

Due Diligence

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

Latest in tax:

**Opportunities in assisting
family-owned businesses in
succession**

Small businesses in Canada

- 98% of businesses in Canada are small businesses with less than 100 employees¹
- More than 60% of family businesses will be changing hands in the next decade²
- Business owners are concerned about tax implications on transferring the business to a family member²
- Significant opportunity to work with small business owners

*Source:

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

² 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

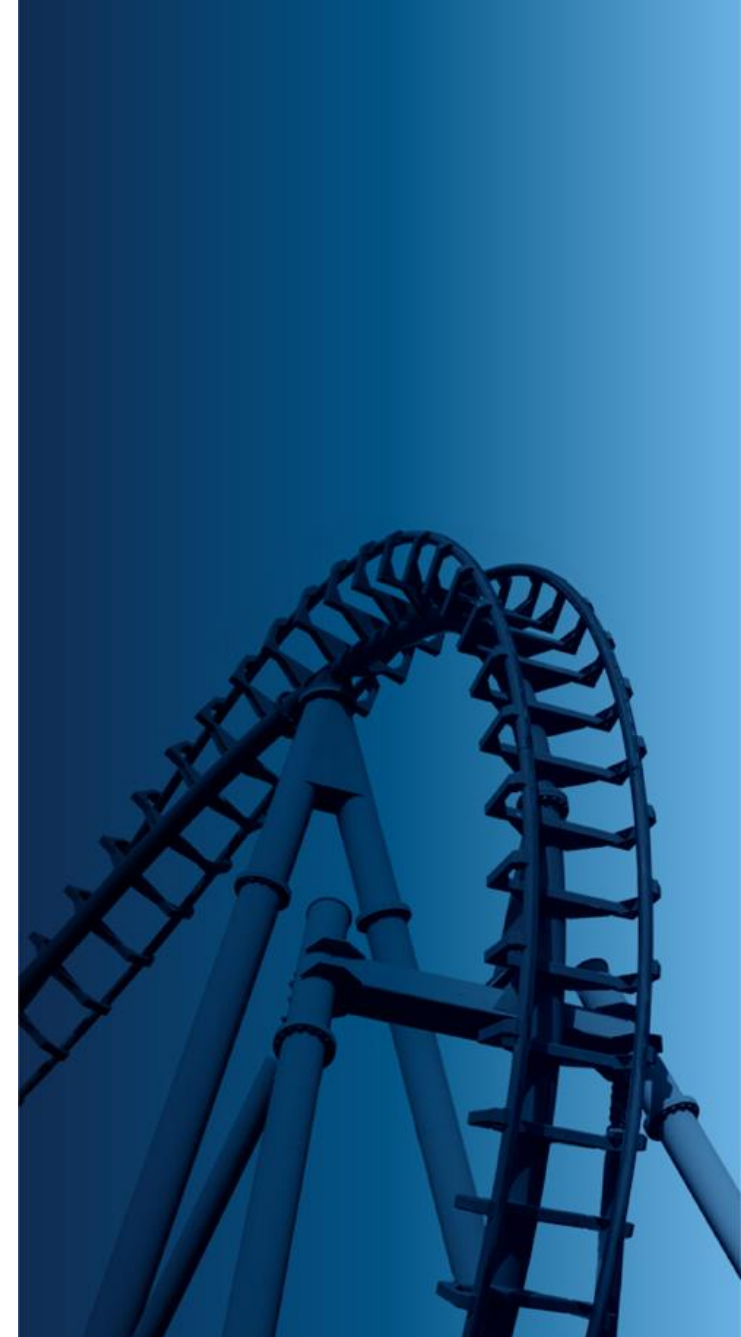
Section 84.1

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- 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

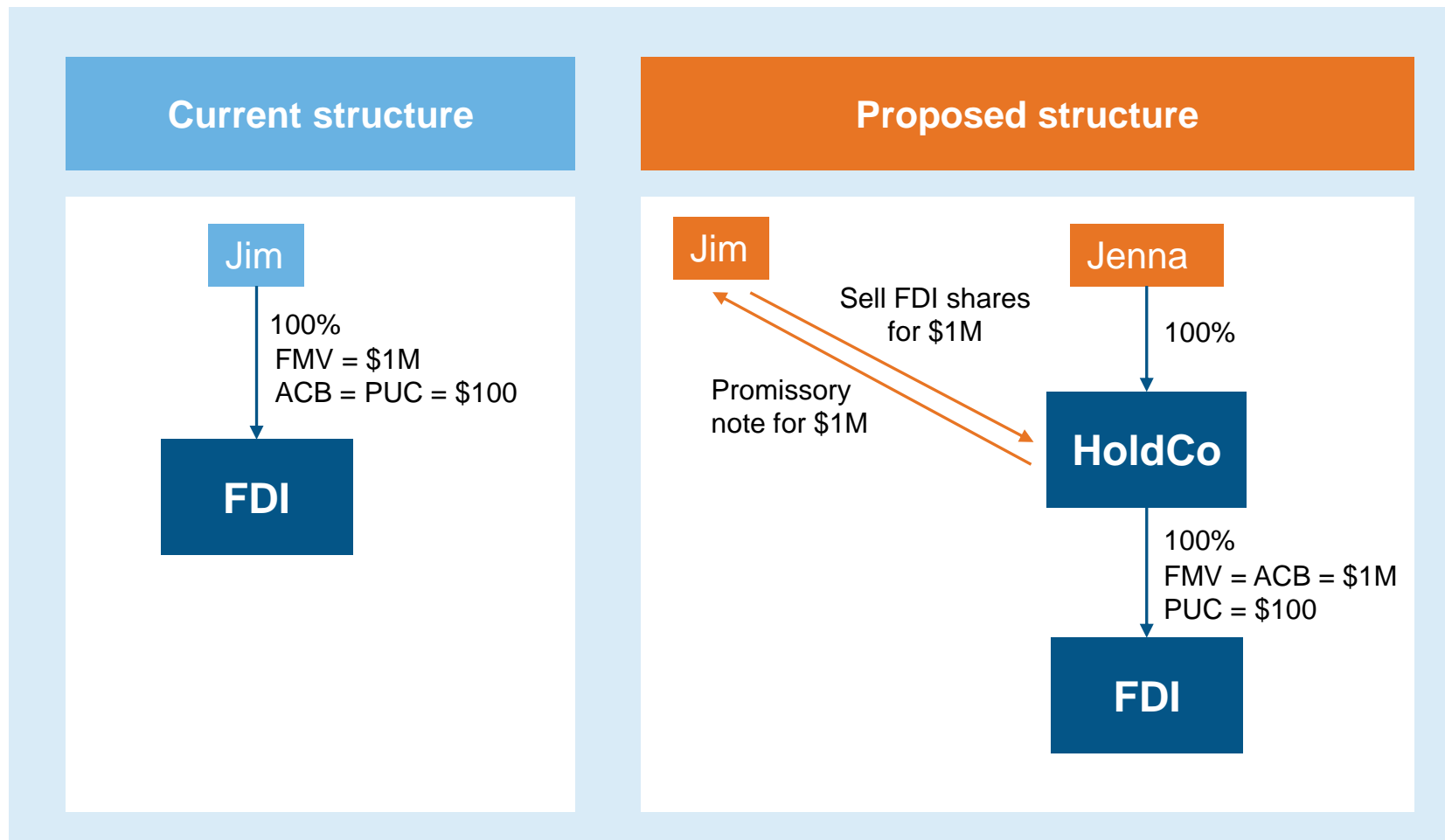
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- Deemed dividend to taxpayer is equal to:
- Non-share consideration received
 - **Less:** greater of "arm's length" ACB and paid-up capital ("PUC")

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 3rd 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"> • Promissory note = \$1M • Less: greater of ACB and PUC = \$100 	Nil
Capital gains	\$999,900
Unused LCGE	(\$913,630)
Income from share sale	\$86,270
Assumed tax rates	26.77%
Estimated tax liability	\$23,094

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"> • Promissory note = \$1M • Less: greater of ACB and PUC = \$100 	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	\$23,094	\$477,352

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



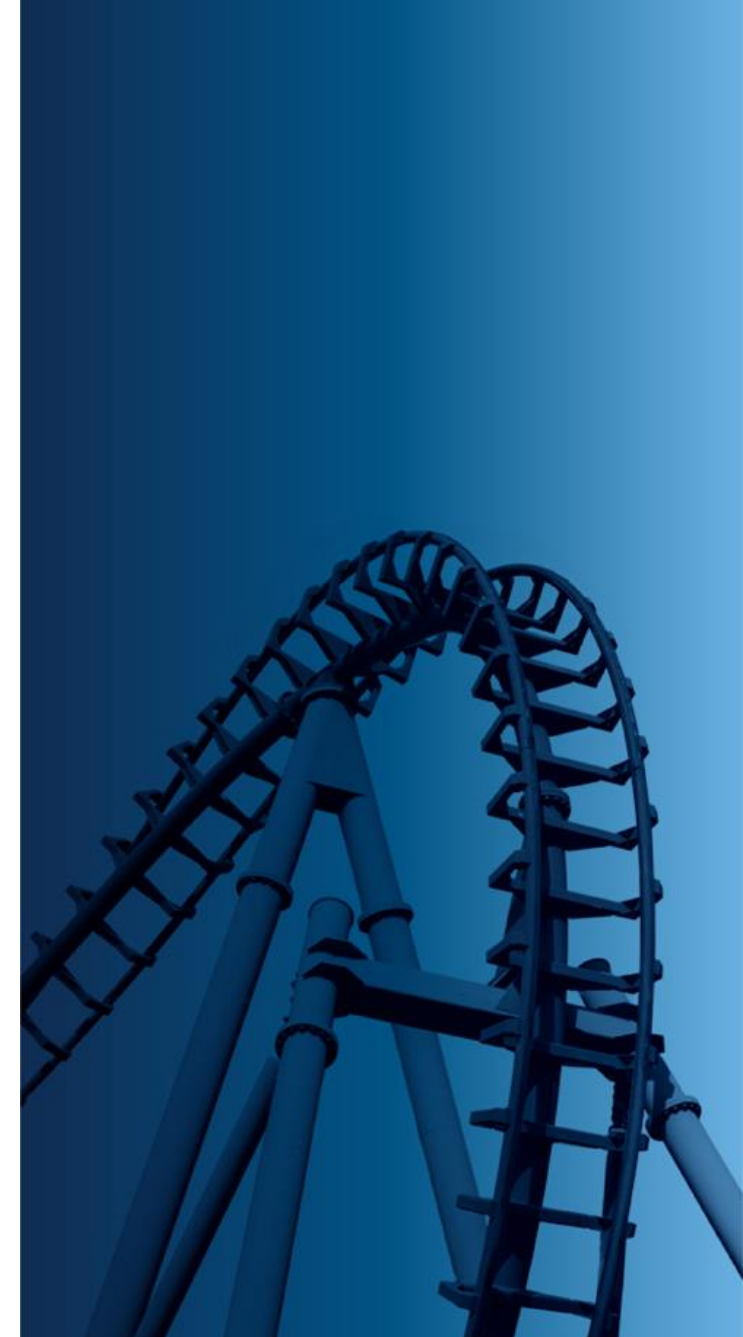
Taxpayer selling the shares may designate all or part of the deemed dividend under section 84.1 to be treated as a deemed capital gain, subject to certain restrictions



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!

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