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CREATING AND MAINTAINING OR RETAINING CCPC STATUS

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Creating and Maintaining or Retaining CCPC Status

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The Income Tax Act (Canada)[1] contains many incentives or preferences applicable to a taxpayer which is a Canadian-controlled private corporation ("CCPC"). This paper will briefly outline such incentives or preferences but otherwise focus on share provisions, contractual arrangements and other transactions or events which may affect CCPC status.

Provisions of the Act Needing CCPC Status

The notable provisions in the Act for which CCPC status is needed are listed below. It goes without saying that provisions listed below have additional prerequisites. As this paper is intended to address CCPC issues, the below summary is merely perfunctory rather than a detailed analysis.[2]

Statutory Provision	Incentive or Preference
Subsection 125(1)	Small business deduction
Subsection 127(10.1)	Enhanced investment tax credit being an entitlement to a 35% (rather than 20%) investment tax credit for qualifying expenditures incurred in scientific research and experimental development
Section 127.1	Refundable investment tax credit
Subsection 129(3)	Additions to refundable dividend tax on hand (other than Part IV tax paid)
Paragraph 39(1)(c)	Allowable business investment loss – CCPC status is fundamental to the definition of "small business corporation" in subsection 248(1) which is a prerequisite for an allowable business investment loss.
Section 110.6	Capital gains exemption – CCPC status is fundamental to the definition of "qualified small business corporation share".
Subsection 7(1.1)	Deferral of recognition of benefit where shares are issued to employees of a CCPC by virtue of

	employment (note also related deduction pursuant to paragraph 110(1)(d.1))
Subsection 89(8)	Low rate income pool – Upon cessation of CCPC status, a corporation must determine its opening "low rate income pool" balance.[3]

In addition, where a corporation ceases to be a CCPC or vice versa, the change in status will trigger a deemed year end pursuant to subsection 249(3.1).[4]

CCPC Definition

A discussion of creating, maintaining or retaining CCPC status necessarily requires analysis of the statutory definition in subsection 125(7) which is reproduced below.

> "Canadian-controlled private corporation" means a private corporation that is a Canadian corporation other than
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> (*a*) a corporation controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation), by one or more corporations described in paragraph (*c*), or by any combination of them,
>
> (*b*) a corporation that would, if each share of the capital stock of a corporation that is owned by a non-resident person, by a public corporation (other than a prescribed venture capital corporation), or by a corporation described in paragraph (*c*) were owned by a particular person, be controlled by the particular person,
>
> (*c*) a corporation a class of the shares of the capital stock of which is listed on a designated stock exchange, or
>
> (*d*) in applying subsection (1), paragraphs 87(2)(*vv*) and (*ww*) (including, for greater certainty, in applying those paragraphs as provided under paragraph 88(1)(*e.2*)), the definitions "excessive eligible dividend designation", "general rate income pool" and "low rate income pool" in subsection 89(1) and subsections 89(4) to (6), (8) to (10) and 249(3.1), a corporation that has made an election under subsection 89(11) and that has not revoked the election under subsection 89(12);

For ease of reference, the particular paragraphs in the CCPC definition will be referred to in this paper as “Paragraph (a)”; “Paragraph (b)”; “Paragraph (c)”; and “Paragraph (d)”.

The definition of CCPC was largely unchanged from its first enactment following 1972 Tax Reform (other than the exception for prescribed venture capital corporations[5]) until the legislative response to widely held shareholder situations like that in *Silicon Graphics Limited v. The Queen*.[6] As originally enacted, the CCPC definition was essentially today’s preamble and Paragraph (a) (without the references therein to prescribed venture capital corporations or Paragraph (c)).

The preamble to the CCPC definition contains the requirement that the corporation be a “private corporation” that is a “Canadian corporation”. Both terms are defined in subsection 89(1). The definition of “private corporation” requires that the corporation be resident in Canada and further, requires that the corporation not be controlled by one or more public corporations. The latter prerequisite is also part of Paragraph (a). The definition of “Canadian corporation” requires that the corporation be incorporated under the laws of Canada. Not satisfying or ceasing to satisfy the prerequisites of residence in Canada or incorporation under the laws of Canada will result in a corporation which is not a CCPC, without having to consider the tests in Paragraphs (a) to (d).[7]

The interaction of the preamble and Paragraphs (a) to (d) leads to negatively framed tests. A corporation described in any of Paragraphs (a) to (d) is not a CCPC.

Paragraph (a) contains both the *de jure* and *de facto* control tests. Both Paragraph (a) and Paragraph (b) will be discussed in greater detail below. The discussion of Paragraph (b) will precede the discussion of Paragraph (a) as the control concepts in Paragraph (a) are largely applicable to Paragraph (b) too.

Paragraph (c) is self-explanatory and will not be discussed in any detail in this paper.

With respect to Paragraph (d), it should be noted that an election made under subsection 89(11) affects the CCPC definition only for the limited purposes set out in the paragraph. The election does not result in the corporation not being a CCPC for all purposes of the Act.

Paragraph (b) – Hypothetical Shareholder

Paragraph (b) is sometimes referred to as the hypothetical shareholder rule. Prior to the addition of this rule, a corporation “controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, by one or more public corporations … or by any combination thereof" was not a CCPC. There was no use of the word "group".

In *Silicon Graphics*, the predecessor corporation of the taxpayer had made an initial public offering of common shares on NASDAQ in 1990. Following the IPO to the end of the corporation's 1993 taxation year, more than 50 percent of the common shares were held by non-residents. The evidence indicated that the corporation was relatively widely held. During the taxation years in question, no single shareholder held more than 13% of the common shares and there were over 300 shareholders of which 200 were non-residents. The majority of the board of directors and the entire management team were residents of Canada. The corporation's principal place of business was in Canada.

The Tax Court of Canada held that once the number of non-resident shareholders reached 50 percent plus one, control passed to the non-resident shareholders without any need for a common connection among the non-residents. There was no evidence of any agreement among shareholders nor any easily available means for shareholders to learn the identity of other shareholders.

The Federal Court of Appeal reversed the Tax Court. The Federal Court of Appeal held that there was no difference between the meaning of the phrases "controlled by a person or group of persons" and "controlled by one or more …persons" (the latter being the wording in the CCPC definition as it was then). Therefore, the omission of the word "group" in the CCPC definition (as it was then) was irrelevant. The Court recognized that most cases relating to control involved a single or a few shareholders with a controlling interest, unlike the widely held shareholder situation in the case at hand. The Court further recognized a difference in legislative use of the words "controlled" versus "owned" and noted that the CCPC definition (as it was then) used "no word connoting mere ownership". Rather, the definition used the word "controlled" and the Court held that "controlled by one or more …. persons" required a "sufficient common link or interest" among a number of shareholders allegedly comprising the group of persons exerting control over a corporation. A simple mathematical majority ownership of shares by an aggregation of non-resident shareholders without a common connection was held not to constitute *de jure* control. AS a result, the particular corporation in *Silicon Graphics* remained a CCPC.

Paragraph (b) was enacted in 1998 applicable to years after 1995 well before the 2001 Tax Court of Canada decision and the 2002 Federal Court of Appeal decision in *Silicon Graphics*. In fact, the Federal Court of Appeal noted the amendment and drew an inference that the statutory amendment was intended to change the law. It is quite clear that if Paragraph (b) had been in effect in the taxation years in issue in *Silicon Graphics*, the particular corporation would not be a CCPC.[8] Although it does not seem to have been the subject of comment, Paragraph (c) would also have resulted in the particular corporation not being a CCPC. Paragraphs (b) and (c) were enacted in the same amending statute. In *Silicon Graphics*, the particular corporation was listed on NASDAQ. It would not have been a public corporation because the public corporation definition in subsection 89(1) referred to a corporation with a class of shares listed on a prescribed stock exchange in Canada. Prior to the enactment of Paragraph (c),[9] listing on a foreign stock exchange did not affect CCPC status.

Paragraph (b) involves a two-step analysis which is described below.

Step 1. All shares of a corporation owned by a non-resident, public corporation or a corporation with a class of shares listed on a designated stock exchange are treated as if they were owned by a "particular person" – the hypothetical shareholder, also referred to as the "mythical particular person" in *Sedona Networks Corp. v. The Queen*.[10] These three categories of shareholders were referred to in *Sedona Networks* as "disqualifying shareholders" and that term is used herein. Shares must be owned. The rule is not restricted to the shares of the corporation whose CCPC status is under review (the "target corporation"). Rather, the rule potentially sweeps into the aggregation analysis any corporation with shares owned by a disqualifying shareholder. While the universe of such corporations is obviously large, clearly only corporations with some connection to the target corporation (notably, a corporation which is a shareholder of the target corporation) would be subject to aggregation analysis because it is control of the target corporation which is at issue.

Step 2. Following the attribution of shares pursuant to Step 1, is the target corporation controlled by the hypothetical shareholder? Paragraph (b) uses the word "controlled" and not the phrase "controlled, directly or indirectly in any manner whatever". Therefore, Paragraph (b) is a *de jure* control test.

In *Sedona Networks*, the effect of Paragraph (b) on 438,597 Class B preferred shares of the target corporation owned by Bank of Montreal Capital Corporation (the "Subject Shares" and "BMCC" respectively) was critical to the target corporation's CCPC status. BMCC was a wholly owned subsidiary of a public corporation, Bank of Montreal ("BMO"). Ignoring the Subject Shares and the question of options granted to certain employees, the ownership of the target corporation's voting shares was summarized by the Federal Court of Appeal as follows:[11]

SHARES	RESIDENTS/NON-PUBLIC	NON-RESIDENTS/PUBLIC
Common and Preferred Shares	9,281,789	9,419,931
Percentage of Control	49.6%	50.4%

Shares in the column labelled “Non-Residents/Public” (i.e., disqualifying shareholders) were attributed to the hypothetical shareholder. If the Subject Shares were added to the column labelled “Residents/Non-Public”, then the target corporation would have been a CCPC. If the Subject Shares were added to the column labelled “Non-Resident/Public”, then the hypothetical shareholder would have controlled the target corporation and it would not have been a CCPC.

BMCC was controlled by a public corporation. Therefore for purposes of Paragraph (b), the shares of BMCC were treated as if owned by the hypothetical shareholder. The longstanding concept of indirect control was applied. Indirect control (as endorsed by the Supreme Court of Canada in *Vineland Quarries and Crushed Stone Limited v. Minister of National Revenue*[12], and Canada Revenue Agency (“CRA”) in *Interpretation Bulletin* IT-64R4 (Consolidated)[13]) holds that if a person controls a parent corporation which in turn controls a subsidiary corporation, then the person controls the subsidiary corporation. In the case at hand, the hypothetical shareholder controlled BMCC, so the Subject Shares controlled by BMCC were considered to be controlled by the hypothetical shareholder. The Subject Shares were added to the column labelled “Non-Residents/Public” with the result that the hypothetical shareholder controlled the target corporation. Therefore, it was not a CCPC.

There was a Management Agreement between BMCC and a private corporation (“Ventures”). Pursuant to the Management Agreement, Ventures had the right to exercise the voting rights of the Subject Shares as it deemed appropriate in its discretion. Ventures also had the right to acquire the Subject Shares from BMCC if the agreement was terminated without cause. The Federal Court of Appeal reviewed the Management Agreement and held that it was not a unanimous shareholder agreement or other constating document.[14] Accordingly, it did not affect *de jure* control of BMCC and accordingly, the Subject Shares. (See the discussion below in the section titled “The Relevance of Constating Documents”.)

The case also raised the question of the interaction of paragraph 251(5)(b) and Paragraph (b), but unfortunately, the answer was not clear. Paragraph 251(5)(b) applies for purposes of the CCPC definition. (See also the discussion below in the section titled "Paragraph 251(5)(b)".) Ventures had the right to acquire the Subject Shares in the event of termination of the Management Agreement without cause. The Tax Court of Canada considered whether paragraph 251(5)(b) deemed Ventures to own the Subject Shares and held that it did not because paragraph 251(5)(b) was a deeming rule of control, not ownership.[15] Further, paragraph 251(5)(b) did not remove BMCC's ownership of the Subject Shares. The Federal Court of Appeal did not expressly consider the application of paragraph 251(5)(b) to the Management Agreement. The Federal Court of Appeal only applied paragraph 251(5)(b) to options for the issuance of shares from treasury which had been granted to employees (both resident and non-resident) and overruled the Tax Court's finding on paragraph 251(5)(b) as follows:[16]

> In my analysis, the legal fiction created by paragraph 251(5)(b) is directed at the concept of ownership, not control. Once it is determined that a person has a right that falls within the scope of paragraph 251(5)(b), it is necessary to assume that the right is exercised and the related shares are actually acquired by the holder of the right. Then, it is necessary to determine how many votes are attached to the shares actually issued and the shares that would be issued if the options were exercised. Finally, answering the question asked by paragraph (b) of the definition of CCPC in subsection 125(7), it is necessary to determine how many votes should be attributed to the mythical "particular person". As this was not the approach adopted by the Judge, I am compelled to conclude that the Judge made a legal error in his interpretation of subparagraph 251(5)(b)(i).

But the calculations in the Federal Court of Appeal decision following the above did not move or add the Subject Shares to the column for ownership by "Residents/Non-Public", which would have been the applicable column for Ventures. The options granted to employees were considered exercised (such that shares would be owned) and where such shares would be owned by a non-resident, they were attributed to the hypothetical shareholder. Strictly speaking, the application of paragraph 251(5)(b) to the Management Agreement would have resulted in Ventures being in the same position in relation to control of the target corporation (as the Subject Shares were shares of the target corporation) as if it owned such shares, but Ventures' control of the target corporation was not in issue and in any event, this would have been a (deemed) minority position. This application of paragraph 251(5)(b) would not have affected control of BMCC by the hypothetical shareholder but only BMCC's control of the shares which it owned. The anomaly is that paragraph 251(5)(b) created a legal fiction of ownership of the Subject Shares by Ventures for purposes of control of the target corporation, yet Paragraph (b) and the indirect control concept attributed the Subject Shares to the hypothetical shareholder, seemingly without recognition of the other legal fiction.

Paragraph (a)

De Jure Control Means Effective Control

Pursuant to Paragraph (a), a private corporation which is a Canadian corporation controlled, directly or indirectly in any manner whatever by one or more disqualifying shareholders is not a CCPC. Based on *Silicon Graphics* (as discussed above), this includes such control by a group of disqualifying shareholders.

It is generally accepted that for purposes of the Act, control denotes *de jure* control and *de jure* control means the ability to elect a majority of the board of directors. This derives from the frequently cited passage in the judgement of Jackett, P. in *Buckerfield's v. Minister of National Revenue*:[17]

> Many approaches might conceivably be adopted in applying the word "control" in a statute such as the *Income Tax Act* to a corporation. It might, for example, refer to control by "management", where management and the board of directors are separate, or it might refer to control by the board of directors. The kind of control exercised by management officials or the board of directors is, however, clearly not intended by Section 39 when it contemplates control of one corporation by another as well as control of a corporation by individuals (see subsection (6) of Section 39). The word "control" might conceivably refer to *de facto* control by one or more shareholders whether or not they hold a majority of shares. I am of the view, however, that in Section 39 of the *Income Tax Act*, the word "controlled" contemplates the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors.

In the Supreme Court of Canada decision in *Duha Printers (Western) Ltd. v. The Queen*[18] Iacobucci, J. cited the above passage from *Buckerfield's* and explained the connection with "effective control" as follows:[19]

> Thus, *de jure* control has emerged as the Canadian standard, with the test for such control generally accepted to be whether the controlling party enjoys, by virtue of its shareholdings, the ability to elect the majority of the board of directors. However, it must be recognized at the outset that this test is really an attempt to ascertain who is in effective control of the affairs and fortunes of the corporation. That is, although the directors generally have, by operation of the corporate law statute governing the corporation, the formal right to direct the management of the corporation, the majority shareholder enjoys the indirect exercise of this control through his or her ability to elect the board of directors. Thus, it is in reality the majority shareholder, not the directors *per se*, who is in effective control of the corporation. This was expressly recognized by Jackett P. when setting out the test in *Buckerfield's.* Indeed, the very authority cited for the test was the following dictum of Viscount Simon, L.C., in *British American Tobacco Co. v. Inland Revenue Commissioners* (1942), [1943] 1 All E.R. 13 (U.K. H.L.) , at p. 15:
>
> The owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and business.

Therefore, pursuant to Paragraph (a), a private corporation which is a Canadian corporation of which one or more disqualifying shareholders have effective control, is not a CCPC.

It is instructive to review the *British American Tobacco Co.* case from which the words "effective control" derive. In *British American Tobacco Co.*, the issue was whether the appellant company had a "controlling interest" in certain lower tier companies which operated outside the United Kingdom. If the appellant company had a "controlling interest", then dividends from such companies were subject to a "national defense contribution". In some of the lower tier companies, the appellant company itself owned shares with more than 50% of the votes. In other cases, the appellant company controlled more than 50% of the votes in conjunction with a company or companies in which it controlled more than 50% of the votes. While one issue in the case was the proper interpretation of the word "interest" (i.e., whether this required direct ownership), the degree of control was also at issue. An argument was made by the appellant that a "controlling interest" meant that the holder had to be able to pass a resolution for which a special majority might be required by law or under the constitution of the particular corporation. This argument was dismissed in the House of Lords as follows (giving rise to the words quoted by Iacobucci, J., in the Supreme Court of Canada decision in *Duha* and previously in *Buckerfield's*):[20]

> As to what may be the requisite proportion of voting power, I think a bare majority is sufficient. The appellant company has, in respect of each of the foreign companies referred to in the case, the control of the majority vote. I agree with the interpretation of "controlling interest" adopted by Rowlatt, J. in *Noble v. Commissioners of Inland Revenue* (1), when construing that phrase in the Finance Act, 1920, s. 53 (2) (*c*). He said at p. 926 that the phrase had a well-known meaning and referred to the situation of a man
>
> …whose shareholding in the company is such that he is more powerful than all the other shareholders put together in general meeting.
>
> The owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and fortunes. It is true that for some purposes a 75 per cent majority vote may be required, as, for instance (under some company regulations) for the removal of directors who oppose the wishes of the majority; but the bare majority can always refuse to re-elect and so in the long run get rid of a recalcitrant board. Nor can the articles of association be altered in order to defeat the wishes of the majority, for a bare majority can always prevent the passing of the necessary resolution.

Parsing the above, the persons who are effectively in control are those who can carry a resolution at a general meeting of shareholders. If the *Buckerfield's* test was applied formalistically, the search for *de jure* control would merely be a confirmatory exercise of reviewing the shareholders ledger and the terms and conditions of the shares. But it was Iacobucci, J. in *Duha* who indicated that this could lead to an "artificial result"[21] so that the *de jure* control analysis asks whether a person holding a majority of the voting shares is in "effective control" of the particular corporation. There was little elaboration of the meaning of effective control until *Kruger Wayagamack Inc. v. The Queen*.[22]

Kruger Wayagamack must be viewed in light of its underlying facts and not simply viewed as a case involving two shareholders. A mill was about to be shut down by Abitibi Consolidated. If the mill was shut down, many jobs would be lost. Kruger Inc., a major player in the paper and wood product industry and a Quebec crown corporation, SGF, came together to acquire the mill, modernize it and make it profitable. The modernization required a very significant expenditure and Kruger Inc. was unwilling to undertake the project alone. Apparently, it was not the practice of the Quebec crown corporation to acquire companies alone. It always worked with partners. The taxpayer was incorporated for the project. Kruger Inc. held 51% of the issued and outstanding shares. The Quebec crown corporation, SGF, owned the remaining 49% of the issued and outstanding shares. The issue was the eligibility of Kruger Wayagamack for refundable investment tax credits. CRA assessed on the basis that Kruger Wayagamack was not entitled to a refundable investment tax credit because it was associated with Kruger Inc. during the years in question. The Tax Court of Canada recognized that Kruger Inc. held 51% of the issued and outstanding shares and therefore had the ability to elect a majority of the board of directors, but held that it did not have "effective control". The Tax Court explained the meaning of effective control as follows:[23]

> "For our purposes in this appeal, it is useful to think of there being a spectrum ranging from complete control to completely shared control. A single shareholder who can name the board has complete control in the sense that, within the legal constraints to which the company is subject, that single shareholder is entirely free to decide what the company should do. A shareholder who is able to elect the majority of the board and who is not subject to any constraints other than those arising from the general law will have effective control.
>
> - That same majority will still have effective control even when there are certain additional but limited constraints imposed by arrangements between shareholders, as was the case in *Duha*.
> - At the other end of the spectrum, if there are, say, two shareholders who, pursuant to a unanimous shareholder agreement, have agreed that all the directors' decisions will be taken unanimously, or that all the directors' decisions will be taken unanimously by the shareholders, then, even if one shareholder has a majority of the shares and the directors, that shareholder will not have effective control."

The Tax Court of Canada referred to *Plomberie J. C. Langlois Inc. v. The Queen*[24] to answer the question: "Just how much control is necessary for someone to have effective control?" It should be noted that *Plomberie Langlois* was actually subsection 256(5.1) *de facto* control case. There were two 50:50 shareholders; one individual was involved in the operational side of the business and the other individual was the sole director and apparently sole officer. In *Plomberie Langlois*, the Tax Court referred to the following legal dictionary definition of control to find that the individual who was sole director had control in fact of the corporation.[25]

> Dominion over the management of a business or organization; power ensuring the one who has it a dominant influence in the

direction of a group, a corporation, etc., or the orientation of its future.

Based on the above, the Tax Court in *Kruger Wayagamack* held that the relevant question was whether Kruger Inc. had a dominant influence in the management or direction of the corporation or dominant influence in the orientation of its future. The Court considered that if "one does not have the ability to make strategic decisions that will change significantly the general course of the business, one does not….have the effective control normally held by a majority of directors".[26]

The Relevance of Constating Documents

It is settled that only constating documents are relevant to the *de jure* control analysis. The following points source from the judgment of Iacobucci, J. in *Duha*:[27]

> (3) To determine whether such "effective control" exists, one must consider:
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> (a) the corporation's governing statute;
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> (b) the share register of the corporation; and
>
> (c) any specific or unique limitation on either the majority shareholder's power to control the election of the board or the board's power to manage the business and affairs of the company, as manifested in either:
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> (i) the constating documents of the corporation; or
>
> (ii) any unanimous shareholder agreement.
>
> (4) Documents other than the share register, the constating documents, and any unanimous shareholder agreement are not generally to be considered for this purpose.
>
> (5) If there exists any such limitation as contemplated by item 3(c), the majority shareholder may nonetheless possess *de jure* control, unless there remains no other way for that shareholder to exercise "effective control" over the affairs and fortunes of the corporation in a manner analogous or equivalent to the *Buckerfield's* test.

Subsequent to the decision in *Duha*, the analysis in jurisprudence and CRA documents has been to consider whether an agreement constitutes a "unanimous shareholder agreement" for purposes of corporate law and if so, the effect of such unanimous shareholder agreement on effective control. The first issue has examined the statutory requirements for a unanimous shareholder agreement and asked whether an agreement should be severed such that only certain portions of such a document should be relevant to the analysis. The second issue has focused on the degree of impact which the terms of the unanimous shareholder agreement have on the decision making power of the board of directors and therefore, effective control.

Under section 108, Ontario Business Corporations Act,[28] the prerequisites for a unanimous shareholder agreement are seemingly simple: (a) written agreement; (b) signed by all of the shareholders; (c) restriction on powers of directors to manage or supervise the management of the business and affairs of the corporation. The agreement need not contain any declaration or statement that it constitutes a unanimous shareholder agreement. The business corporations statutes of some provinces impose an obligation to file the document with a particular government registry.[29]

An agreement which is not on its face intended to be a unanimous shareholder agreement, could be construed as one if the statutory prerequisites are met. In *Sedona Networks*, as discussed above, the taxpayer unsuccessfully argued that a certain Management Agreement was a unanimous shareholder agreement. *Deans Knight Income Corporation v. The Queen*[30] is a case where the Crown alleged that a certain Investment Agreement was a unanimous shareholder agreement. The reported case was a motion brought by the taxpayer to strike out all or various portions of the Crown's reply. The facts involved a loss utilization arrangement. CRA reassessed to deny the utilization of non-capital losses on the basis of an acquisition of control, or alternatively, on the basis of GAAR. One portion of the Reply which the appellant sought to strike out pled that an agreement, "Investment Agreement", was a unanimous shareholder agreement under the Canada Business Corporations Act.[31] The appellant was previously the wholly-owned subsidiary of Forbes Medi-Tech Inc. which held in excess of 34 million common shares. 1250280 Alberta Ltd. became the holder of 100 common shares of the appellant. An Investment Agreement was entered into among the appellant, Forbes Medi-Tech Inc. and another company, Matco Capital Ltd. which the Reply alleged placed restrictions on the actions which the appellant could take without the prior written consent of such third party. The appellant unsuccessfully moved to strike the portion of the Reply containing the Crown's unanimous shareholder agreement argument. No detail was given regarding the Crown's basis for arguing that the Investment Agreement constituted a unanimous shareholder agreement given that one of the shareholders of the appellant (albeit holding a nominal number of shares) was not, on the face of the document, a party to such agreement. However, the case serves as a reminder that an agreement need not be called a unanimous shareholder agreement to be one and thereby potentially affect *de jure* control.

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Severing a Unanimous Shareholder Agreement

In *PricewaterhouseCoopers Inc. acting in the capacity of trustee and bankruptcy of Bioartificial Gel Technologies (Bagtech) v. The Queen*[32], the particular corporation, Bagtech, had multiple shareholders, both resident and non-resident. Bagtech was a corporation incorporated under the CBCA. More than 50% of the shareholders of Bagtech were non-residents. At first blush, it would seem that by virtue of Paragraph (b) of the CCPC definition, Bagtech was not a CCPC. The case analyzed both of the two issues mentioned above (i.e., severing the agreement and effective control).

A unanimous shareholder agreement had been entered into containing what has been described as "director election provisions".[33] Specifically, the document prescribed the number of directors and provided that certain named groups of shareholders were entitled to nominate a number of individuals to the board of directors. Further, the parties agreed that they would vote their shares to carry out the terms of the agreement.

> Group A was entitled to nominate two directors.
>
> Group B was entitled to nominate three directors.
>
> Group C was entitled to nominate two directors.

The non-resident shareholders were spread among all three groups although all the members of Group C were non-residents. Later the unanimous shareholder agreement was amended so that Group C (comprised solely of non-resident shareholders) was entitled to nominate three members of the board of directors (out of a total of eight). At no time was Group C (or indeed, any single named group) entitled to nominate a majority of the number of directors. No details were provided regarding the internal decision making process of each group.

It was unsuccessfully argued at both the Tax Court of Canada and the Federal Court of Appeal that the unanimous shareholder agreement should be severed so that only certain portions of the agreement should be considered for purposes of the *de jure* control analysis. In particular, it was argued that only the specific provisions of the agreement which actually limited, restricted or removed the powers of the directors to manage or supervise the management of the affairs of the corporation should be considered a unanimous shareholder agreement relevant to *de jure* control.[34] Under this argument, because the director election provisions did not actually restrict the powers of the directors, they would simply be considered a legally binding agreement among the shareholders (irrelevant to *de jure* control) rather than part of the unanimous shareholder agreement. The argument was based upon the specific wording in the statutory definition of unanimous shareholder agreement in the CBCA. A unanimous shareholder agreement is defined in subsection 2(1), CBCA as an agreement described in section 146, CBCA which in turn reads as follows:

> An otherwise lawful written agreement among all the shareholders of a corporation, or among all the shareholders and one or more persons who are not shareholders, that restricts, in whole or in part, the powers of the directors to manage, or supervise the management of, the business and affairs of the corporation is valid.

The question is whether the phrase “in whole or in part” refers to the written agreement or the restriction of the powers of directors. If the former, then the entire agreement constitutes a unanimous shareholder agreement. If the latter, then only the part that restricts the authority of the directors constitutes a unanimous shareholder agreement. It is interesting to note that some of the Canadian business corporation statutes (e.g., Yukon, Alberta, Newfoundalnd, Nunavut) are more broadly worded so that a restriction on the powers of directors to manage the business is not a prerequisite to a unanimous shareholder agreement. Further, in these statutes, provisions for the regulation of rights and obligations among the shareholders *inter se* or a shareholder(s) and others, and the regulation of the election of directors are expressly included in the statutory definition of a unanimous shareholder agreement.[35] In these jurisdictions, the severing argument could not be raised.

In *Bagtech*, the severing argument was unsuccessful. The Court held that the entire agreement should be considered in the *de jure* control analysis including the director election provisions.

The application of Paragraph (b) was considered in *Bagtech* in light of the number of non-resident shareholders. At the Tax Court of Canada, it was argued that *de jure* control by the hypothetical shareholder had to be determined without reference to the unanimous shareholder agreement. This had been CRA’s stated administrative position for a number of years on the basis that the hypothetical shareholder was not and could not be a party to the unanimous shareholder agreement.[36] The Tax Court ruled that the unanimous shareholder agreement applied to the hypothetical shareholder. Paragraph (b) imposed a legal fiction and the Tax Court considered that the “particular person” was thereby deemed to have the same rights and be subject to the same obligations as the non-resident shareholders themselves. This ruling was not appealed to the Federal Court of Appeal.[37] Although the hypothetical shareholder held more than 50% of the voting shares of Bagtech, because the hypothetical shareholder would be bound by the unanimous shareholder agreement and the director election provisions therein, it could not elect the majority of the board of the directors. Therefore Bagtech continued to be a CCPC.

Leave to appeal to the Supreme Court of Canada was not sought. In response to a question at the 2014 CALU Conference,[38] CRA indicated that it will adopt the views expressed in *Bagtech* "where appropriate".

Provisions in a Unanimous Shareholders Agreement which might adversely affect "effective control"

It is difficult to glean rules from the limited jurisprudence regarding the effect of specific provisions in isolation. Rather, although trite to state, it is likely the collective restrictions or requirements in an agreement which may be considered to oust the power and authority of the board. If so, the shareholder who holds the majority of the voting shares and thereby has the ability to elect a majority of the board would not be considered to have effective control.

In *Duha,* the unanimous shareholder agreement restricted the ability to issue additional shares without unanimous shareholder approval. This was the only restriction mentioned by Iaccobucci, J. This restriction on the powers of the directors to manage the business and affairs of the corporation was held to not be so severe a restriction that the majority shareholder lost the ability to exercise effective control over the affairs or fortunes of the corporation.[39]

In *Bagtech*, the unanimous shareholder agreement contained substantially more restrictions on the power of the directors.[40]

- An individual was named to act as chair of the board of directors as long as the majority of shareholders agreed.
- The number of meetings of the board of directors each year was mandated including the period of time between meetings.
- Quorum requirements for any meeting of the board of directors was specified.
- In two enumerated circumstances involving the transfer of shares, the directors were mandated to authorize such transfer notwithstanding any other provision of the charter or by-laws of the corporation.
- In the event that there was no public issuance or sale of the shares or assets of the corporation by a specified date, a bank selected by a majority vote of certain shareholders would be retained for certain consultancy purposes.
- Upon bankruptcy, insolvency or permanent incapacity of a shareholder, the remaining shareholders would determine by majority vote whether such shareholder's shares were to be redeemed by the corporation or purchased by the shareholders.
- 50% shareholder vote required for the issuance of additional securities.

The above listed items were matters which a board of directors would typically establish by means of by-law, e.g., notice and quorum for meetings and appointing a chair for any directors' meeting, or otherwise approve by directors' resolution. Stipulating same in the unanimous shareholder agreement took away the power of the directors to make such decisions. But the Court considered these to be "minor restrictions" which did not strip the hypothetical shareholder of effective control.

Reference may be made to CRA document number 2007-0253591I7[41] in which a public corporation owned more than 51% of the issued and outstanding shares of a particular corporation. (This CRA document predates *Bagtech* and *Kruger Wayagamack*.) There was a unanimous shareholder agreement. In this CRA document notwithstanding the terms of the unanimous shareholder agreement, CRA considered that the majority shareholder exercised effective control. As a result, the particular corporation was held not to be a CCPC. The CRA document listed the following decisions as requiring a certain percentage vote of shareholders (reproduced below exactly as is from the CRA document).

- "Any shareholder who owned more than 50% of the issued and outstanding voting shares shall be entitled to nominate such number of additional directors so as to give such shareholder control of the Board (XXXXXXXXXX).
- Any of the following decisions had to be ratified by shareholders holding at least XXXXXXXXXX% of the issued and outstanding voting shares: (i) change in the number of directors (ii) amendment of its articles of incorporation and/or by-laws (iii) sale of all or substantially all of its assets and/or undertakings (iv) re-organization, dissolution or wind-up (v) dividend payments (vi) redemption of its share capital (vii) issuance of securities, debt and guarantees (XXXXXXXXXX).
- The XXXXXXXXXX shall not be amended except by a written agreement executed by shareholders holding at least XXXXXXXXXX% of the voting shares (XXXXXXXXXX)."

Because of redacted information, it is unclear whether the majority shareholder had sufficient votes to approve the above actions. But it may be inferred that the redacted percentage was different than 50% given that other portions of the CRA document did specify 50%.

While the CRA document stated that the board was "stripped of its ability to approve exceptional decisions", it was also stated that these were not significant enough that the majority shareholder no longer had the ability to exercise effective control over the particular corporation's business operations. If the OBCA was the applicable business corporations statute, a number of the listed items would not have been director level decisions in any event and would have required approval by special resolution of the shareholders.[42] Only the listed items of dividend payments, redemption of share capital and issuance of securities, debt and guarantees are powers of the directors under the OBCA. Based on the CRA document, moving these powers to the shareholders may not be sufficient to remove effective control.

In contrast, the unanimous shareholder agreement in *Kruger Wayagamack* contained clauses which were held to prevent the majority shareholder from exercising effective control. The unanimous shareholder agreement included the following provisions:

- Additional shares could not be issued without unanimous shareholder approval
- No transfer of shares could be made without unanimous shareholder approval
- The number of directors was set at five with three to be appointed by Kruger Inc. (51% shareholder) and two to be appointed by SGF (49% shareholder)
- The quorum for a meeting of the board of directors effectively required the attendance of at least one representative of SGF (49% shareholder)
- There was a long list of decisions requiring unanimity of the board of directors such as acquisition of shares of any entity; any borrowing in excess of $1 million; approval of annual business plan and annual marketing plan; the hiring, firing and compensation of any officer reporting to the general manager; granting bonuses to any manager; any litigation with a claim in excess of $50,000; any lease with a term greater than two year; adopting any banking resolutions.
- A considerable number of decisions required unanimous approval of the shareholders such as any "important change" to the mission of the corporation; investing in any manner in a permanent activity other than envisaged in the initial business plan; any change to the authorized capital; granting security over the company's assets; amending the articles or other constitutional documents or the unanimous shareholders agreement; sale of the business of the company or any subsidiary in whole or in part (not just all or substantially all) including granting an option with respect to same.

In the absence of a unanimous shareholders agreement mandating unanimity of the board of directors for various decisions, a board of directors can typically transact business by means of a majority resolution. In this case, the unanimity requirement effectively provided the two directors appointed by the 49% shareholder with a right of veto. Indirectly, this meant that the 49% shareholder had a right of veto. The Tax Court of Canada reviewed the terms of the agreement and noted that the majority of the board of directors could make what it considered to be “significant decisions” but these were not “strategic decisions”. The Court gave the following examples of board decisions determined by a majority: decisions in relation to the management of production operations and management of the projects; policies in relation to operations and implementation of the mission; and setting the parameters of labour agreements. Because “strategic decisions” required unanimity of the board or unanimous approval of the shareholders, the Court held that the 51% shareholder did not have effective control notwithstanding that it was able to elect a majority of the board of directors.[43]

Other Constating Documents

The traditional constitutional documents of a corporation are its articles and bylaws.

The key constating document in an amalgamation under the OBCA is the articles of amalgamation. Absent using the short form amalgamation provisions available for certain amalgamations,[44] an amalgamation agreement must be entered into by the amalgamating corporations (whose shareholders will, as a result of the amalgamation, become shareholders of the amalgamated corporation) and it is included as a schedule to the articles of amalgamation. The contents of an amalgamation agreement are specified in subsection 175(1), OBCA[45] and in addition to providing for the exchange of shares of an amalgamating corporation for shares of the amalgamated corporation, there is a basket clause as follows:

> Where corporations propose to amalgamate, each such corporation shall enter into an agreement setting out the terms and means of effecting the amalgamation and, in particular, setting out ….
>
> (e) such other details as may be necessary to perfect the amalgamation and to provide for the subsequent management and operation of the amalgamated corporation.

Because the amalgamation agreement is attached to the articles of amalgamation, it is part of the constating documents. Pursuant to paragraph (e) above, it may be that an amalgamation agreement can contain provisions relating to management and control which affect effective control of the corporation. This would be similar to the effect of a unanimous shareholder agreement.

Avotus Corp. v. The Queen [46] is a case where the terms of an amalgamation agreement were considered. In *Avotus*, the predecessor to the taxpayer had been formed by amalgamation. The Tax Court of Canada found that the non-resident individual shareholder (who held 50% of the issued and outstanding shares) had *de jure* control in addition to *de facto* control. Based upon the decision in *Duha*, the Court noted that reference can be made to the applicable governing statute and the corporation's constitutional documents for purposes of determining *de jure* control. Thus the amalgamation agreement was considered. The Court then stated:[47]

> In this case, … [i.e., the non-resident shareholder] was given the power to elect the majority of the directors by virtue of provisions contained in the Appellant's amalgamation agreement and bylaws, both of which are constating documents. Under the former, … [i.e., the non-resident shareholder] was appointed chairman of the board of directors, and under the latter the chairman was given the casting vote at meetings of the shareholders and directors. The casting vote provisions, along with … [the non-resident shareholder]'s 50% shareholding in the Appellant resulted in his having the power to control the election of the directors.

In the articles of amalgamation and amalgamation agreement (to which the bylaw was attached) of the predecessor corporation in question (MDR Telemanagement Ltd.)[48], the officers of the amalgamated corporation were named, "until changed by the directors" and the non-resident individual was named as the Chairman of the Board. The first directors of the corporation were also named as required by statute and one of the two first directors was the non-resident individual. The articles of amalgamation actually provided for a minimum of one director and a maximum of ten directors and the number of directors within the minimum and maximum range was fixed in the amalgamation agreement. Also, the amalgamation agreement included a provision whereby the directors could determine the number of directors within the minimum/maximum range from time to time. As a result of the terms of the amalgamation agreement, it appears that the authority of the non-resident individual was crystallized in the constitutional documents.

Contrary to the finding in *Avotus* reproduced above, it is not entirely clear that the non-resident individual had the power to control the election of directors by virtue of provisions in the amalgamation agreement and bylaws. However, it may be that the amalgamation agreement put the non-resident 50% shareholder in effective control of the corporation. As recognized in *Duha*, *de jure* control analysis is an attempt to determine the person who is in "effective control" of the corporation. A constating document named the non-resident individual as director and chairman of the board with a casting vote. This could not be changed without his agreement. Perhaps because the constitutional document named him as chairman with a casting vote (rather than being subsequently appointed to this office by a directors' resolution (which is not a constating document)), this colours the character of the casting vote.

This might be contrasted with a new incorporation of a corporation. The first directors named in the articles of incorporation hold office from the date of incorporation until the first meeting of shareholders and at the first meeting of shareholders, the shareholders are required to elect directors.[49] Articles of incorporation usually do not name officers although they could do so and they could provide that the chair of a shareholders' meeting has a casting vote.[50] Thus upon incorporation, it might be possible to lock in the power of a first director who is a 50% non-resident shareholder in the same way as the amalgamation agreement in *Avotus*, leading to non-CCPC status.

Both the above comment regarding articles of incorporation and the amalgamation agreement in *Avotus* may rely on the concept of an overhanging director or board of directors. Pursuant to subsection 119(7), OBCA,[51] if directors are not elected at a meeting of shareholders, the incumbent directors continue in office until their successors are elected. First directors named in the articles hold office from the endorsement of the certification of incorporation until the first meeting of shareholders and subsection 119(3), OBCA expressly states that the first directors have all the powers and duties and are subject to all the liabilities of directors. If individuals are named as first directors and rights are specified in the articles, the articles cannot be amended without a special resolution of shareholders requiring a 2/3 vote, and the first directors cannot be replaced without a majority vote.

The above "locking in" of rights and directors seemed to be the compelling factor in *International Mercantile Factors Ltd. v. The Queen.*[52] In *International Mercantile*, two public companies held an aggregate of 50% of the voting shares. The taxpayer was in financial difficulty and the services of Eric Bissell were sought. The deal with Mr. Bissell was that he would become president and he (or his holding company) would become the holder of 50% of the voting shares. There were five directors of the corporation and four were the nominees of the two public companies. The former president resigned from the board and Mr. Bissell became the fifth director. A shareholders' agreement was entered into but it did not address the election of directors. The Court held that under the bylaw of the corporation, if a new board of directors was not elected, the existing board remained. The Court concluded that this gave the two public company shareholders effective control; no change to the status quo could be made without their affirmative vote.

Because of the above, even in corporations where there is a deadlock between a Canadian resident shareholder and a disqualifying shareholder, the first directors named in articles should be selected carefully to avoid a "locking in" argument.

Control Currently or In The Long Run

The "long run" concept as used in *British American Tobacco Co.* related to control of the board. The holder of a simple majority of the voting shares could elect the majority of the board of directors. "In the long run" simply meant that such shareholder could elect the directors of its choice at the next annual general meeting if one or more of the existing board members was "recalcitrant".

The concept was expanded upon in *Donald Applicators Ltd. v. Minister of National Revenue*,[53] which the Exchequer Court called an analysis of the quantity of voting power versus the quality of voting power. The issue in *Donald Applicators* was whether certain companies were associated. The ten appellant companies had two classes of authorized capital, Class A shares and Class B shares. The Class A shares carried the right to vote. The Class B shares also carried the right to vote except that they could not vote on the election of directors. For each of the ten appellant companies, there were two issued and outstanding Class A shares held by different unrelated members of a Bahamian law firm. In each case, the two Class A shareholders elected themselves as the directors of the particular company. None of the ten companies had the same two Class A shareholders. Each of the ten appellant companies also had 498 issued and outstanding Class B shares held by Saje Management Limited, an Alberta company. Given the rights of the Class B shares, the Class B shareholder did not own shares giving it a majority of the votes in the election of the board of directors.

Thurlow, J. speaking for the Exchequer Court noted that the Class B shareholder (while not having the right to vote on the election of directors) had sufficient voting power to pass any ordinary resolution (other than the resolution electing directors) or pass any special resolution that might be proposed. Therefore the Class B shareholder had the voting power to change the articles of the company. Thurlow, J. referred to the words from *British American Tobacco Co.* reproduced above, and expanded the "long run" concept. *British American Tobacco Co.* used "in the long run" to refer to a subsequent annual meeting of shareholders. The words of the House of Lords in *British American Tobacco Co.* immediately following the use of "in the long run" simply indicated that the holder of the majority of the voting shares could prevent a change to the articles of the company. This was a statement of the mathematical effect of a majority. *British American Tobacco Co.* contemplated the exercise of voting rights in the normal course in the future (i.e., in the long run) and did not extend to the taking of possible but legally permissible corporate steps.

In *Donald Applicators*, the "in the long run" concept was applied as follows:[54]

> While the present is a converse case in that a particular shareholder has the voting power to pass a special resolution but no immediate right to elect directors, it seems to me that the same guiding principle can be applied. 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. Such a person in my view has the kind of *de jure* control contemplated by Section 39 of the Act. It follows that Saje Management Limited had control of all ten appellant companies at the material times and that they were all "associated" with one another within the meaning of Section 39.

Based on *Donald Applicators*, share attributes which will theoretically permit the particular holder to take steps such that he/she/it can elect a majority of the board of directors means control in the long run.

In CRA document number 2011-0402571R3[55], the "long run" concept was accepted. An advance income tax ruling was given that there was no acquisition of control of Profitco or Lossco (as those terms were used in the CRA document) based on the following facts.

- Lossco had two classes of issued and outstanding shares referred to as Class A shares and Class B shares. The Class A shares and Class B shares were identical in all respects except for their voting rights. Each Class A share and each Class B share was allocated one vote per share but only the Class A shares carried the right to vote with respect to the election or removal of directors.
- Parent held both Class A shares and Class B shares. Mr. A held Class B shares. Class A Shareholder (who dealt at arm's length with Parent, Lossco and Profitco at all times) held Class A shares and Class B shares.
- Given the redacted information, no numbers or percentages can be determined for any shareholder but the disclosed facts stated that

> Parent held shares with sufficient number of votes on any matter other than the election or removal of directors that would entitle it to successfully propose and pass a resolution of the shareholders to approve a stock consolidation and associated purchase for cash of fractional shares. Such a resolution would have required a ⅔ vote. Apparently, if implemented, this would have permitted the consolidation of Class A shares into fractions of shares that could be cancelled for a cash payment without any special resolution of the holders of the Lossco Class A shares voting separately as a class.[56]

Parent was the sole shareholder of Profitco. The proposed transactions involved the amalgamation of Profitco and Lossco. On the amalgamation, Parent received Amalco common shares in exchange for its Lossco Class A shares and Lossco Class B shares. The other two shareholders received non-voting preferred shares of Amalco which were proposed to be redeemed immediately for cash consideration.

It seems that the possible but legally permissible corporate steps which Parent could take were taken into account, based on *Donald Applicators*. The analysis appears to be that because Parent could theoretically take action that would eliminate the Class A shareholders (who otherwise voted on the election or removal of directors), Parent was considered to have *de jure* control of Lossco. As a result, the proposed amalgamation of Lossco and Profitco (a corporation all of whose shares were held by Parent) was ruled not to result in an acquisition of control of either corporation. If Parent did not have *de jure* control of Lossco, subparagraph 256(7)(b)(ii) would have deemed Parent to have acquired control of Lossco immediately before the amalgamation which would have engaged the loss restriction rules in subsection 111(5).

In *Kruger Wayagamack*,[57] the Tax Court of Canada noted that the "in the long run" analysis looks to what a person could do in the future with present shareholdings. This was a rejection of the Crown's argument that the 51% shareholder's call option on the shares held by the other shareholder meant that it had control in the long run. (It is not clear why subsection 256(1.4) was not raised instead.) Notwithstanding that the call option was not exercisable for seven years, it is unclear why the exercise of a paragraph 251(5)(b) right should not factor into long run control.

It is clear that long run control should be considered where there are classes of shares with different voting rights.

Circumstances of de facto control – documentary evidence and/or authorization

The statutory basis for the *de facto* control test is subsection 256(5.1) which states in part as follows:

> "For the purposes of this Act, where the expression "controlled, directly or indirectly in any manner whatever," is used, a corporation shall be considered to be so controlled by another corporation, person or group of persons (in this subsection referred to as the "controller") at any time, where, at that time, the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation …"

Paragraph (a) uses the expression "controlled, directly or indirectly in any manner whatever". Therefore, it incorporates a *de facto* control test. A private corporation which is a Canadian corporation which is *de facto* controlled by one or more disqualifying shareholders is not a CCPC.

There has been considerable commentary on the scope and applicable test for *de facto* control.[58] There is the standard laid down in *Silicon Graphics* of a "clear right and ability to effect a significant change in the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors".[59] There is a broader test which has been applied in a line of cases[60] including *Lyrtech* (discussed below in section titled "Use of Trusts") and most recently, *McGillivray Restaurant Ltd. v. The Queen*.[61] In these cases, the key factors have been operational control and economic/financial dependence. It goes without saying that all cases in this area are dependent on the particular facts. In *McGillivray*, the Tax Court of Canada attempted to reconcile the test laid down in *Silicon Graphics* and the broader influencing factors considered in subsequent cases. Patrick Boyle, J. observed that the *de jure* control analysis attempts to discern who is in effective control of the affairs and fortunes of the corporation and held that *de facto* control analysis should similarly attempt to determine who is in effective control, albeit by a factual review. Thus the door opened to other considerations and not merely factors that might effect a change in the board of directors (per *Silicon Graphics*).

General factors which CRA has listed in Interpretation Bulletin IT-64R4 as relevant in the determination of *de facto* control include:[62]

- Percentage of ownership of voting shares in relation to other shareholders
- Ownership of a large debt of the corporation
- Commercial or contractual relationships of the corporation
- Possession of special expertise needed for the corporation's business

- Influence of a family member (shareholder, creditor, supplier etc. of the corporation) over another family member who is a shareholder
- Composition of the board of directors
- Control of day to day management and operations

Corporate resolutions may illustrate delegation of authorization, signing authority and decision making. *Sociètè Foncière D'Investissement Inc. v. The Queen*[63], an informal Tax Court of Canada decision, is a rather extreme example. In this case, the board of directors (who appeared to be family members including two adult daughters who held all but 0.2% of the common shares) passed resolutions appointing Mr. Allain (who held 0.2% of common shares) as "General Manager" and providing him with the following extensive authority:

(i) purchasing, selling, exchanging, transferring or otherwise alienating any movable and immovable property of the company in such manner and for such sum of money or other consideration as he shall see fit;

(ii) borrowing any sum of money and, encumbering or mortgaging all the movable or immovable property of the company, as the case may be;

(iii) coming to an agreement, arrangement, compromise or out-of-court settlement with regard to any claim by or against the company;

(iv) signing any partial or complete discharge for any amount received by the company and accruing to it under any instrument whatever;

(v) signing any release from privileges, from mortgages created in the company's favour, with or without consideration;

(vi) signing any mortgage, with or without payment, as he shall see fit;

(vii) settling, negotiating and entering into contracts for and on behalf of the company with interested bodies, to carry out the purposes for which the company is in operation

(viii) purchasing, leasing or otherwise obtaining equipment required to carry on the company's activities;

(ix) obtaining the necessary permits or any other legal authorization required for operating the company;

(x) acting as surety.

Bowman, TCJ (as he was then) held that Mr. Allain had "complete authority to manage all aspects of the corporation's commercial and financial dealings" and found that he had *de facto* control.[64]

In contrast to a casting vote (discussed below), a shareholder could be given an express veto over specified actions or decisions. This would be a factor in *de facto* control analysis. At the 2000 APFF Conference,[65] CRA stated in response to a question that a shareholder who had veto rights in a shareholders' agreement over dissolution of the corporation; changes to the articles or bylaws; issuance of shares; or the purchase of shares in another corporation, did not necessarily have control in fact of the corporation. These were considered means of influence which together with other factors could constitute *de facto* control.

Exception in subsection 256(5.1) de facto control

The exception in subsection 256(5.1) is sometimes referred to as the "franchise exception" and thus, on its face excludes a franchise agreement from the consideration of *de facto* control. But the wording of the exception is wider. In *Brownco Inc. v. The Queen*[66], an argument was made that the exception in subsection 256(5.1) should apply to a unanimous shareholder agreement. The case involved two equal shareholders who entered into a unanimous shareholder agreement. *De facto* control was an issue because of a casting vote provision. The exception in subsection 256(5.1) reads as follows:

> " … except that where the corporation and the controller are dealing with each other at arm's length and the influence is derived from a franchise, license, lease, distribution, supply or management agreement or other similar agreement or arrangement, the main purpose of which is to govern the relationship between the corporation and the controller regarding the manner in which a business carried on by the corporation is to be conducted, the corporation shall not be considered to be controlled, directly or indirectly in any manner whatever, by the controller by reason only of that agreement or arrangement."

While the Court accepted that the particular unanimous shareholder agreement may be considered to be similar to a "management agreement" (which is provided for in the exception), the Court held that the "main purpose" of the agreement was not to deal with the manner in which the business was to be carried on but rather to govern the relationship between the two shareholders. Thus in *Brownco*, the exception in subsection 256(5.1) did not apply.

In *Kruger Wayagamack*, the unanimous shareholder agreement included a comprehensive list of decisions requiring unanimity of the shareholders. The Court applied the same test with respect to lack of strategic decision making power as in its analysis regarding *de jure* control and held that Kruger Inc. (51% shareholder) did not have *de facto* control. There was no discussion of the exception in subsection 256(5.1) and indeed, no need to refer to same given the Court's finding. However, if the main purpose of the agreement between shareholder and corporation was to govern the manner in which the business was carried on, then the exception would apply and the agreement would not be considered in the subsection 256(5.1) *de facto* control analysis. The particular unanimous shareholder agreement certainly contained much detail and scope regarding business operations so that an argument could have been posed regarding the exception in subsection 256(5.1) if need be. A further difficulty may be that the exception uses "the main purpose" language, rather than "one of the main purposes" language. In other words, while it may be viable to argue that one of the main purposes of the typical shareholders' agreement is to govern the manner in which the business of the corporation is carried on, it may not be the main purpose.

Casting Vote

A casting vote may be relevant in either a director's meeting or a shareholders' meeting. At common law, the chairman did not have a casting vote.[67] A casting vote can arise pursuant to statute, the corporation's by-laws, and a shareholders agreement including a unanimous shareholder agreement or otherwise be included in the articles of the corporation.

Paragraph 97(a), OBCA provides that the chair of a shareholders' meeting shall not have a second or casting vote, subject to the provisions of the legislation, the articles, by-laws or any unanimous shareholder agreement. This may be contrasted with section 188 of the Quebec Business Corporations Act which provides for the opposite. Specifically, under the Quebec Business Corporations Act, unless otherwise provided in the by-laws, the chair of a shareholders' meeting has a casting vote. At the 2013 APFF Conference,[68] CRA was asked whether such a casting vote gave the chair of the meeting *de facto* control of the corporation pursuant to subsection 256(5.1). The CRA's position was that section 188 of the Quebec Business Corporations Act would not automatically result in the chair of the meeting having *de facto* control.

It has long been settled that a casting vote does not give the holder *de jure* control of a corporation. The basis for this conclusion is that the casting vote is not a property right of the holder but rather a function of office, i.e., deriving from the position as the chair of the meeting.[69]

There are a number of instances where the existence of a casting vote has been a tipping factor in the *de facto* control analysis.[70] This has also been noted by CRA in *Interpretation Bulletin* IT-64R4.[71]

In CRA document number 9216045,[72] two shareholders each had an equal number of shares albeit different classes of shares with identical rights. There was a shareholders' agreement (not specified to be a unanimous shareholder agreement) under which each of the two shareholders had the right to elect an equal number of directors. The shareholders' agreement also specified that the chairman of the meeting of the board of directors would have a casting vote and that the chairman would be one of the directors elected by shareholder number two. The CRA document indicated that such shareholder would be considered to have *de facto* control pursuant to subsection 256(5.1).

Brownco[73] involved a similar situation with the same result except that it involved a unanimous shareholder agreement. The Tax Court of Canada held that the shareholder whose nominee on the board of directors had the casting vote as chairman had *de facto* control of the corporation.

Avotus might be considered an example of inadvertently falling into a *de facto* control situation by virtue of a casting vote. For the taxation years in question, Avotus (or technically its predecessor) had three shareholders. One shareholder was a non-resident and held 50% of the issued and outstanding shares. The other two shareholders were Canadian residents and each held 25% of the issued and outstanding shares. For the taxation years in question, there were two directors, one being the non-resident shareholder and other being one of the two Canadian resident shareholders. The corporation was formed by an amalgamation and the by-laws adopted at the time of amalgamation provided that the chairman of the board of directors, if present, would preside as chairman at all meetings of the directors and shareholders. The by-law also provided that the chairman would have a casting vote at any shareholders' meeting. It was argued that the casting vote provision in the by-laws was not known to the non-resident individual. The Tax Court of Canada held however that whether he was aware of such provision or not, the non-resident individual shareholder had *de facto* control of the corporation.

It is interesting to note that much of the discussion has related to the casting vote at a meeting of directors. Curiously however, it is a casting vote at a shareholders' meeting which could result in any particular director being elected (where shareholders' votes are otherwise tied).

Paragraph 251(5)(b)

Paragraph 251(5)(b) applies for purposes of the CCPC definition. It is instructive to reproduce portions of the paragraph so that the breadth of the wording can be seen:

> where at any time a person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently,
>
> (i) to, or to acquire, shares of the capital stock of a corporation or to control the voting rights of such shares, the person shall, except where the right is not exercisable at that time because the exercise thereof is contingent on the death, bankruptcy or permanent disability of an individual, be deemed to have the same position in relation to the control of the corporation as if the person owned the shares at that time;

Only subparagraph (i) is reproduced above. Subparagraphs (ii) – (iv) refer to causing a corporation to redeem or acquire shares owned by other shareholders; acquiring or controlling voting rights in respect of shares and causing the reduction of voting rights in respect of shares owned by other shareholders.

The potential application of paragraph 251(5)(b) where options or rights in respect of shares of a private corporation are granted to a disqualifying shareholder must be borne in mind. Where applicable, the disqualifying shareholder will be deemed (for purposes of the CCPC definition) to be in the same position in relation to control of the target corporation as if the disqualifying shareholder owned the shares.

- It has been CRA's longstanding administrative position that although the wording in paragraph 251(5)(b) may be broad enough to include almost any buy-sell agreement, it will not normally be applied to a right of first refusal or a shotgun arrangement.[74] CRA has resisted extension of this administrative position.[75]
- The application of paragraph 251(5)(b) to put rights in respect of which there may or may not be a matching call option, is not clear. Some commentators have stated that paragraph 251(5)(b) is applicable.[76]

CRA has suggested that paragraph 251(5)(b) could apply to a partner of a partnership which holds shares of a corporation, where the terms of the partnership agreement provide that the partner has a right to receive a portion of the shares upon partnership dissolution.[77] This obviously depends on the terms of the agreement. A dissolution clause often does not provide for the distribution of specific property of the trust to partners but rather, following the payment of debts and liabilities and establishment of reserves necessary to satisfy contingent liabilities, the balance of the partnership property (which may be in cash or in kind) may be distributed to the partners.

Power of Attorney and Proxy

A Power of Attorney or proxy cannot effect *de jure* control of a corporation as neither is a constating document.[78] However, by virtue of paragraph 251(5)(b), these documents are relevant in the determination of CCPC status. Arguably, they should also be taken into account in *de facto* control analysis.

In CRA document number 9814370,[79] CRA stated its position with respect to an enduring Power of Attorney which is unrestricted and can be exercised at any time. The CRA document related to a Power of Attorney for Property granted under the Ontario Substitute Decisions Act, 1992.[80] CRA's stated position was that the attorney under such a Power of Attorney had the right to control the voting rights of shares owned by the grantor even if no voting powers were in fact exercised. Therefore, subparagraph 251(5)(b)(i) and paragraph 256(1.4)(a) applied. As a result, if the attorney is a non-resident, CCPC status may be affected pursuant to subparagraph 251(5)(b)(i) depending on the grantor's position and rights with respect to any particular private corporation.

There is an exemption from subparagraph 251(5)(b)(i) and paragraph 256(1.4) if the exercise of the right is contingent on death, bankruptcy or permanent disability. However, there is no definition of the term "permanent disability" in the legislation. Sometimes a Power of Attorney granted for estate planning reasons might spring into effect upon the grantor's disability or other ill health. In the absence of a definition or parameters for the phrase "permanent disability", it is questionable whether such a "springing" Power of Attorney will necessarily fit within the exemption from subparagraph 251(5)(b)(i) or paragraph 256(1.4)(a).

Under the OBCA, a shareholder may appoint a proxy as his or her nominee to attend and act at a shareholders meeting "in the manner, to the extent and with the authority conferred by the proxy".[81] The document appointing a proxy is effectively a contract of agency. It is questionable whether an irrevocable proxy can be granted in Canada.[82] This is also supported by the requirements for a proxy pursuant to the regulations under the OBCA.[83] The form of proxy must indicate "the meeting at which it is to be used" which arguably implies that the proxy is granted on a meeting by meeting basis.

In *Ekamant Canada Inc. v. The Queen*[84], the corporation had four shareholders, each of whom held 25% of the issued and outstanding shares. One shareholder was a Canadian resident, Mr. Cotè. The three remaining shareholders were a father and his two adult children, all of whom were U.S. residents. The issue was the CCPC status of Ekamant Canada Inc. Mr. Cotè (the Canadian resident) argued that he had an option to acquire all of the shares held by the other three shareholders but this argument failed as there was no evidence to support his position.

The two non-resident children had granted their father an irrevocable Power of Attorney (the term proxy was also used in the document). Under such irrevocable Power of Attorney, the children appointed their father to attend and vote for them at any special and annual general meeting of the shareholders including the right to vote for the election of directors, to appoint auditors and to fix the remuneration of auditors and otherwise granted the attorney discretion with respect to amendments of any matters identified at a notice of meeting of shareholders. Later, the father granted Mr. Cotè a proxy. Although this document was in virtually identical language to the Power of Attorney granted by the two children to their father, the judgement referred to it as a proxy.

The Court noted that pursuant to Paragraph (b) of the CCPC definition, the particular corporation was not a CCPC. There was no discussion of paragraph 251(5)(b).

If paragraph 251(5)(b) had been applied to the Power of Attorney granted by the children to their father, the corporation would be considered controlled by the non-resident father for purposes of the CCPC definition . While the father granted a proxy to Mr. Cotè which might fall within paragraph 251(5)(b), such proxy could only apply to the shares owned by the non-resident father. Therefore, Mr. Cotè would have had the right to vote only 50% of the issued and outstanding shares (being the shares owned by him and the shares owned by the father). Although there is no discussion of same in the judgement, it is submitted that the father could not as a matter of law have sub-delegated his rights as attorney to vote his children's shares (which right was granted to him by virtue of Power of Attorney). In the above analysis, there seem to be competing applications of paragraph 251(5)(b) leading in the one case to control by father (non-resident) and in the other case to control of 50% of the votes by Mr. Cotè (meaning no control by the non-resident). CRA has been of the view that paragraph 251(5)(b) can be applied selectively on a holder-by-holder basis and that the statements of the Federal Court of Appeal in *Sedona Networks* on the application of paragraph 251(5)(b) were *obiter.*[85] Thus in the above situation, CRA might argue that the non-resident father was deemed to be in control of the corporation by virtue of paragraph 251(5)(b).

Use of Trusts

According to *Duha*, where a trust holds shares of a corporation, it is permissible to examine the trust agreement to determine the limitations, if any, on the power of the trustees to vote the shares. Although the trust agreement or trust deed would be considered an external document rather than a constating document of the corporation, Iaccobucci, J. considered the trust and trustees to be unique. Fiduciary obligations are imposed upon the trustees and this, in and of itself, imposes limitations on the trustees. This was contrasted with the case of a shareholder freely agreeing to a limitation in an external document.

Based on *Minister of National Revenue v. Consolidated Holding Co.*,[86] it is generally considered that where a majority of the voting shares of a corporation are held by a trust, it is the trustees who exercise *de jure* control as they have the right to vote the shares. A review of the trust agreement may show that the trustees are required are required to act by unanimity or majority or otherwise. This will determine the group that exercises control. It has been CRA's administrative position for many years that in the absence of evidence to the contrary, all of the trustees of a trust are presumed to constitute a group of persons.[87]

In CRA document number 2013-0494981E5 (Fr.),[88] CRA confirmed its administrative position that where a trust holds all of the issued and outstanding common shares, it is the trustees of the i*nter vivos* trust which have de jure control. CRA did not change its position when advised that the sole beneficiary had the power to remove trustees and appoint new trustees. Paragraph 251(5)(b) was apparently not discussed. Nonetheless, based on *Campbell v. The Queen*,[89] and *Lusita Holdings Ltd. v. The Queen*[90], the ability to remove and appoint trustees should not be considered a subparagraph 251(5)(b)(i) right to control the votes held by the trust. This may be contrasted with the decision in *Hudson's Investment Company (London) Ltd. v. Minister of National Revenue*[91] involving a voting trust for shares owned by minors. The voting trust agreement required the voting trustee to act on the advice and opinion of RS; failure to do so meant that the voting trustee had to resign and a new voting trustee would be appointed. RS was held to have a right under contract pursuant to former paragraph 139(5d)(b) (similar to the current subparagraph 251(5)(b)(i)) in respect of the shares in the voting trust.

There have been two reported cases (*Lyrtech RD Inc. v. The Queen*[92] and *Solutions Mindready R & D Inc. v. The Queen*[93]) in which CRA has challenged the CCPC status of a corporation whose voting shares were held by an *inter vivos* trust. In each case, the corporation sought to benefit from the enhanced investment tax credit in subsection 127(10.1) and the refundable investment tax credit in section 127.1. In each case, the corporation was held to not be a CCPC on the basis of *de facto* control by the public corporation which had established the trust.[94]

In *Lyrtech*, a public company settled a discretionary *inter vivos* trust. The trust was the sole shareholder of Lyrtech RD Inc. Under the terms of the trust agreement, the income beneficiaries were the public company and two named subsidiaries while the capital beneficiaries were three named subsidiaries of the public company (two of which were also income beneficiaries). The Trustees of the trust were required to be directors of the public company and it was mandated that the number of Trustees could not be greater than the number of directors of the public company. For the taxation years in question, there were three and later two Trustees, all of whom were directors of the public company and of the underlying subsidiaries. There was a unanimous shareholder declaration as permitted by subsection 146(2) of the CBCA pursuant to which all of the powers of the directors were withdrawn to the *inter vivos* trust as sole shareholder.

The public company transferred all of its R & D assets (except intellectual property) to the corporation in question at fair market value.

The relationship between the appellant and the public company included the following:

- The appellant occupied the same premises as the public company.
- There was no written lease and no rental payments were made by the appellant.
- The officers of the appellant and the public company were the same. Some of the employees of the appellant were also employees of the public company.
- It appeared that no amounts were invoiced by the appellant to the public company although there was movement of funds between the two corporations.

The Tax Court of Canada held that the public company exercised a dominant economic influence over the appellant and it had *de facto* control. This was confirmed by the Federal Court of Appeal.

CRA also argued that the capital beneficiaries of the trust had a right pursuant to paragraph 251(5)(b) so that they should be considered to own the shares of the appellant. The Tax Court rejected this argument on the basis that the nature of the interest of the capital beneficiaries was "too aleatory, uncertain or indirect to be a right to the appellant shares under paragraph 251(5)(b).[95] Previously, CRA's administrative position had been that where shares of a corporation are owned by a trust, paragraph 251(5)(b) would apply where the beneficiaries have an “absolute, though not necessarily immediate right to the shares” under the terms of the trust and further would not generally be applied to a discretionary trust.[96]

In the context of trust ownership of shares and CCPC status, reference should also be made to a recent Ontario rectification case, *Kaleidescape Canada Inc. v. Computershare*.[97] Kaleidescape Canada Inc. (“K-Can”) successfully sought rectification of a Deed of Trust to delete one paragraph. K-Can was a research and development company. Prior to 2006, the shares of K-Can were owned by Mr. Collens, a Canadian citizen residing in Ontario and by Kaleidescape Inc. (“K-US”), a Delaware company. The voting shares of K-Can were split equally between Mr. Collens and K-US. When Mr. Collens announced his intention to leave employment of K-Can in 2006, the Kaleidescape Canada Employment Trust was created. A new class of voting shares, Class C special voting shares, were created and subscribed to by the trust. The Class B voting shares held by Mr. Collens were purchased for cancellation. Thus, steps were taken to maintain equal voting rights between K-US (100 voting shares) and the Trust (100 Class C special voting shares). The two original trustees of the trust later resigned and were replaced by an institutional trustee, Computershare. The new institutional trustee required a restated and amended deed of trust, one term of which stated:

> “Where this deed of trust requires or authorizes the settlor to give directions to the trustee, the trustee shall accept only a direction in writing from the CEO or president of the settlor.”

Both the CEO and President of the settlor were non-residents of Canada. Based on the foregoing provision, CRA reassessed K-Can on the basis that it was not a CCPC. Reference was made to the judgement of Iacobucci, J. in *Duha* wherein he indicated that for purposes of *de jure* control, a trust document could be reviewed and if the trust document imposed limitations upon the capacity of the trust to vote shares, then these must be taken into account. Because of the foregoing provision of the Trust Agreement, CRA considered that K-US had the ability to control the election of the board of directors of K-Can and accordingly took the position that K-Can was not a CCPC. On the basis of affidavit evidence in support of the rectification by officers of K-Can and the professional advisers involved in the establishment of the structure, the rectification order was granted. *Kaleidescape* illustrates the discerning eye with which trust agreements have been reviewed where ownership of a majority of voting shares have been placed in a trust. There seem to be overtones of the control concerns where subsection 75(2), the so-called reversionary trust rule, is a potential issue.

Closing Comments

This paper has reviewed the CCPC definition and commented on documents and circumstances where factors relevant to either or both of *de jure* control and *de facto* control may be found. Recent cases have elaborated on the meaning of effective control and seemingly made it possible that a corporation with a majority of its voting shares held by non-residents (or other disqualifying shareholders) may retain CCPC status with an appropriately drafted unanimous shareholder agreement. Although it is the unanimous shareholder agreement that usually comes to mind in terms of documents (other than the articles) which may affect the authority of directors to govern the business and affairs of a corporation, there are other constating documents such as the amalgamation agreement and bylaw which should also be reviewed where necessary. *De facto* control analysis is not, of course, limited to constating documents and recent cases have supported consideration of broader factors of operational control rather than a limitation to factors with effect on director election.

All of the above is important where CCPC status is desirable.

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[1] R.S.C. 1985, c.1 (5th Supp.) as amended, hereinafter referred to as the Act. Unless otherwise stated, statutory references in this paper are to the Act.

[2] There is substantial literature discussing the listed incentives. For example, reference may be made to the following papers: Jeffrey R. Foreman, "Selected Tax Aspects Related to Canadian-Controlled Private Corporations", *2006 British Columbia Tax Conference* (Vancouver: Canadian Tax Foundation, 2006) 19:1-31; Catherine Brayley and Peter Jovicic, "Maintaining Tax Effective Status", *2007 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2007) 7:1-27

[3] For a detailed discussion of the consequences, see John Granelli, "Getting a Handle on GRIP", *Tax Topics* no. 2252 (Toronto: Wolters Kluwer, May 7, 2015).

[4] This paper will not discuss the anomalies which initially arose from the interaction of the deemed year end rule in subsection 249(3.1), the election in subsection 256(9) and *La Survivance v. The Queen* 2006 FCA 129. For details, see e.g., David Louis, "Parallel Universe: La Survivance and the Capital Gains Exemption", *Tax Topics* no. 1881, (Toronto: Wolters Kluwer, March 27, 2008). Subsection 256(9) was amended by S.C. 2009, c.2. s.78(2)

applicable in respect of an acquisition of control of a corporation that occurs after 2005 such that subsection 256(9) does not apply for purposes of determining if a corporation is a CCPC. See Joan E. Jung, "The 'Sign and Close' – Deemed Year End Rules", Ontario Bar Association Taxation Section Newsletter, vol. 23, no. 1, October 2012.

5 S.C. 1980-81-82-83, c.48.

6 2002 FCA 260 reversing 2001 DTC 379 (TCC) ("*Silicon Graphics*").

7 A discussion of corporate residence is beyond the scope of this paper. See subsection 250(4) which deems a corporation incorporated in Canada after April 26, 1965 to be resident in Canada. A corporation may also be resident in Canada under the common law test of central management and control.

8 See *Income Tax Technical News*, no. 25, October 30, 2002 where CRA stated that it accepted the result in *Silicon Graphics*, although in the context of the CCPC definition, the appellate decision was of historical interest only in light of Paragraph (b).

9 Both Paragraph (c) and the definition of public corporation in subsection 89(1) were amended to replace "prescribed stock exchange" with "designated stock exchange" by S.C 2007, c.35, applicable on and after December 14, 2007.

10 2007 FCA 169 ("*Sedona Networks*").

11 *Sedona Networks*, *ibid*, at paragraph 7.

12 67 DTC 5283 (SCC).

13 See *Interpretation Bulletin* IT-64R4 (Consolidated), "Corporations: Association and Control," October 13, 2004, at paragraph 17 under the heading, "Indirect Control":

> 17. It is possible for a person to have *de jure* control over a corporation without ownership of any of its shares if that person controls one or more other corporations which, singly or among them, have voting control of the first-mentioned corporation. For example, if Y controls Corporation A which in turn controls Corporation B, then Y also controls Corporation B. Similarly, if Corporation P controls Corporations M and N which, between them, own more than 50 per cent of the voting shares of Corporation X, then Corporation P controls Corporation X, and all four of the corporations are associated with each other. See *Vineland Quarries and Crushed Stone Limited v. MNR,* 66 DTC. 5092 [1966] CTC. 69 (affirmed from the bench without written reasons by the Supreme Court of Canada, 67 DTC. 5283).

14 The argument was made that the agreement restricted the power of the directors of BMCC to manage its business and affairs. See *Sedona Networks*, *supra* footnote 10, at paragraph 17, for a description of some terms which the taxpayer argued were a restriction on the powers of the board of directors sufficient to satisfy the requirements of a unanimous shareholder agreement under section 146, CBCA. The Federal Court of Appeal did not agree. But notably,

the sole shareholder of BMCC was not a party to the agreement. It appeared that an argument was made that it was a party on the basis of agency.

[15] 2006 TCC 80, at paragraphs 13 and 18-19.

[16] *Sedona Networks*, *supra* footnote 10, at paragraph 28.

[17] [1965] 1 Ex. C.R. 299 (Ex. Ct), at paragraph 10 ("*Buckerfield's*"). It is interesting to note that the decision in *Buckerfield's* arguably turned more on the interpretation of "group of persons" than the concept of control. Other than the frequently cited passage reproduced in this paper, there was little discussion or analysis of control. The issue in *Buckerfield's* was whether two corporations with the same 50:50 shareholders were associated corporations. Neither shareholder alone had control. There was a written agreement under which the two shareholders agreed that they would have "an equal voice … in the control and operation of Buckerfield's" (see paragraph 5); each was entitled to nominate 50% of the board of directors and management of Buckerfield's was to be acceptable to both parties. See also Robert Couzin, "Some Reflections on Corporate Control," (2005), vol. 53, no. 2 *Canadian Tax Journal*, 305-332 at p.309 for insightful contextual comments regarding the oft-cited passage.

[18] [1998] 1 SCR 795 ("*Duha*").

[19] *Duha*, *ibid*, at paragraph 36.

[20] *British American Tobacco Co. v. Inland Revenue Commissioners* (1942), [1943] 1 All E.R. 13 (H.L.), at p. 15.

[21] *Duha*, *supra* footnote 18, at paragraph 37.

[22] 2015 TCC 90("*Kruger Wayagamack*"). Notice of Appeal to the Federal Court of Appeal filed April 2015 (File A-223-15).

[23] *Kruger Wayagamack*, *ibid*, at paragraphs 22-24.

[24] 2004 TCC 734 affirmed 2006 FCA 113 ("*Plomberie Langlois*")

[25] *Plomberie Langlois* TCC, *ibid*, at paragraph 39. The definition was sourced from G. Cornu, dir. *Vocabulairejuridique*, 2d. ed. (Paris: Presses universitaires de France, 1990).

[26] *Kruger Wayagamack*, *supra* footnote 22, at paragraph 28.

[27] *Duha*, *supra* footnote 18, at paragraph 85.

[28] R.S.O. 1990, c B.16 as amended ("OBCA").

[29] In *Duha*, the taxpayer was governed by the Manitoba business corporations statute, Corporations Act, R.S.M. 1987, c.C225, pursuant to subsection 140(6) of which, notice of the unanimous shareholder agreement was required to be filed in the public registry. It was not

filed. The failure to file was only raised in connection with a sham argument made in the Federal Court of Appeal ([1996] 3 FC 78, at paragraph 23) and otherwise did not factor in the *de jure* control analysis.

[30] 2015 TCC 143. See also *Ekamant*, *infra* footnote 84, where the Court looked at the irrevocable Power of Attorney granted by the children to the father and the proxy granted by the father to Mr. Cotè and considered whether these documents on a combined basis might constitute a unanimous shareholder agreement. In this respect, the answer was no because Mr. Cotè was not a signatory to any of the documents. In other words, the documents (even on a combined basis) were not signed by all shareholders.

[31] R.S.C. 1985, c. C-44 as amended ("CBCA").

[32] 2013 FCA 164 affirming 2012 TCC 120 ("*Bagtech*")

[33] See Manu Kakkar, Nathan Wright, and Martin Barsalou, "Current Issues Forum," *2014 Ontario Tax Conference*, (Toronto: Canadian Tax Foundation, 2014), 1: 1-18, at p.17-18.

[34] This was also the position taken by CRA in CRA document no. 2009-0314351I7, January 7, 2010. See the critical analysis by Paul Lamarre, "*Unanimous Shareholder Agreements and CCPC Status*", Ontario Bar Association Taxation Law Section Newsletter, vol. 21, no.1, October 2010. See also CRA document no. 2010-0379351I7, December 14, 2010 and CRA document no. NV91_134.136, November 15, 1991.

[35] See for example the following business corporations statutes.

Yukon	paragraph 148(1)(a), *Business Corporations Act*, R.S.Y. 2002, c.20
Alberta	paragraph 146(1)(a), *Business Corporations Act*, R.S.A. 2000, c.B-9
Newfoundland	paragraph 245(1)(a), *Corporations Act*, R.S.N. 1990, c.C-36
Nunavut	paragraph 148(1)(a), *Business Corporations Act*, S.N.W.T. 1996, c.19

[36] See CRA document no. 2008-0265902I7 (relevant portion translated in *Bagtech* TCC, *supra* footnote 32, at paragraph 27) and *Income Tax Technical News*, no. 44, April 14, 2011.

[37] *Bagtech* FCA, *supra* footnote 32, at paragraph 17.

[38] See CRA document no. 2014-0523301C6, May 6, 2014. The critical portion of the reply is reproduced below.

> The interpretation that the CRA had given to the *Duha* case in the documents referred to above cannot be reconciled with the interpretation of that case by the

Courts in *Bagtech*. In determining if a shareholder has *de jure* control, the CRA will adopt the views of the Court in *Bagtech* where appropriate in determining which shareholder or group of shareholders has "effective control" (paragraph 36 of the *Duha* case) or "long run" control (*Donald Applicators Ltd. et al v. MNR*, [1969] C.T.C. 98 69 D.T.C. 5122) of the corporation in light of the applicable provisions of the Act. The CRA will also consider the existence of avoidance transactions that might result in a misuse or abuse having regard to the provisions of the Act for purposes of applying subsection 245(2).

39 See *Duha*, *supra* footnote 18, at paragraph 83.

40 See *Bagtech*, *supra* footnote 32. A portion of the unanimous shareholder agreement is reproduced in Appendix 1 to the Tax Court of Canada decision. Appendix 3 is a list of the provisions in the unanimous shareholder agreement that expressly limit the power of the directors.

41 March 18, 2007.

42 A special resolution of shareholders is required for a change in the number of directors (paragraph 168(1)(m), OBCA); amendment to the articles (subsection 168(1), OBCA); approval of a sale of all or substantially all of the business and undertaking (subsection 184(3), OBCA) and approval for dissolution of the corporation (paragraph 237(a), OBCA).

43 See CRA document no. 2009-0314351I7, *supra* footnote 34 which predated *Bagtech* where CRA severed the agreement and stated that only those provisions which restrict or modify the provisions of the OBCA (i.e., provisions which include the words "subject to any unanimous shareholder agreement") were relevant to *de jure* control analysis. There was a comprehensive description of the terms of a unanimous shareholder agreement which included a significant number of items requiring unanimous shareholder approval, some of which seem similar to those in *Kruger Wayagamack*. Curiously, the only provisions which were considered to interfere with the directors' managerial powers (and which were therefore considered by CRA in its *de jure* control analysis) were the ability of a named shareholder to demand retraction of its shares (apparently common shares) and the ability of the same named shareholder to prevent the corporation from entering into contracts with affiliated entities.

44 See section 177, OBCA. A short-form amalgamation may be available for the amalgamation of a parent and subsidiary, or the amalgamation of sister corporations.

45 Subsection 175(1), OBCA reads as follows:

> Where corporations propose to amalgamate, each such corporation shall enter into an agreement setting out the terms and means of effecting the amalgamation and, in particular, setting out,
>
> (a) the provisions that are required to be included in articles of Incorporation under section 5;
>
> (b) subject to subsection (2), the basis upon which and manner in which the holders of the issued shares of each amalgamating corporation are to receive,
>
> (i) securities of the amalgamated corporation,
>
> (ii) money, or
>
> (iii) securities of anybody corporate other than the amalgamated corporation, in the amalgamation;
>
> (c) the manner of payment of money instead of the issue of fractional shares of the amalgamated corporation or of any other body corporate the securities of which are to be received in the amalgamation;
>
> (d) whether the by-laws of the amalgamated corporation are to be those of one of the amalgamating corporations and the address where a copy of the proposed by-laws may be examined; and
>
> (e) such other details as may be necessary to perfect the amalgamation and to provide for the subsequent management and operation of the amalgamated corporation.

See also subsection 182(1), CBCA.

[46] 207 DTC 215 (TCC) ("*Avotus*").

[47] *Avotus*, *ibid*, at paragraph 73.

[48] MDR Telemanagement Ltd., Intelligent Computing Devices Limited and T.C. Networking Ltd. amalgamated by Articles of Amalgamation dated May 1, 1994 to continue as MDR Telemanagement Ltd. (Ontario Corporation Number 1079147).

[49] See section 119, OBCA.

[50] Presumably in the "Other Provisions" section of Form 1, Articles of Incorporation as prescribed under the OBCA.

[51] See also subsection 106(6), CBCA.

[52] 90 DTC 6390 (FCTD) ("*International Mercantile*"). Appeal to the Federal Court of Appeal was dismissed without reasons 94 DTC 6365.

[53] [1969] 2 Ex. C.R. 43 (Exch. Ct.), affirmed 71 DTC 5202 (SCC) ("*Donald Applicators*").

[54] *Donald Applicators* Exchequer Court, *ibid*, at paragraph 13. The appellant corporations were incorporated in Alberta under the Companies Act, R.S.A. 1955, c.53 which was the older style of corporate statute (modelled after English law) prevalent in Canada before the modernization of business corporations statutes in the 1970's. The companies were incorporated by articles and memorandum of association which together comprised today's Articles of Incorporation and general by-law. Thurlow, J. noted that article 55 of Table A of the First Schedule to the Companies Act (which had been adopted as the articles of association) could be amended by the voting power of the holder of the Class B shares, reducing directors to "the status of errand boys" (at paragraph 11). Article 55 provided for the general authority of the directors to manage the business of the company as follows:

> 55. The business of the Company shall be managed by the directors, who may pay all expenses incurred in getting up and registering the Company, and may exercise all such powers of the Company as are not, by *The Companies Act* , or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the Company in general meeting, subject nevertheless to any regulation of these articles, to the provisions of the said Act, and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by ordinary resolution, whether previous notice thereof has been given or not; but no regulations made by ordinary resolution shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

The reference to reducing directors to "errand boys" and other comments in the judgement to the effect of directors being "shorn of authority to make decisions binding upon the company" are precursors to the unanimous shareholder agreement/effective control analysis.

[55] 2012. See also Mickey Sarazin, "The Income Tax Rulings Directorate and Its Interaction with Practitioners," *Report of Proceedings of the Sixty-Fourth Tax Conferenc*e, 2012 Conference Report (Toronto: Canadian Tax Foundation, 2013), 5:1-17 at p.5:15.

[56] It appeared that the applicable corporate statute in the ruling was the CBCA given its inclusion in the definitions, but no details were provided of the corporate steps by which the Class A shares could effectively be eliminated. Under the CBCA, directors are removed by ordinary resolution of the shareholders (section 109, CBCA) and are elected by ordinary resolution (section 106(3), CBCA). An ordinary resolution is a resolution passed by a majority of the votes cast by shareholders who votes in respect of the resolution (see definition in subsection

2(1), CBCA). Pursuant to paragraph 173(1)(h), CBCA, the articles of a corporation may be amended to change the shares of a class into a different number of shares of the same class. While holders of a class of shares are entitled to a separate class vote on a proposal to amend the articles to effect an exchange, reclassification or cancellation of all or part of such class pursuant to paragraph 176(1)(b), CBCA, this particular separate class vote can be expressly eliminated in the articles.. Parent did not hold more than 50% of the Class A shares and could not ensure the passing of a separate Class A vote. But Parent held sufficient Class A and Class B shares so that it could pass a special resolution. Although it is conjecture, perhaps the rights of the Class A shares of Lossco were restricted in the articles so that a separate class vote of the Class A shareholders was not required. If so, Parent could pass a special resolution to amend the articles and provide for the exchange (i.e., consolidate the Class A shares using a sufficiently high consolidation ratio leaving holders with fractional shares) and cancellation of the Class A shares. Presumably such articles would also amend the terms and conditions of the Class B shares so that they could thereafter vote on the election of directors.

[57] *Kruger Wayagamack*, *supra* footnote 22, at paragraph 69.

[58] See e.g., Brian Studniberg and Joel Nitikman, “De Facto Control: Do We Know What it Means – Yet? Part I and Part II”, *Tax Topics* nos. 2244 and 2245 (Toronto: Wolters Kluwer, March 12and 19, 2015); and Philip Friedlan, "De Facto Control: Meaning, Implications and Planning under Subsection 256(5.1) of the Income Tax Act," *2010 Ontario Tax Conference*, (Toronto: Canadian Tax Foundation, 2010), 4:1-21.

[59] *Silicon Graphics*, *supra* footnote 6, at paragraph 67.

[60] See *Mimetix Pharmaceuticals Inc. v. The Queen* 2001 DTC 1026 (TCC) affirmed 2003 FCA 106; *Transport M.L. Couture Inc. v. The Queen* 2003 DTC 817 (TCC) affirmed 2004 FCA 23; *Corpor-Air Inc. v. The Queen* 2006 TCC 75; *Taber Solids Control (1998) Ltd. v. The Queen* 2009 DTC 1343 (TCC).

[61] 2014 TCC 357 (“*McGillivray*”). Appeal to Federal Court of Appeal filed December 2014 (File A-571-14).

[62] *Interpretation Bulletin* IT-64R4, *supra* footnote 13, at paragraph 23.

[63] 1995 CarswellNat 1504, [1996] 3 C.T.C. 2537. Mr. Allain was previously the sole shareholder and had transferred all but 0.2% of the shares to his two daughters many years prior to the taxation years in issue.

[64] As a harbinger of subsequent cases, Bowman, TCJ (as he was then) stated, at paragraphs 9-10:

> Since these decisions, other words have been added for the clear purpose of broadening the concept of control, in particular the words "directly or indirectly in any manner whatever". So far as I know, the point has not been decided, but I would have thought that it could reasonably be argued that these words necessarily include the idea of *de facto* control of a corporation in the case of a person who does not hold more than 50 per cent of the shares but has a controlling influence, whether economic, contractual or moral, over a corporation's affairs. It is hard to imagine words with a broader meaning.
>
> Apparently, the Parliament of Canada feared that the words "directly or indirectly in any manner whatever" did not go far enough. (It therefore tried to reinforce their effect by means of paragraph 256(5.1).

[65] CRA document no. 2000-0038085, October 6, 2000.

[66] 2008 TCC 58 (TCC) ("*Brownco*")

[67] Hartley R. Nathan, Q.C., *Nathan's Company Meetings,* 10th edition (Toronto: Wolters Kluwer, 2013), p.39.

[68] CRA document no.2013-0495811C6, October 11, 2013 (French only). See summary in *CRA Views in Focus* (December 4, 2013).

[69] *Alpine Drywall & Decorating Ltd. v. Minister of National Revenue*, [1967] SCR 233, at paragraph 16 citing Thurlow, J. in the Exchequer Court decision of *Aaron's (Prince Albert) Ltd. v. Minister of National Revenue*, [1967] 1 Ex. C.R. 21, at paragraph 39 ("*Aaron's*"). The Supreme Court of Canada decision was a combined appeal of five cases including *Aaron's*. It is curious that in the Exchequer Court, although Thurlow, J. stated: " … the casting vote, unlike the votes arising from shareholding, which are exercisable without responsibility to the company to other shareholders, is, in my opinion, not the property of the holder, but is an adjunct of an office", he also stated that "it is not necessary for me to reach a concluded opinion on the question". There was no evidence in the corporate records that the particular individual had been elected as the chairman of the board of directors. Hall, J. in the Supreme

Court of Canada stated his agreement with the above reproduced statement about the casting vote being an “adjunct of office” with no reference to Thurlow, J.’s finding that the individual had not been elected as chairperson.

[70] Lack of a casting vote was a factor in *Multiview Inc. v. The Queen* 1977 CarswellNat 1052 (TCC) and *Lenester Sales Ltd. v. The Queen* 2003 TCC 531 affirmed 2004 FCA 217. This was a franchise case and the exception in subsection 256(5.1) was also found applicable.

[71] *Interpretation Bulletin* IT-64R4, *supra* footnote 13, at paragraph 16.

[72] August 12, 1992.

[73] *Brownco*, supra footnote 66.

[74] See *Interpretation Bulletin* IT-419R2, “Meaning of Arm’s Length”, June 8, 2004 at paragraph 17 and Income Tax Folio S1-F5-C1, “Related Persons and Dealing at Arm’s Length”, June 8, 2015 at paragraph 1.28. There is a similar statement with respect to subsection 256(1.4) which is similarly worded in *Interpretation Bulletin* IT-64R4, *supra* footnote 13, at paragraph 37. See also CRA document no. 900285, May 28, 1990 in which CRA indicated that a pre-emptive right granted to all shareholders in a shareholders agreement to subscribe for their proportionate share of all future share offerings by the corporation would not generally be considered a paragraph 251(5)(b) right.

[75] See CRA document no. 2007-024321, October 5, 2007 which describes a “non-standard” shotgun provision. See also the discussion by the author of the history of CRA’s administrative position in Joan E. Jung, "Shareholders Agreements: Selected Tax Issues," *2005 Ontario Tax Conference*, (Toronto: Canadian Tax Foundation, 2005), 8B:1-59, at p.8B:36/36; and Gord Squire and Marissa Halil, "Shareholder Agreements - Selected Tax Issues," *2005 Prairie Provinces Tax Conference*, (Toronto: Canadian Tax Foundation, 2005), 7:1-28 at p.7:6 for discussion of paragraph 251(5)(b) to various shareholder agreement provisions.

[76] See Evelyn R. Schusheim, "Shareholders' Agreements," *2012 Ontario Tax Conference*, (Toronto: Canadian Tax Foundation, 2012), 12: 1-23 at p. 12:6/7/8 but see Gord Squire and Marissa Halil, "Shareholder Agreements - Selected Tax Issues," *2005 Prairie Provinces Tax Conference*, (Toronto: Canadian Tax Foundation, 2005), 7:1-28 at p.7:7 citing CRA document no. 900351, April 30, 1990 (which seems to be the same as CRA document no. ACC9132, April 30, 1990). This CRA document referred to the then version of *Interpretation Bulletin* IT-64R2 (note version was 64R2). Paragraph 30 of that version (IT-64R2) stated: “… it is the

Department's practice not to apply this paragraph unless both (or all) parties clearly have either a right or an obligation to buy or sell, as the case may be." This wording no longer appears in *Interpretation Bulletin* IT-64R4, paragraph 37 or *Interpretation Bulletin* IT-419R2, paragraph 17, *supra* footnote 74. Note that in CRA document no. 9407695, April 19, 1994, CRA stated that a put option is an "obligation to purchase the shares" in the context of a question regarding the "guarantee arrangement" rule in subsection 112(2.2).

[77] See CRA document no. 2009-0329941C6, October 9, 2009.

[78] This was confirmed in CRA document no. 2012-0454111C6 (Fr), October 5, 2012.

[79] June 12, 1998. See also the following similar CRA responses addressing an enduring Power of Attorney under Alberta legislation: CRA document no. 9623675, October 17, 1996, and CRA document no. 9726535, November 26, 1997.

[80] S.O. 1992, c.30.

[81] See section 110, OBCA.

[82] See Hartley R. Nathan, Q.C. and Mihkel E. Voore, "*Corporate Meetings – Law and Practice*", (Toronto: Thomson Reuters, 2013) vol.1, p.18-69. By analogy, it should be noted that there is a statutorily prescribed one year termination of a proxy granted by the shareholder of an offering corporation pursuant to subsection 110(2.1), OBCA.

[83] See Regulation 29, O. Reg. 62 under the OBCA.

[84] 2009 TCC 408.

[85] See CRA document no. 2011-0426411C6, November 29, 2011 and CRA document no. 2007-0253591I7, March 18, 2008.

[86] [1974] SCR 419.

[87] See CRA document no. 2004-087761E5, May 24 2005.

[88] May 1, 2014. See summary in *CRA Views in Focus* (May 21, 2014) and *The Estate Planner* no. 234 (Toronto: Wolters Kluwer, July 2014).

[89] 1999 CarswellNat 186 (TCC).

[90] [1983] 1 FC 493 (FCTD) confirmed 84 DTC 6346 (FCA).

[91] 68 DTC 83 (TAB).

[92] 2013 TCC 12 affirmed 2014 FCA 267 ("Lyrtech"). Application for leave to appeal to the SCC was dismissed on July 9 2015.

[93] 2015 TCC 17.

[94] In its March 26, 2015 provincial budget, Quebec has proposed changes to its provincial taxation legislation apparently aimed at structures similar to those in *Lyrtech*. For purposes of the various incentives under provincial legislation, a trust will be deemed to be a corporation whose voting shares are held by the beneficiaries of the trust proportionate to the fair market value of their interest in the trust. This seems analogous to paragraph 256(1.2)(f) which is part of the comprehensive associated corporation rules.

[95] *Lyrtech* TCC, supra footnote 92, at paragraph 55.

[96] See CRA document no. 2m01530, July 29, 1992 and in particular question 24 therein. This may be contrasted with CRA document no. 9235395, January 12, 1993 where paragraph 251(5)(b) was stated to apply in circumstances where a widow was the sole beneficiary under the Will of her late husband. See also CRA document no. 2009-0329941C6, October 9, 2009 which referred to an "absolute right as a capital beneficiary (provided under a trust agreement" to eventually receive shares of the capital stock of a corporation held by the trust".

[97] 2014 ONSC 4983 ("*Kaleisdescape*").