

**TRANSFER OF ASSETS AND UNDERTAKING OF A CORPORATION
TO ITS SOLE SHAREHOLDER ON A GOING CONCERN BASIS:
ISSUES FOR CONSIDERATION**

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When tax or other considerations dictate that the operations of a company be merged, on a going concern basis, with those of its shareholder, there are myriad considerations. While not quite as complex as the divestiture of a business to a third-party purchaser, many of the same considerations will apply. When the entity, like many of our clients, is involved in the real estate business, there are particular issues, so that's the type of entity used here as an example. There are of course many industry, regulatory and company specific issues applicable to other activities and corporations, so this outline is no substitute for a careful analysis of any enterprise being considered for a transfer of its undertaking.

1. Preservation of Goodwill

Just as in typical arms-length sales of the undertaking of a business, the preservation of goodwill means that messaging throughout, both to employees, suppliers, customers and to the public, must be carefully managed to ensure that it's clear that activities will not be fundamentally changed and that stakeholders will not be adversely affected. Otherwise competitors will quickly see an opportunity to disrupt relationships. The 'boilerplate' explanation in standard private company amalgamation agreements is a good example: "For tax and administrative efficiency, the activities of the entities will be combined, and ultimate control of the enterprise being subsumed will not change". Sometimes the less said, the better, if the majority of the operations of the corporation will continue, as a division of the shareholder.

2. Human Resources

The greatest impact is generally on the employees, from the most recent hire to the CEO. Their reporting structure may change, even if their job description doesn't, at least initially. Their employment agreements need to be reviewed, as each employee is being terminated, since their employer will no longer exist. If working notice in lieu of a severance payment is an alternative, that may be appropriate, however for important employees, making the severance payment, in whole or in part, may garner their support and undiluted effort for the process, all while continuing to do their 'usual' jobs.

3. Timing

For a number of reasons, the preferred date for effecting the transfer will likely be the fiscal year end of the corporation or the calendar year end. While, unlike an arms-length share sale, the transaction doesn't create a new year-end, there are accounting, CPP, EI and bonus plan issues which are simplified that way. For employees, a change of employers means that CPP and EI deductions can be 'doubled up', with no recovery until tax return time the following year. If there are year-end bonuses, it may be hard to pro rate them when performance for the full year hasn't been measured. From an accounting perspective, the transferring entity will have a final year's operations to be reported, whether a full year or a partial year. If earnings from the corporation normally result in a dividend to the shareholder, a full year will generate a full year's dividend, making performance comparisons to prior periods clear.

4. Material Contracts

Here the work required is very similar to the due diligence associated with a more conventional divestiture. All of the contractual arrangements of the divesting company must be reviewed: firstly, to ensure that they are all assigned, if they are assignable without consent, and unless it's adverse, that notice of the assignment is given to the counterparty to the contract, and secondly, that consent to the assignment is obtained, if consent is required. In non-arms-length transactions, a 'general transfer and assignment' is often used, but it will also include an assumption by the acquirer of all of the obligations under those contracts, so it is important to have a record of what liabilities are being taken on by the shareholder. In some instances, activities were undertaken in a separate corporation to limit the liability of the shareholder and a general assumption of liabilities, without a review of documents, removes that protection. If consents to assignment are required, and are not obtainable, consideration may be given to continuing the legal existence of the corporation so that it may serve as a nominee and bare trustee of the beneficial owner, and hold any contracts which may not be assignable.

Leases and tenancy arrangements will be covered "Premises" and "Real Estate Assets and Secured Indebtedness" below.

5. Insurance

Unless coverage already maintained by the shareholder includes the assets and activities of the corporation under a blanket policy, the insurance arrangements will need to be reviewed. If the business activities of the shareholder are different from those of the corporation, there may be no difference between the cost of existing coverages and the coverage available to the shareholder after the combination, but the sooner the brokers are put to work on the issue, the less likely that it will be a scramble to be dealt with late in the piece.

6. Premises

There is no need to change premises initially or at all, however over time there may be some consolidation of administrative and accounting activities, which may dictate that some or all staff are relocated. Separating the accounting personnel from the development management activities may be an issue, although these days we are all becoming more accustomed to working with others who are located remotely!

If the premises are leased from a non-arms-length landlord, in many instances the consent of the landlord to the assignment of the lease will be required.

7. Financial (Current) Assets

Some assets are easy to deal with: continuing counterparties are informed, and they will remit payment directly to the shareholder moving forward. Banks will all be informed and cash is easily transferred (although loans will be dealt with later, under “Liabilities”). Portfolio investments may be transferred in specie but there is a disposition of those investments for tax purposes and gains or losses are realized. Performance bonds must be replaced and depending on the holder and the issuer, may require legal undertakings for substitution of the new performance bond against cancellation of the old. Bonding companies will need updated information before issuing new bonds, so like other insurers, they should be contacted on a timely basis. Partnership investments will likely have been the subject of material contracts, and been reviewed. They may require specific transfer arrangements, in addition to notices under the terms of the agreements. If they involve direct ownership of real estate, then the real estate considerations below will apply.

8. Liabilities

While a general assumption agreement makes the shareholder liable to satisfy the liabilities of the corporation, it doesn't operate to release the corporation. Instead of asking a third party for a release, it's easier to let the corporation continue to legally exist, albeit without operating, until all of the liabilities have been satisfied. This doesn't apply to bank loans, which will need to be replaced. It doesn't apply to secured indebtedness where a transfer of ownership of the real estate or other security almost always requires consent from the lender, and failing to secure that consent results in a default under the credit arrangement.

9. Real Estate Assets and Secured Indebtedness

As this usually represents its largest asset category, the most specialized of its human resources and the most complex of its contractual arrangements, it will need the most attention. Investment real estate and property being held for future development can and will be transferred in the same manner as would apply in an arms-length transaction, without the need for the representations and warranties in a comprehensive purchase agreement, the due diligence related to condition of the assets or the need for property specific adjustments. Tenants will get notice of the change of ownership, and be directed as to how future payments are to be made. Service contracts are assigned (most are usually of relatively short duration) and any on site staff are dealt with in conjunction with the other employees. The lenders and partners must consent and will require amendments and new documents to add the shareholder as a party or to substitute the shareholder to replace the corporation.

If legal title to real estate assets is to be transferred, property transfer tax will be payable on the fair market value. If beneficial title is to be transferred, the change in beneficial ownership will need to be recorded once the *Land Ownership Transparency Act* is in force, which is expected to occur in 2020 when the regulations are passed – however, property transfer tax is not currently payable. This is the biggest reason to retain the legal existence of the corporation as a non-operational nominee and bare trustee for the shareholder. It may be appropriate, in that case, to change the name of the corporation to reflect its status, but the word trustee can't be included in its name, for example, Smith Assets Nominee Corporation.

Development assets are more complex as their status changes more quickly. Permit applications will need revision, construction contracts will be assigned, and the steps needed, in addition to those applicable to investment properties and land holdings, will depend on the stage of development of each asset. The development manager will, in each case, be in the best position to outline what will be

needed and to oversee the transition process (which is why it's a good idea to incent and retain those employees through the transition period).

10. Governance

The majority of corporations with single shareholders only have shareholder representatives on their boards, and are wholly owned subsidiaries that are directly controlled by their shareholder. Some however have outside (independent) directors. It will be up to the shareholder to determine whether its interests are best served by asking independent directors to continue to sit on the board of the corporation during the transition period, and up to the independent directors to decide whether they wish to continue to serve in that role. If they do remain they will continue to have a fiduciary obligation. They will be responsible to ensure that the process is carried out in a responsible manner, such that obligations to third parties are fully assumed and that the corporation is not left in a position where it has disposed of its assets and has not adequately provided for its liabilities, whether they are direct and current, or contingent and 'off balance sheet'.

11. Questions

If there are questions or concerns that haven't been fully addressed, or have been missed entirely, please contact me at ckerfoot@kornfeldllp.com or call me at (604) 331-8302.