TAX NEWSLETTER Winter 2013

An Independent Member Firm of DFK Canada Inc. and DFK International

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Special points of interest:

- *The deadline for 2012 RRSP contributions is March 1, 2013.*
- *The deadline for filing your 2012 personal tax return is April 30, 2013.*
- *Personal tax instalments:*
  - *March 15, 2013*
  - *June 15, 2013*
  - *September 15, 2013*
  - *December 15, 2013*

Breaking Up is Hard To Do

Jeff Saunders, CA, Tax Partner, Teed Saunders Doyle & Co., Fredericton, NB, DFK Member Firm

Much like romantic relationships, business relationships do not always last forever. When shareholders of a privately held corporation decide to go their separate ways, it can lead to anger, tears and potentially significant tax consequences. With proper planning, especially at the creation of the corporation, negative consequences of a business breakup can be minimized or eliminated.

Careful planning can be extremely beneficial when done at the beginning of a business relationship. At the outset of a business venture, a properly structured shareholders agreement should be created containing guidelines for how to handle a multitude of situations, including any potential future breakups. Having an agreed upon plan in place can save time, frustration, bitterness, and money should issues arise in the future.

If there is no prior agreement in place when it is determined that a business relationship should not continue, there are still several options available. One method of dismantling a company is a series of transactions generally referred to as “butterfly transactions”. A butterfly transaction can involve a complete tax-deferred division of the company’s assets and liabilities amongst all of the shareholders on a pro-rata basis. The circumstances in which this type of division of assets is permitted under the *Income Tax Act* are very limited. As there are numerous tax traps one can fall into when planning this type of transaction, careful planning is essential before attempting this method of breaking up a company.

There are other methods to consider when planning to dissolve a company. One or more shareholders can purchase shares belonging to the other shareholders. Alternatively, all of the company’s assets could be sold, the remaining liabilities paid off, and any remaining after-tax proceeds distributed to the shareholders. The company could then be dissolved. Either of these options may trigger immediate income taxes for the company and/or the shareholders. With proper planning, the taxes can often be reduced. For example, the purchase of shares may qualify for the lifetime capital gains exemption. As this exemption has a limit of $750,000, it could potentially eliminate personal income taxes for an individual selling their shares; however, the company and the shares being sold must meet certain criteria in order for the exemption to apply. Tax-free capital dividend elections and dividend refunds may also be available to help reduce taxes on the corporate sale of assets and dissolution of the company.

Regardless of which method is chosen to dismantle a company, proper advice and advance planning are essential to minimizing the income tax consequences. It is recommended that you consult your legal and tax advisors before attempting any form of corporate breakup.

Sale of Taxable Canadian Property by Non-Residents

Colin Younker, CA, Senior Tax Manager, MRSB Chartered Accountants, Charlottetown, PEI, DFK Member Firm

Non-Canadian residents are subject to tax on gains related to dispositions of taxable Canadian property such as Canadian real estate and corporate shares where the corporation derives greater than 50% of its value from Canadian real estate. To help ensure the government receives the appropriate tax due at the time of a sale, the Income Tax Act has put the onus on the purchaser to withhold tax. The tax withheld can be minimized or eliminated depending on the process followed by the purchaser and vendor. Based on what actions the vendor takes, there are options available to the purchaser as to the amount of tax to be withheld.

Under the Act, there are rules in place that allow the Canada Revenue Agency (CRA) to issue a certificate related to the proposed sale following notification from the vendor. The Act requires vendors to notify CRA for certain dispositions of taxable Canadian property. If notification is not made prior to the sale, it must be completed within 10 days following the sale. Form T2062 is used to notify CRA and to estimate the capital gain on the disposition; form T2068 is the certificate issued by CRA to the vendor with a copy to the purchaser. Once issued, the purchaser must withhold 25% of the calculated gain as per the certificate. If the certificate is not issued before the sale, 25% of the cost of the property is to be withheld. The purchaser can deduct that amount from the sale price.

To avoid the withholding tax, the non-resident can furnish security satisfactory to CRA. The tax does not have to be withheld if, after reasonable inquiry, the purchaser has determined that the vendor is not a non-resident.

As the Act requires the purchaser to pay a specified amount, in the case where the vendor has failed to comply, the purchaser is entitled to withhold the amount from the non-resident vendor.

The purchaser’s liability for the tax to be withheld has no time limits. CRA can issue an assessment at any time should they become aware of a non-resident disposition with the vendor or purchaser having not followed the requirements of the Act. The tax amounts payable by the purchaser must be remitted within 30 days of the end of the month in which the purchase was made. If the payment is not made, CRA can assess interest and apply a penalty on the amount due. If CRA is processing a T2062 notification and 25% of the calculated gain was remitted with it, they will generally allow payment of the remainder to be delayed until they complete their review. The interest and penalty may be waived if it is determined by CRA that they resulted from circumstances beyond the control of the purchaser. If the purchaser has already remitted the funds in full to the vendor, the purchaser may not be able to recover the tax liability incurred as a result of the vendor not notifying CRA and the purchaser not withholding tax.

When purchasing property from non-residents, a purchaser should be aware that there is a withholding tax that may apply to the purchase. If they are not aware and a purchase is made without the tax being withheld, the purchaser may find that the cost of the property has unexpectedly increased.

Reorganization – Why a Valuation?

Ron Martindale Jr., CPA, CA, CBV, Davis Martindale LLP, London, ON, DFK Member Firm

You have just left a financial planning meeting with your DFK advisors. They have recommended a reorganization of your business' corporate structure to allow future growth of the company. This will benefit your children, provide you with an opportunity to income split with your family members and reduce any future transfer taxes as part of your estate and succession plan. Though the opportunities are appealing and you would like to begin right away, it will take some time for the necessary paperwork to be completed. Your DFK tax advisors will need to design the reorganization and instruct your legal counsel on the appropriate changes. Your DFK advisors have also informed you that a business valuation of your shares will be required, but you are wondering why that is necessary.

Canada Revenue Agency (CRA) tends to be apprehensive when there is a possibility that an incorrect value will confer a benefit on a related party such as your children or your spouse (i.e., lost tax revenue on behalf of the government). For example, let's say your business is worth $1 million. You exchange your $1 million of common shares for $700,000 in preference shares and your child purchases new common shares for $1. Ignoring the personal capital gains exemption and other planning opportunities for now, you would pay tax on the $700,000 proceeds, but not the $1,000,000. CRA would lose the tax revenue on the remaining $300,000. Your child is likely to have to pay tax on that $300,000, but that may not be for another 30 or 40 years.

To counter this possibility, CRA requires that your shares be valued at fair market value. If they are not, CRA will invoke rules that will create double taxation of your assets. CRA will recognize the escape clause (called a price adjustment clause) in the reorganization. This clause permits one to change the value in the reorganization without penalty from CRA if the agreement reflects a bona fide intention of the parties to transfer the property at fair market value and to arrive at that value for the purposes of the agreement has been determined by a fair and reasonable method.

A reasonable attempt is understood to follow the requirement set out by CRA's Information Circular 89-3 policy statement on business equity valuations. Essentially, this document requires the taxpayer to follow the definition of fair market value and follow the generally accepted body of knowledge for business valuations.

In Canada, the Chartered Business Valuator (CBV) designation is the premier credential for professional business appraisers and is recognized by CRA. When a CBV follows the standards as set out by the Canadian Institute of Chartered Business Valuators (CICBV) in preparing a valuation, CRA will accept the valuation as a reasonable attempt at value allowing the escape clause to become available to you. Fortunately, your DFK team includes many CBVs across the country:

DFK Business Valuator	Office
Bill Vienneau, CA, CBV	Halifax, NS
Craig Maloney, CA, CBV	Halifax, NS
Jonathan Gallant, CA, CBV	Halifax, NS
Lloyd Compton, CA, CBV	Charlottetown, PE
Pat Day, CA, CBV	Ottawa, ON
Mike Carnegie, CPA, CA, CBV	Hamilton, ON
Ron Martindale, CPA, CA, CBV	London, ON
Bill Simpson, CPA, CA, CBV	London, ON
Mark Weston, CA, CBV	Calgary, AB
Randy Popik, CA, CBV	Edmonton, AB
Sandi Adachi, CA, CBV	Surrey BC
Joe Bring, CA, CBV	Surrey, BC

Getting the Most Out of Moving Expenses

Justin K. Hoffman, Senior Tax Analyst, Davis Martindale LLP, London, ON, DFK Member Firm

The financial burden of moving can be sizeable. These costs can often be offset by claiming the deduction for moving expenses; however, an individual must first satisfy several conditions:

1) The new residence must be at least 40km closer to the new place of work or study;
2) The individual typically must be moving within Canada;
3) The move must be in connection with employment, business, or post-secondary education;
4) The expenses must be deducted in the year of the move or the following year; and
5) The expenses can only be deducted from income or taxable scholarships earned at the new location.

Some major expenses that can be deducted include:

1) Travelling costs for the taxpayer and their family;
2) Costs of transporting and storing furniture;
3) Costs of food and lodging while between homes (up to 15 days);
4) Costs of cancelling a lease on the former residence;
5) Costs of selling the former residence;
6) Legal costs of acquiring a new residence (if the old residence was sold);
7) Costs of maintaining the former residence while it awaits sale (up to $5,000); and
8) Costs of revising legal documents for the new address (driver's license, etc.).

Other individuals often miss the opportunity to claim the deduction. Students moving to and from their hometown to attend university may lose the deduction, because the deduction can only be claimed against income earned while working at the new location or against taxable scholarships received. Individuals with no change in employment lose the deduction if the moving expenses do not relate to a change in residence necessitated by a change of workplace.

Remember that moving expenses are a deduction - not a tax credit - so their value increases at higher income levels.