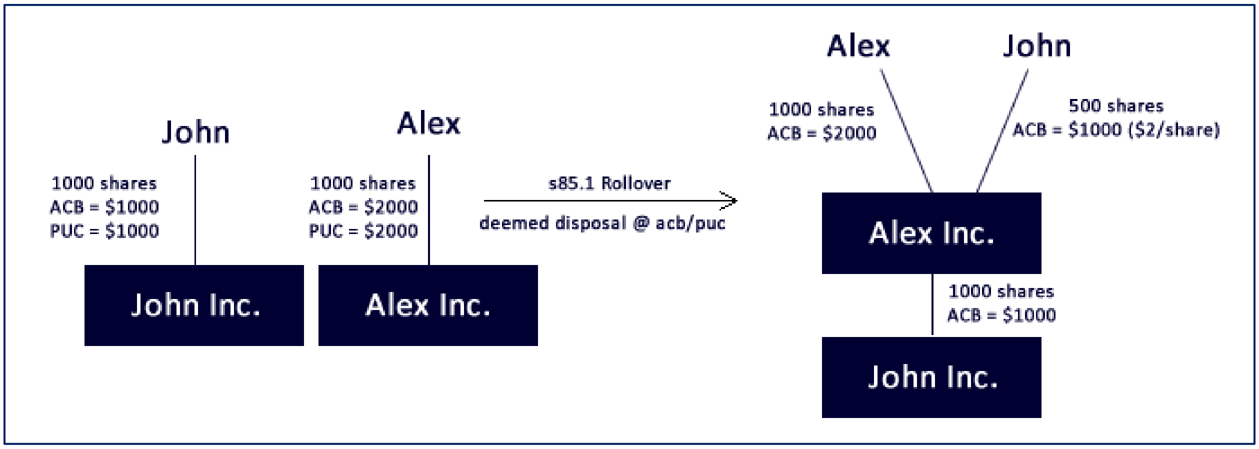
SHARE FOR SHARE EXCHANGE S. 85.1 ROLLOVER

- The **s85.1 Share for Share Exchange** is an **automatic rollover** (therefore, no elections need to be made by the person exchanging the shares)
- The s85.1 is used when an acquirer corporation wants to take over an acquiree corporation (takeover and business combinations)
  - The shareholders of the acquiree corporation exchange their shares in the acquiree corporation for shares of the acquirer corporation
  - Although, the shareholders of the acquiree can exchange their shares in a tax-free manner using s. 85 (1); this is not ideal in situations where there are a large number of diverse shareholders because each shareholder would need to manually make an election
  - With s. 85.1 no election is needed; an exchange happens at the **Adjusted Cost Base (ACB)** and the **Paid up Capital (PUC)** automatically – Therefore **no Capital Gains or Deemed Dividends**

Example: 85.1

- John is the shareholder of John Inc. John owns all 1000 of the shares (with ACB/PUC)=$1,000
- Alex owns all 1000 of Alex Inc. shares (with ACB/PUC=$2,000)
- Alex Inc. wants to buyout John Inc.
- Alex Inc. exchanges 500 of its own shares for 1000 shares of John Inc.
- Alex Inc. shares are worth $20/share



- **Without s85.1**, John is deemed to have disposed his shares at fair value = $20*500 = 10,000; he will have a capital gain of $9,000 ($10,000-1,000).
- **With the s85.1** Rollover, the transfer happens at the ACB; therefore, no capital gains.
  - New ACB = OLD ACB=$1,000
  - The Old PUC gets added to the PUC of Alex Inc. shares; $1,000 will get added to the PUC of Alex Inc. shares; therefore total PUC of Alex Inc. shares = $3,000 (John's PUC = 3000*500/1500 = $1,000)

- The ACB of John Inc. shares to Alex Inc. equals to the **lesser of**
  - a) Fair Market Value = 20*500 = $10,000; or
  - b) PUC of John Inc. shares = $1,000
    - Therefore ACB of John Inc. shares to Alex Inc. = $1,000

Criteria for s85.1

1. The shares exchanged by the shareholder (John) **must not be held to earn business income** (see business income vs. capital gains notes)
2. The Acquirer (Alex Inc.) needs to be a **Canadian corporation**
3. The share-for-share exchange needs to be **arms-length** (the shareholder cannot be related to the acquirer corporation)
4. The shareholder or a related party **cannot control the Acquirer Corporation immediately after the exchange** (John cannot control Alex Inc. immediately after the exchange)
5. No election can be made under s85(1) if 85.1 is used
6. The Acquirer Corporation must issue its own shares and only one class of shares