

# Due Diligence

Portfolios **RE:** Constructed  
with **Mackenzie**

# Due Diligence

**Portfolios  Constructed  
with Mackenzie**

**Latest in tax:  
Opportunities in assisting  
family-owned businesses in  
succession**

Jacqueline Power  
Assistant Vice President, Tax and Estate  
Planning

# Small businesses in Canada

- 98% of businesses in Canada are small businesses with less than 100 employees<sup>1</sup>
- More than 60% of family businesses will be changing hands in the next decade<sup>2</sup>
- Business owners are concerned about tax implications on transferring the business to a family member<sup>2</sup>
- Significant opportunity to work with small business owners

\*Source:

<sup>1</sup> Innovation, Science and Economic Development Canada, Key Small Business Statistics—2021 (Ottawa: Innovation, Science and Economic Development Canada, 2021), <https://ic.gc.ca/sbststatistics>.

<sup>2</sup> Family Enterprise Foundation, "Ready, Willing and Interested—Or Not? Canadian Family Business Transition Intentions," February 2022, <https://familyenterprise.ca/wp-content/uploads/2021/10/Research-Report-Ready-Willing-and-Interested-or-Not.pdf>

# Agenda



Section 84.1

---



2017 tax proposals

---





Bill C-208



# Section 84.1

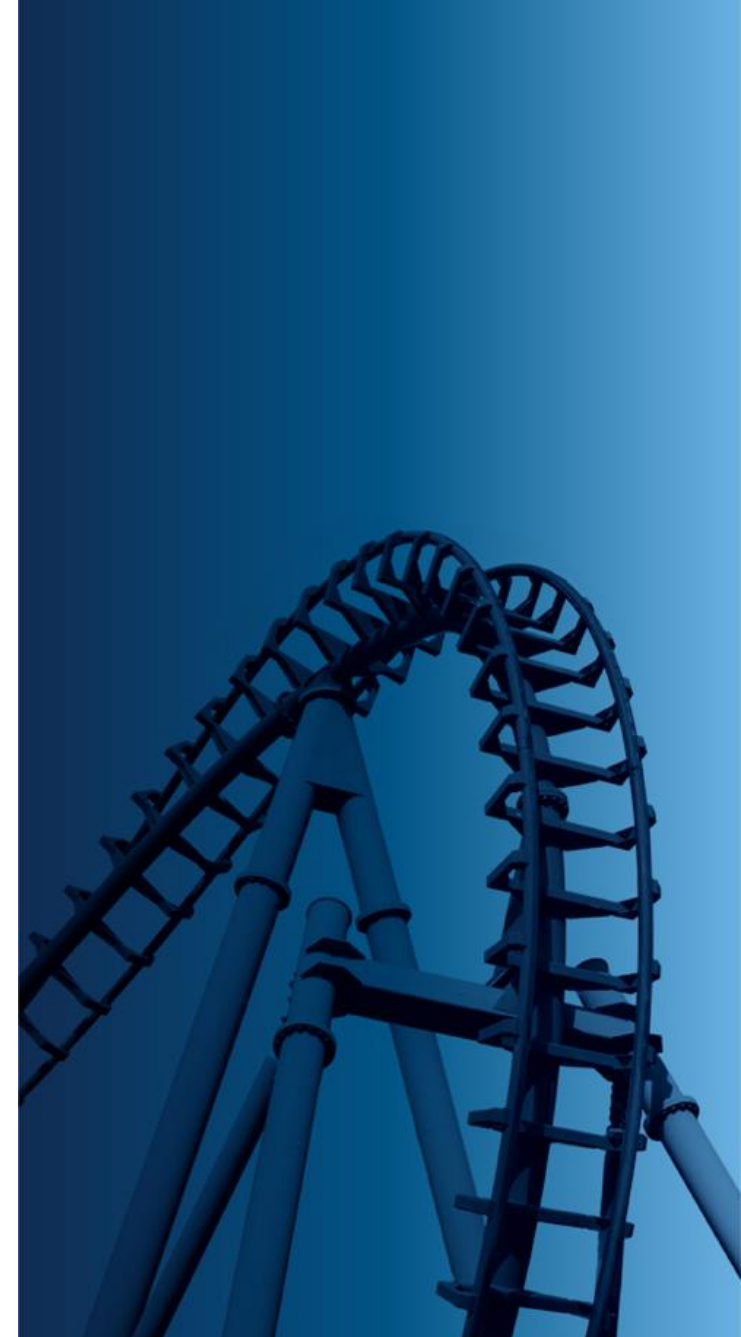
## Section 84.1

- 
- Applies where the following conditions are met:
- A Canadian resident disposes of shares of a corporation resident in Canada
  - The shares disposed are capital property of the taxpayer
  - The shares are disposed to a non-arm's length corporation
  - Both corporations are connected immediately after the disposition

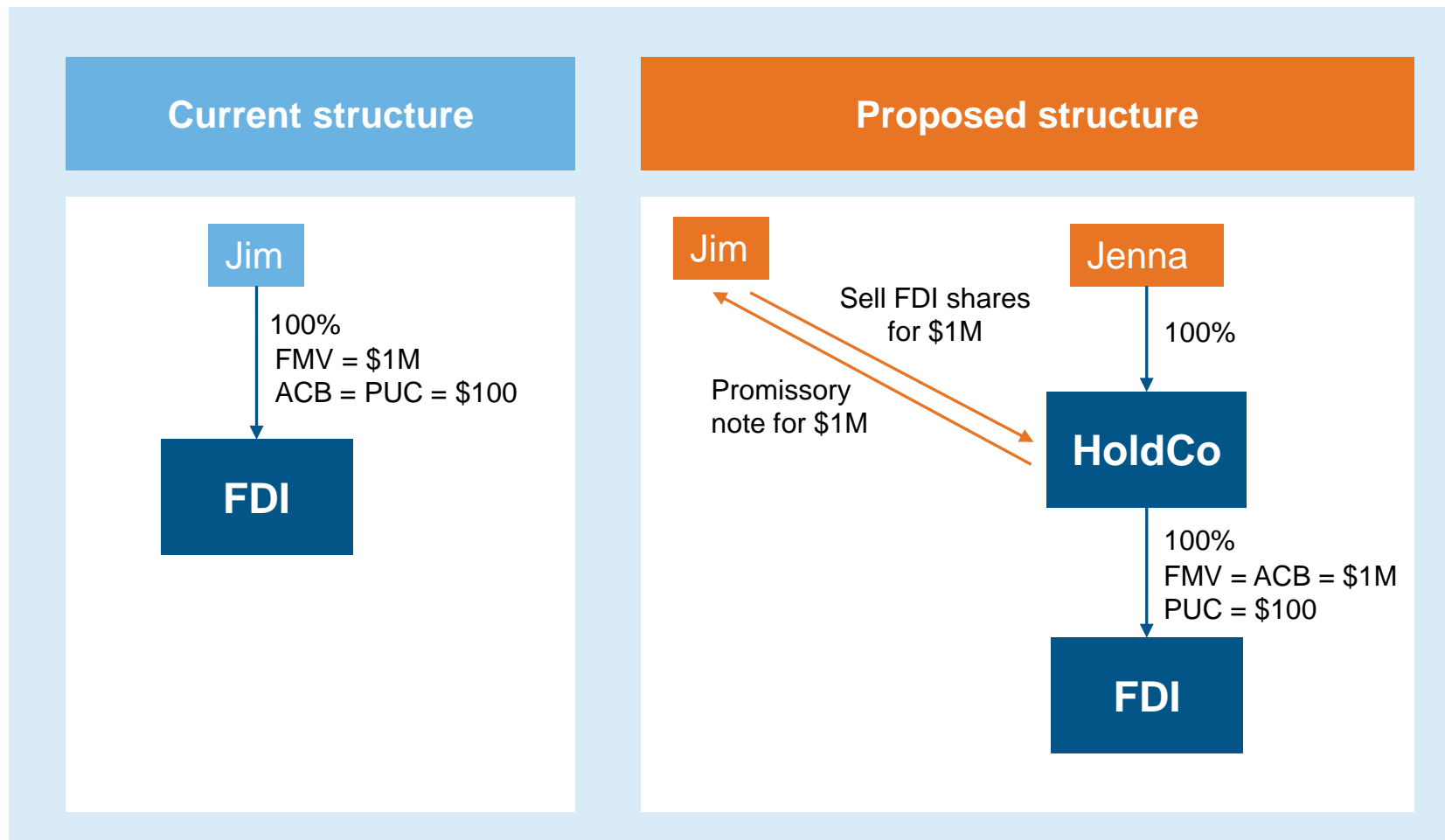
- 
- Deemed dividend to taxpayer is equal to:
- Non-share consideration received
  - **Less:** greater of "arm's length" ACB and paid-up capital ("PUC")

# Example – Fine Dining Inc.

- Jim has operated Fine Dining Inc. (“FDI”) for more than 40 years
- His daughter Jenna has been involved for many years
- Jim is ready to retire
- He wants to sell FDI shares
- Jenna wants to buy the business but lacks funding
- Jim also has other interested buyers
- He wants to compare the two options – sell to Jenna or 3<sup>rd</sup> party?



# Sell FDI shares to Jenna using HoldCo





# Tax implications for Jim

|  | Arm's length sale |
|--|-------------------|
| Sale price for Jim   | \$1,000,000       |
| Adjusted cost basis  | (\$100)           |
| Deemed dividends under 84.1 <ul style="list-style-type: none"> <li>• Promissory note = \$1M</li> <li>• Less: greater of ACB and PUC = \$100</li> </ul> | Nil               |
| Capital gains  | \$999,900         |
| Unused LCGE  | (\$913,630)       |
| Income from share sale   | \$86,270          |
| Assumed tax rates  | 26.77%            |
| Estimated tax liability  | <b>\$23,094</b>   |

# Tax implications for Jim

|  | Arm's length sale | Sale to Jenna    |
|--|-------------------|------------------|
| Sale price for Jim   | \$1,000,000       | \$1,000,000      |
| Adjusted cost basis  | (\$100)           | (\$100)          |
| Deemed dividends under 84.1 <ul style="list-style-type: none"> <li>• Promissory note = \$1M</li> <li>• Less: greater of ACB and PUC = \$100</li> </ul> | Nil               | \$999,900        |
| Capital gains  | \$999,900         | Nil              |
| Unused LCGE  | (\$913,630)       | n/a              |
| Income from share sale   | \$86,270          | \$999,900        |
| Assumed tax rates  | 26.77%            | 47.74%           |
| Estimated tax liability  | <b>\$23,094</b>   | <b>\$477,352</b> |

**Tax savings of \$454,258 by not selling to Jenna!**

# Summary of 84.1



Sale proceeds taxed as dividends, not capital gains

---



LCGE not applicable

---



Higher tax cost on sale to Jenna

**Unfair tax treatment when transitioning the business to family!!**

# 2017 tax proposals

# 2017 tax proposals



Finance Canada concerned about transactions avoiding section 84.1 by:

- Selling to an individual
- Using capital dividends



Two draft legislative “anti-avoidance” proposals introduced:

1. Limit or suppress “hard tax cost” of private company shares where an individual realizes a capital gain on sale of shares, and shares are subsequently transferred to a related corporation
2. Re-characterization of certain tax-free distributions from corporation into a taxable dividend



# 2017 tax proposals



Proposals resulted in double taxation

---



CDA could not be used

---



Retracted on October 19, 2017 due to significant backlash!

---



Finance Canada stated they will continue to work on maintaining integrity of the tax system

# Bill C-208

# Bill C-208



Received royal assent on June 29, 2021



Provides an exception to 84.1 by deeming the taxpayer and purchasing corporation to be dealing at arm's length where the following conditions are met:

- Shares are of a QSBC, family farm, or fishing corporation
- Shares are sold to a purchaser corporation controlled by one or more children/grandchildren who are at least 18 years of age, and
- Purchaser corporation does not dispose of the shares within 60 months



Required to provide CRA the following:

- Independent assessment of FMV of shares being sold
- Affidavit attesting to the disposition of the shares



# Bill C-208



Department of Finance concerns:

- Taxpayer is not required to give up legal or factual control
- Rules do not prevent sale of shares in purchaser corporation within 60 months
- Lack of clarity on tax implications if shares sold within 60 months



Announced that revised legislation will be introduced



Revisions could include additional requirements or restrictions that limit situations in which Bill C-208 applies

- Based on Quebec's legislation?



Revised legislation is expected in fall 2022



# Quebec's tax rules



Legislative changes were introduced in 2016 to provide an exception for certain qualifying intergenerational share transfers



Already accounts for the Department of Finance's concerns on Bill C-208



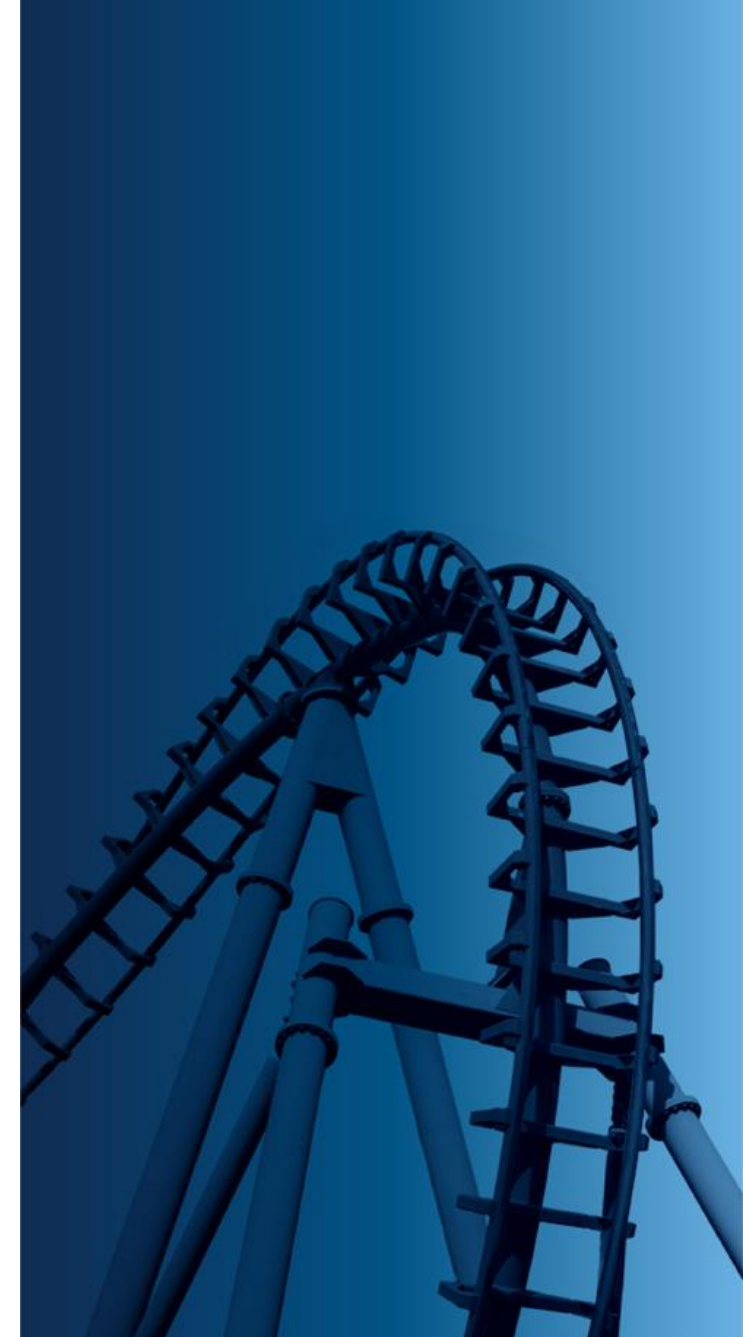
Taxpayer selling the shares may designate all or part of the deemed dividend under section 84.1 to be treated as a deemed capital gain, subject to certain restrictions



Amendments under Bill C-208 prevents the application of these rules in Quebec as there will be no deemed dividends under section 84.1



Finance Quebec stated that Quebec's tax legislation will be amended so that the restrictions in Quebec would continue to apply despite Bill C-208



**Stay tuned!**

# Disclaimer

**FOR ADVISOR USE ONLY.** No portion of this communication may be reproduced or distributed to the public as it does not comply with investor sales communication rules. Mackenzie disclaims any responsibility for any advisor sharing this with investors.

The content of this presentation (including facts, views, opinions, recommendations, descriptions of or references to, products or securities) is not to be used or construed as investment advice, as an offer to sell or the solicitation of an offer to buy, or an endorsement, recommendation or sponsorship of any entity or security cited. Although we endeavour to ensure its accuracy and completeness, we assume no responsibility for any reliance upon it.

This should not be construed to be legal or tax advice, as each client's situation is different. Please consult your own legal and tax advisor.