CAN YOU AFFORD TO SELL? EFFECTIVELY STRUCTURING YOUR COMPANY FOR TRANSITION

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For the past ten years, Perry has provided various tax planning and advisory services to high net worth clients, privately-held businesses, public corporations, foreign corporations with Canadian operations, family trust matters and estates of Canadian citizens and residents. He previously taught as a group study leader for the CICA In-depth Tax Course

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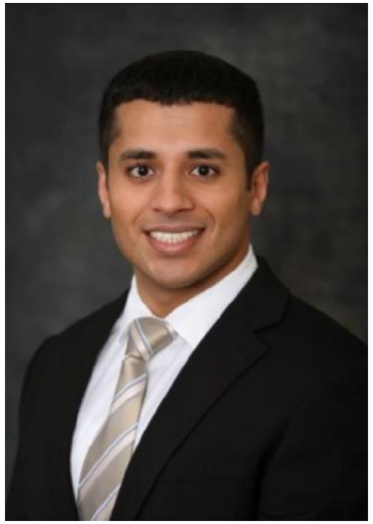

Kam is a senior manager in BDO's Canadian tax department with over 10 years of public practice experience. He specializes in tax planning for privately held businesses and high net worth individuals. He advises clients on corporate reorganizations, mergers and acquisitions, divestitures and estate planning.

Kam is a committee member of the CPABC Taxation Forum as well as a group study leader and in-residence tutorial leader for Part II of the CPA Canada In-Depth Tax Course.

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Begin with the End in Mind

- Assess who your likely buyers are and align your business structure accordingly:
  - Private Equity?
  - U.S. / Offshore?
  - Key Employees?
  - Family?
  - Canadian public companies?
- What is your exit time frame?

Keeping Your Tax House in Order

Watch out for these potential roadblocks:

- Personal / questionable expenses deducted in the business
- Higher than market wages to family members who may only be peripherally involved in the business
- Unreported income
- Inadequate record keeping
- Unsupported filing positions
- Missed / late tax filings, GST, PST, foreign reporting
- Unremitted balances – corporate tax, etc.
- Poor CRA history, both personal and corporate

Evaluating Your Corporate Structure

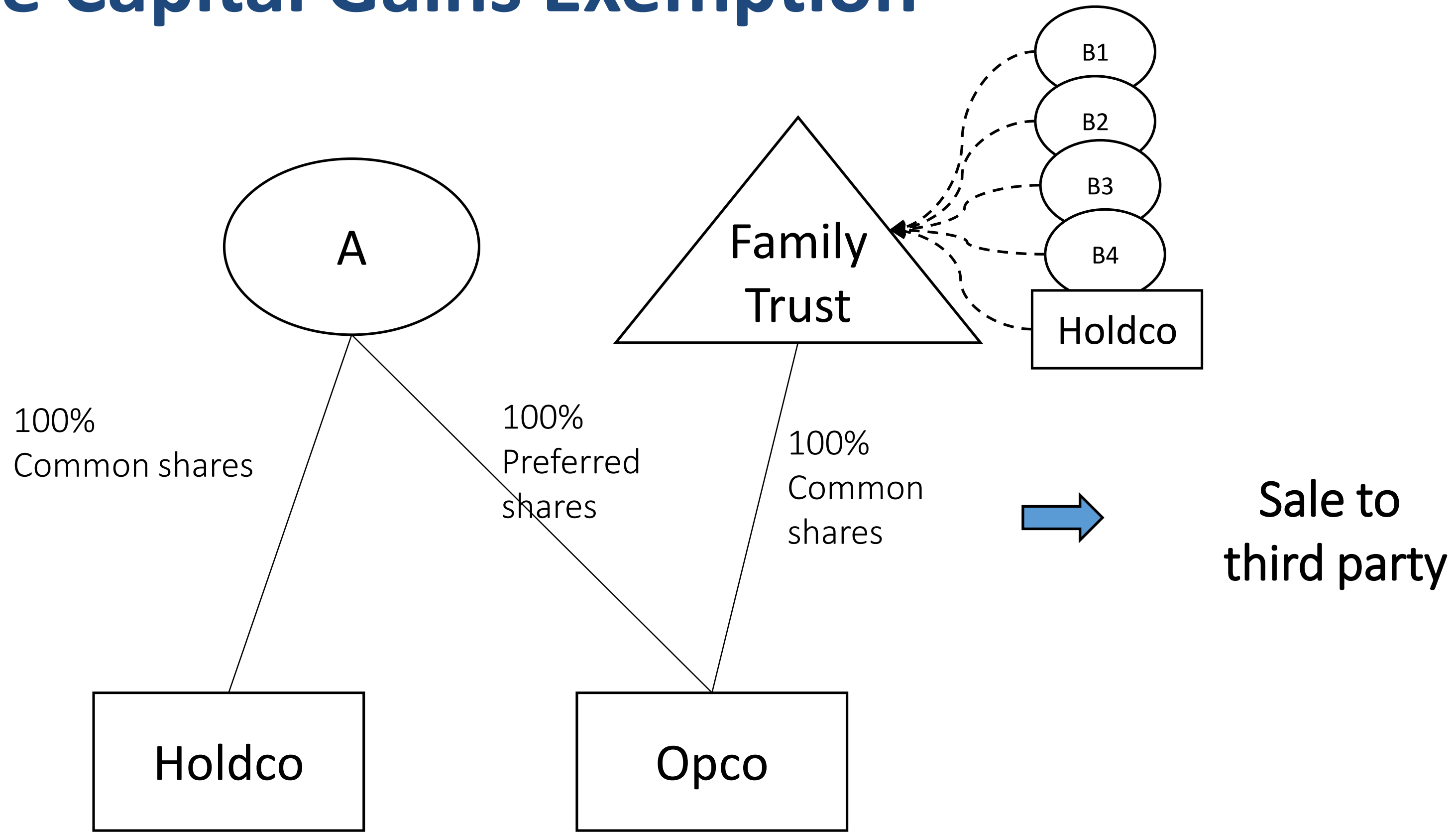
Items to watch out for:

- Old structures that are no longer optimal
- Overly complex organizational structures
- Holding companies in the wrong place in a corporate group
- Non-business assets in an operating company (passive investments, rental properties, boats, cars, aircraft etc.)
- Real Estate – should not be held in an operating company even if used in the business
- Missing or inadequate documentation

Using Your "QSBC" Capital Gains Exemption

- 2016 - $824,176 individual lifetime limit for sale of shares of qualified small business corporations ("QSBC").
- 3 strict tests must be met every day during the 2 year period ending on the date of sale. Many successful businesses do not meet these tests without some pre-sale planning (can take 2 years to re-qualify).
- Your corporate structure and personal tax past may impact your ability to claim the CGE (holding company trap, CNIL, ABIL claims, etc.).
- Consider implementing a plan to access multiple capital gains exemptions (family trusts).
- If selling to family, don't count on using your capital gains exemption.

Multiplying the Capital Gains Exemption



Alternatives if the Shares Do Not Qualify

What can you do if your company does not meet the criteria?

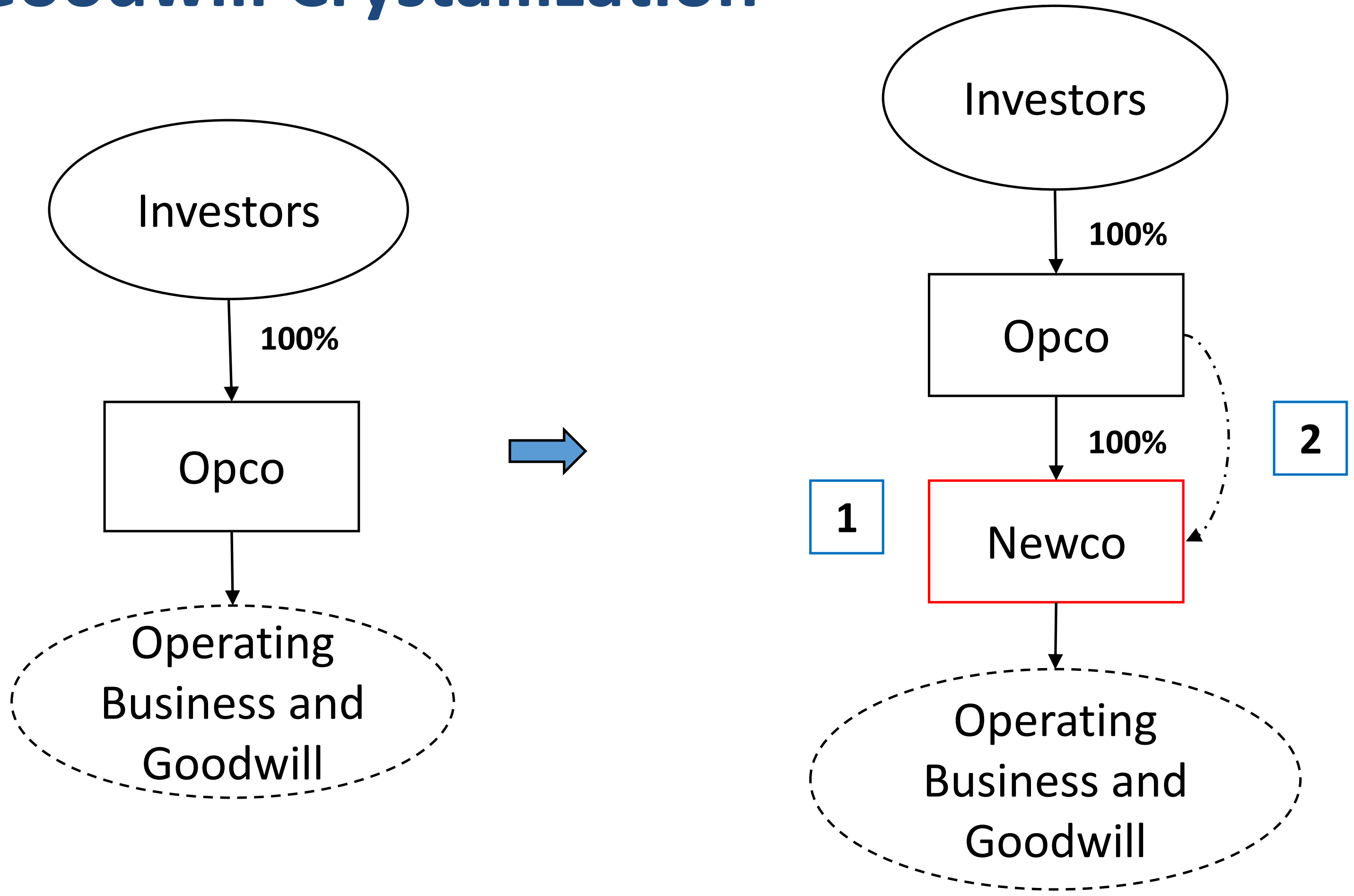
- Remove excess passive assets, or “purify” it, to make it a QSBC.
- Examples:
  - Use liquid assets that do not earn business income to repay liabilities.
  - Pay a dividend or bonus to individual shareholders.
  - Issue a return of capital to shareholders, reducing the ACB and PUC of each shareholder’s shares.

Eligible Capital Property – Planning Opportunities

What is Eligible Capital Property ('ECP')?

- ECP generally includes goodwill, customer list/relationship, trademarks, certain patents, etc.
- Tax treatment of ECP will be changing after December 31, 2016
- Currently, if a company sells ECP and incurs a gain, 50% of the gain is taxed as business income at **13%** or **26%**.
- After December 31, 2016, if a company sells former ECP and incurs a gain, 50% of the gain is taxed as investment income at **49.67%**.
- Opportunity for companies to "crystallize" internally-generated goodwill prior to January 1, 2017.

Goodwill Crystallization



1 Incorporate Newco

2 Transfer Operating Business and Goodwill to Newco

Goodwill Crystallization – Cont'd

Example: Selling goodwill before January 1, 2017 versus post-December 31, 2016 (using BC tax rates)

	Before Jan. 1, 2017	After Dec. 31, 2016
Proceeds	$1,000,000	$1,000,000
Cost	Nil	Nil
Gain from sale of goodwill	1,000,000	1,000,000
Effective tax rate	50%	50%
Taxable portion of gain	500,000	500,000
Tax rate	26%	49.67%
Estimated taxes payable from sale of goodwill	**$130,000**	**$248,350**

Immediate Tax Savings:
$118,350

Goodwill Crystallization – Cont'd

Benefits:

- Shareholders wanting to sell their business in an asset sale in the near future and do not need the cash personally (i.e. refundable tax arising on a post-2016 goodwill gain).
- 50% of the gain from the sale of goodwill will be added to the corporation's capital dividend account ('CDA') balance. The company can pay tax-free dividends to its shareholder(s) up to the amount of its CDA balance.
- Step-up in the value of internally generated goodwill.

Issues with Multiple Shareholders in a Corporate Group

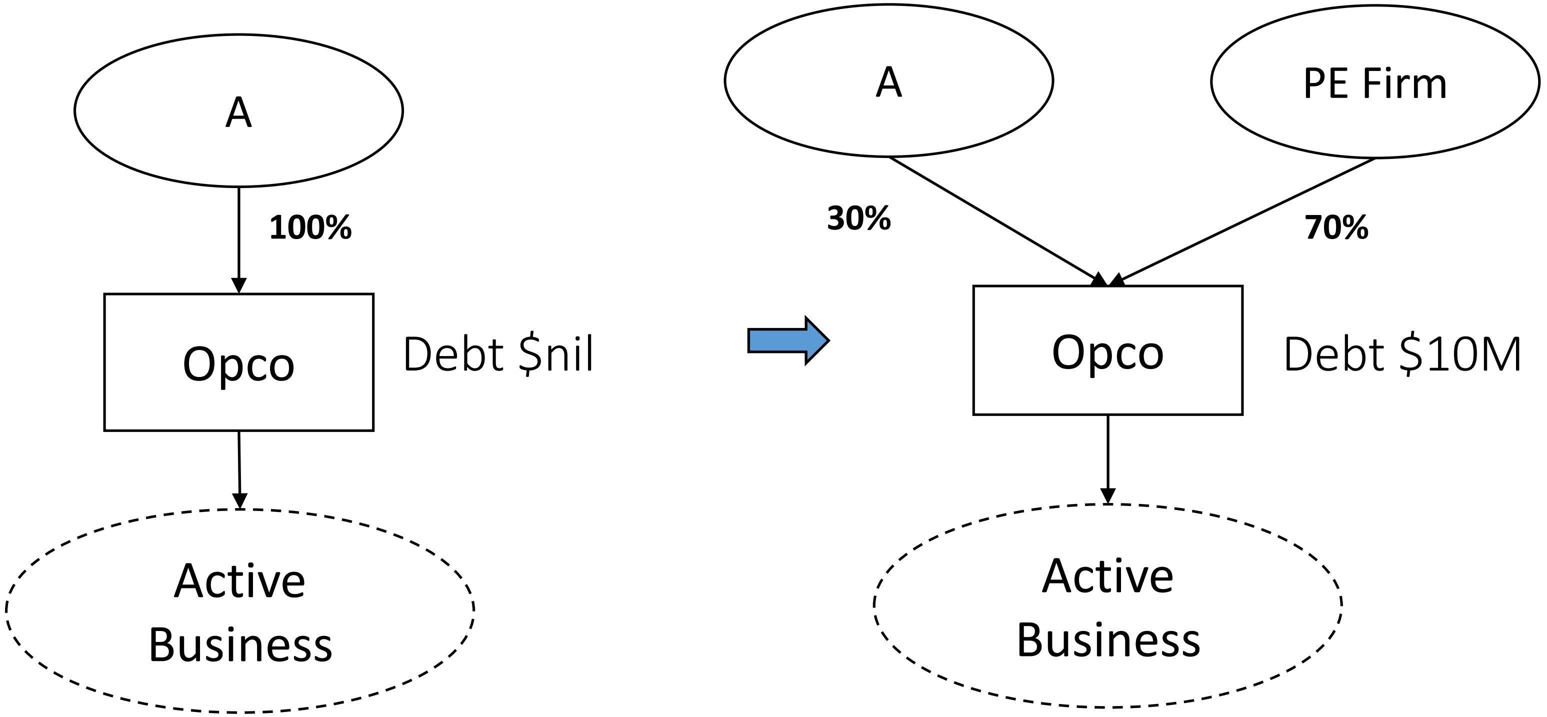
- What happens if not everyone wants to sell?
  - Is there a Shareholders Agreement in place?
  - Right of first refusal, tag along/drag along rights.
  - Minority rights
- Is there a conflict resolution process?
- Employee shareholders – what happens if a key individual leaves employment?
- What happens on death, disability?

Private Equity Recapitalization

What is it?

- Allows a business owner to sell a portion of the business and still retain an equity ownership in the company.
- A portion of the purchase price of the company is funded by way of debt.
- At a later date the business is sold again (hopefully) at a higher valuation.

Private Equity Recapitalization – Cont’d



Private Equity Recapitalization – Cont'd

Total enterprise value of Opco	$20,000,000
Less: Debt on recapitalization	($10,000,000)
New equity value of Opco	$10,000,000
Total enterprise value of Opco	$20,000,000
Less: Buy-in for 30% of the equity value	($3,000,000)
Pre-tax proceeds to shareholder	**$17,000,000**

Private Equity Recapitalization – Cont'd

Second sale of business - Assume that enterprise value doubles	$40,000,000
Less: Debt outstanding on second sale (estimate)	($5,000,000)
Equity value of Target co.	$35,000,000
30% equity value on second sale	**$10,500,000**

Private Equity Recapitalization – Cont’d

Advantages

- Reduce amount of capital tied up in the company
- Reduce involvement in daily operations
- Share continued growth in the company

Private Equity Recapitalization – Cont'd

Risk associated with private equity recapitalization

- Loss of control
- Significant amount of debt
- Unguaranteed value in the future

Building a Great Advisory Team

- Banker
- Lawyer
- Accountant
- Tax Specialist
- Other advisory as required (financial planner, investment advisor, etc.)

Tax Checkup

- Existing situation
- Annually

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