



BUSINESS
TRANSITIONS
FORUM

OCT 10-11, 2018
WESTIN CALGARY

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

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Agenda

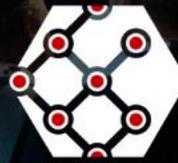
Pre-Sale Considerations

Sale Planning

- Asset vs. share sales
- Transaction alternatives
- Common pitfalls
- Future tax audits and disputes

New Reality Post-Sale

- Tax on split income or “TOSI” rules
- Other tax considerations



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Pre-Sale Considerations

- Optimal vendor sale planning should commence while sale is at conceptual stage (or before) and well before implementation



Pre-Sale Considerations

- Succession plan: family, employees and/or arm's length purchasers
 - Very different tax planning considerations and opportunities
- Estate planning
 - Is the vendor set up for optimal use of the capital gains deduction?
 - QSBC Shares
 - Shares must be owned by individuals
 - Consider use of a family trust



Pre-Sale Considerations

- Corporate records and tax compliance: current and accurate
 - Facilitates likely due diligence phase
 - Helpful in providing representations in sale agreements
- Structure
 - Identifying businesses/assets to be “kept” and “sold”
 - Are businesses/assets owned by the appropriate entities in the group to accommodate sales?
 - Holding corporations
- Dividend policies



Sale Considerations

- There are usually significant opportunities for “value added” planning for vendors, if the planning is carefully tailored and implemented
- Be wary of “marketed” or “off the rack” plans!



Sale Planning – Assets vs Shares

- “Usual” Preferences
 - Vendors generally desire a share sale
 - One level of tax, normally on capital account
 - Potentially tax-favoured for foreign shareholders
 - No recapture/income to target corporation
 - Liabilities assumed by purchaser
 - Access to capital gains exemption
 - Extraction of safe income
 - Purchasers generally prefer an asset purchase
 - Tax deductible cost of depreciable / resource property
 - Avoids risk of assuming (most) undisclosed liabilities
 - Opportunity to acquire selected assets
 - Purchaser may prefer share purchase
 - Target has unused tax attributes
 - Indirect cost of acquiring assets (PST, land transfer tax, conveyancing requirements)



Sale Planning – Assets vs Shares

- Consider if an “earn-out” can help bridge the valuation gap
 - Taxation of earn-outs on a share sale is more straightforward
 - Earn-out on an asset sale (typically relating to goodwill) generally requires a reverse earn-out to maintain capital treatment
- Other options
 - Tax deferred investment in shares of purchaser corporation
 - Consulting agreements
 - Partnership
 - Joint ventures



Sale Planning – Assets vs Shares

- Share sale issues
 - Reorganization may be required if only a portion of the business is to be sold
 - Indemnities to protect the purchaser from historic liabilities that would be inherited through a share purchase
- Asset sale issues
 - Conveyance costs
 - Purchase price allocation negotiations
 - Recapture of depreciation on depreciable assets included in income
 - Inventory gains on income account
- Potential “rollover” for any non-cash consideration
 - Avoids paying tax on share consideration



Sale Planning – Share Sale

- Lifetime capital gains deduction (“CGD”):
 - Allows up to roughly \$850,000 of capital gain to be realized on “qualified small business corporation shares” → more than \$200,000 of tax savings per capital gains deduction utilized
 - Vendor must be an “individual” to claim their CGD (*i.e.*, a “Holdco” does not qualify)
 - Various share ownership and asset-mix tests need to be satisfied
- Consider restructuring to:
 - Ensure corporation is “pure” and meets the asset-mix tests
 - Optimize access to available CGDs (*e.g.*, through family trust)
 - Ensure saleable portions of the business are appropriately separated
 - For family succession planning (sales to children) - 10 year deferral possible



Sale Planning – Share Sale

- Deferral or “safe income” planning
 - Use tax attributes to defer tax (generally up to retained earnings)
 - Requires use of a Holdco
- Deferral is only useful if you don’t need the cash personally, so consider:
 - Age and health of shareholders
 - Personal cash needs of shareholders
 - Whether shareholders plan on staying in Canada



Sale Planning – Asset Sale

- Asset sale – consider a “hybrid” transaction structure to access individuals’ available capital gains deductions
 - Involves sale of assets and sale of shares
 - Purchaser obtains full “tax cost” in the target assets
 - Shareholders of vendor corporation save tax on extracting after-tax proceeds → approximately \$340,000 of potential tax savings per capital gains deduction utilized
 - Not as universal as they once were, but still useful in the right circumstances



Sale Planning – Canadian Resource Property

- Specific tax rules and opportunities for resource companies
 - Value of resource pools to vendor vs. purchaser
 - Use of holding corporations and partnerships in asset dispositions
- Regulatory restrictions on debt/asset ratio for purchasers (2:1)



Sale Planning - Other

- Other planning considerations will vary depending on the business complexity and degree of tax risk acceptable to the vendor, including:
 - International planning (*e.g.*, operations, assets, intellectual property in other countries)
 - Planning using non-CCPCs in an effort to defer tax
 - “Section 84.1” deferral planning
 - Loss corporation planning
 - Deferral for CCPC stock option shares



Sale Planning – Common Pitfalls

- There are a variety of common traps and pitfalls arising in sale transactions, including risks arising from:
 - Risk of reallocation of purchase price
 - Non-competition covenants or agreements
 - Pre-closing dividends
 - Structuring how earn-outs are calculated and paid
 - Sales to family members
 - Getting paid with your own money by your employees
 - GST/HST
 - Section 116 certificates for non-resident vendors
 - Acquisitions of control
 - Loss of CCPC status
 - Provincial tax considerations (e.g., PST or land transfer tax)
 - Deductibility of transaction costs



Sale Planning – Future Tax Audits & Disputes

- Effective planning to mitigate future tax audits and disputes
 - Obtain tax memorandum (or at least detailed transaction steps)
 - Documentation carefully implemented to reflect tax memorandum
 - Canada generally is a “form over substance” jurisdiction for tax purposes
 - Ensure the transactions are legally effective as intended
 - Appropriate allocation of risk in agreements
 - Consider defined responsibilities and cooperation with respect to future tax audits/disputes
 - Legal privilege over sensitive tax planning communications
 - Fixing mistakes – consider options



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New Reality Post-Sale

- After a sale has been completed, there continue to be important opportunities and pitfalls with respect to taxation of sale proceeds



Important Considerations

- Tax efficient extraction of sale proceeds (*i.e.*, from a “HoldCo”)
- Tax on split-income rules
- Limitations on deductions post-sale
- Passive income proposals
- Salaries
- Shareholder loans



Options to Extract Sale Proceeds

- Capital gain rates are preferable to taxable dividend rates
 - Tax rate for top bracket taxpayer in Alberta (approx.):
 - Personal capital gains 24%
 - Eligible dividends 32%
 - Ineligible dividends 42%
- Consider strategies to extract cash at capital gains rates (or better)
 - Time sale of appreciated assets before sale of loss assets (*e.g.*, marketable securities)
 - Create an internal capital gain (a “pipeline” transaction)



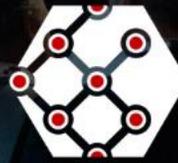
Tax On Split Income (“TOSI”)

- Concerned with “dividend sprinkling” to family members who are not active in the business
- Perceived mischief:
 - Paying dividends to related low income shareholders that are not involved in the business to use their unused marginal tax brackets
- If rules apply, split income is taxed at the highest marginal rate
- Potential savings of over \$30,000 per year per person if you can avoid TOSI application



Tax On Split Income (“TOSI”)

- The new rules add complexity
- Numerous potential exclusions, including:
 - Shareholder is active in the business – but there is threshold activity level required
 - 10% share ownership threshold (votes and value) for many shareholders – provided the business is NOT a service business
- Difficult to safely pay dividends to children under the age of 25
- More difficult to safely pay dividends from holding corporations and through family trusts
- Fewer exceptions for professionals and those operating service businesses



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Questions

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