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Quarterly legal newsletter intended for accounting, management, and finance professionals

Contents

QUEBEC MODERNIZES ITS CORPORATE LAW

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Bill 63 – The *Business Corporations Act* was tabled before the National Assembly on October 7, 2009 and assented to on December 4, 2009. It will come into force on a date to be set by the government of Quebec. For the time being, the ministère des Finances expects the new provisions to take effect in January 2011. This bill makes important, and awaited for, changes to the substantive law governing companies incorporated under Quebec law.

The amendments are aimed in part at harmonizing Quebec law with federal law (the *Canada Business Corporations Act*) and the laws in force in other provinces. However, the Quebec legislator was careful to preserve certain advantages in the new statute from the existing statute, while innovating in other respects.

The following paragraphs summarily outline some of the elements of the new *Business Corporations Act* (the "Act"):

Harmonization with other business corporations acts

- Ability to continue a Quebec corporation under a foreign business corporations act and vice versa (import and export of corporations)
- Elimination of restrictions on granting financial assistance to shareholders
- Remedies provided for minority shareholders
- Ability to revive a dissolved corporation
- Elimination of directors' personal liability for a dissolved corporation's debts
- Arrangement mechanism
- Specific authorization of fractional shares

Maintaining of certain advantages

- Ability to issue shares with par value
- Ability to issue non-fully paid shares
- No Quebec residency requirement for directors

Innovations

- Ability not to create a board of directors if all powers are exercised by the shareholders
- Ability to indicate a specific time at which the articles take effect
- Holding of the parent corporation's shares permitted for a maximum of 30 days (tolerance of corporate incest)
- Express recognition that several classes of shares may have exactly the same rights and restrictions

When the Act comes into force, the companies governed by Part 1A of the *Companies Act* will be automatically governed by the new Act, while companies still governed by Part 1 of the *Companies Act* will have to be continued under the new Act within five (5) years after it comes into force. If they fail to do so, they will be automatically dissolved.

A special edition of *Ratio* that considers certain aspects of the Act in greater detail of particular interest to accounting, management and finance professionals will be published in 2010.◂

CHOOSING A NAME YOU INTEND TO KEEP

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The name of a business is an important distinguishing factor for its target clientele. Business names, which may confer intrinsic commercial value, are often chosen without adequate research or reflection. Unfortunately, many entrepreneurs fail to conduct an adequate search of the availability of a name before incorporating their company.

Also, many wrongly believe that a company's name is permanently acquired merely by the company's incorporation under the *Companies Act*.

However, the Enterprise Registrar of Quebec (the "Registrar") does not require an availability search before articles of incorporation are filed. The Registrar will only refuse to register the incorporation under a given name if it is identical to a pre-existing name. We will see that the Registrar may even permit the incorporation of the company under a name that is in breach of the law!

In order to guard against unfair competition, the legislator has adopted rules to prevent new businesses from appropriating the goodwill of others by using a name that leads to confusion with that of an existing business. Where a business believes that such a situation of unfair competition exists (the "petitioner"), it may apply to the Registrar to obtain an order for a change of name against a business registered in Quebec whose name leads to confusion with its own (s. 123.27.1 of the *Companies Act*).

Should such a petition be filed, the Registrar will use a two-stage analysis to determine whether the name does in fact lead to confusion.

Firstly, he assesses the distinctiveness of each name and each of their elements, their visual or phonetic similarity, and the similarity between the images they conjure up. He also assesses the way in which the names are used.

If, based on the above criteria, the Registrar determines that a name is "likely to lead to confusion", he will then consider the prominence of each name as well as the competition or likelihood of competition between the entities designated by the name in question based on different criteria, in particular, the entities' activities, the goods or services they offer and quantity thereof supplied, the territories covered and number of persons served. For the order to issue, the Registrar must be convinced that the company whose name is likely to lead to confusion may appropriate the petitioner's goodwill.

Given these criteria, where an entrepreneur wishes to adopt a name and intends to invest time and money in exposure for the name, it would be wise to conduct a sufficient search beforehand.

Our Corporate Law Group can help you to obtain a name search and quickly interpret the results. If this advice does not come on a timely basis, and your name is being contested, we can also act in a more traditional role by assessing the merits of the contestation and developing the appropriate strategy in response. ◂

DEEMED YEAR-END ON LOSS OF CCPC STATUS: ONE POSSIBLE SOLUTION

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Tax professionals are familiar with the general tax consequences of the acquisition of control of a Canadian corporation (deemed taxation year-end, restrictions on the use of losses, etc.), but sometimes neglect to consider the tax impact that different stages of a given transaction can have on the tax status of such a corporation and the specific tax consequences they can trigger.

In a purchase and sale transaction of the shares of a Canadian corporation, control of the corporation is acquired when share ownership is transferred (the "Closing"), which generally occurs at the time the legal documents giving effect to the transaction are signed. The acquisition of control of a Canadian corporation leads to several tax consequences, including the end of the corporation's taxation year, which is deemed to occur immediately before control is acquired. The parties to the transaction (purchaser and selling shareholders) frequently sign a purchase and sale agreement for the shares of the target corporation (the "Agreement") several days or even weeks before the Closing. Where a non-resident of Canada ("Non-resident") or a publicly held corporation acquires the shares of a Canadian-controlled private corporation ("CCPC"), the target corporation loses its tax status as a CCPC.

Under the *Income Tax Act* (Canada) ("ITA"), the change of status from a CCPC triggers the end of a taxation year, which is deemed to occur immediately before this change of status. The CCPC's change of status can occur as soon as the purchaser (Non-resident or public corporation) has an immediate, future or conditional right to acquire the CCPC's shares, while control of the corporation is only acquired when the shares are legally transferred from the vendor to the purchaser.

Thus, where a Non-resident or a public corporation wishes to acquire all of the issued and outstanding shares of a CCPC, and where an Agreement has been signed to this effect and the Closing is only scheduled to occur several days after the Agreement is signed, the CCPC may undergo two successive deemed tax year-ends[1] due to the lag time between the signature of the Agreement (change of status) and the Closing (acquisition of control). To avoid this, the ITA allows an election to be made that enables the CCPC to cease being considered as such for certain purposes provided by the ITA.

To illustrate the relevance of making such an election, consider the following example. The end of a CCPC's financial year falls on December 31 ("Target Corporation"). An agreement is concluded on January 9, 2010 between a Non-resident and the shareholders of the Target Corporation whereby the Non-resident agrees to purchase all of the issued and outstanding shares of the Target Corporation. The Closing is held on January 22, 2010, the date on which the share transfer occurs. The Target Corporation then elects to no longer be considered a CCPC from January 1, 2010.

The election by the Target Corporation will enable it to prevent a deemed tax year-end from occurring immediately before the signature of the Agreement, and to ensure its deemed tax year-end coincides with its normal tax year-end (December 31, 2009).

One must however pay special attention to the potential tax consequences of this election. In some situations, the disadvantages will outweigh the advantages.

1 Note that special care should also be taken where a letter of intent is signed.

RENEWAL OPTION OR PRIVILEGE

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Commercial leases often contain an option for the tenant to renew its lease for a specified term based, as a general rule, on the same conditions, except for the base rent payable for the renewal term. The base rent is either predetermined in the wording of the option itself, or must be agreed to between the landlord and the tenant before the beginning of the renewal term.

Despite the use of the term "option", the right to renew a lease where the parties must still agree on the rent is not a true option, but, at best, an obligation on the parties to negotiate the rent payable during the renewal term in good faith. If the parties do not reach an agreement despite their good faith negotiations, the lease will come to an end and the right of renewal will lapse.

The general view is that a true option must provide for the essential terms of the lease, including the rent. Therefore, where all the essential terms are predetermined, the exercise of the option by the tenant according to a specified procedure will be a simple formality that automatically renews the lease.

A true renewal option will eliminate the uncertainty of the mere renewal privilege, whose outcome depends on the parties' negotiations.

Thus, since it may be risky for the landlord to set the amount of the rent in advance, renewal privileges rarely provide for a predetermined rent. To address this issue and reduce the uncertainty of the exercise of the renewal privilege by the tenant, it may be wise to include a clause in the lease which provides for the issue of rent to be submitted to arbitration if the parties cannot agree on the rent payable for the renewal term. The arbitration should however be based on pre-set parameters, such as the market rate for similar space and similar use, without taking into account any leasehold improvements made to the premises. In this way, the exercise of the renewal privilege by the tenant is not likely to fall through, and the landlord will not have to assume the commercial risk of setting the rent too far in advance. ◂

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