

**TAX AND CORPORATE LAW BULLETIN**

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**AN UNBIASED LOOK AT UNLIMITED LIABILITY COMPANIES IN CANADA**

Many sophisticated cross-border structures have been developed to enhance the after-tax returns earned by non-residents that invest in Canada. For instance, US resident investors have frequently formed unlimited companies (“ULCs”) under the Nova Scotia *Companies Act* (the “NSCA”) when structuring their Canadian business activities. ULCs formed under the NSCA (“NSULCs”) are hybrid entities that are treated as corporations for Canadian corporate and tax law purposes, even though the shareholders of an NSULC may ultimately be liable for the residual debts of the company.

The unique corporate status of an NSULC is significant because US resident taxpayers are generally entitled to elect to treat an NSULC as a branch or partnership for US tax purposes under the US *Simplification of Entity Classification Rules*, commonly known as the “check-the-box” regulations (the “US Regs”). As a result, US resident investors that hold their Canadian investments through an NSULC may generally consolidate the profits and losses of their indirect Canadian operations with those of the other members of their corporate group when computing their US tax liabilities, while preserving many of the benefits of maintaining a separate corporate presence in Canada.

Until recently, the Province of Nova Scotia was the only jurisdiction in Canada in which a ULC could be formed. However, on May 17, 2005, the Province of Alberta amended its *Business Corporations Act* (the “ABCA”) to permit the formation of unlimited liability corporations under Alberta law (“ABULCs”).

While the introduction of ABULCs represents a positive development for US residents that wish to invest or conduct business in Canada, it is critical to recognize that the legal attributes of NSULCs and ABULCs are far from identical. Accordingly, a number of important factors must be considered when deciding whether to form an NSULC or an ABULC or to convert an existing NSULC into an ABULC.

**NSULCs vs. ABULCs: A COMPARATIVE CORPORATE LAW ANALYSIS**

As the following table illustrates, no single entity best suits the needs of all potential US investors. Rather, each of the criteria set out below should be closely considered to determine whether the use of an NSULC or an ABULC best facilitates the achievement of an investor’s commercial and tax-related objectives.

<i><b>CRITERION</b></i>	<i><b>NSULCs</b></i>	<i><b>ABULCs</b></i>
General Structure of Corporate Statutes	The NSCA is a highly idiosyncratic statute based on the old UK <i>Companies Act</i> , the form of which is generally unfamiliar to US investors and their US-based advisors.	The ABCA is a modern statute, largely based on the <i>Canada Business Corporations Act</i> (the “CBCA”). The CBCA is an analogue of US corporate statutes with which most sophisticated US investors are familiar.
Liability Regime	The shareholders of an NSULC are liable for the debts and liabilities of the company only upon the wind-up or dissolution of the company.  Shareholder liability is limited to the debts and liabilities of the NSULC. The shareholders of an NSULC might not be liable for torts committed by the company or for contractual damages awarded against the company.	The shareholders of an ABULC are directly liable to creditors or other third parties for any liability, act or default of the company.  The liability of shareholders is unlimited in extent and joint and several in nature and does not solely arise on the liquidation of the company.  Most significantly, shareholders appear to be liable not only for antecedent debts of the company (as under the ...

<b>CRITERION</b>	<b>NSULCs</b>	<b>ABULCs</b>
Liability Regime (cont'd)	Finally, the shareholders of an NSULC are not liable for the debts and obligations of the company if: (i) they ceased to be shareholders of the company at least one year before the commencement of the wind-up of the company; (ii) the debts or liabilities at issue arose after the shareholders ceased to hold shares of the company or a court is satisfied that the existing shareholders of the NSULC are capable of covering any financial shortfall; or (c) <b>a contract with the ULC limits the obligation of the shareholders to make a financial contribution on the wind-up of the company.</b>	NSCA), but also for debts that arise after the shareholder ceases to hold shares of the company. Except by virtue of general limitation laws, the ABCA contains no provisions that cut-off the liability exposure of a shareholder of an ABULC or allow shareholders to contract-out of their statutory liabilities.  <b>Nevertheless, so long as a US special purpose entity (an "SPE") is used to hold the shares of an ABULC, the additional liability exposure borne by shareholders of an ABULC will be largely mitigated.</b>  However, if an individual or an entity having value holds the shares of an ABULC, such shareholders could inadvertently be exposed to liability in excess of that faced by shareholders of an NSULC.
Corporate Name	An NSULC can use the words "company" or "corporation" as a legal element of its corporate name.	<b>An ABULC must use either "ULC" or "unlimited liability corporation" as part of its corporate name - which initially may be less commercially recognized and accepted than the legal elements of a corporate name permitted to be used by an NSULC.</b>
US Tax Treatment	NSULCs are expressly referred to in the US Regs.	The US Regs contemplate other Canadian unlimited liability entities qualifying as a branch or partnership for US tax purposes. Specifically, the US Regs capture any Canadian "company or corporation all of whose owners have unlimited liability pursuant to federal or provincial law" (the "Expanded Definition"). Thus, the US tax treatment accorded to ABULCs depends on whether ABULCs fall within the Expanded Definition. <b>While there is no reason to believe that ABULCs will not be treated in a manner comparable to NSULCs for US tax purposes, the Internal Revenue Service has not yet formally confirmed the status of an ABULC under the US Regs.</b>
Canadian Tax Treatment	An NSULC is treated as a corporation for the purposes of the <i>Income Tax Act</i> (Canada) (the "ITA"). Therefore, if non-residents, public companies, or a combination thereof control an NSULC, the company will not qualify as a "Canadian-controlled private corporation" under the ITA.	Treatment is identical to that afforded to NSULCs.
Incorporation Expense	If formed on incorporation or amalgamation, <b>incorporation tax = CAN\$4,000.</b> Not applicable if formed by way of statutory arrangement.	<b>Applicable fee of CAN\$100 on incorporation. If all else is considered equal, the incorporation tax and annual filing fees may act as a tie-breaker favouring the use of an ABULC.</b>
Annual Filing Fee	<b>CAN\$2,000 for filing an annual statement under the NSCA.</b>	<b>Written filings are required, but no filing fee is required to be remitted.</b>
Board Residency Requirements	<b>The NSCA imposes no Canadian residency requirements on the board of directors of an NSULC or on any committee of the board.</b> Shareholders are able to elect inside or outside directors regardless of statutory residency considerations.	The ABCA requires that a minimum of 25% of the members of the board of an ABCA corporation (including an ABULC) be Canadian residents. However, no residency requirements restrict the composition of any board committees. <b>The effect of the applicable Canadian residency requirements can be partly mitigated by entering into a unanimous shareholder agreement that transfers all board powers and liabilities to its shareholders (who are already exposed to unlimited liability).</b>

<b>CRITERION</b>	<b>NSULCs</b>	<b>ABULCs</b>
"Conversion" (i.e. the process of changing a non-ULC into a ULC) or "Continuance" (a "reincorporation" in US corporate law parlance)	For "conversion" into an NSULC, a corporation must first be, or continue as, a company limited by shares under the NSCA. Conversion is then effected by statutory amalgamation or arrangement (both of which require court orders). <b>Accordingly, there would be a temporary loss of unlimited liability status if an ABULC were converted into an NSULC.</b>	Limited corporations and ABULCs are inter-convertible by articles of amendment, amalgamation or arrangement under the ABCA. NSULCs or non-ULCs may be converted into ABULCs concurrently upon reincorporation from another jurisdiction.
Reductions of Paid-Up Capital	The NSCA does not provide an easy mechanism to reduce the paid-up capital of an NSULC for corporate purposes (i.e. requires a court order).	The ABCA contains a straightforward process for reducing the stated capital of an ABULC, provided that certain solvency (working capital and net asset) tests are met.
Other Issues	There are numerous other differences between the NSCA and the ABCA that are often cited but <b>will not often factor into a decision to form a ULC under the NSCA or the ABCA.</b> For example, unlike the ABCA, the NSCA allows for par value shares but has cumbersome requirements for share certificates.	Unlike the NSCA, the ABCA imposes liability on directors for unpaid employee wages and other monies due to employees wherever they are employed.

Ultimately, the introduction of ABULCs offers US investors an alternative when determining how best to structure investments and business activities in Canada. However, the subtle differences between the NSCA and the ABCA demand that non-residents conduct a diligent review of both statutory regimes before deciding whether to utilize an NSULC or an ABULC as the centrepiece of their chosen Canadian holding structure.

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*The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.*

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