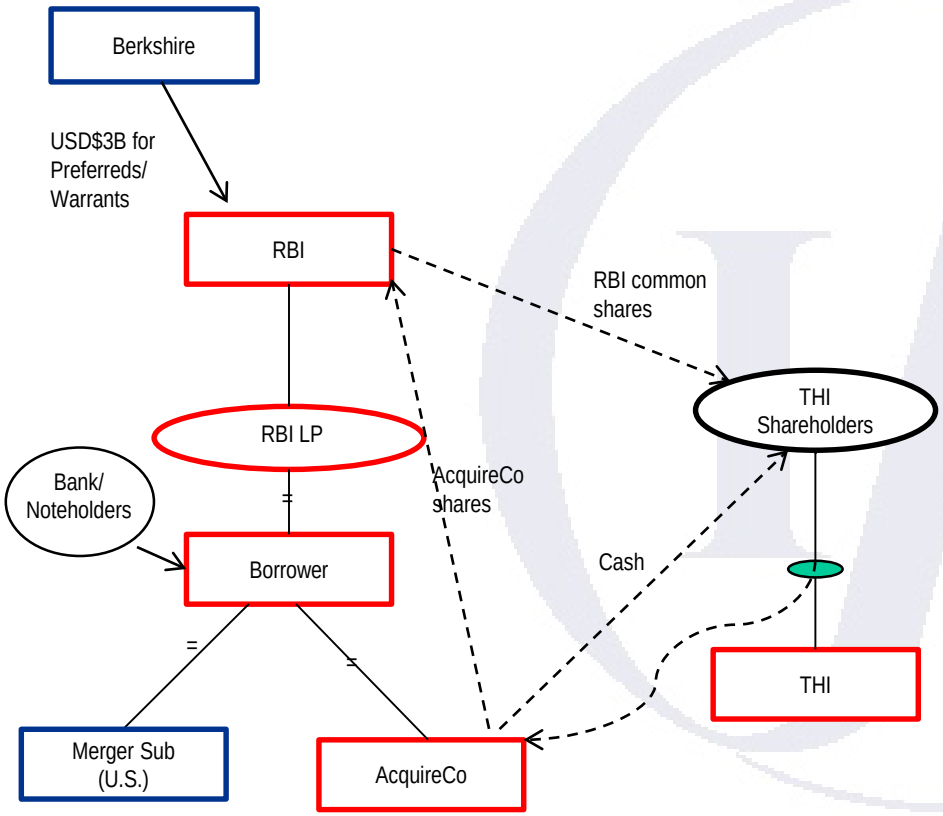
- Tim Hortons Inc. (THI) and Burger King Worldwide, Inc. (BKW) combined to create: Restaurant Brands International Inc. (RBI), a CBCA parent company
  - RBI shares are listed on the TSX and NYSE
  - RBI indirectly holds BKW and THI through Restaurant Brands International Limited Partnership (RBI LP), an Ontario limited partnership
- THI shareholders received cash and RBI common shares
- BKW shareholders received RBI common shares and/or units of RBI LP that are exchangeable for RBI common shares.
- RBI LP exchangeable units are listed on the TSX

Formation of RBI (RBI), RBI LP, etc.



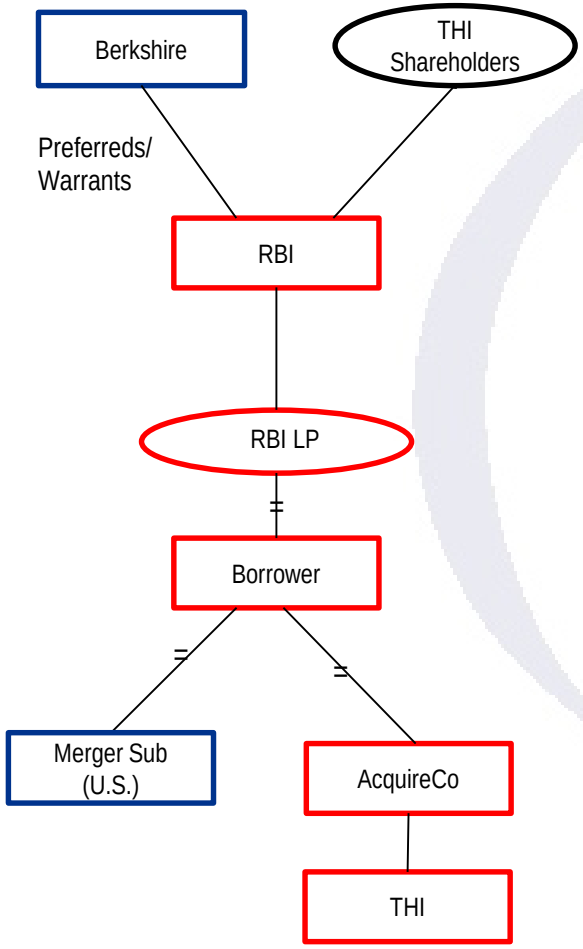
- BKW formed RBI with nominal consideration. BKW's interest in RBI was cancelled prior to the plan of arrangement transactions.
- Borrower borrowed USD $9B in October 2014 pursuant to a offering of notes and a term loan financing. The funds were put in escrow until the December 12, 2014 closing.

Acquisition of THI



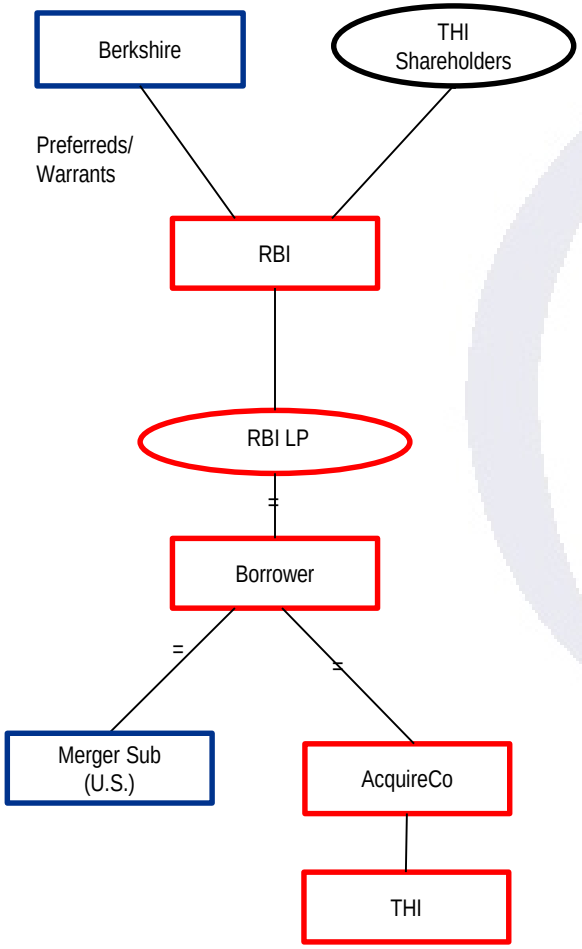
- Berkshire contributed USD $3B for preferred shares and warrants of RBI.
- Pursuant to a CBCA plan of arrangement, AcquireCo purchased the THI shares from the THI shareholders in consideration for: (1) CAD 8.7B, and (2) RBI common shares worth CAD 4.7B.
- The RBI common shares were delivered by RBI (on behalf of AcquireCo) to the THI shareholders and AcquireCo issued its shares to RBI in consideration for RBI delivering the share consideration to the THI shareholders.
- RBI subsequently dropped the AcquireCo shares down the chain so that they were held by AcquireCo's direct parent.

Acquisition of THI (continued)



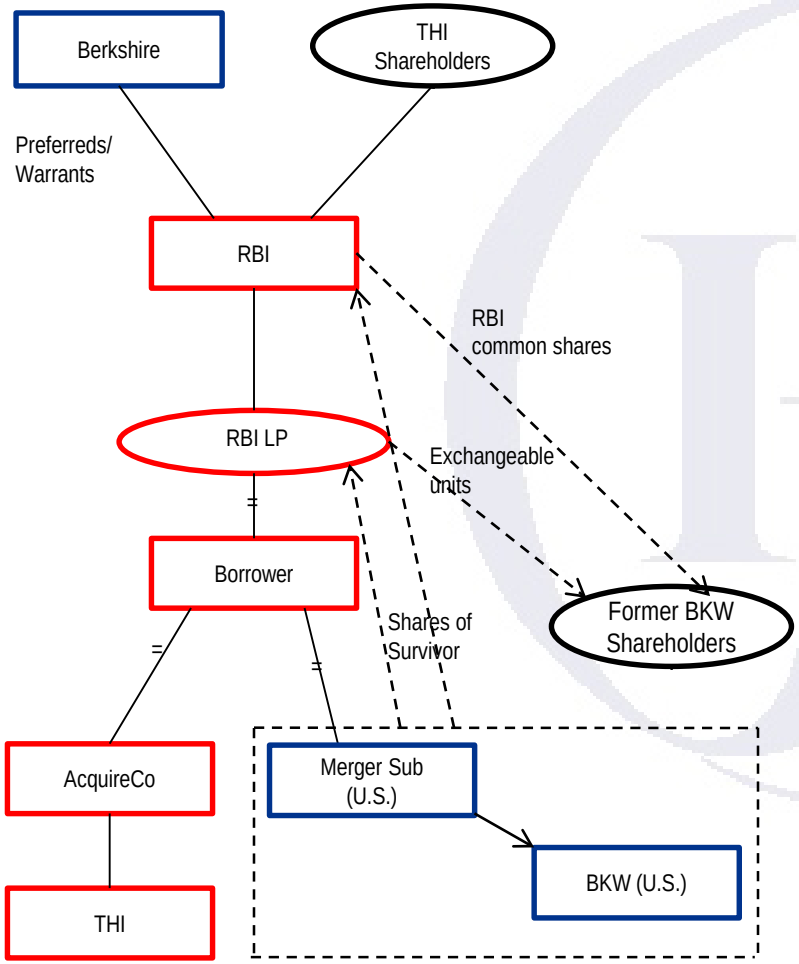
- As part of the plan of arrangement, AcquireCo and THI were to be amalgamated. It was important that Amalco not be a "public corporation" for purposes of the ITA because returns of capital by a public corporation are deemed to be dividends pursuant to s.84(4.1) (except in very limited circumstances).
- Pursuant to the definition of public corporation in s.89(1), a corporation whose shares were listed on a designated stock exchange in Canada is a public corporation after its shares cease to be listed unless it meets the prescribed conditions in regulation 4800(2) and it files an election to cease to be a public corporation.
- The prescribed conditions require a small group of shareholders to hold the shares that were previously listed on the designated stock exchange in Canada.
- If AcquireCo and THI amalgamated when THI was a public corporation, Amalco would be deemed to be a public corporation pursuant to s.87(2)(ii).

Acquisition of THI (continued)



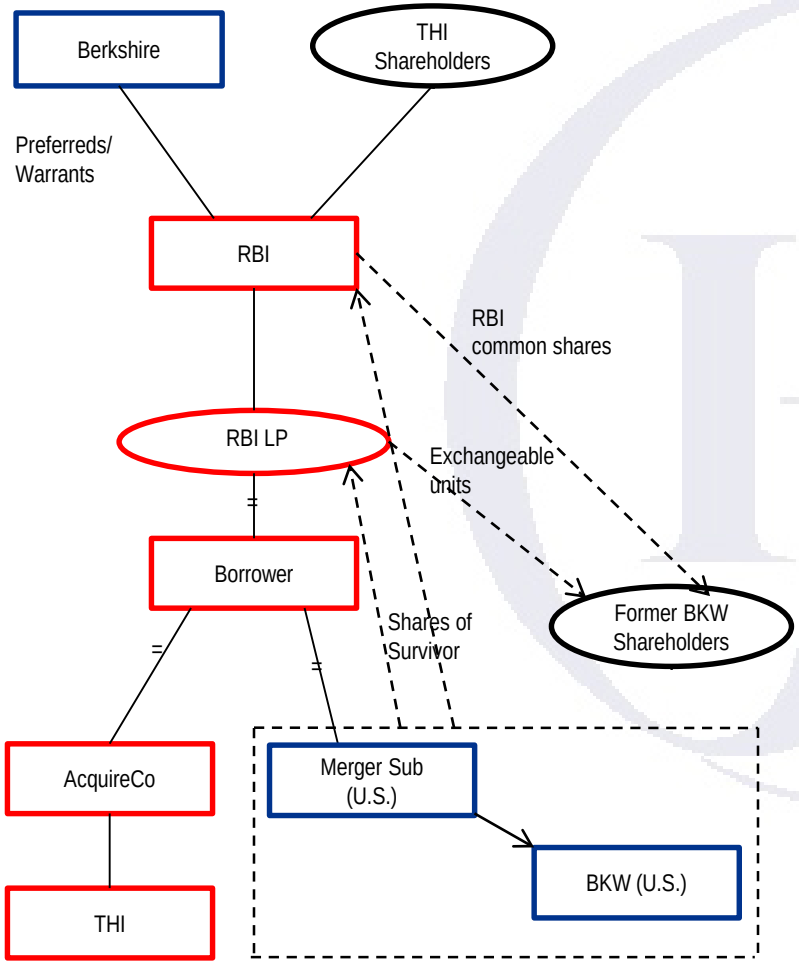
- Amalco could technically never satisfy the prescribed conditions to make the election to cease to be a public corporation because the shares that were listed (i.e., the THI shares) would cease to exist on the vertical amalgamation. However, see CRA Ruling 2010-0355001R3.
- To ensure the technical issue did not arise, a letter was obtained from the TSX confirming the THI shares ceased to be listed at 4 pm and AcquireCo and THI amalgamated under the plan of arrangement at 11:59 pm. (Delisting from NYSE took a few days but the public corporation definition only refers to a designated stock exchange in Canada. The amalgamation was a US survivor style amalgamation under which THI was the survivor (see the Kodiak/Whiting transaction description).
- An election to cease to be a public corporation was filed with the CRA immediately after the de-listing and before the amalgamation. (The election could have been filed once the prescribed conditions have been met and before de-listing and THI would have ceased to be a public corporation once de-listing occurred, which must be before the amalgamation).

Merger of BKW and Merger Sub



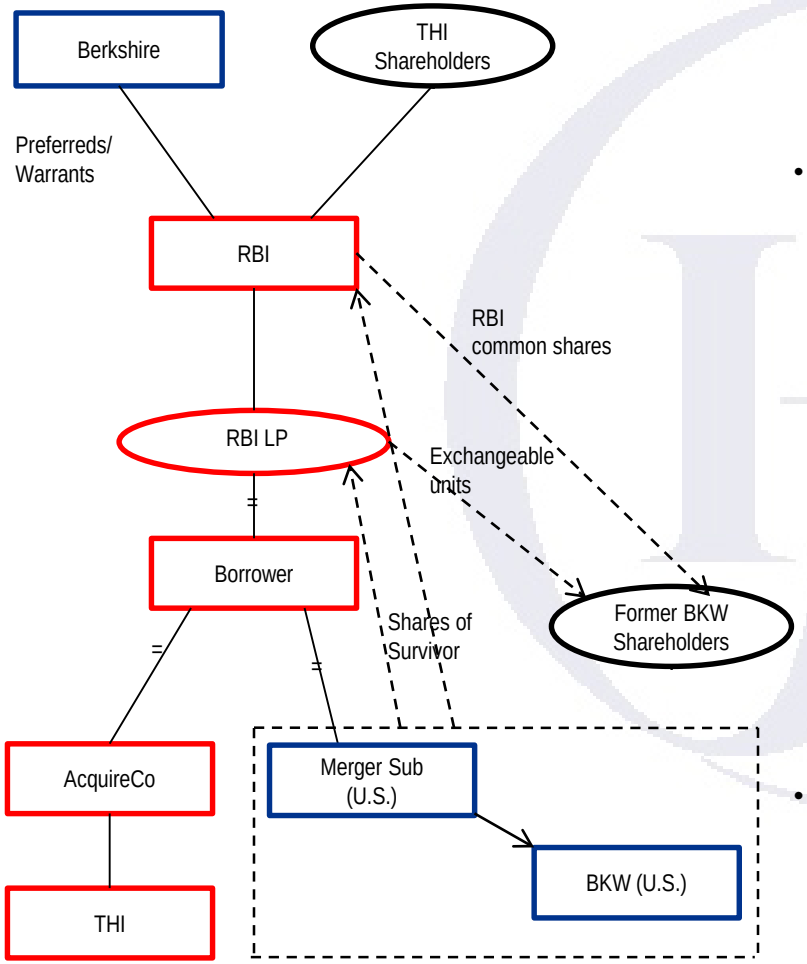
- BKW and Merger Sub merged under a Delaware merger with BKW as the survivor. On the merger, BKW shareholders received either:
  - .99 of a RBI common share and 0.01 of an RBI LP exchangeable unit for each BKW share; or
  - One RBI LP exchangeable unit for each BKW share.
- For each RBI LP exchangeable unit, the holder is entitled to one vote at RBI pursuant to a voting trust arrangement.
- The RBI LP exchangeable units are listed and posted for trading on the TSX such that RBI LP is a publicly traded partnership for the purposes of the US inversion rules.

Merger of BKW and Merger Sub



- On the merger, pursuant to agreements entered into with Merger Sub immediately prior to the merger:
  - RBI received BKW survivor shares with a FMV equal to the RBI shares delivered on the merger to compensate RBI for delivering its shares on the merger; and
  - RBI LP received BKW survivor shares with a FMV equal to the RBI LP units delivered on the merger to compensate RBI LP for delivering its units on the merger.
- A typical Delaware merger would not provide for the issuance of shares of the survivor as compensation for the consideration delivered on the merger but this is important from a Canadian tax perspective to establish:
  - the conversion of the merger sub shares into the shares of the survivor does not result in a gain; and
  - there is FMV cost in the shares of the survivor.
  - See, for example, CRA ruling 2001-0068223.

RBI LP



- RBI LP and the issuance of exchangeable units to electing shareholders was intended to provide US shareholders of BKW with the opportunity of a tax-deferred transaction for US tax purposes under section 721 of the Code.
- To qualify for the rollover it was important that the exchangeable units not be considered shares of RBI. The features of the exchangeable units that were important to this conclusion:
  - holders of exchangeable units cannot exercise their right of exchange for one year; and
  - where a holder requests to exchange the exchangeable units for RBI shares, RBI LP has the option to deliver cash equal to the FMV of the RBI shares instead of delivering the RBI shares.
- Because RBI LP's units are listed on the TSX, it is a SIFT partnership for Canadian tax purposes. However, since RBI LP is only expected to receive dividends from subsidiaries, the SIFT rules should have no impact.

US Inversion Analysis

Section 7874 of the Code - A foreign corporation (RBI) or publicly traded partnership (RBI LP) that engages in a transaction satisfying the following three conditions is treated as a US domestic corporation:

1. Acquisition of substantially all the assets of a US corporation or of a US partnership trade or business
2. By reason of the acquisition, former owners of the target hold 80% (by vote or value) of the acquirer

   => Not satisfied because THI shareholders hold 22% of RBI on a fully diluted basis

3. The acquirer group does not have substantial business activities in the acquirer's home country
   - Substantial business activities exemption available where three-part test is satisfied: (i) 25% of employees by headcount & compensation; (ii) 25% of assets; and (iii) 25% of income during the testing period.
   - For the purposes of this test, RBI needed to hold more than 50% (in terms of votes and value) of RBI LP for RBI LP to be considered part of the expanded affiliated group. As a result, the issuance of exchangeable units of RBI LP to former BKW shareholders was limited to 49.9%. This condition is not satisfied either because RBI and RBI LP have substantial business activities in Canada.

RECENT CASE LAW UPDATE

George Weston Limited v. The Queen (2015 TCC 42)

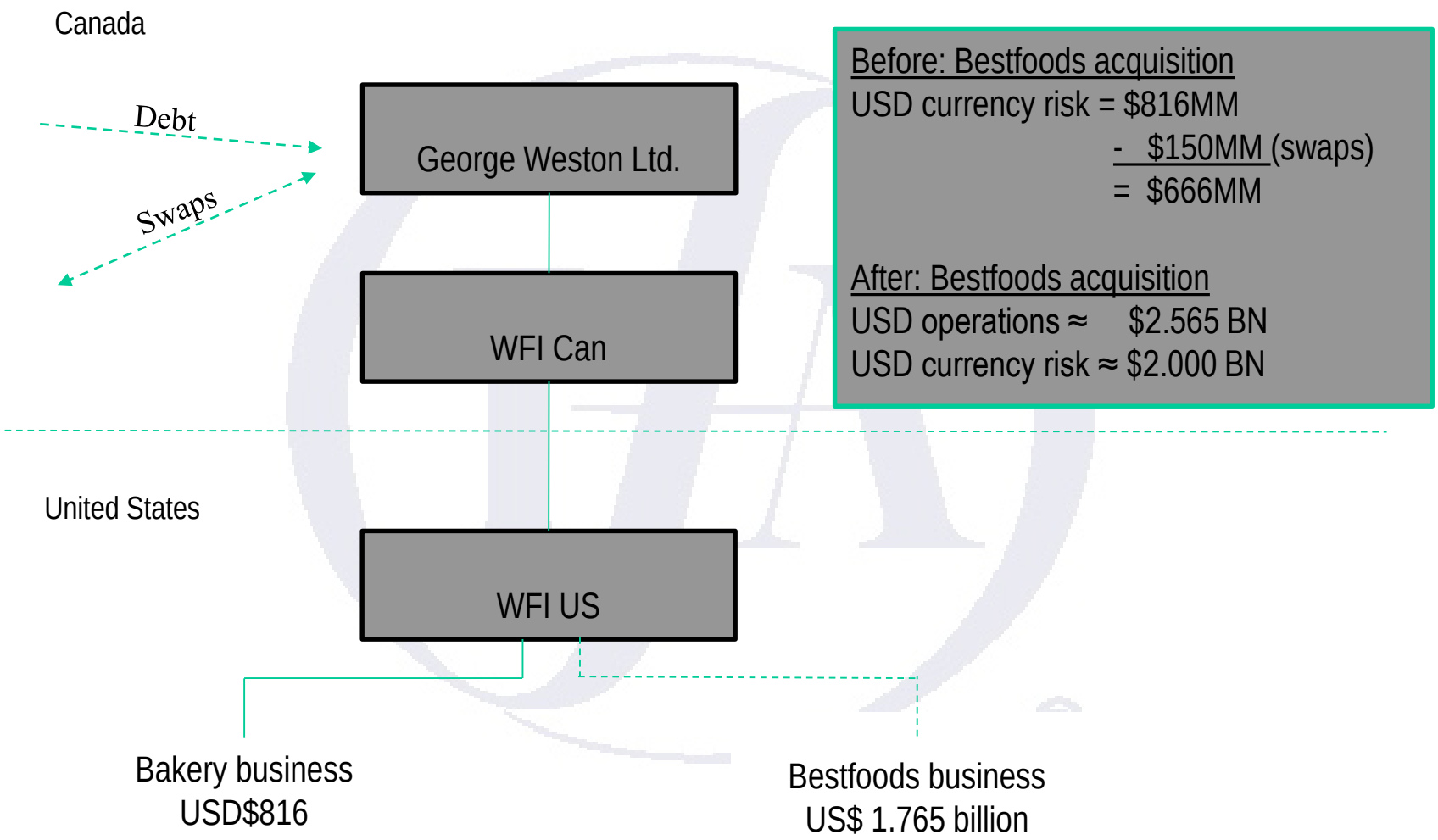
George Weston Limited v. The Queen

- Addresses the circumstances under which proceeds arising on the termination of a currency derivative (currency swap) may be treated as a capital gain
- The character of the gain or loss realized on a derivative transaction is to be established through “linkage” to the item being hedged
- *Weston* rejects CRA’s narrow application of the linkage test
- Principles set out in the case will likely have broad application to other derivative hedging transactions

George Weston Limited v. The Queen

- Publicly traded GWL borrowed CAD 2.1 B and USD 400 MM to permit its indirect subsidiaries to acquire a U.S. bakery business and related trademarks ("**Bestfoods**")
- Acquisition made in USD, in 2001 when CAD was at historic lows:
- 1 CAD = 0.6179 USD
- GWL consolidated financial statements reported in CAD
- When value of net investments in USD operations translated into CAD, the fluctuation of the exchange rate affected the equity section of GWL's consolidated balance sheet (through the cumulative foreign currency translation adjustment (CTA) account)
- Any increase in CAD would erode GWL's consolidated equity, causing the debt-equity ratio to exceed the internal 1 to 1 cap
- Negative for equity investors, credit rating agencies, and market perception

George Weston Limited v. The Queen



George Weston Limited v. The Queen

Bestfoods Acquisition Debt financed in 2001

- CAD 2.1 billion
- USD 400 million

Weston Consolidated Balance Sheet after Acquisition
(1 CAD approx 0.65 USD) (1:1 Debt:Equity)

Assets	Debt
USD 1,765mM = CAD2,715 MM	**CAD 2,100mM** → Fixed debt USD 400MM = CAD 615 MM
= CAD 2,715 MM	= CAD 2,715 MM

Weston Consolidated Balance Sheet Notional
(1 CAD = 0.80 USD) (1.18:1 Debt: Equity)

Assets	Debt
USD 1,765mM = CAD 2,206.0mM	**CAD 2,100mM** → Fixed debt USD 400MM = CAD500 MM
= CAD 2,206 MM	= CAD 2,600 MM

George Weston Limited v. The Queen

- GWL entered into currency swaps to protect against FX fluctuations affecting the reported value of its USD operations
- Swaps had aggregate notional amount that closely approximated the total net investments in the USD operations exposed to currency risk and 10-15 year terms
- As USD declines, decrease in GWL's consolidated equity attributable to the USD operations offset by increase in value of swaps
- In 2002, GWL terminated $200 million of the swaps in response to the sale by its indirect subsidiaries of USD.
- Remaining swaps terminated by GWL in 2003 after value of CAD had increased, and GWL had taken other steps to eliminate currency risk
- Realized gain on the swap termination of CAD 317 MM.

George Weston Limited v. The Queen

- Was Gain on Capital or Income Account?

- Purpose of the swaps: the court was satisfied that the swaps were not speculative transactions but rather hedges, principally for the following reasons:
  - The USD notional value of the swaps "closely approximated" the investments in the USD operations that were exposed to currency risk
  - The swaps were entered into "fairly close" to the Bestfoods acquisition
  - The balance sheet risk arising from the USD operations was capable of being hedged by GWL for tax purposes, even though the assets and liabilities, and transactions giving rise to risk were in its U.S. subsidiaries

George Weston Limited v. The Queen

- Linkage principle:
  - Identify the “item at risk”, and then its nature
  - Is the hedge sufficiently linked to an underlying capital item?

- CRA’s prior interpretation of the linkage principle:
  - the test will be satisfied by a taxpayer’s use of a derivative only when there is an expected underlying capital transaction of that same taxpayer being hedged
  - a hedging contract can never be on capital account if it is regarding a capital asset being held indefinitely

- The court rejected CRA’s interpretation.
- If a derivative is used to hedge a capital item any gain or loss derived from the derivative will be on capital account, and there does not need to be a sale or proposed sale.

George Weston Limited v. The Queen

Dealing with the Crown's reliance on the Shell Canada case at paragraph 81, the Tax Court judge stated:

"*The Supreme Court recognized the existence of two transactions but did not say that the gain or loss on a derivative transaction must necessarily be linked to a gain or loss on another transaction as argued by the respondent. What is important is to identify the risk to which the derivative transaction is related and to determine whether the related item at risk (be it a debt obligation or foreign investments) is capital or income in nature. I am therefore prepared to accept the appellant's proposition that, if it is found that the derivative was used to hedge a capital investment, any gain derived from the derivative will be on capital account.*"

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- Alternative argument by the Crown: swaps entered into in the course of an adventure or concern in the nature of trade.

- Court's conclusions:
  - No profit-making scheme
  - Purpose was to hedge against currency risk impact on consolidated equity, not to speculate in currency markets
  - Long term of the swaps indicative of a non-speculative intention
  - Terminating a derivative transaction before maturity, when it is in the money, is not determinative of a speculative secondary intention that gives rise to income treatment

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Summary

- Clarifies the items of risk that may be subject to hedge treatment for tax purposes
- Provides helpful guidance regarding the criteria necessary to establish a sufficient link between an item at risk and a hedging derivative for tax purposes
- Identifies an administrative position of the CRA, long thought to be out of step with commercial reality, as inconsistent with the law

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Kruger Wayagamack Inc. v. The Queen

- According to the Supreme Court in *Duha Printers* (98 DTC 6334):

> "… it is possible to determine whether de jure control has been lost as a result of a USA by asking whether the USA leaves any way for the majority shareholder to exercise effective control over the affairs and fortunes of the corporation in a way analogous or equivalent to the power to elect the majority of the board of directors (as contemplated by the *Buckerfield's* test) ... It will in every case be necessary to establish this result by examining the specific provisions of the USA in question."

- *Kruger* follows on the heels of "Bagtech" (2013 DTC 5155 (FCA)), which grappled with the application the *Duha Printers'* approach and, more fundamentally, the nature of a USA

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- K*ruger* considers the issue of when *a* unanimous shareholders agreement (USA) may deprive a majority shareholder of legal control of a corporation
- In the international context, this may be relevant to, for example, the application of the Foreign Affiliate Dumping rules, the Transfer Pricing Rules and to the availability of refundable ITCs, which is dependent on CCPC status
- *Kruger* also contains an interesting discussion on the meaning of (*de jure* and *de facto*) control, which has far broader implications

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Bagtech

- The specific issue was whether Bagtech was a CCPC, in which case it would be entitled to refundable ITCs
  - Non-residents cumulatively owned 60% to 70% of Bagtech's voting shares during the relevant years
  - Under an agreement among all of Bagtech's shareholders, Canadian residents could elect four members of the seven member board; the agreement limited some of the powers of the board and thus had the characteristics of a USA
  - Absent the agreement, the hypothetical shareholder rule in paragraph (b) of the CCPC definition would have caused Bagtech to not be a CCPC

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Bagtech

The existence of the agreement gave rise to two related sub-issues:

1. Was the entire agreement, including the voting provisions, a USA, or just the provisions that limited the directors' powers?

2. Was the hypothetical shareholder in paragraph (b) of the CCPC definition a party to the agreement?

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Bagtech

1. **USAs are inseverable**: On the first issue, the FCA held that the entire agreement, including the provisions dealing with the election of directors, constituted a USA:

> "I therefore read *Duha Printers* as holding that once the conditions set out in section 146(1) of the CBCA have been fulfilled, the Agreement qualifies as a USA and the two types of restrictions described at item (3)(c) of paragraph 85 [viz., restrictions on the majority shareholder's power to control the election of the board or the board's power to manage the corporation's business] must be taken into consideration when determining who has *de jure* control of the Corporation."

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Bagtech

2. **Hypothetical shareholder bound by USA**: On the second issue, the trial judge had held (and this holding was not appealed) that the hypothetical shareholder would be bound by the agreement in the same way any third party purchaser would be bound by a USA.

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Bagtech

- Despite the trial judge's ruling, he subscribed to a conceptual criticism of the approach in *Duha Printers*, namely that it appears illogical to take into account voting provisions related to the election of directors in the determination of “effective control” when a pre-condition of a USA (at least, one governed by the CBCA) is that it restrict the powers of those directors.

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The FCA rejects this criticism:

- "With respect, I do not share this opinion … Clearly, clauses regarding the election of the board of directors can have a crucial impact on a majority shareholder's ability to effectively control a corporation. In order to avoid creating uncertainty for taxpayers, the SCC concluded that such clauses should not be taken into consideration when simply included in private agreements between shareholders. In seeking to strike a fair balance between these two concerns, it is logical that the special nature of USAs, which are constating documents, and the fact that USAs are easily accessible … make a difference. It is not unusual in tax law to obtain a different result by using one form rather than another."

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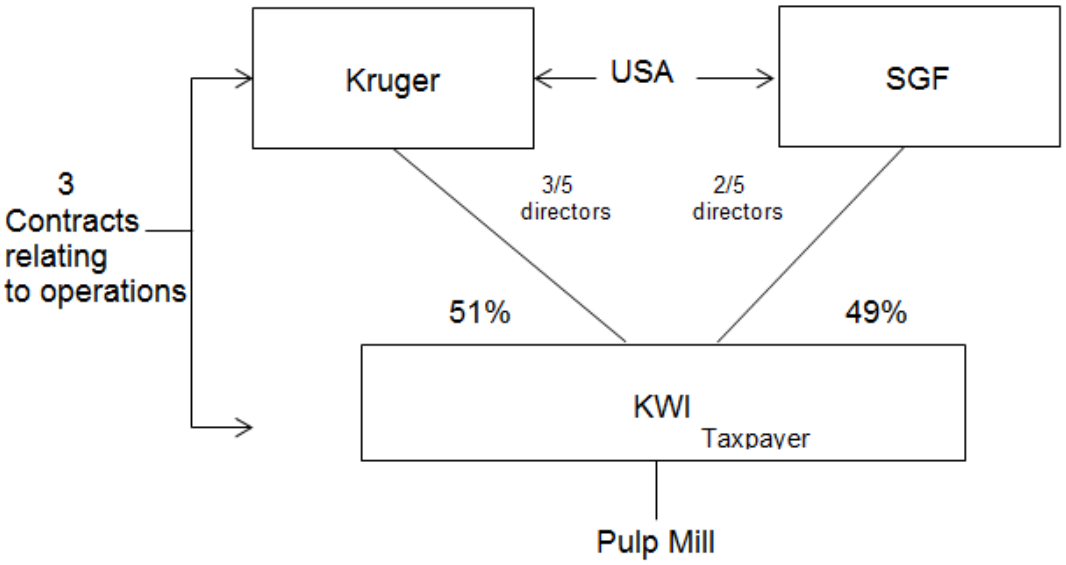
Basic
Facts:



Issue: Is the Taxpayer associated with Kruger, its majority shareholder?

Tax Consequences : If associated, then the Taxpayer is not entitled to refundable investment tax credits

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The USA

The following decisions of the shareholders must be unanimous:

1- any important change to KWI's mission, which is to carry out the "Project" of modernizing the mill in view of producing a certain quantity of pulp;

2- the cost and business plan of the Project;

3- any modifications to the Management Service Agreement, to the Marketing Agreement or to the Kraft Pulp Selling Agreement;

4- the disposal of the business, as well as the sale, lease or exchange of all or a substantial part of property of KWI or any of its subsidiaries, including the sale of intellectual property rights.

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The USA

The following decisions of the board must be unanimous:

1- approval of the annual business plan and the annual marketing plan as well as any amendments thereto;

2- approval of the annual capital budget and the annual operating budget, along with the approval of any amendments thereto, the approval of any expenditure that is part of the annual capital budget for an amount in excess of one million dollars ($1,000,000) and approval of any capital expenditures not included in such budget;

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The USA

3- As well as the following laundry list of items:

(a) any form of financing in excess of $1 million per year;

(b) any loan made by KWI to a third party or any security provided for third party debts;

(c) hiring, establishing the compensation of, or termination of, any officers including the controller but not including the general manager;

(d) granting of any form of bonus to a manager;

(e) compensation of directors;

(f) execution of any contract outside the normal course of business;

(g) institution or defence of legal proceedings where the amount at issue is $50,000 or more or if the total amounts claimed in a year exceed $50,000;

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(h) execution of leases exceeding two years or with a rent of more than $300,000 in a year;

(i) approval of non-arm's length contracts including contracts with shareholders, anyone associated with a shareholder and directors as well as approval of contracts outside the normal course of business;

(j) the creation of any subsidiary and any investment not envisaged in the original business plan;

(k) amendments to the articles of incorporation, the by-laws or the USA;

(l) any decision to use corporate assets to secure a loan;

(m) any modification to the Management Services Agreement, the Kraft Pulp Selling Agreement or the Marketing Agreement between KWI and Kruger; and

(n) the liquidation, dissolution, wind up or merger of KWI.

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The USA

Conversely, the following decisions can be taken by a majority of the board:

> "all decisions in relation to management of production operations and management of the modernization project; all sorts of policies in relation to operations and implementation of the mission … and … some very important decisions such as setting the parameters for negotiating labour agreements."

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Meaning of Control

- The Court equates "control", both *de facto* and *de jure*, with the ability to make strategic decisions on behalf of a corporation:

> "… the question is: Does Kruger have a dominant influence in the management or direction of the appellant or a dominant influence in the orientation of its future?"

> "In *Duha,* it is clear that effective control means the control which a majority of the board of directors normally has. If one does not have the ability to make strategic decisions that will change significantly the general course of a business, one does not, in my view, have the effective control normally held by a majority of directors."

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Meaning of Control

The difference between *de facto* and *de jure* control, therefore, is simply a matter of the considerations that are relevant to the determination of control:

> "In determining whether there is *de jure* control, one may only examine those documents described in paragraph 85(3) of *Duha*, above, and one may take account of any relevant consideration found within those documents."

> "In determining whether there is *de facto* control, there is no limitation on what may be examined and, again, any relevant considerations may be taken into account."

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***De Jure* Control**

- After having examined the provisions of the USA, the Court asks the following question:

> "… the question is: Does Kruger have a dominant influence in the management or direction of the appellant or a dominant influence in the orientation of its future?"

- The Court concludes as follows:

> "The answer is clearly no in this case. Because the directors or the two shareholders must decide unanimously so many key decisions for the direction and orientation of the appellant, Kruger does not have such dominance. Kruger cannot substantially change the overall course of the appellant; it cannot make strategic decisions."

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***De Facto* Control**

- The Court considers that the powers afforded to Kruger under the USA in terms of managing KWI's business, i.e. the Project, might be described as "operational control", in contradistinction to strategic control
- The Court states that Kruger is a significant industry player with more expertise than SGF and that it has more influence than SGF over KWI's operations
- However, it views the three operating contracts as neutral factors because of the arm's length nature of their terms and conditions.

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***De Facto* Control**

- The Court concludes that:

> "These circumstances do not change the balance so as to give Kruger control of strategic decisions.
>
> As a result, Kruger does not have *de facto* control."

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Control In The Long Run (CITLR)

- Under the USA, Kruger had options to purchase SGF's shares of KWI; the Crown asserted that these gave Kruger CITLR of KWI
- The Judge rejects this assertion on the grounds that CITLR considers only existing shareholdings, not potential ones

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Control In The Long Run (CITLR)

- What is CITLR? Thurlow, J. of the Exchequer Court describes it as follows in *Donald Applicators* (69 DTC 5122):

> "A shareholder who, though lacking immediate voting power to elect directors, has sufficient voting power to pass any ordinary resolution that may come before a meeting of shareholders and to pass as well a special resolution through which he can take away the powers of the directors and reserve decisions to his class of shareholders, dismiss directors from office and ultimately even secure the right to elect the directors is a person of whom I do not think it can correctly be said that he has not in the long run the control of the company."

- Thurlow, J. is clearly focused on rights relating to the powers of the directors and their election; rights which, if exercised, would result in effective control of the corporation by the rightholder under the *Buckerfield's* test

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Control In The Long Run (CITLR)

- *Oakfield* (71 DTC 5175) and *Imperial General Properties* (*IGP*) (85 DTC 5500) dealt with situations where, in order to avoid association, corporations issued low-value, non-participating voting preferred shares to third parties, thereby splitting their voting shares 50/50
- In each case, the corporations could be wound-up by a resolution supported by 50% of all voting rights
- The Supreme Court held that the latter right gave the holders of the common shares CITLR

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Control In The Long Run (CITLR)

- In a stinging dissent in *IGP*, Wilson J. states that *Oakfield* is anomalous and should not be followed and makes the following (astute) observation:

> "It seems to me that in *Oakfield* the Court moved from *de jure* to *de facto* control when de jure control did not provide an answer. The greater de jure rights on the winding-up was the basis of the finding of *de facto* control.
>
> In my view, *Oakfield* stands for the proposition that, when voting control is evenly divided, the other rights attaching to the shares held by the two groups must be examined to see if they provide a basis for attributing *de facto* control to one group rather than the other, whatever the breakdown of share ownership by the two groups may be. Such control was inferred in *Oakfield* from the fact of greater participation by one group on a winding-up but I see no logical reason why the principle, if adopted, would not apply in other circumstances."

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Control In The Long Run (CITLR)

- *Duha Printers* suggests that CITLR applies only in situations where no person or group controls under the *Buckerfield's* test:

> "However, as shall be seen, the question of control "in the long run" does not arise in the instant case, as the majority shareholder group retained the *immediate* voting power to elect directors."

- Conceptually, I would have expected the opposite, namely that despite majority voting power, control could be shifted to another shareholder by virtue of certain other rights set out in the corporation's constating documents – rights relating to the powers of the board or the election of directors under the concept of CITLR described in *Donald Applicators*

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Control In The Long Run (CITLR)

- Since Wilson J.'s dissent in *IGP* is quoted favourably in *Duha Printers*, the above approach may be Justice Iacobucci's way of heeding her warning that it becomes difficult to distinguish between *de jure* and *de facto* control if CITLR may exist despite the identification of a majority shareholder under the *Buckerfield's* test
- Indeed, the certainty provided by the *Buckerfield's* test seems illusory if the approach to CITLR in *Oakfield* is good law
- It also seems to me that the *de facto* control test in subsection 256(5.1) is redundant if *Oakfield* is good law and that the introduction of the tax attribute trading rule in section 256.1 is likewise premised on the ineffectiveness of *Oakfield* and *IGP* post *Duha Printers*
- That leaves only the narrow concept of CITLR as stated in *Donald Applicators*, which *Duha Printers* tells us is inapplicable if a majority shareholder exists – indeed, the origin of the CITLR concept is the House of Lords decision in *Imperial Tobacco*, which sated that the shareholder holding the majority of the votes possesses CITLR

Kruger Wayagamack Inc. v. The Queen

Control In The Long Run (CITLR)

- Ironically, *Duha Printers* raises a similar (uncertainty-related) issue: Which powers or rights, or combination of powers or rights, in a USA can cause a majority shareholder to lose control of a corporation?
- Kruger's answer is: the rights to make strategic decisions for a corporation (in contradistinction to operational ones)
- Naturally, this begs the further question of how to distinguish decisions that are "strategic" from ones that are merely "operational"?

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- **Strategic Decisions**
  - Examples
    - 1 - The (mix of) products to be sold
    - 2 - The markets in which they will be sold
    - 3 - The customers targeted and the level of trade
    - 4 - The functions to be out-sourced
    - 5 - Approval of the budget plan, i.e., the allocation of human and financial capital to projects
    - 6 - Mix of debt & equity
    - 7 - Financings over a certain dollar amount
    - 8 - The issuance of shares
    - 9 - Dividend policy
    - 10 - Hiring/firing senior management
    - 11 - Organic growth vs acquisitions
    - 12 - Sale/change of business

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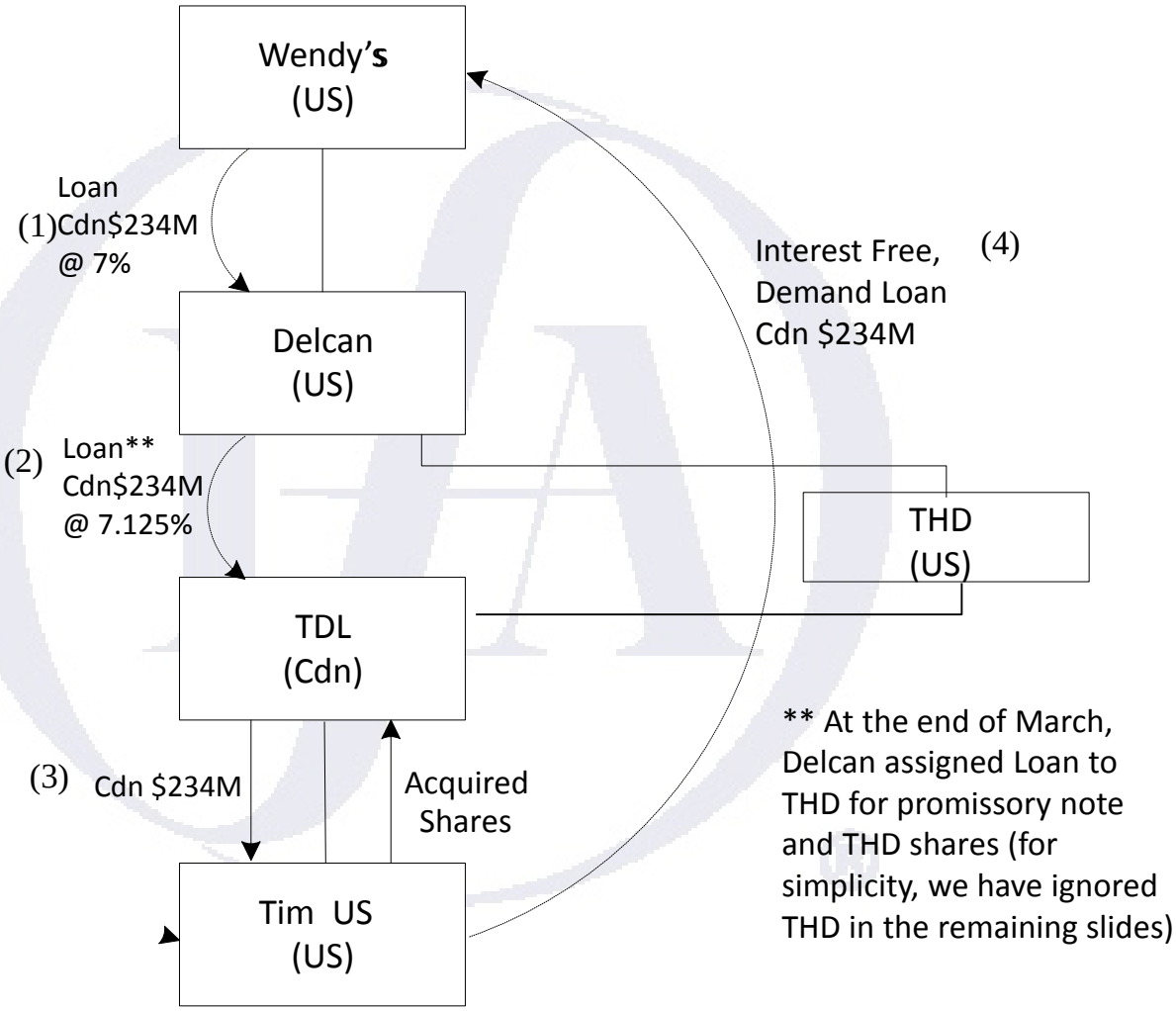
- Associated by virtue of 256(1.2)(c) and (g) ITA?

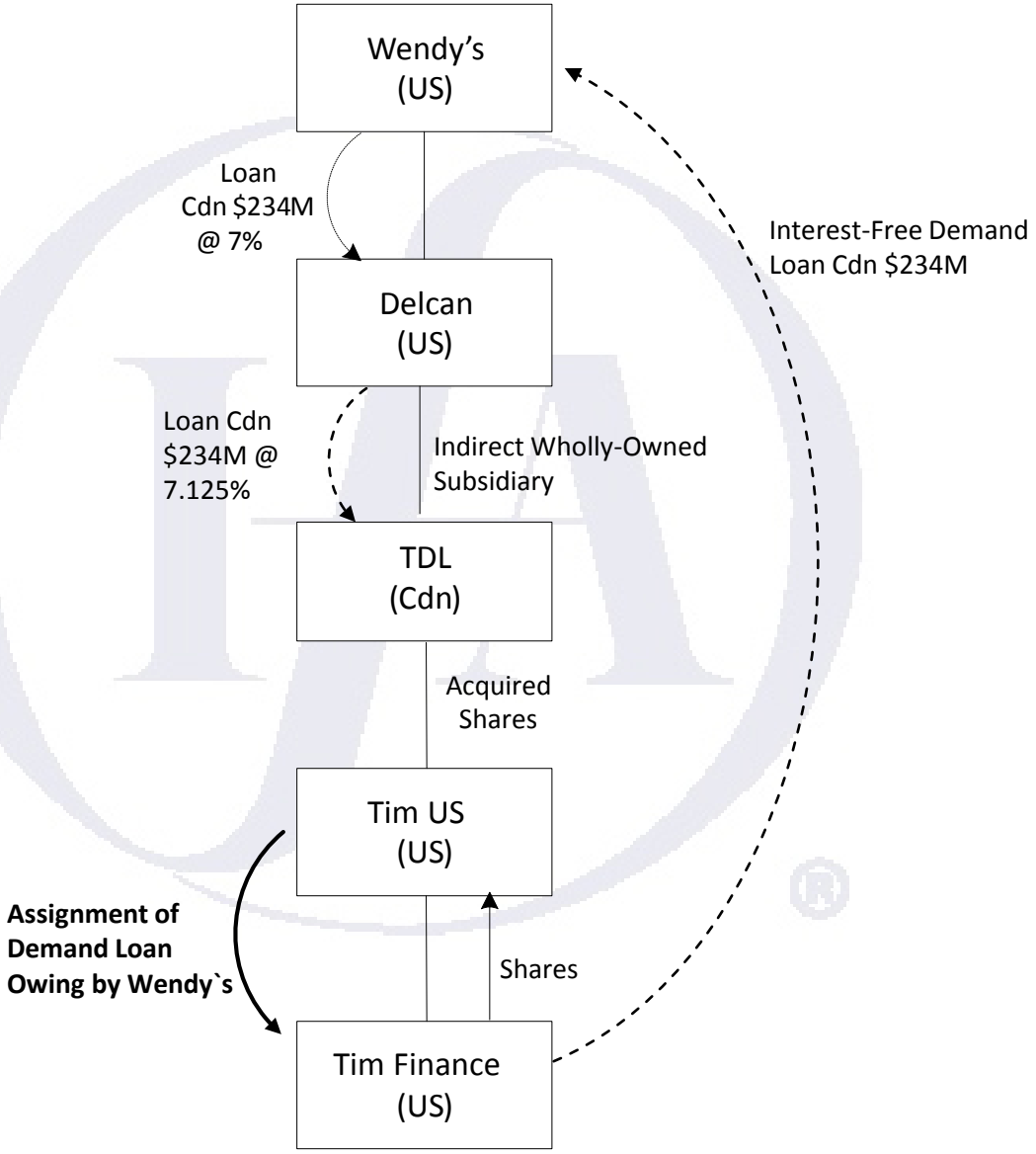
- The last issue is Whether Kruger's shares are worth more than 50% of the FMV of all of KWI's outstanding shares, assuming such shares are non-voting; if so, then Kruger and KWI are associated
- The answers seem obvious but an issue arises because the USA provides SGF with the right, under certain conditions, to put its shares of KWI to Kruger at a price equal to their FMV, computed without regard to any minority or liquidity discounts
- The Court concludes that Kruger's 51% interest is worth more than SGF's 49% interest in KWI despite the put rights because such rights were provided to SGF "*in personam*" and thus a third party could not benefit from them even though they were contained in a USA; thus Kruger and KWI are associated to each other by virtue of 256(1.2)(c) and (g) ITA
  - Given that the commercial deal was a joint venture, the application of a minority discount to SGF's shareholdings on a sale thereof to Kruger would have been inappropriate and thus the calculation of an adjusted FMV was merely intended to equalize the value of the joint venturers' shareholdings on a per share basis

The TDL Group Co. v. The Queen (2015 TCC 60)

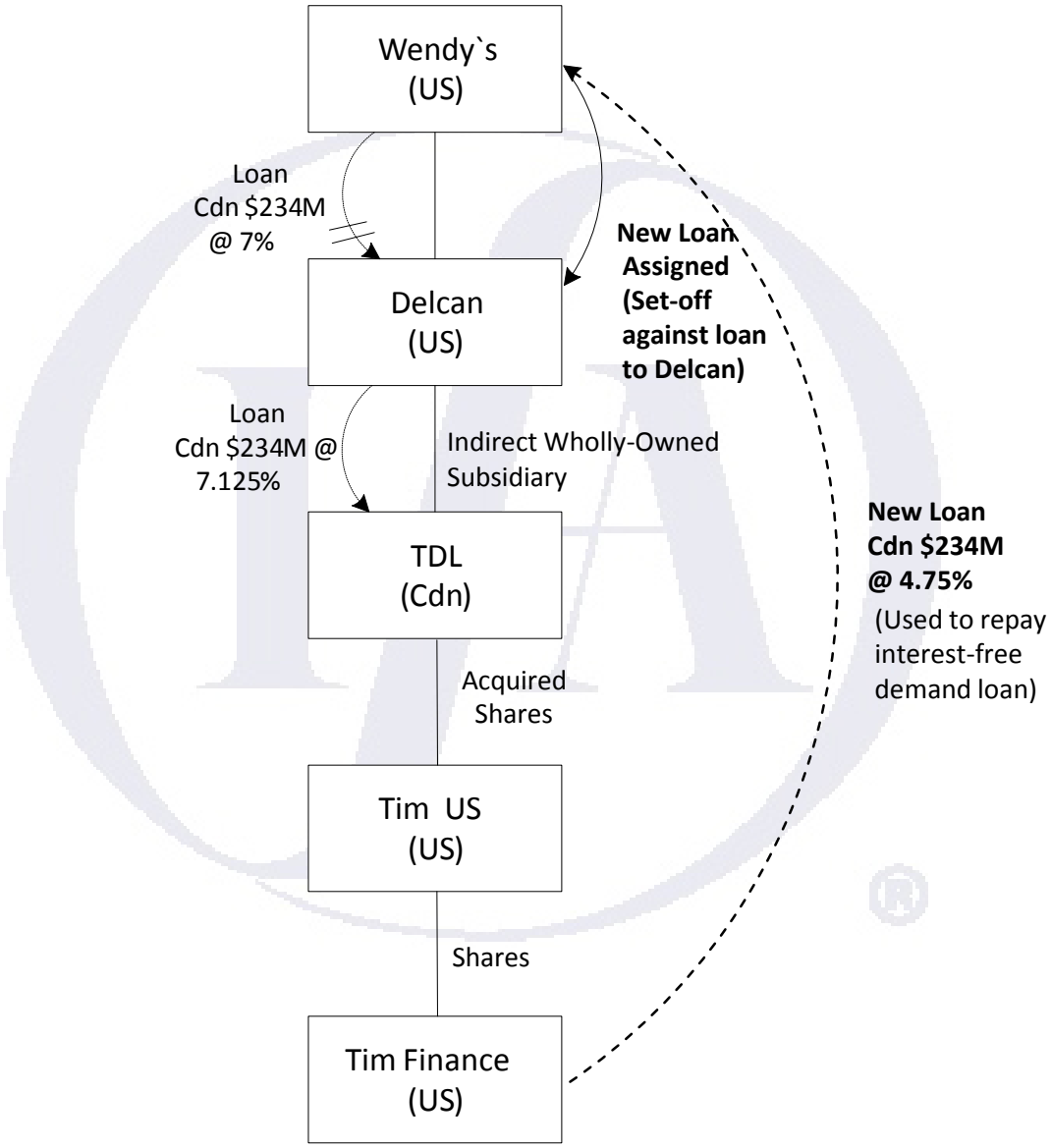
March Transactions



June to October Transactions



November Transactions



Additional Facts Noted by TCC

- Tim US had been a wholly-owned subsidiary of TDL since 1998
- At the time that TDL acquired additional shares, Tim US had no history of paying dividends
- Tim US also had operational losses in the previous four years
- Tim US paid $100,000 annual dividends in 2007-2009; $1,000,000 annual dividends in 2010 and 2011; $500,000 dividend in 2012

TCC Analysis

“Purpose” Test

20(1)(c) interest — an amount paid in the year or payable in respect of the year (depending upon the method regularly followed by the taxpayer in computing the taxpayer's income), pursuant to a legal obligation to pay interest on

> (i) borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt or to acquire a life insurance policy), [Emphasis added]

TCC Analysis

“Purpose” Test

- Parties did not dispute direct use of borrowed funds – namely, the acquisition by TDL of shares in Tim’s US
- Issue was whether TDL satisfied the purpose test
- Based on *Ludco* (2001 SCC 62):

  > “whether, considering all the circumstances, the taxpayer had a reasonable expectation of income at the time the investment is made”

TCC Analysis

“Purpose” Test

- TCC ruled against taxpayer
- TCC focused on the words “considering all the circumstances”
- TCC concluded that the words were very broad and permitted a court to look at:
  - The use of the funds by Tim’s US and other members of the group – “the determination of the ‘purpose’ for buying the shares does not preclude looking at the indirect use of the funds”; and
  - Any series of transactions related to the direct investment