Dividends, Paid-up Capital Transactions and Related Corporate events

P. Robert Arkin
Partner, Halifax Office

Overview

- Share Issuances
- Dividends
- Capitalization of Surplus Accounts
- Reduction of Capital
- Share Redemptions

Overview

- Statutory Regimes Considered
  - Ontario *Business Corporations Act*
  - *Canada Business Corporations Act*
  - Nova Scotia *Companies Act*

Share Issuances

- OBCA/CBCA:
  - Shares are without nominal or par value (OBCA 22(1)/CBCA 24(1))
  - Share shall not be issued until consideration is fully paid in money or in property or past services not less in value than the fair equivalent of the money the corporation would have received if issuing for money (OBCA 23(3)/CBCA 25(3))

Share Issuances

- NSCA:
  - Shares may be without nominal or par value or may have a par value
  - Shares may be issued as partially paid/subject to a call for the unpaid portion of the subscription price
  - Payment for shares with non-cash consideration requires written contract (NSCA 109(1) and (2))

Share Issuances

- Capital Accounts
  - Corporation required to maintain a separate stated capital account for each class/series of shares (OBCA 24(1)/CBCA 26(1))
  - Nova Scotia company limited by shares “shall maintain or be deemed to maintain” a capital account for each class/series of shares (NSCA 26(17))

Share Issuances

- Capital Accounts – A Brief Word About Paid-Up Capital
  - The expression "paid-up capital" is defined in subsection 89(1) of the ITA
  - In general terms, paid-up capital (or "PUC") represents capital that can be returned to a shareholder on a non-taxable basis
  - PUC is your friend

Share Issuances

- Capital Accounts – A Brief Word About Paid-Up Capital
  - PUC is initially determined under the applicable corporate law, subject to a variety of adjustments under the ITA
  - PUC can be reduced ("PUC grind") under various provisions of the ITA ("Tax PUC" and "Corporate PUC" may be different)
  - PUC is averaged across a class/series of shares

Share Issuances

- Capital Accounts
  - General Rule: A corporation is required to add to the appropriate stated capital account the full amount of the consideration received for the issued shares (OBCA 24(2)/CBCA 26(2)/NSCA 26(17))
  - Exceptions: For certain transactions less than the full amount may be added (generally the purpose is to ensure that Corporate PUC = Tax PUC)
  - NSCA: PUC cannot exceed aggregate par value

Share Issuances

- Capital Accounts: Circumstances where less than full amount of consideration may be added:
  - Shares issued as consideration for property received from a person who was not at arm's length (within the meaning of the ITA) with the corporation immediately before the issue

OBCA 24(3)(a)(i)/CBCA 26(3)(a)(i)/NSCA 26(18)(a)(i)

Share Issuances

- Capital Accounts: Circumstances where less than full amount of consideration may be added
  - Shares issued in exchange for shares of, or another interest in, a body corporate that immediately before the exchange, or that because of the exchange, did not deal at arm’s length with the issuing corporation

OBCA 24(3)(a)(ii)/CBCA 26(3)(a)(ii)/NSCA 26(18)(a)(ii)

Share Issuances

- Capital Accounts: Circumstances where less than full amount of consideration may be added
  - Shares issued in exchange for property of a person who, immediately before the exchange, dealt with the corporation at arm’s length if the person, the corporation and all holders of shares of the series/class consent to the exchange

OBCA 24(3)(a)(iii)/CBCA 26(3)(a)(iii)

Share Issuances

- Capital Accounts: Circumstances where less than full amount of consideration may be added
    - NSCA 26(18)(c): In any other case, where permitted by law, if the person, the company and all holders of shares in the class or series consent to the amount so added

Share Issuances

- Generally share issuances are at the discretion of the directors (OBCA 23(1)/CBCA 25(1))
- NSCA does not expressly address this, but the Articles of Association typically confer share issuance discretion on directors
- OBCA/CBCA: Shares shall not be issued until consideration is paid in full (if not paid in money then in property/past services not less in value than the fair equivalent of money the corporation would have received) (OBCA 23(3)/CBCA 25(3))

Share Issuances

- For the purposes of OBCA 23(3)/CBCA 25(3), "property" does not include a promissory note issued by the subscriber or a person dealing on a non-arm's length basis with the subscriber
- NSCA:
  - Shares can be issued unpaid/partially unpaid, and therefore subject to call
  - If not fully paid on issue, a written contract is required (subs. 109(1) & (2))

Share Issuances

- Directors' resolution allotting and issuing shares
  - Recitals
    - *Subscription has been received (name of subscriber/details of subscription price)*
    - *Subscription price has been received (and, if paid in kind, is the fair equivalent of a cash subscription price)*
    - *Expedient/in the best interest of the corporation to accept the subscription/issue the shares*

Share Issuances

- Directors' resolution allotting and issuing shares:
  - Operative provisions
    - *Subscription is accepted*
    - *Shares are allotted and issued*
    - *Issuance of share certificate is authorized/directed*
    - *Minute book records (including shareholders' register) to be amended*
    - *Addition to capital account*

Dividends

- Dividends
- Stock (Share) Dividends
- Capital Dividends
- Eligible Dividends

Dividends

- Dividends Generally
  - Corporation may pay a dividend by issuing
    - *fully paid shares (CBCA, 43(1))*
    - *fully paid shares or options/rights to acquire fully paid shares (OBCA 38(1))*
  - Corporation may pay a dividend in money or property, subject to relevant solvency test (OBCA 38(1)/CBCA 43(1))

Dividends

- Dividends Generally – Solvency test
  - The directors/corporation shall not declare/pay a dividend if there are reasonable grounds for believing that
    - *the corporation is, or after the payment would be, unable to pay its liabilities as they become due; or*
    - *the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes*

  OBCA 38(3)/CBCA 42

Dividends

- Dividends Generally – Nova Scotia
  - NSCA does not have an express solvency test
  - Dividend provisions typically set out in the Articles of Association
  - Power to declare dividends typically granted to the directors
  - Dividends to be declared out of the "profits" of the company (see, for example, Article 159 of the Table A Articles)

Dividends

- Cash Dividend Resolution
  - Recitals
    - *Expedient/in the best interests of the corporation to pay a dividend*
    - *Specify class of shares/record date*
    - *Recite compliance with solvency test (or, in the case of a Nova Scotia company, the existence of undistributed profits out of which a dividend can be validly declared/paid)*

Dividends

- Cash Dividend Resolution
  - Operative provisions
    - *Declare dividend as a cash dividend on particular class of shares*
    - *Specify record date/time*
    - *Specify date/time at which dividend becomes payable*
    - *Authorize officers to effect payment*

Dividends

- Stock/share dividends
  - Authorized by OBCA 38(1)/CBCA 43(1)
  - Not expressly authorized by NSCA but contemplated in clause 19A(2)(b) and Article 166 of the Table A Articles
  - For tax purposes, the amount of the dividend is generally the amount added to the relevant capital account (paragraph (c) of the definition of “amount” in subsection 248(1) of the ITA)

Dividends

- Stock/share dividends
  - OBCA 38(2): All or a part of the value of the stock dividend shares to be added to the stated capital account
  - CBCA 43(2): The declared amount of the dividend stated as an amount of money shall be added to the stated capital account
  - NSCA: Does not address the issue of addition to the capital account, but par value shares can be used to manage this issue (particularly if the objective is low PUC shares)

Dividends

- Stock/share dividend resolution:
  - Recitals
    - *Expedient/in the best interests of the corporation to pay the dividend*
    - *Specify class of shares/record date*
    - *Dividend to be paid by the allotment and issuance of shares*

Dividends

- Stock/share dividend resolution:
    - Operative provisions
        - *Declare dividend on particular class of shares*
        - *Specify the amount of the dividend in cash*
        - *Resolve that the dividend is to be paid by way of the allotment and issuance of shares of a particular class*
        - *Resolve for share certificates to be issued and the minute book records to be amended accordingly*
        - *Addition to relevant capital account*

Dividends

- Capital Dividends
  - Provided for in subs. 83(2) of the ITA
  - Private corporation can elect for the full amount of a dividend to be a capital dividend to the extent of the corporation’s capital dividend account
  - Result: dividend is not included in recipient’s income for tax purposes

Dividends

- Capital Dividends
  - Dividend-paying corporation must elect in prescribed form and manner at or before:
    - *the time the dividend becomes payable; or*
    - *the first day on which any part of the dividend is paid (if earlier than the date/time the dividend becomes payable)*

Dividends

- Capital Dividends
  - Manner of electing (Regulation 2101):
    - *Prescribed form: T2054*
    - *Certified copy of directors' resolution authorizing the election to be made*
    - *Schedules showing computation of capital dividend account*

Dividends

- Eligible Dividends
  - Defined in subsection 89(1) of the ITA: The portion of a taxable dividend received by a person resident in Canada, paid by a corporation resident in Canada and designated under subsection 89(14) to be an eligible dividend
  - In general terms, eligible dividends are paid out of a corporation's general rate income pool, and receive a more favourable dividend tax credit to compensate for higher corporate taxes paid at the general rate

Dividends

- Eligible Dividends
  - Dividend must be designated in accordance with subsection 89(14)

“A corporation designates a portion of a dividend it pays at any time to be an eligible dividend by notifying in writing at that time each person or partnership to whom the dividend is paid that the portion of the dividend is an eligible dividend.”

Dividends

- Eligible Dividends
  - Notification to shareholders must be given before or at the time the dividend is paid
  - Notification methods acceptable to the CRA:
    - *Identifying eligible dividends through letters to shareholders*
    - *Dividend cheque stubs*
    - *If all shareholders are directors, a notation in the minutes*

Dividends

- Eligible Dividends
  - Notification methods acceptable to the CRA for public corporations:
    - *Posting a notice on the corporation's website*
    - *Giving notice in corporate quarterly or annual reports*
    - *Giving notice in shareholder publications*

Dividends

- Eligible Dividend Resolution
  - Recitals
    - *Expedient/in the best interests of the corporation to pay the dividend and to designate the entire/a portion of the dividend as an eligible dividend*
    - *Specify class of shares/record date*
    - *Recite compliance with solvency test*

Dividends

- Eligible Dividend Resolution
    - Operative Provisions
        - *Declare dividend as a cash dividend on a particular class of shares*
        - *Specify class on which dividend is declared*
        - *Specify record date/time*
        - *Specify payment time/date*
        - *Resolve to designate dividend as an eligible dividend*
        - *Acknowledgement of notice from shareholder(s)*

Capitalization of Surplus Accounts

- OBCA/CBCA Corporations: Subject to compliance with certain restrictive provisions, a corporation may add to the stated capital account maintained in respect of any class/series of shares any amount it has credited to a retained earnings or other surplus account (OBCA 24(5)/CBCA 26(6))
- NSCA Companies: Company may, at any time, add to a capital account of a class/series any amount it credited to retained earnings, share premium, contributed surplus or other surplus account (provided that the par value may not be exceeded)

Capitalization of Surplus Accounts

- Restriction (OBCA 24(6)): Special resolution approval of addition to stated capital account required if:
  - The amount to be added was not received as consideration for shares (for instance, a contribution of capital, or retained earnings) <u>or</u> was received as consideration for the issue of shares but does not form part of the stated capital; and
  - Shares of more than one class or series are outstanding
- Class vote for any class differently affected (OBCA 24(7))

Capitalization of Surplus Accounts

- Restrictions in CBCA 26(5) and in NSCA 26(20) are materially the same as OBCA 24(6)
- Ensure that amount in question has been credited to the relevant surplus account (generally an accounting determination)
- Ensure that capitalization occurs before any subsequent reduction

Capitalization of Surplus Accounts

- Tax considerations
  - With certain exceptions, an increase in PUC of a class of shares results in a deemed dividend (84(1) ITA)
  - Exceptions to deemed dividend treatment:
    - *Stock dividend (84(1)(a) ITA)*
    - *Transaction by which value of assets less liabilities is increased (84(1)(b)(i) ITA)*
    - *Transaction by which liabilities less value of assets decreases (84(1)(b)(ii) ITA)*

Capitalization of Surplus Accounts

- Exceptions to deemed dividend treatment (continued)
  - *Transaction by which PUC of other share classes is reduced by an amount not less than the increase in PUC (84(1)(c) ITA)*
  - *Any action by which the corporation converts into PUC in respect of a class of shares any of its contributed surplus that arose on the acquisition of property by the corporation (for no consideration or for consideration that did not include shares of the corporation) from a person who at the time of the acquisition held issued shares of the class (ie. a contribution of capital): (84(1)(c.3)(ii) ITA)*

Capitalization of Surplus Accounts

- Exceptions to deemed dividend treatment (continued)
  - *Any action by which the corporation converts into PUC in respect of a class of shares any of its contributed surplus that arose as a result of any action by which the PUC in respect of that class of shares (or in respect of shares of a substituted class) was reduced (84(1)(c.3)(iii) ITA)*
- Exception in 84(1)(c.3)(ii) generally allows capitalization of contributed surplus without triggering a deemed dividend
- Exceptions in 84(1)(c) and/or 84(1)(c.3)(iii) *may* allow PUC shifting between classes

Reduction of Capital

- OBCA 34(1)(b): A corporation may by special resolution reduce stated capital for any purpose, including:
  - Distributing to shareholders an amount not exceeding the stated capital of the class/series; or
  - Declaring stated capital to be reduced by an amount not represented by realizable assets or an amount otherwise determined in respect of which there shall be no distribution to the shareholders

Reduction of Capital

- OBCA 34(4) solvency test: Corporation shall not take action to reduce capital (other than in respect of an amount that is not represented by realizable assets) if there are reasonable grounds for believing that:
  - Corporation is/after reduction will be unable to pay liabilities as they become due; or
  - After reduction, the realizable value of assets would be less than aggregate liabilities

Reduction of Capital

- OBCA 34(3): Special resolution must specify the capital account(s) from which the reduction will be made
- OBCA 34(2): Class vote for any class/series affected differently by proposed stated capital reduction
- CBCA 38(1), (3) materially the same as OBCA 34(1)(b), 34(4)
- NSCA 57(1) and (2) allow a limited Nova Scotia company to reduce capital with special resolution approval on substantially the same terms as OBCA/CBCA corporations

Reduction of Capital

- Resolution drafting issues
  - If a reduction of capital is accompanied by a distribution of cash or other assets, a directors’ resolution (in addition to the special resolution) is required (or at least advisable)
  - For a Nova Scotia company, the special resolution should expressly state that, after the reduction of capital, the shares are still considered to be fully paid

Reduction of Capital

- Resolution drafting issues
  - If reducing capital of a class of par value shares of a Nova Scotia company, the special resolution must alter the memorandum of association by reducing the amount of the company's share capital and shares accordingly (NSCA, 57(2))

Share Redemptions

- OBCA 32(1): Corporation may purchase/redeem any redeemable shares issued by it at prices not exceeding the redemption price stated in articles/determined by formula stated in articles
- OBCA 32(2): Solvency test – no payment to redeem if there are reasonable grounds for believing that:
  - After payment corporation would be unable to pay liabilities as they become due; or

Share Redemptions

- After payment, realizable value of corporation's assets would be less than the aggregate of:

  - *The corporation's liabilities; and*

  - *the amount that would be required to pay the holders of shares that have a right to be paid, on redemption or liquidation, rateably with or before holders of the redeemed shares*

Share Redemptions

- OBCA 35(1): Deduction from capital account upon redemption
  - Amount to be deducted is the product obtained when:
    - *Stated capital of the class/series*

      is multiplied by

    - *The number of shares redeemed divided by the number of shares of the class/series immediately before the redemption*

Share Redemptions

- CBCA 36(1) and (2) materially the same as OBCA 32(1) and (2)
- CBCA 39(1) materially the same as OBCA 35(1)
- NSCA 51(9): A Nova Scotia company may redeem redeemable shares for an amount not exceeding the redemption price thereof, subject to a solvency test in subs. 51(10) that is materially the same as OBCA 32(2)/CBCA 36(2)

Share Redemptions

- On a redemption of shares by a Nova Scotia company, notice of the redemption must be given to the Registry of Joint Stock Companies within one month of the redemption (NSCA 50(5))
- On a redemption of shares (or any repurchase of shares) by a Nova Scotia company, the authorized capital is reduced correspondingly
- Acquisition by a NS company of its common shares must be approved by special resolution

Cox & Palmer

Thank you

Questions/Comments