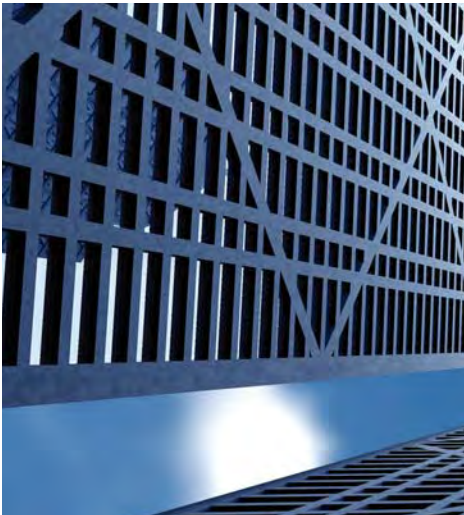


# Guide to Canadian M&A





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## Gowlings at a Glance

Gowlings is one of Canada's largest national full-service law firms.

Gowlings employs over 750 professionals and has 10 offices worldwide.

Gowlings is recognized for its expertise in M&A particularly in the energy, mining and technology industries.

Gowlings is focused on highly responsive, high-quality client service and places tremendous value on relationships. We act quickly on matters as they arise and allocate the necessary, most efficient and cost-effective personnel to each matter.

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## CANADIAN M&A FREQUENTLY ASKED QUESTIONS (FAQs)

This Guide answers many frequently asked questions we receive from our international clients as they look at acquiring Canadian companies or their assets.

Canadian M&A is straightforward:

- Mergers and acquisitions with Canadian companies can be straightforward and can be accomplished quickly and efficiently.
- Canadian M&A rules favour the acquirer. For example, “poison pills” and other defence strategies by a target are very limited.
- Government approvals are limited. If an approval is required, in most cases, it is routinely granted.
- Canada is a business-friendly environment and consistently ranks at the top of the best places to do business.

## PLANNING AN M&A TRANSACTION

### **We would like to acquire 100 per cent of a TSX-listed company. Can we buy some of the target’s stock in the market (called a “toehold”) before we make our approach? How much toehold stock can we buy?**

Yes, acquisition of a toehold is permissible, subject to some limitations. The take-over bid rules (discussed below) do not come into play until the acquirer accumulates 20 per cent or more of the target’s voting or equity securities or securities convertible into voting or equity securities (collectively “equity shares”). Acquirers sometimes accumulate a toehold to: (i) lower the overall purchase price for the target (the acquirer avoids paying a premium for shares purchased in advance of a formal offer); (ii) establish an edge against a competitive bidder; and/or (iii) provide a gain if the target is lost to a competitor at a higher price.

### **Will we have to publicly report our toehold?**

Canadian securities laws require “early warning” public disclosure of holdings of 10 per cent or more of any class of the target’s equity shares. Additional public disclosure is required for accumulations of 2 per cent or more thereafter. Accumulations of a toehold under 10 per cent would not require disclosure under Canadian laws (unless the target is already the subject of an ongoing take-over bid or sale transaction, in which case the disclosure threshold is reduced to 5 per cent). (Note that U.S. laws, when applicable, always require early warning disclosure at 5 per cent). Typically, an acquirer may accumulate a toehold that is just below the disclosure level in order to prevent speculation about a possible bid (and possible upward price movement) before it is made.

### **Are there any disadvantages to acquiring a toehold?**

Acquiring toehold stock can potentially impact the bid price. Subject to an exemption for certain normal course purchases over a stock exchange, the highest price that the acquirer pays for the securities of the target within 90 days of launching a take-over bid (including the cash value of any non-cash consideration paid for such securities) sets the floor for the lowest price that the acquirer is permitted to offer to shareholders under a take-over bid (the “pre-bid integration rule”). Similarly, the minimum percentage of outstanding target securities subject to the bid must be equal to the highest percentage of outstanding target securities purchased from any one shareholder in the 90 days prior to a bid.

### **What is the significance of the 20 per cent threshold? Can we avoid it through affiliates or in side deals?**

An acquirer cannot accumulate more than 20 per cent ownership of a class of equity shares unless the offer to acquire securities is made to all of the holders of the class. Outside of an offer made to all of the holders of a class, accumulations in the secondary market over 20 per cent can only be made under limited exceptions (see below). Side deals are not an effective means to avoid crossing the threshold. Canadian securities laws contain anti-avoidance provisions, the effect of which is to include in the calculation of whether the 20 per cent threshold has been met (and whether the 10 per cent threshold for the early warning disclosure mentioned above has been met): shares and convertible securities owned directly, or indirectly, through affiliates or nominees; and shares owned by persons or companies acting jointly or in concert with a bidder under an agreement, commitment or understanding.

### **How can we find out information on the target or about the target’s major shareholders?**

Publicly disseminated information about Canadian public companies, including early warning reports filed by shareholders who hold more than 10 per cent of the company’s outstanding equity shares, is posted online at [www.sedar.com](http://www.sedar.com). In addition, insider reports that provide current trading information for large shareholders and other Canadian public company insiders, such as directors and officers, can be found online at [www.sedi.ca](http://www.sedi.ca).

### **Can we negotiate directly with major shareholders? Can we buy a large stake from a major shareholder group without having to make an offer to all shareholders?**

Yes, subject to specific rules, if a target has several large shareholders, it is possible to negotiate a private sale for their shares. In certain



circumstances, a “control block” (over 20 per cent) may be purchased by an acquirer without making an offer to all shareholders, thus enabling a large stake to be acquired at one time rather than through a gradual build up in the market. These rules require that there not be more than five sellers, and that the value of consideration paid not exceed 115 per cent of market price (determined as prescribed).

In circumstances where 100 per cent ownership of the target is the objective, an acquirer will often negotiate a “lock-up” agreement with major shareholders and, in a friendly transaction, with the directors and officers of the target. Under a lock-up agreement, the major shareholder(s) agree to tender their securities to the acquirer’s offer. In a “hard” lock-up, the shareholders agree to sell their securities to the acquirer no matter what. In a “soft” lock-up, the shareholders may sell their securities to a competing superior offer in certain circumstances. The majority of lock-up agreements in Canada are “soft.”

## **Should we launch a surprise bid (“unsolicited bid”) or should we approach the target board of directors in a “friendly” transaction?**

Although friendly bids are more common, unsolicited bids are acceptable and cannot, in most circumstances, be blocked indefinitely by a target’s board of directors from consideration by the target’s shareholders.

An unsolicited bid would typically be made with no access to confidential information (i.e., due diligence has to be based on the public record only). In a friendly transaction, the target will typically allow an acquirer to conduct due diligence prior to launching a bid, but will typically require that the acquirer agree to sign a non-disclosure or confidentiality agreement and to refrain from launching a take-over bid for the target’s securities for a lengthy period of time, unless the bid has the support of the target’s board (a “standstill” agreement). In a friendly transaction, the parties will also negotiate a support agreement that would typically provide the acquirer with a “break fee” if the target’s shares are ultimately purchased by another third party making a superior competing offer.

In an unsolicited offer, the acquirer runs the risk that the target board implements a “tactical” shareholder rights plan to delay the bid in order to seek out a superior competing offer. For additional information regarding the case law in Canada on shareholder rights plans, please search “shareholder rights plans” on [www.gowlings.com](http://www.gowlings.com).

## **If we already own a large percentage of the target, are there special rules for acquiring additional securities?**

Yes, subject to exceptions. A take-over bid launched by a large shareholder (10 per cent or greater) will be considered to be an “insider bid” and the consideration offered in the bid must be supported by an independent valuation unless an exception applies. The exceptions available include circumstances where the large shareholder has had no management representation or representative directors on the target’s board in the last 12 months; where the value of the consideration being offered is accepted and agreed to by certain other large arm’s-length shareholders; or where the target is the subject of an active auction (i.e., another take-over bid or sale transaction is ongoing).

## **Do we need to keep our intentions to make a bid secret?**

Yes. Canada regulates insider trading and tipping. Information about a potential take-over bid for a Canadian public company could be used by traders for unfair profit. Further, information leaks of a possible bid tend to lead to trading that drives the stock price up to the disadvantage of the acquirer. It is important to manage the process of a take-over bid to protect against information leaks or improper trading by persons privy to confidential information. Once the decision to pursue a potential acquisition transaction in Canada is made, the acquirer’s directors, officers, employees, consultants, professional advisers and affiliates should not trade in the target’s securities, or tip or advise others to do so. Only the acquirer itself (or its joint actors) may purchase securities in advance of launching a bid.

## **EXECUTING AN M&A TRANSACTION**

### **How are mergers and acquisitions with Canadian companies typically structured?**

There are three main options for structuring an acquisition of a Canadian-listed company:

- take-over bid (an offer made directly to shareholders, not necessarily with agreement of the target);
- amalgamation (a “merger” made by agreement with the target, filed with a government ministry for routine processing after approval has been obtained at a special shareholder meeting); and
- plan of arrangement (a “merger” made by agreement with the target, submitted for court approval after the shareholders approve it at a special meeting).

Features of each option are outlined in the following chart. The most suitable structure for a transaction will depend on a variety of factors and should be discussed with your legal adviser.



## Canadian M&A Structures

	Take-over Bid	Amalgamation	Plan of Arrangement
<b>Structure</b>	Acquirer incorporates a Canadian special purpose company to make an offer to acquire securities directly to shareholders.	Acquirer incorporates a Canadian special purpose company to merge with the target and become the sole shareholder.	Acquirer incorporates a Canadian special purpose company to merge with the target and become the sole shareholder.
<b>Shareholder Action</b>	Tender securities to the offer.	Vote at special shareholder meeting.	Vote at special shareholder meeting.
<b>Time Period</b>	At least 35 days (although target shareholder rights plans sometimes require an offer to be open longer – typically 60 days). If the terms of the bid are amended or the bid is extended, the acquirer will be required to mail a notice of change or variation and the bid will be required to remain open for at least 10 days.	Approximately 60 days.	Approximately 60-90 days.
<b>Other Approvals</b>	Any applicable regulatory approvals (i.e., Investment Canada, competition, etc.).	Any applicable regulatory approvals.	Court approval of plan of arrangement, plus any applicable regulatory approvals.
<b>Advantages</b>	Can be the fastest acquisition process. The only process suitable for unsolicited bids. The process is driven by the acquirer. A one-step process if 90% of the target's securities are tendered to the offer.	One-step process. Fewer rules than take-over bid. May be easiest way to achieve 100% ownership.	One-step process. Fewer rules than take-over bid. Greater flexibility for complex acquisitions and permits U.S. acquirers to issue security without filing a registration statement. Court has significant discretion to address transaction issues, such as the elimination of out-of-the-money options or debt.
<b>Getting to 100% ownership</b>	If 90% of the target's securities are tendered to the offer, the acquirer can quickly compel the sale of the remaining shares. If less than 90% but, typically, more than 66 2/3% of the target's securities are tendered, the acquirer may carry out a second-step "squeeze out" transaction if it wishes to eliminate the remaining minority security holders. This second-step transaction must offer the same consideration. This usually is done by an amalgamation, approved at a shareholder meeting and takes approximately 60 days to complete. See "What level of shareholder acceptance is needed for us to achieve 100% ownership?" on p. 5.	Requires approval at special shareholder meeting. See "What level of shareholder acceptance is needed for us to achieve 100% ownership?" on p. 5.	Requires approval at special shareholder meeting. See "What level of shareholder acceptance is needed for us to achieve 100% ownership?" on p. 5.
<b>Disadvantages</b>	May require a second-step transaction to gain 100% ownership of the target if less than 90% of the target's securities are tendered to the offer.	Process driven by target (with oversight by acquirer). May take significant time to negotiate and complete.	Process driven by target (with oversight by acquirer). Requires court approvals (which can be an opportunity for objection by special interests). May take significant time to negotiate and complete.
<b>Main Required Documentation</b>	Take-over bid circular and directors' circular; notice of change (if required); support agreement (if friendly); lock-up agreements (if applicable); information circular (for second-step, if required).	Acquisition or combination agreement; lock-up agreements (if applicable); information circular for special shareholder meeting.	Acquisition or combination agreement; lock-up agreements (if applicable); information circular for special shareholder meeting; various court documents.



## Are there any differences to be aware of if the consideration offered includes securities?

There are several factors to take into consideration when an acquirer is offering its securities as consideration or partial consideration for the target's shares. First, any bid circular or information circular will be required to contain "prospectus-level" disclosure regarding the acquirer. This is often accomplished by "incorporating by reference" the acquirer's existing continuous disclosure record into the bid circular or information circular. It should also be noted that a bid circular may be required to be translated into French if the acquirer's securities are being offered to more than a nominal number of shareholders in Québec.

Second, in a transaction involving a share exchange, the acquirer may inherit the target's reporting issuer status and may become subject to Canadian continuous disclosure requirements upon completion of the transaction. For acquirers in several non-Canadian countries including, among others, the United States, the United Kingdom, France, Germany, Australia, South Africa and Spain, the Canadian continuous disclosure obligations can generally be satisfied by filing in Canada the continuous disclosure reports that are filed with the securities regulator in the acquirer's home jurisdiction.

Third, the sale of a Canadian security in exchange for a security issued by a non-Canadian company will be a taxable event for the Canadian shareholders, resulting in a capital gain or capital loss that must be reported in the year that the disposition occurs. In circumstances where the negative tax consequences of the sale may influence shareholders' approval or acceptance of the transaction, or in other circumstances where, for example, the acquirer wishes to motivate certain significant shareholders to remain invested in the combined company, it may be possible to effect an acquisition on a tax-deferred basis through an exchangeable share structure. The circumstances of each transaction will determine whether the additional complexity and administrative requirements warrant implementing an exchangeable share structure. An exchangeable structure would be designed to permit Canadian resident shareholders to receive exchangeable shares of a Canadian company on a tax-deferred basis for their target shares. The Canadian exchangeable shares would have attributes that effectively mirror the economic rights of the acquirer's non-Canadian shares. Over a period of time (often five years, subject to negotiation) Canadian shareholders would be permitted to exchange their exchangeable shares for the acquirer's corresponding non-Canadian shares, thereby triggering a taxable disposition at a time of their choosing. The acquirer's non-Canadian shares would be issued to the Canadian shareholders either under a court order pursuant to a plan of arrangement or under a U.S. registra-

tion statement that qualifies the securities for distribution in both the U.S. and Canada using U.S. documentation only.

Fourth, it should be noted that in friendly, negotiated acquisitions where the consideration involves the issuance of the securities of a U.S. acquirer, the transaction will almost invariably be structured as a plan of arrangement. This is because there is an exemption from the registration requirements of the U.S. *Securities Act of 1933* in respect of securities issued pursuant to a transaction, the fairness of which has been approved by a court, as is the case in a plan of arrangement. Note that this exemption is not available for a securities exchange take-over bid.

## What role does the target's board play in the transaction?

The role of the target's board of directors differs depending on the transaction structure used. In an unsolicited take-over bid, the target's board role is more limited. It will issue a recommendation to shareholders in a "Directors' Circular" regarding the offer, and it will also likely look for competing bids to maximize shareholder value. The target may have or implement a "shareholder rights plan" to delay the expiry of an unsolicited bid for a few weeks while it looks for an alternative superior transaction.

In most cases, the shareholders will ultimately be provided with the opportunity to make the decision to either accept or reject the acquirer's offer.

In a "friendly transaction," the target's board will typically negotiate and sign a "business combination agreement" or "support agreement" where the target and its board commit, among other things, to facilitate the acquisition transaction, make a positive recommendation to shareholders, hold a shareholder meeting to approve the transaction, obtain necessary regulatory approvals and, if applicable, pay a break fee if the transaction fails for specified reasons.

## Is the target's board of directors required to conduct an auction?

No. Directors owe a fiduciary duty to act in the best interests of the company. While maximizing shareholder value will be of primary concern to directors when a company finds itself as an acquisition target, it is not necessarily the sole concern (as in the United States). In a change of control situation, directors are required to seek the best value reasonably available to shareholders. While it is not mandatory, when considering the best interests of the company, directors may consider the interests of stakeholders other than shareholders, including employees,



customers, suppliers, the community at large and others. Many friendly transactions in Canada are consummated without an auction.

## What level of shareholder acceptance is needed for us to achieve 100 per cent ownership?

Under a take-over bid, if shareholders holding 90 per cent of the target's outstanding securities (other than those held by the acquirer) accept the offer, then the remaining securities can be compulsorily acquired at the same price in a matter of a few weeks. If the 90 per cent threshold is close to being reached when the bid expires, the acquirer will typically take up the shares tendered and announce a 10-day extension to seek additional tenders and reach the threshold.

Typically, a bid is structured so that an acquirer can accomplish a second-step "squeeze out" transaction when less than 90 per cent of the target's securities are tendered to the offer. A second-step squeeze-out transaction will eliminate the remaining shareholders for the same consideration as the bid. The squeeze-out needs approval by: (i) a "special resolution" passed by, typically, 66 $\frac{2}{3}$  per cent of the shares voted in person or by proxy at the meeting (this can include all of the securities held by the acquirer and its joint actors); and (ii) a resolution approved by a "majority of the minority" (that is, more than 50 per cent of the shares voted in person or by proxy at the meeting, excluding the shares owned by the acquirer and its affiliates and joint actors prior to the bid, but including the shares purchased by the acquirer and its joint actors in the take-over bid). Since the acquirer can vote the shares it acquires in the bid in the minority approval resolution, this second vote only becomes critical when the acquirer launches its bid with a starting point of more than 33.3 per cent of the outstanding shares of the class. Note that shares excluded from the minority vote have the effect of reducing the denominator (thus potentially benefiting the acquirer).

Note, the "squeeze of threshold" can be up to 75 per cent for certain provincially incorporated companies.

Any securities acquired prior to the launch of a take-over bid: (i) may not be counted towards the 90 per cent threshold; and (ii) may not be voted by the acquirer in favour of a second-step going-private transaction that may be proposed to squeeze out minority shareholders in the event that less than 90 per cent of the equity shares are tendered to a bid. The size of the toehold acquired in advance of a bid must take into consideration an analysis of the various thresholds and approvals required after a bid is completed in order to ensure that the acquirer can successfully purchase 100 per cent of the target's outstanding securities.

If a plan of arrangement or amalgamation structure is used instead of a take-over bid, the approval threshold is the same as previously discussed for a second-step squeeze-out transaction.

Canada has a dissent process where shareholders being squeezed out can dissent from the transaction and demand to a court to be paid fair value. This process is rarely used effectively.

## What is the typical "minimum threshold"? What if we do not get to our minimum threshold? What are other typical bid conditions?

In a take-over bid, the acquirer can specify a minimum number of shares to be tendered to the offer and is not obliged to purchase any of the target's securities unless this minimum threshold condition and other bid conditions are satisfied or waived. Typically, the minimum specified is two-thirds of the outstanding shares not owned by the acquirer in order to assure that the acquirer can move quickly to a second-step transaction to achieve 100 per cent ownership, as discussed above.

A more aggressive bidder may be prepared to set the minimum lower — for example, 50 per cent plus one share — in order to eliminate competition and achieve control, but not necessarily with assurance of getting to 100 per cent. The bidder may then be prepared to attempt to acquire the remainder through bid extensions and other measures.

Other typical conditions include the receipt of required regulatory approvals and no material adverse change.

Often an acquirer will extend the bid and/or raise its consideration to reach a successful conclusion.

The only condition that cannot be included in a take-over bid is a financing condition. Financing must be in place before a bid is launched. If the financing itself is conditional, the acquirer must reasonably believe the possibility to be remote that, if the conditions to the bid are satisfied or waived, the acquirer will be unable to pay for the securities tendered to the bid due to a financing condition not being satisfied.

## Can we acquire target shares in the market during a take-over bid?

Yes, up to 5 per cent of the target's shares may be acquired in market purchases during the course of a bid. In addition, commencing on the third day following the launch of the bid, additional shares may be purchased in the market so long as you comply with a number of condi-



tions including (i) stating the intention to acquire shares in the market in the take-over bid circular; and (ii) publicly disclosing daily, by press release, the number of securities acquired in the market and the average price paid. An acquirer cannot sell any target shares during the course of a bid (starting from when the acquirer announces an intention to make a bid).

## Can we offer different consideration to different shareholders or “side deals”?

Take-over bid rules require all shareholders to be offered the same consideration or the same choice of consideration, and no collateral benefits or “side deals” are permitted with select shareholders. Plans of arrangement and amalgamations are not as restrictive.

## Can we make a take-over bid conditional on regulatory approvals required outside of Canada?

Yes, for international acquirers, typical bid conditions include receipt of approvals in other jurisdictions, such as antitrust approvals in the U.S. and elsewhere.

## What happens if another offer comes along to compete with ours? How does deal protection work in Canada?

In a friendly transaction, a target will typically agree to refrain from soliciting other offers and to support the offer made by the acquirer. If a competitive bid does emerge, then typically the target’s board can only enter into negotiations with and ultimately support a competing offer if it is “superior.” Typically, the acquirer will ask for a matching right and a right to a break fee if it loses to a superior offer. The non-solicitation and superior-offer provisions of a support agreement are highly negotiated, with the acquirer attempting to tightly restrict the target’s ability to pursue and accept another offer while permitting the target’s directors to discharge their fiduciary duties. The target’s board will seek as much flexibility as possible without completely hampering deal certainty.

## What if the target has a significant number of shareholders in the United States?

So long as the Canadian target qualifies as a “foreign private issuer” under U.S. securities laws, Canadian securities laws will govern the offer made to a U.S. shareholder provided that: (i) less than 40 per cent of the target’s shares are held by U.S. shareholders (calculated at a specified date prior to launch of the bid); (ii) the bid is not exempt under Canadian securities laws; and (iii) U.S. shareholders participate in the bid on terms that are no less favourable than those offered to Canadian shareholders.

In respect of a non-Canadian acquirer, these rules only apply in the case of an all-cash offer. Where the foregoing exemption from U.S. requirements does not apply, both Canadian and U.S. rules, which are similar in most material respects, must be complied with in respect of the bid. For offers involving share consideration, compliance with U.S. tender offer rules may be required. In many instances, to avoid U.S. registration requirements, instead of delivering acquirer shares to U.S. shareholders, the consideration shares will be sold by the acquirer into the market on behalf of the U.S. target shareholders, and the proceeds of sale will be delivered to the U.S. target shareholders.

## REGULATORY APPROVALS

### What typical regulatory approvals are needed for a non-Canadian acquirer to acquire or invest in a Canadian company?

Acquisitions or investments that exceed certain thresholds are subject to review under the *Investment Canada Act* (foreign investment review) and pre-notification under the *Competition Act*. Canadian M&A is generally based on “free market” principles, with minimal regulatory involvement.

### How does the foreign investment review process apply to a non-Canadian acquirer?

Foreign investment in Canada is regulated by the *Investment Canada Act*. Proposed acquisitions of “control” of a Canadian business that exceed certain monetary thresholds are subject to review under the *Investment Canada Act*. Acquisitions of control below the applicable threshold are exempt.

**Thresholds.** For WTO investors, the review threshold is crossed if the book value of the Canadian business exceeds C\$330 million. As a result of some recent amendments to the *Investment Canada Act* that are intended to facilitate additional foreign investment in Canada, this threshold will soon be increased to C\$600-million enterprise value, with additional increases to follow. Note that a much lower, C\$5-million threshold applies if the target carries on a “cultural” business. For non-WTO investors, the threshold is exceeded if the book value of the Canadian business exceeds C\$5 million.

**Control.** The *Investment Canada Act* includes detailed provisions defining the concept of an acquisition of “control.”

In summary, these provisions state that control can be acquired only through the acquisition of: (i) voting shares of a corporation; (ii) “voting interests” of a non-corporate entity (which for partnerships and trusts



means an ownership interest in the assets thereof that entitle the owner to receive a share of the profits and to share in the assets on dissolution); or (iii) all or substantially all of the assets of a Canadian business.

For the purposes of determining whether an investor has acquired “control,” the following general presumptions apply:

- the acquisition of greater than 50 per cent of a target’s voting shares is deemed to be an acquisition of control;
- the acquisition of one-third or more, but less than a majority, of voting shares is presumed to be an acquisition of control, unless it can be shown that the acquired shares do not give the investor “control in fact” over the corporation (e.g., another shareholder owns a majority of the voting shares); and
- the acquisition of less than one-third of the voting shares is deemed not to be an acquisition of control.

**Timing.** The initial review period is 45 days from submission of application for review. The Minister of Industry has a unilateral right to a 30-day extension. Further extensions can be agreed to between the Minister and the purchaser. (As a practical matter, the purchaser must agree to further extensions if it wishes to complete the transaction, as the right to close requires affirmative approval, not just passive expiration of a waiting period.) In our experience, the review period for large and complex transactions is typically between three and six months, due to the number of federal government departments and affected provincial governments with which Industry Canada must consult.

**Test.** The standard of the review is whether the transaction is likely to be of “net benefit” to Canada.

In applying this test, the Minister of Industry will review the investor’s plans for the Canadian business (which are required to be set out in its application for review) with a view to assessing:

- the effect on the level of economic activity in Canada, on employment, on the utilization of parts and services produced in Canada, and on exports from Canada;
- the degree and significance of participation by Canadians in the Canadian business;
- the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- the effect of the investment on competition within any industry in Canada;
- the compatibility of the investment with national industrial, economic and cultural policies; and
- the contribution of the investment to Canada’s ability to compete in world markets.

**Possible Outcomes.** The Minister of Industry may either approve the acquisition or not approve the acquisition. Almost all proposed acquisitions are ultimately approved. Prior to 2010, only one application had been formally rejected from the multitude of applications filed over the years (unknown others may have been withdrawn before an adverse decision was rendered).

Before an acquisition is approved, there is typically a negotiation between the investor and the Minister of Industry with respect to “undertakings” the investor is prepared to give in relation to the operation of the Canadian business post-acquisition. Such undertakings typically relate to the factors outlined above, and are intended to satisfy the Minister of Industry that the acquisition will be of net benefit to Canada.

In the recent economic climate, our experience has been that the Minister of Industry’s primary concern has been to receive specific undertakings with respect to employment levels at the Canadian business for a period of time post-closing (typically three years).

In November 2010, a second Investment Canada application was denied. Canada’s Minister of Industry sent a notice to BHP Billiton indicating that he was not satisfied that the application of BHP Billiton for approval of the acquisition of Potash Corporation of Saskatchewan Inc. is likely to be of net benefit to Canada. BHP Billiton was provided 30 days to make any additional representations and submit any undertakings; however, BHP Billiton withdrew its offer.

The Minister further stated at the time of the decision: “Canada has a long-standing reputation for welcoming foreign investment. The Government of Canada remains committed to maintaining an open climate for investment.” BHP Billiton’s proposed acquisition of Potash Corporation received considerable media attention as one of the world’s largest mining M&A transactions, with Potash Corporation, the world’s largest potash producer, being regarded as an asset of strategic national significance.

The Minister subsequently indicated that the size of the Potash transaction and a potential for long-term reduction of capital investment in the Canadian potash mining industry generally as a result of the proposed acquisition were factors of the BHP Billiton decision. He also indicated that a process would be undertaken for providing further clarity to the investment community concerning the acquisition of strategically significant assets under the *Investment Canada Act*.



## What is a “national security review”?

The *Investment Canada Act* was amended in 2009 to provide the government with a right to review any foreign investment that “could be injurious to national security.”

There is no minimum review threshold, and the national security review provision applies to minority investments and to the establishment of new Canadian businesses, not just the acquisition of “control” of existing Canadian businesses. The national security review can also apply to investments that have tenuous links to Canada (for example, a business with any part of its operations in Canada). The national security review process can take up to 130 days. The government may, without giving reasons, prohibit proposed investments, impose conditions on their completion or require divestiture of completed investments.

When the national security review provisions were adopted, many potential foreign investors became concerned that Canada had become, or was becoming, inhospitable to foreign investment. However, experience to date with the national security review provisions shows that this is not the case.

## Will the Canadian government require that a Canadian partner be involved in the transaction?

The general rule is that a foreign investor is not required to invest alongside a majority or minority Canadian partner. Only in certain regulated industries that have Canadian minimum ownership limitations, such as uranium, telecommunications, banking and transportation, would a majority partner be required.

There is, from time to time, a great deal of media commentary on this issue in the context of a high-profile foreign take-over of a major Canadian company. This commentary is purely speculative. The fact is that the *Investment Canada Act* does not require or contemplate the involvement of a Canadian partner in a foreign acquisition, and the Canadian government does not have an historical track record of requiring this.

## If we are considering involving a Canadian partner, would this eliminate foreign investment review?

Foreign investment review under the “net benefit to Canada” test would be avoided if the transaction is structured such that the non-Canadian investor does not acquire “control.”

If the non-Canadian investor acquires control under the transaction, then the “net benefit” test would apply whether or not there is a Canadian

partner. It is possible that the presence of the Canadian partner may ameliorate political concerns in high-profile transactions; however, as noted above, this has never been required as a condition of approval.

## How does competition review apply to Canadian M&A?

Notification of proposed transactions that exceed certain monetary thresholds must be provided before closing to the Competition Bureau, which can challenge any transaction that it believes will prevent or lessen, or is likely to prevent or lessen, competition substantially.

Notification is only required if both of the following thresholds are exceeded: (i) the parties, together with their affiliates, have assets in Canada, or annual gross revenues from sales in, from or into Canada, greater than C\$400 million, and (ii) the assets in Canada of the acquired business, or the annual gross revenues from sales in or from Canada generated by such assets, exceed C\$77 million. Note that in transactions involving the acquisition of voting securities, if these thresholds are exceeded, notification may be required, even if less than a majority of voting securities are being acquired (for example, the acquisition of more than 20 per cent of publicly traded voting securities).

The basic waiting period is 30 days from filing the prescribed notification form. The Competition Bureau has the power to issue a supplementary information request within the initial 30 days. A supplementary information request extends the waiting period for an additional 30 days from compliance with such a request, as determined by the Bureau. The Bureau has various other powers to delay closing.

The test applied by the Bureau is whether the proposed transaction prevents or lessens, or is likely to prevent or lessen, competition substantially.

## ASSET ACQUISITIONS

### Our target is an asset owned by a Canadian company. We only want the asset and not the whole company. How is an asset acquisition typically structured?

An asset sale involves the negotiated purchase of the assets of a company without acquiring the entity that owns them. This typically happens when only a single property or division is of interest, or the new owner wishes to cap legacy liability exposure.

### What approvals are needed for an asset sale?

A sale of all or substantially all of a target’s assets requires approval of shareholders at a meeting by special resolution (two-thirds of the



shares voted at the meeting). Less significant asset transactions can be approved by the target's board. An asset sale typically involves transfers of title and assignments of contracts, so more approvals and filings are typically required than a sale of the shares of a corporation. See also the previous responses regarding *Competition Act* and *Investment Canada Act*.

## How long does the asset sale process typically take?

Sixty to 90 days if a shareholder meeting is required, much less if no shareholder meeting is required, depending on the complexity of the transaction.

## INTERNATIONAL ASSETS

### Our target is an international asset owned by a Canadian-listed company. How does the process differ from buying a company with a Canadian asset?

Local foreign investment, competition and other approvals may be required. The specific mix of such approvals will vary depending on the jurisdiction and the nature and size of the target's operations in such a jurisdiction. Canadian foreign investment review may not apply, depending on the circumstances.

### Can we eliminate the Canadian ownership structure after we buy the company owning the international assets?

Yes, there is full flexibility to eliminate the Canadian ownership structure post-acquisition. However, it is important to focus on this issue early as part of the implementation to optimize tax efficiencies.

## TAX MATTERS

### What vehicle should be used for a Canadian acquisition?

Typically, a non-Canadian acquirer would establish a Canadian subsidiary to act as the acquisition vehicle. The use of a Canadian subsidiary serves a number of purposes, including insulating the acquirer from the activities of the target.

### Are there any tax advantages to using a Canadian subsidiary?

Yes, a Canadian subsidiary may provide a number of advantages to the acquirer from a Canadian tax perspective. These advantages may include: (i) facilitating the deduction of interest on financing for the acquisition against the income of the Canadian target; (ii) creating high

paid-up capital in the shares of the Canadian subsidiary to facilitate repatriation of funds back to the non-Canadian parent corporation free of Canadian withholding tax; and (iii) positioning the acquirer for a possible "bump" in the tax cost of the Canadian target's non-depreciable capital property.

To take advantage of some of these benefits, it may be necessary to carry out a subsequent merger of the acquisition vehicle and Canadian target.

Care is also required in designing the share structure of the Canadian subsidiary and arranging for it to be properly capitalized and financed for the acquisition.

Where assets are being acquired rather than shares, it is even more important to consider using a Canadian subsidiary. If the non-Canadian acquirer buys Canadian business assets, it will be directly liable for debts and liabilities that arise from the operations. It will also be liable for Canadian tax on the income from those assets and will have to file Canadian income tax returns every year, reporting its income from Canadian operations. However, by using a Canadian subsidiary to acquire the assets and to conduct the Canadian operations, the subsidiary becomes responsible for reporting the income and paying tax on the income instead of the non-Canadian parent.

### Are there tax advantages to acquiring shares of a target rather than assets?

A sale of shares can be more tax efficient for shareholders of the target company compared to an asset purchase. Therefore, the vendors may be more inclined to agree to a share purchase than an asset purchase.

In some cases the target company may have advantageous tax pools such as non-capital loss carry forwards, Canadian exploration expenses, Canadian development expenses, scientific research and experimental development credits, net capital losses or other valuable tax attributes. In general, these tax attributes can only benefit the acquirer by purchasing the shares of the target company, not by purchasing assets from the target company.

Where the target company has valuable tax attributes, it is important to structure the acquisition very carefully. This is because the Canadian tax rules contain a number of limitations on using the tax attributes of the target following an acquisition.

Where the target company has no special tax attributes, or where its assets have a very low tax basis compared to the purchase price, it may



be advantageous for the acquirer to acquire the assets directly rather than shares of the target. By acquiring the assets, the tax basis for the assets will be equal to the purchase price paid. This creates a high tax basis in the assets for the acquirer, which can result in tax savings to the acquirer in the future. Where assets are purchased, it will be important to allocate the total purchase price between the various assets. Amounts reasonably allocated to inventory or depreciable property can be more tax efficient than amounts allocated to non-depreciable capital property such as land.

## **How would the Canadian subsidiary be taxed in Canada?**

A subsidiary incorporated anywhere in Canada is subject to taxation in Canada on its worldwide income. A Canadian resident corporation is subject to both federal and provincial income tax. Canadian corporate tax rates have fallen over the past several years and are comparable to the rates in many other countries.

Often in the early start-up years of a subsidiary's business, operating losses may be incurred, in which case there would generally be no income tax payable by the subsidiary. Furthermore, any such business losses can be carried forward for 20 years to offset income earned after the operations become profitable.

## **Are there situations where a non-Canadian parent would carry on the Canadian business directly?**

In some situations where a non-Canadian acquirer has other profitable operations, the acquirer may wish to structure the acquisition as an asset purchase and carry on the operations initially as a branch of the acquirer in order to deduct the start-up losses against the earnings from the other profitable operations.

This type of structure is not common and must be implemented very carefully, especially once the operation becomes profitable. For example, any non-Canadian acquirer that carries on business in Canada must pay Canadian income tax on any income it earns in Canada through a permanent establishment. Difficult questions can arise in calculating the income that is derived from a Canadian permanent establishment, and there are no clear guidelines for the calculations under Canadian law. In addition, the non-Canadian acquirer must pay an additional branch tax based on the profits from the Canadian operation which are not reinvested back in Canada. As well, the books and records of the non-Canadian acquirer may be subject to audit by the Canada Revenue Agency. For this reason, LLCs and other fiscally transparent vehicles may be considered. The rules are complex and

should be reviewed carefully in every case. The non-Canadian acquirer will also be responsible for Canadian payroll taxes and remittances on any employees who work in Canada.

## **What are some of the Canadian withholding taxes that would apply to payments by the Canadian subsidiary to a non-Canadian corporate parent?**

Withholding tax will be payable on the gross amount of dividends paid or credited by a Canadian subsidiary to any non-resident shareholder. This tax is required to be deducted or withheld by the Canadian subsidiary on behalf of its parent corporation. The *Income Tax Act* (Canada) imposes a general 25 per cent withholding tax rate that may be reduced under an applicable tax treaty.

Canadian withholding tax also applies to interest that is paid to a non-resident parent corporation, or to any other person with whom the subsidiary does not deal at arm's length. The withholding rate on interest is generally 25 per cent, but may also be reduced under an applicable tax treaty.

## **Are there situations where Canadian withholding tax does not apply?**

The withholding tax on dividends only applies to payments that are dividends or similar distributions under corporate law. However, a return of capital that is properly made under Canadian corporate law by the Canadian subsidiary to its non-Canadian parent corporation is not treated as a dividend for Canadian income tax purposes. As a result, capital can generally be repaid free of Canadian withholding tax. To take advantage of this rule, advance planning is required and suitable share rights and capitalization of the subsidiary is necessary.

As well, interest paid to an arm's-length lender is now free from Canadian withholding tax, as long as it is not participating debt interest. Therefore, interest on financing for the acquisition from banks or other arm's-length parties outside of Canada directly to the Canadian subsidiary can be free of withholding tax in appropriate circumstances.

Finally, the principal amount of a loan can be paid free of Canadian withholding tax. Where a payment includes both interest and principal, the amount of principal should be specified clearly so that withholding tax is not payable on that portion of the amount.



## **Are there any tax restrictions on how a non-Canadian parent corporation funds the Canadian subsidiary?**

One key decision is whether to fund the Canadian subsidiary with debt or equity. A number of tax rules affect this decision. For example, interest is only deductible to the extent it is reasonable. As well, interest paid by a Canadian subsidiary to its parent corporation will be subject to special requirements under Canadian transfer pricing rules. The subsidiary must be able to prove that the interest rate it pays is the same as the interest it would pay to an arm's-length lender, and it must have suitable supporting documents available to show to the Canadian tax authorities if requested.

Under Canadian tax rules, there is a limit on the amount of debt that the Canadian subsidiary should borrow from its parent. This is because there are restrictions on the amount of interest the subsidiary can deduct on debts owing to specified non-residents. In order to have full interest deductibility, the debt-equity ratio of the subsidiary should be limited to two to one. This restriction is known as the thin capitalization rule. A non-Canadian shareholder should be mindful of the thin capitalization rules when funding its Canadian subsidiary.

## **OTHER CONSIDERATIONS**

### **Does Canada have currency controls?**

No, Canada has no currency controls.

### **What process is involved in bringing non-Canadian workers into Canada to work at a Canadian company acquired by a non-Canadian parent?**

Canada's immigration programs and rules are designed to facilitate the entry of business people, managers and skilled workers.

Executives, senior managers and technical personnel needed to work on a project in Canada may apply for work permits to allow them to work in Canada on behalf of a foreign business or a related Canadian entity. To be eligible for a work permit, the applicant must qualify under one of Canada's work permit categories. Such workers may sometimes be eligible for intra-company transfer work permits. These are available to eligible managerial-level employees or key specialists who are being transferred from an employer outside of Canada to a related Canadian entity.

Work permit applications are filed at a Canadian visa office. Some workers must also obtain a temporary resident visa (TRV) as part of

the process. They will also need to pass an immigration medical if they are coming to Canada for more than six months. When the visa office approves an application, it will issue a TRV and a letter of authorization allowing the worker to fly to Canada. The work permit itself is issued at the port of entry in Canada.

Accompanying spouses of most foreign nationals working in Canada may apply for a work permit under the Spousal Employment Program. Temporary immigration documentation may also be obtained for accompanying children.

The federal departments of Human Resources and Skills Development Canada and Citizenship and Immigration Canada jointly administer the Temporary Foreign Worker Program and ensure that employing foreign workers has a neutral or positive effect on the Canadian labour market and economic growth.

In some cases where the intra-company transferee category is not available, it is necessary to first obtain a Labour Market Opinion from the Canadian government before the work permit application can be made. This is done by way of an application filed in Canada. Several criteria must be met. For example, it must be shown that qualified Canadian workers are not available and the wage being offered must meet the prevailing wage rate for the occupation in the location of the work.

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