

ONTARIO ULCs: PROPOSAL FOR BRINGING ULCs TO ONTARIO¹

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Introduction

For more than two decades, the unlimited liability company (a “ULC”) has become a popular corporate vehicle for facilitating cross-border operations and investments into Canada, especially from the United States (the “US”). Currently, the corporate statutes of only three Canadian provinces, Nova Scotia, Alberta and British Columbia, allow for the incorporation of ULCs. In recent years there has been significant discussion in Ontario about reforming Ontario’s business corporations statute, the *Business Corporations Act* (Ontario) (the “OBCA”), to allow for, among other things, the incorporation of ULCs. In February 2015, the Minister of Government and Consumer Services for Ontario asked a panel of business law experts to provide the Ontario government with a list of recommendations aimed at making Ontario a more attractive choice for operations and investment. One recommendation from this panel was to revised the OBCA to permit the incorporation of ULCs.²

This article provides a brief history of ULCs in Canada, examines and compares certain key provisions of the relevant legislation relating to ULCs across the three Canadian provinces that permit their incorporation of ULCs and concludes with a chart contrasting our view of certain key provisions that should be included in the OBCA that would achieve the Minister of Government and Consumer Services’ goal to make Ontario a more attractive choice for operations and investment with existing relevant legislation.

Brief History of ULCs in Canada

A company with unlimited liability for its shareholders may initially appear counterintuitive – why would shareholders want to risk incurring an unlimited amount of liability in connection with their investment in a corporation? In the context of a US person or business considering operating or investing in Canada, the typical answer is simple – to achieve one or more of the following goals: (i) to legally limit its tax burden; (ii) avoid “double taxation”; and/or (iii) reduce withholding tax payable on funds transferred back to US shareholder(s).

As its name suggests, generally speaking, the shareholder(s) of the ULC will be exposed to unlimited joint and several liability after exhausting the balance sheet of the ULC. However, as

¹ The authors would like to thank Aird & Berlis LLP student-at-law Liam Tracey-Raymont for his significant contribution to the preparation of this paper and the background research related thereto.

² *Business Law Agenda: Priority Findings & Recommendations Report* – Recommendation 2d.

this articles explores, the context and circumstances in which such liability arises varies amongst the three provinces that allow for ULCs. In each jurisdiction, structural techniques can be used to mitigate potential unlimited liability for shareholder(s) of the ULC, such as including additional entities into the broader corporate structure to act as “blockers” between the Canadian ULC and US shareholder(s), but the risk of unlimited liability to shareholder(s) of the ULC remains.

For many decades prior to 2005, ULCs were unique to Nova Scotia because, unlike other Canadian provinces which over time remodeled their business corporations statutes, Nova Scotia retained the English companies law model for its business corporations statute.³ It was not until the 1990’s that Nova Scotia ULCs (“NSULCs”) became more commonly utilized in corporate structures. Interestingly, rather than Canadian tax advisors and lawyers including NSULCs in corporate structures, the inclusion of NSULCs in cross-border was popularized by US professional advisors. In the US, ULCs are generally treated as economically transparent entities or “flow-through” vehicles for tax purposes, similar to a general partnership, regardless of any other corporate features the entity may possess. In other words, under US tax law a ULC may not have any entity level taxation. In 1997, certain rules under US tax law known as the “check-the-box” rules came into effect which allowed Canadian corporations with unlimited shareholder liability to elect to be treated, for tax purposes, as either a partnerships or, if there is only a single shareholder, be disregarded as an entity separate from its owner(s).⁴ Since that time, Alberta and British Columbia have both amended their business corporations statutes to permit the incorporation of ULCs, and all three jurisdictions have attracted a significant number of ULC incorporations as a result.

Comparing Canadian Jurisdictions

Although conceptually similar, there are material differences between certain key aspects of ULCs across the three existing Canadian jurisdictions in which they are currently permitted.

Nova Scotia

Although generally treated as “flow-through” vehicles for US tax purposes similar to a general partnership, members of an NSULC (as shareholders are referred to under the *Companies Act* (Nova Scotia)⁵ (the “NSCA”)), have no direct liability to creditors, as would partners of a general partnership. A member’s liability only crystalizes when the assets of an NSULC are insufficient to satisfy its obligations upon the winding-up, dissolution, or bankruptcy of the NSULC.⁶ Moreover, past members are only liable to contribute to satisfy obligations of the

³ Jack Bernstein and Sky Jondhal, “The Alberta Unlimited Liability Corporation”, online: (2005) *Tax Notes International*.

<www.airdberlis.com/Templates/Articles/articleFiles/577/The%20Alberta%20Unlimited%20Liability%20Corporation%20Aug%208,%202005.pdf>.

⁴ *IRS Internal Revenue Manual*, Part 4., Chapter 61, Part 5.3.1.

⁵ RSNS 1989, c.81.

⁶ *Ibid*, s. 135.

NSULC upon the winding-up, dissolution, or bankruptcy of the NSULC if those members held shares of the NSULC within one year prior to the commencement of a winding-up, dissolution or bankruptcy⁷ and only if it appears to a court that the existing members are unable to satisfy the obligations of the NSULC at the applicable time.⁸ In terms of director's liability, the NSCA does not have any specific provisions establishing director or officer liability, regardless of whether the corporation is an NSULC or has limited liability and, therefore, as such, the liability of directors and officers of an NSULC is governed by common law.

A company incorporated in another jurisdiction, whether or not it is unlimited, may be continued into Nova Scotia as an NSULC if there is unanimous approval by that company's shareholders with voting rights.⁹ Amalgamations may occur between two corporate entities resulting in the formation of a NSULC through either a long or short form amalgamation, provided, however, that any corporations looking to amalgamate must both be either formed and registered or continued under the NSCA.¹⁰

In Nova Scotia, there are no Canadian residency requirements for board members of the NSULC.

Alberta

Alberta ULCs ("AULCs") have only been permitted since 2005. Unlike the English-inspired NSCA, Alberta's corporate legislation, the *Business Corporations Act (Alberta)*¹¹ (the "ABCA"), is based on the modern, US-style, business corporations statutes.

The articles of incorporation for an AULC, in contrast to those of a corporation with limited liability, must contain an express provision that states that the liability all of its shareholders for any liability, act or default of the AULC is unlimited and joint and several in nature.¹² The liability of AULCs shareholders is broad and is considered to be unlimited from incorporation.¹³ Furthermore, a former AULC shareholder can be liable for a liability, act or default of the corporation that occurred while they were a shareholder for two years from any date upon which they ceased to be a shareholder.¹⁴

The ABCA requires that at least 25% of directors be Canadian residents.¹⁵ In terms of director liability, the ABCA directly provides for such liability in specific instances, such as for the

⁷ *Ibid*, s. 135(a).

⁸ *Ibid*, s. 135(c).

⁹ *Ibid*, ss. 133(1) and (1A).

¹⁰ *Ibid*, s 134(1) and based on definition of "company" in s. 2(1)(c).

¹¹ RSA 2000, c. B-9, s.15.3.

¹² *Ibid*, s. 15.3.

¹³ *Ibid*, s. 529.

¹⁴ *Ibid*, s. 15.2(2).

¹⁵ *Ibid*, s. 105(3).

improper issuance of shares, the improper acquisition of shares, improper dividends and other improper payments to shareholders.¹⁶

A company incorporated in another Canadian jurisdiction, whether or not its shareholders have unlimited liability, may be continued in Alberta. The ABCA only requires that such continuance be authorized by the laws of the jurisdiction in which the company was incorporated.¹⁷ Further to the point of AULCs' shareholders being unlimited from the time of incorporation, when an extra-provincial company is continued under the ABCA as an AULC, any liabilities, outstanding actions or proceedings against the previously limited liability company that existed prior to the date of continuance will then be continued against the shareholders of the AULC.¹⁸ The same liability concerns arise when a corporation with limited liability amalgamates with an AULC.¹⁹ The ABCA allows extra-provincial corporations to amalgamate in Alberta if one is a wholly-owned subsidiary of the other so long as the extra-provincial corporation is authorized to do so by the laws of its incorporating jurisdiction.²⁰ Such amalgamations, like other short form amalgamations in Alberta between a parent corporation and its subsidiaries or two wholly-owned subsidiaries of the same corporate parent, only require a resolution from the board of directors of the corporations.²¹

British Columbia

In 2007, British Columbia became the third Canadian province to make ULCs available as a form of incorporation. British Columbia's corporate legislation, the *Business Corporations Act* (British Columbia)²² (the "BCBCA"), is based on the modern, US-style, business corporations statutes. The structure of the BCBCA's provisions dealing with ULCs are similar to those of the ABCA, however, the actual application of, and language in, those provisions is a hybrid of the Nova Scotia and Alberta models.

In British Columbia, when filing a notice of articles with the Registrar of Companies, in order to incorporate a corporation will only be deemed unlimited if its articles contain the following prescribed statement: "The shareholders of this company are jointly and severally liable to satisfy the debts and liabilities of this company to the extent provided in s. 51.3 of the Act."²³ This is similar to Alberta. However, the BCBCA provides that shareholders are only liable to the British Columbia ULC's (the "BCULCs") creditors if the BCULC liquidates and has outstanding debts and liabilities or upon dissolution for unpaid debts and liabilities.²⁴ This

¹⁶ *Ibid*, s. 118(3).

¹⁷ *Ibid*, s. 188(1).

¹⁸ *Ibid*, s. 15.5(1)(c-f).

¹⁹ *Ibid*, s. 15.6(2).

²⁰ *Ibid*, s. 187.

²¹ *Ibid*, ss. 184(1) and 184(2).

²² SBC, 2000, c. 57.

²³ *Ibid*, s. 51.11.

²⁴ *Ibid*, s. 51.3(1)(a) and (b).

framework more closely resembles that of Nova Scotia and represents a material and significant distinction with Alberta. Former shareholder liability for unpaid debts and liabilities of the BCULC are confined to those liabilities that arise within one year of the shareholder ceasing to hold shares of the BCULC,²⁵ and former shareholders are only expected to contribute if the current shareholders are unable to satisfy those liabilities.²⁶

In British Columbia, there are no director residency requirements for any corporation, including BCULCs.²⁷ Directors do have prescribed liability under the BCBCA, as they are liable for a number of improper acts, such as improper payment of dividends.²⁸

Corporations from other Canadian jurisdictions may only be continued as a BCULC if the continuing corporation is already a ULC in Nova Scotia or Alberta²⁹ and that NSULC or AULC complies with the BCBCA's general provisions related to ULCs. Continuance of limited liability corporations as BCULCs is not permitted. Similarly, amalgamations involving non-British Columbia limited liability corporations and BCULCs, or non-BCULCs and any corporation in British Columbia, are not permitted.³⁰ However, two British Columbia limited liability corporations can amalgamate as a BCULC, provided that a unanimous resolution of all the shareholders, whether or not their shares carry the right to vote, of both amalgamating corporations is passed approving the amalgamation.³¹

Proposals for Ontario

After canvassing the ULC regimes in the three Canadian provinces that currently permit them, it is clear that there are two significantly different regimes in Alberta and Nova Scotia, with British Columbia sharing attributes of both. Our favoured provisions from the statutes on the points we canvassed are as follows:

- shareholder liability limited to outstanding unpaid debts and liabilities of the ULC upon dissolution, winding-up or bankruptcy only (Nova Scotia & British Columbia);
- one year duration of former shareholder liability once it sells its shares (Nova Scotia & British Columbia);
- prescribed director liability (Alberta & British Columbia);

²⁵ *Ibid*, s. 51.3(2)(b).

²⁶ *Ibid*, s. 51.3(2).

²⁷ *Ibid*, s. 34(1).

²⁸ *Ibid*, s. 154(1)(a-f).

²⁹ *Ibid*, s. 51.8(a).

³⁰ *Ibid*, s. 51.5(a) and (b).

³¹ *Ibid*, s. 51.6(1)(b).

- allowing corporations formed outside of the province to amalgamate with local ULCs, provided one of the corporations is either the sole parent or a wholly-owned subsidiary of the other (Alberta); and
- no director residency requirements (Nova Scotia & British Columbia).

The following chart summarizes the key differences mentioned above and our proposals for certain key provisions for the OBCA based on existing ULC legislation that, in our view, would achieve the Minister of Government and Consumer Services' to make Ontario a more attractive choice for operations and investment:

**Comparison of Key ULC Provisions Across Existing
Canadian Jurisdictions and Proposals for Ontario**

	Nova Scotia	Alberta	British Columbia	Proposals for Ontario
Provisions in articles	Same as for any other company.	Requirement that articles specify that shareholders have unlimited liability for any acts, debts and defaults of AULC.	Similar to Alberta, except the statement does not include liability for “acts”.	Adopt a requirement that articles specify that shareholders have unlimited liability for any debts and defaults of ULC.
Director residency requirements	None.	25% of board must be a Canadian resident (or at least one Canadian resident if lower than four directors).	None.	Remove the requirement that 25% of board be Canadian residents for ULCs and limited liability corporations, alike.
Shareholder liability	Shareholders are only liable for the unpaid debts/liabilities of the ULC upon winding-up, dissolution or bankruptcy.	Shareholders are directly liable to creditors or other parties for any liability, acts of default of the ULC, throughout the life of the corporation.	Shareholders are liable for the corporation’s creditors if the company liquidates or dissolves and has outstanding debts/liabilities.	Adopt a framework where shareholders are liable for the corporation’s creditors if the company liquidates or dissolves and has outstanding debts/liabilities.
Duration of	One year.	Two years.	One year.	One year.

former shareholder liability				
Statutorily codified actions attracting director liability?	Nothing prescribed in statute – based entirely on common law.	In addition to common law duties, there is a non-exhaustive list of prescribed actions attracting director liability.	In addition to common law duties, there is a non-exhaustive list of prescribed actions attracting director liability.	Maintain prescribed list of actions attracting director liability, which exist in conjunction with common law duties.
Continuance as ULC for corporations from other provinces?	Yes – requires unanimous shareholder approval.	Yes – requires that it be authorized by the exporting jurisdictions laws.	Yes – if it is a current ULC from Nova Scotia or Alberta.	Adopt provisions allowing such action, so long as it be authorized by the exporting jurisdiction’s laws.
Amalgamation with corporations from other provinces to form a ULC?	Yes – amalgamations with ULCs are only permitted with corporations formed and registered or continued in Nova Scotia.	Yes – if the non-Alberta corporation is the sole parent or a wholly-owned subsidiary of the AULC.	No – non-British Columbia corporations may not amalgamate with a British Columbia corporation, of any kind, to form a BCULC.	Adopt provisions allowing such actions, so long as the non-Ontario corporation is the sole parent or a wholly-owned subsidiary of the Ontario ULC.