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The Eligible Dividend Rules – Not So “New” Anymore

Small Practitioners Forum
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Brief History

- November 23, 2005 – Department of Finance News Release.
- Announces that, effective January 1, 2006, taxation will be reduced for “eligible dividends” in order to level the playing field for corporations and income trusts.
- Many questions/issues.
- Draft legislation released June 29, 2006 – 66 pages of draft amendments and explanatory notes.

Department of Finance Release Brief History

- September 29, 2006: CICA-CBA Joint Committee on Taxation releases comments to Department of Finance.
- 2nd round of draft legislation released October 16, 2006 – mostly minor changes but some changes noteworthy.
- Bill C-28, which contained eligible dividend draft legislation, received First Reading October 18, 2006 and passed by the House of Commons on December 11, 2006.

Department of Finance Release Brief History (cont'd)

- Received 3rd reading on February 14, 2007 and Royal Assent on February 21, 2007.

The New Tax Pools

- By definition, dividends are paid out of after-tax corporate retained earnings.
- New rules introduce two new tax pools:
 - General-rate income pool (“GRIP”); and
 - Low-rate income pool (“LRIP”)
- At most, a given corporation will have one GRIP or one LRIP at any time.

GRIP – Calculation - Overview

- Computed by formula:
A – B
- Can be a positive or negative amount.

General Rate Income Pool ("GRIP")

- Definition of GRIP appears in subsection 89(1) of the Act.
- Applicable only for a taxable Canadian corporation that is a Canadian-controlled private corporation ("CCPC") or a deposit insurance corporation ("DIC").
- DIC's are ignored for the purposes of this presentation.

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Subsection 89(1) "general rate income pool" at the end of a particular taxation year, of a taxable Canadian corporation that is a Canadian-controlled private corporation or a deposit insurance corporation in the particular taxation year, is the positive or negative amount determined by the formula

$$A - B$$

where

A is the positive or negative amount that would, before taking into consideration the specified future tax consequences for the particular taxation year, be determined by the formula

$$C + 0.68(D - E - F) + G + H - I$$

where

C is the corporation's general rate income pool at the end of its preceding taxation year,

D is

(a) unless paragraph (b) applies, the corporation's taxable income for the particular taxation year, and

(b) if the corporation is a deposit insurance corporation in the particular taxation year, nil,

E is the amount determined by multiplying the amount, if any, deducted by the corporation under subsection 125(1) for the particular taxation year by the quotient obtained by dividing 100 by the rate of the deduction provided under that subsection for the particular taxation year,

F is

(a) *if the corporation is a Canadian-controlled private corporation in the particular taxation year, the lesser of the corporation's aggregate investment income for the particular taxation year and the corporation's taxable income for the particular taxation year, and*

(b) *in any other case, nil,*

G is the total of all amounts each of which is

(a) *an eligible dividend received by the corporation in the particular taxation year, or*

(b) *an amount deductible under section 113 in computing the taxable income of the corporation for the particular taxation year,*

H is the total of all amounts determined under subsections (4) to (6) in respect of the corporation for the particular taxation year, and

I is

(a) *unless paragraph (b) applies, the amount, if any, by which*

(i) *the total of all amounts each of which is the amount of an eligible dividend paid by the corporation in its preceding taxation year*

exceeds

(ii) *the total of all amounts each of which is an excessive eligible dividend designation made by the corporation in its preceding taxation year, or*

(b) *if subsection (4) applies to the corporation in the particular taxation year, nil, and*

B is 68% of the amount, if any, by which

(a) *the total of the corporation's full rate taxable incomes (as would be defined in the definition "full rate taxable income" in subsection 123.4(1), if that definition were read without reference to its subparagraphs (a)(i) to (iii)) for the corporation's preceding three taxation years, determined without taking into consideration the specified future tax consequences, for those preceding taxation years, that arise in respect of the particular taxation year,*

exceeds

(b) *the total of the corporation's full rate taxable incomes (as would be defined in the definition "full rate taxable income" in subsection 123.4(1), if that definition were read without reference to its subparagraphs (a)(i) to (iii)) for those preceding taxation years;*

"taxable Canadian corporation" means a corporation that, at the time the expression is relevant,

(a) *was a Canadian corporation, and*

(b) *was not, by virtue of a statutory provision, exempt from tax under this Part;*

"Canadian-controlled private corporation" means a private corporation that is a Canadian corporation other than

(a) a corporation controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation), by one or more corporations described in paragraph (c), or by any combination of them,

(b) a corporation that would, if each share of the capital stock of a corporation that is owned by a non-resident person, by a public corporation (other than a prescribed venture capital corporation), or by a corporation described in paragraph (c) were owned by a particular person, be controlled by the particular person,

(c) a corporation a class of the shares of the capital stock of which is listed on a prescribed stock exchange, or

(d) in applying subsection (1), paragraphs 87(2)(vv) and (ww) (including, for greater certainty, in applying those paragraphs as provided under paragraph 88(1)(e.2)), the definitions "excessive eligible dividend designation", "general rate income pool" and "low rate income pool" in subsection 89(1) and subsections 89(4) to (6), (8) to (10) and 249(3.1), a corporation that has made an election under subsection 89(11) and that has not revoked the election under subsection 89(12);

GRIP - Timing

- GRIP is calculated at the end of a particular taxation year.

GRIP – Calculation of GRIP

- See subsection 248(1) for the definition of “specified future tax consequences”.
- See new T2 Schedule 53 – GRIP Calculation
- Previous version of Schedule 53 miscalculated the GRIP balance.
- Revised form released on June 13, 2007.

GRIP – Calculation of GRIP (cont'd)

- Corporation that paid out eligible dividends in excess of their GRIP as a result of the error in previous Schedule 53 will not be subject to penalties if:
 - ➔ they contact Wayne Adams (Director, General, Income Tax Rulings) before December 31, 2007 (See CRA News Release 2007-07-10 (July 10, 2007))

GRIP Calculation – Overview

- In broad terms, A is the corporation's GRIP at the end of the taxation year determined without reference to any specified future tax consequences.
- Specified future tax consequences includes the carryback of non-capital losses under paragraph 111(1)(a).
- B adjusts that amount calculated under A to the extent that specified future tax consequences for preceding taxation years reduce the corporation's taxable income subject to tax at the general corporate rate.

Low Rate Income Pool ("LRIP")

- Generally relevant for determining the extent to which the non-CCPC can pay eligible dividends in any given taxation year without making an excessive eligible dividend designation.
- Defined in subsection 89(1) of the Act.

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Subsection 89(1) "low rate income pool", at any particular time in a particular taxation year, of a corporation (in this definition referred to as the "non-CCPC") that is resident in Canada and is in the particular taxation year neither a Canadian-controlled private corporation nor a deposit insurance corporation, is the amount determined by the formula

$$(A + B + C + D + E + F) - (G + H)$$

where

A is the non-CCPC's low rate income pool at the end of its preceding taxation year,

B is the total of all amounts each of which is an amount deductible under section 112 in computing the non-CCPC's taxable income for the year in respect of a taxable dividend (other than an eligible dividend) that became payable, in the particular taxation year but before the particular time, to the non-CCPC by a corporation resident in Canada,

C is the total of all amounts determined under subsections (8) to (10) in respect of the non-CCPC for the particular taxation year,

D is

(a) if the non-CCPC would, but for paragraph (d) of the definition "Canadian-controlled private corporation" in subsection 125(7), be a Canadian-controlled private corporation in its preceding taxation year, 80% of its aggregate investment income for its preceding taxation year, and

(b) in any other case, nil,

E is

(a) if the non-CCPC was not a Canadian-controlled private corporation in its preceding taxation year, 80% of the amount determined by multiplying the amount, if any, deducted by the corporation under subsection 125(1) for that preceding taxation year by the quotient obtained by dividing 100 by the rate of the deduction provided under that subsection for that preceding taxation year, and

(b) in any other case, nil,

F is

(a) if the non-CCPC was an investment corporation in its preceding taxation year, four times the amount, if any, deducted by it under subsection 130(1) for its preceding taxation year, and

(b) in any other case, nil,

G is the total of all amounts each of which is a taxable dividend (other than an eligible dividend, a capital gains dividend within the meaning assigned by subsection 130.1(4) or 131(1) or a taxable dividend deductible by the non-CCPC under subsection 130.1(1) in computing its income for the particular taxation year or for its preceding taxation year) that became payable, in the particular taxation year but before the particular time, by the non-CCPC, and

H is the total of all amounts each of which is an excessive eligible dividend designation made by the non-CCPC in the particular taxation year but before the particular time;

LRIP - Timing

- Unlike GRIP, the LRIP is computed at any particular time in a taxation year.
- Given above, the non-CCPC's LRIP at the end of the preceding taxation year is already adjusted to take into account any taxable dividends other than eligible dividends paid, and excessive eligible dividend designations made, by the non-CCPC in the preceding taxation year.
- New schedule 54 of T2.

Election to Not Be a CCPC – New Subsection 89(11)

- New subsection 89(11).
- If prescribed form filed with Minister on or before its filing-due date for a particular taxation year, the corporation is deemed not to be a CCPC for purposes of new paragraph (d) of the definition of CCPC that is added under subsection 125(7) to accommodate the election.
- See new T2002.
- Election is only for purposes of GRIP and SBD – CDA and RDTOH not affected.

Subsection 89(11) Election: non-CCPC -- Subject to subsection (12), a corporation that files with the Minister on or before its filing-due date for a particular taxation year an election in prescribed form to have this subsection apply is deemed for the purposes described in paragraph (d) of the definition "Canadian-controlled private corporation" in subsection 125(7) not to be a Canadian-controlled private corporation at any time in or after the particular taxation year.

Election to Not Be a CCPC – New Subsection 89(11) (cont'd)

- As per CRA News Release 2007-07-10 (July 10, 2007), private corporations who wished to make the election under subsection 89(11) for their 2006 taxation year will be considered to have been filed on time if filed on, or before, December 31, 2007.

CCPC Definition

- As stated on previous slide, new paragraph (d) of CCPC definition under subsection 125(7) added that excepts a corporation from being a CCPC. New paragraph (d) exception reads as follows:

In applying subsection (1), paragraphs 87(2)(vv) and (ww) (including, for greater certainty, in applying those paragraphs as provided under paragraph 88(1)(e.2)), the definitions "excessive eligible dividend designation", "general rate income pool" and "low rate income pool" in subsection 89(1) and subsections 89(4) to (6), (8) to (10) and 249(4.1), a corporation that has made an election under subsection 89(11) and that has not revoked the election under subsection 89(12);

- Applies only for purposes of SBD and various other specified purposes.

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Subsection 125(7) "Canadian-controlled private corporation" means a private corporation that is a Canadian corporation other than

(a) a corporation controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation), by one or more corporations described in paragraph (c), or by any combination of them,

(b) a corporation that would, if each share of the capital stock of a corporation that is owned by a non-resident person, by a public corporation (other than a prescribed venture capital corporation), or by a corporation described in paragraph (c) were owned by a particular person, be controlled by the particular person,

(c) a corporation a class of the shares of the capital stock of which is listed on a prescribed stock exchange, or

(d) in applying subsection (1), paragraphs 87(2)(vv) and (ww) (including, for greater certainty, in applying those paragraphs as provided under paragraph 88(1)(e.2)), the definitions "excessive eligible dividend designation", "general rate income pool" and "low rate income pool" in subsection 89(1) and subsections 89(4) to (6), (8) to (10) and 249(3.1), a corporation that has made an election under subsection 89(11) and that has not revoked the election under subsection 89(12);

Revoking the Election – Subsection 89(12)

- Election under subsection 89(11) to not be a CCPC applies until it is revoked under subsection 89(12).

Subsection 89(12) Revoking election -- If a corporation files with the Minister on or before its filing-date for a particular taxation year a notice in prescribed form revoking, as of the end of the particular taxation year, an election described in subsection (11), the election ceases to apply to the corporation at the end of the particular taxation year.

Revoking Elections – New Subsection 89(13)

- New subsection 89(13):
If a corporation has, under subsection (12), revoked an election, any subsequent election under subsection (11) or subsequent revocation under subsection (12) is invalid unless
 - (a) the Minister consents in writing to the subsequent election or the subsequent revocation, as the case may be, and*
 - (b) the corporation complies with any conditions imposed by the Minister.*
- Elections and revocations under 89(11) – (13) will not be prescribed for purposes of section 600 of the Income Tax Regulations – late filed elections. Caution!

Subsection 89(13) Repeated elections -- consent required -- *If a corporation has, under subsection (12), revoked an election, any subsequent election under subsection (11) or subsequent revocation under subsection (12) is invalid unless*

- (a) the Minister consents in writing to the subsequent election or the subsequent revocation, as the case may be; and*
- (b) the corporation complies with any conditions imposed by the Minister.*

Definition of “Eligible Dividend”

- Defined under subsection 89(1).
- Dividend needs to be a taxable dividend – therefore in no case can capital dividends or capital gains dividends be eligible dividends.
- Received by a person resident in Canada.
- Paid after 2005.
- Designation under new subsection 89(14) must be made.
- *“Eligible dividend” means a taxable dividend that is received by a person resident in Canada, paid after 2005 by a corporation resident in Canada and designated, as provided under subsection (14), to be an eligible dividend;*

Designation Under Subsection 89(14)

- Must notify each person (including partnership) in writing at the time each person or partnership to whom it pays all or any part of the dividend is an eligible dividend.
- *A corporation designates a dividend it pays at any time to be an eligible dividend by notifying in writing at that time each person or partnership to whom it pays all or any part of the dividend that the dividend is an eligible dividend.*
- Given above wording, it was initially unclear whether that partial eligible dividends designations could be made – unlike capital dividends (see wording under subsection 83(2)).
- However, better view seems to be no partial eligible dividend designations.

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Subsection 89(14) Dividend designation -- *A corporation designates a dividend it pays at any time to be an eligible dividend by notifying in writing at that time each person or partnership to whom it pays all or any part of the dividend that the dividend is an eligible dividend.*

Designation Under Subsection 89(14) (cont'd)

- CICA-CBA Joint Committee comments on this in September 29, 2006 letter to Department of Finance.
- Again, subsection 89(14) will not be prescribed for purposes of Regulation 600 – late filed elections. Caution! CICA-CBA Joint Committee comments on this in September 29, 2006 letter to Department of Finance.
- Note that a designation under subsection 89(14) will be deemed to have been made in a timely manner if it is made on or before the day that is 90 days after the day which new draft legislation becomes law.
- See CRA comments on how to designate under subsection 89(14) – December 20, 2006 News Release.

Penalty Tax – Excessive Eligible Dividend Designations

- New Part III.1 of The Act introduced.
- New sections 185.1 and 185.2
- Applies a tax to a corporation that has made an “excessive eligible dividend designation”.
- If a CCPC has made an excessive designation in an amount that exceeds its GRIP at the end of the year, the tax under Part III.1 is equal to 20% of the excessive designation.
- If a non-CCPC designates an eligible dividend at a time when it has a positive LRIP balance, the Part III.1 tax will be equal to 20% of the amounts of the dividend that should have been LRIP.
- Defined in subsection 89(1) as referenced to by subsection 248(1).
- See new T2 schedule 55

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"excessive eligible dividend designation", made by a corporation in respect of an eligible dividend paid by the corporation at any time in a taxation year, means

(a) unless paragraph (c) applies to the dividend, if the corporation is in the taxation year a Canadian-controlled private corporation or a deposit insurance corporation, the amount, if any, determined by the formula

$$(A - B) \times C/A$$

where

A is the total of all amounts each of which is the amount of an eligible dividend paid by the corporation in the taxation year,

B is the greater of nil and the corporation's general rate income pool at the end of the taxation year, and

C is the amount of the eligible dividend,

(b) unless paragraph (c) applies to the dividend, if the corporation is not a corporation described in paragraph (a), the amount, if any, determined by the formula

$$A \times B/C$$

where

A is the lesser of

(i) the total of all amounts each of which is an eligible dividend paid by the corporation at that time, and

(ii) the corporation's low rate income pool at that time,

B is the amount of the eligible dividend, and

C is the amount determined under subparagraph (i) of the description of A, and,

(c) an amount equal to the amount of the eligible dividend, if it is reasonable to consider that the eligible dividend was paid in a transaction, or as part of a series of transactions, one of the main purposes of which was to artificially maintain or increase the corporation's general rate income pool, or to artificially maintain or decrease the corporation's low rate income pool;

Subsection 185.1 (1) Tax on excessive eligible dividend designations -- *A corporation that has made an excessive eligible dividend designation in respect of an eligible dividend paid by it at any time in a taxation year shall, on or before the corporation's balance-due day for the taxation year, pay a tax under this Part for the taxation year equal to the total of*

(a) 20% of the excessive eligible dividend designation, and

(b) if the excessive eligible dividend designation arises because of the application of paragraph (c) of the definition "excessive eligible dividend designation" in subsection 89(1), 10% of the excessive eligible dividend designation.

Definition of Excessive Eligible Dividend Designation

- Paragraph (b) formula, which applies to non-CCPCs, effectively introduces an ordering rule by requiring corporations to first pay taxable dividends other than eligible dividends to the extent of its LRIP (in order to avoid the penalty tax under Part III.1) at the time it pays the dividends.
- Note the anti-avoidance rule in paragraph (c) – need to be careful!

Definition of Excessive Eligible Dividend Designation (cont'd)

- Paragraph (c) will apply *“if it is reasonable to consider that the eligible dividend was paid in a transaction, or as part of a series of transactions, one of the main purposes of which was to artificially maintain or increase the corporation’s general rate income pool, or to artificially maintain or decrease the corporation’s low rate income pool”*.
- See following slides for consequences of falling into this anti-avoidance rule.

Definition of Excessive Eligible Dividend Designation - Anti-Avoidance Rule

- Explanatory Notes further explain what the Department of Finance means by “artificially maintained or increased...” as follows:

In general terms, it is intended that a corporation be considered to have artificially maintained or increased its GRIP if the transaction or series of transactions produces a GRIP that is unreflective of income retained by it after payment of tax under Part I (whether the tax is paid by the corporation or another corporation) at a rate not less than that which applies to full rate taxable income (as defined in subsection 123.4(1) of the Act). Likewise, it is intended that a corporation generally be considered to have artificially maintained or decreased its LRIP if the transaction or series of transactions produces a LRIP that is unreflective of income retained by it after payment of tax under Part I (whether the tax is paid by the corporation or another corporation) at a rate less than that which applies to full rate taxable income.

Part III.I – Extra Penalty Tax

- As noted above and in definition of “excessive eligible dividend designation”, paragraph (c) is an anti-avoidance rule.
- If paragraph (c) applies, penalty tax is increased by 10% and would be 30% of the full amount of the eligible dividend.
- Caution!

Part III.I – Penalty Tax

- If paragraph (c) of excessive eligible dividend designation does not apply, an election can be made under new subsection 185.1(2) to treat excessive amount as an ordinary taxable dividend.
- The election must be made in prescribed manner on or before the day that is 90 days after the mailing of the notice of assessment that deals with the Part III.I tax that the corporation would otherwise pay.
- A late-filed election will not be possible.

Subsection 185.1(2) Election to treat excessive eligible dividend designation as an ordinary dividend -- *If, in respect of an excessive eligible dividend designation that is not described in paragraph (1)(b) and that is made by a corporation in respect of an eligible dividend (in this subsection and subsection (3) referred to as the "original dividend") paid by it at a particular time, the corporation would, if this Act were read without reference to this subsection, be required to pay a tax under subsection (1), and it elects in prescribed manner on or before the day that is 90 days after the day of mailing the notice of assessment in respect of that tax that would otherwise be payable under subsection (1), the following rules apply:*

(a) notwithstanding the definition "eligible dividend" in subsection 89(1), the amount of the original dividend paid by the corporation is deemed to be the amount, if any, by which

(i) the amount of the original dividend, determined without reference to this subsection exceeds

(ii) the amount claimed by the corporation in the election not exceeding the excessive eligible dividend designation, determined without reference to this subsection;

(b) an amount equal to the amount claimed by the corporation in the election is deemed to be a separate taxable dividend (other than an eligible dividend) that was paid by the corporation immediately before the particular time;

(c) each shareholder of the corporation who at the particular time held any of the issued shares of the class of shares in respect of which the original dividend was paid is deemed

(i) not to have received the original dividend, and

(ii) to have received at the particular time

(A) as an eligible dividend, the shareholder's pro rata portion of the amount of any dividend determined under paragraph (a), and

(B) as a taxable dividend (other than an eligible dividend) the shareholder's pro rata portion of the amount of any dividend determined under paragraph (b); and

(d) a shareholder's pro rata portion of a dividend paid at any time on a class of the shares of the capital stock of a corporation is that proportion of the dividend that the number of shares of that class held by the shareholder at that time is of the number of shares of that class outstanding at that time.

Part III.I – Penalty Tax (cont'd)

- Note conditions pursuant to subsection 185.1(3), for election under subsection 185.1(2) to apply:
- *An election under subsection (2) in respect of an original dividend is valid only if*
 - (a) it is made with the concurrence of the corporation and all its shareholders*
 - (i) who received or were entitled to receive all or any portion of the original dividend,*
and
 - (ii) whose addresses were known to the corporation; and*

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Subsection 185.1(3) Concurrence with election -- *An election under subsection (2) in respect of an original dividend is valid only if*

- (a) it is made with the concurrence of the corporation and all its shareholders*
 - (i) who received or were entitled to receive all or any portion of the original dividend,*
and
 - (ii) whose addresses were known to the corporation; and*
- (b) either*
 - (i) it is made on or before the day that is 30 months after the day on which the original dividend was paid, or*
 - (ii) each shareholder described in subparagraph (a)(i) concurs with the election, in which case, notwithstanding subsections 152(4) to (5), any assessment of the tax, interest and penalties payable by each of those shareholders for any taxation year shall be made that is necessary to take the corporation's election into account.*

Part III.I – Penalty Tax (cont'd)

(b) either

(i) it is made on or before the day that is 30 months after the day on which the original dividend was paid, or

(ii) each shareholder described in subparagraph (a)(i) concurs with the election, in which case, notwithstanding subsections 152(4) to (5), any assessment of the tax, interest and penalties payable by each of those shareholders for any taxation year shall be made that is necessary to take the corporation's election into account.

Part III.I – Penalty Tax (cont'd)

- For large dividend-payers, such election may contain practical problems regarding shareholder consent.
- See new subsection 185.1(4) that excludes shareholder concurrence for subsection 185.1(3) if all of the affected shareholders are persons all of whose taxable income is exempt from tax under Part I. If applicable, the election must be made within 30 months after the payment of the original dividend.

Subsection 185.1(4) Exception for non-taxable shareholders -- *If each shareholder who, in respect of an election made under subsection (2), is deemed by subsection (2) to have received a dividend at a particular time is also, at the particular time, a person all of whose taxable income is exempt from tax under Part I,*

(a) subsection (3) does not apply to the election; and

(b) the election is valid only if it is made on or before the day that is 30 months after the day on which the original dividend was paid.

Part III.I – New Section 185.2

- Every corporation that pays a taxable dividend (other than a capital gains dividend) in a taxation year must now file by the corporation's filing-due date file a return under Part III.I.
- New return prescribed by the Minister.

Subsection 185.2 (1) Return -- *Every corporation resident in Canada that pays a taxable dividend (other than a capital gains dividend within the meaning assigned by subsection 130.1(4) or 131(1)) in a taxation year shall file with the Minister, not later than the corporation's filing-due date for the taxation year, a return for the year under this Part in prescribed form containing an estimate of the taxes payable by it under this Part for the taxation year.*

Part III.I – Joint Liability

- New subsection 185.2(3)
- If CCPC pays an eligible dividend to a non-arm's length shareholder and makes an excessive designation in respect of the eligible dividend, the shareholder is jointly and severally liable with the corporation for a proportionate share of the Part III.I tax.

Subsection 185.2(3) Joint and several liability from excessive eligible dividend designations --
Without limiting the liability of any person under any other provision of this Act, if a Canadian-controlled private corporation or a deposit insurance corporation pays an eligible dividend in respect of which it has made an excessive eligible dividend designation to a shareholder with whom it does not deal at arm's length, the shareholder is jointly and severally, or solidarily, liable with the corporation to pay that proportion of the corporation's tax payable under this Part because of the designation that the amount of the eligible dividend received by the shareholder is of the total of all amounts each of which is a dividend in respect of which the designation was made.

Year End on Status Change

- New subsection 249(3.1) added.
- Applies to a CCPC if it ceases to be a CCPC otherwise than because of an acquisition of control.
- If applicable, the corporation's taxation year is deemed to end immediately before the status change.

Year End on Status Change (cont'd)

- *Under the old rules, a corporation must be a CCPC throughout any particular taxation year in order to be eligible to claim the small business deduction. One effect of the new deemed year-end rule is that this requirement will in all cases be met where a corporation is a CCPC at any time in a particular taxation year, since under this new rule corporations can no longer be a CCPC for only part of a taxation year.*

Subsection 249(3.1) Year end on status change -- *If at any time a corporation becomes or ceases to be a Canadian-controlled private corporation, otherwise than because of an acquisition of control to which subsection (4) would, if this Act were read without reference to this subsection, apply,*

(a) subject to paragraph (c), the corporation's taxation year that would, if this Act were read without reference to this subsection, include that time is deemed to end immediately before that time;

(b) a new taxation year of the corporation is deemed to begin at that time;

(c) notwithstanding subsections (1) and (3), the corporation's taxation year that would, if this Act were read without reference to this subsection, have been its last taxation year that ended before that time is deemed instead to end immediately before that time if

(i) were this Act read without reference to this paragraph, that taxation year would, otherwise than because of paragraph 128(1)(d), section 128.1 and paragraphs 142.6(1)(a) or 149(10)(a), have ended within the 7-day period that ended immediately before that time,

(ii) within that 7-day period no person or group of persons acquired control of the corporation, and the corporation did not become or cease to be a Canadian-controlled private corporation, and

(iii) the corporation elects, in its return of income under Part I for that taxation year to have this paragraph apply; and

(d) for the purpose of determining the corporation's fiscal period after that time, the corporation is deemed not to have established a fiscal period before that time.

Eligible Dividends - General Comments – Almost Two Years In

1. Careful GRIP and LRIP tracking necessary – extra compliance.
2. Tax compliance software generally does a good job in assisting with the calculation of GRIP and LRIP.
3. Will CRA eventually keep track of GRIP and report it or confirm it on Notice of Assessment under Part I or Part III.I? Haven't seen this yet.
4. New tax return under Part III.I now required to be filed when dividends paid – extra compliance – see Schedule 55 of T2.

Eligible Dividends - General Comments (cont'd)

5. With the exception of public corporations (that need to pay LRIP balances as taxable dividends first to avoid Part III.I tax), no ordering rules apply for the payment of eligible dividends.
6. What does "artificially maintain or increase the corporation's GRIP, or to artificially maintain or decrease the corporation's LRIP" under paragraph (c) of the definition of "excessive eligible dividend designation" mean? See Explanatory Notes. Not real helpful.

Eligible Dividends - General Comments (cont'd)

7. Provincial responses to new rules have not been consistent.
8. The notional addition to the GRIP balance for 2006 reporting full rate income for corporations for taxation years 2001 – 2005 is nice but why only those taxation years taken into account? Very labor intensive.

Eligible Dividends - General Comments (cont'd)

9. Some concern has been expressed that existing subsection 104(19) may not be sufficient to enable the retention of the eligible dividend character at the beneficiary level for such dividends received by a trust and allocated to the beneficiary(ies) debatable. No amendment in October 16, 2006 Release and no further amendment contemplated.

Eligible Dividends - General Comments (cont'd)

10. Alternative minimum tax thresholds have not been adjusted. Accordingly, the increased dividend tax credit may cause AMT to apply in unintended situations.
11. Given the policy reasons for eligible dividends, should public companies have a capital dividend account like private corporations?
12. With reduced rate on eligible dividends, does the use of personal services business corporations now make sense?
13. Existing shareholders agreements will likely need to be revisited to deal with GRIP usage.
14. Do bonuses from CCPCs (or other amounts such as EPSP or RCA payments) now make sense?

Proposed Corporate Tax Rates – October 30, 2007 Economic Update

General Federal Corporate Income Tax Rate Reductions

(per cent)

	2007	2008	2009	2010	2011	2012
Existing Rates	22.12	20.5	20.0	19.0	18.5	18.5
Proposed Rates	22.12	19.5	19.0	18.0	16.5	15.0

Alberta Tax Summary – Bonus vs. No Bonus - \$1,000,000

Alberta Tax Summary		2006		2007		2008		2009	
	Bonus	No Bonus	Bonus	No Bonus	Bonus	No Bonus	Bonus	No Bonus	
Taxable income	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	
Bonus	\$ 700,000	\$ -	\$ 600,000	\$ -	\$ 600,000	\$ -	\$ 600,000	\$ -	
Taxable income after bonus	\$ 300,000	\$ 1,000,000	\$ 400,000	\$ 1,000,000	\$ 400,000	\$ 1,000,000	\$ 400,000	\$ 1,000,000	
Corporate income tax									
Federal - small business rate	\$ 39,360	\$ 39,360	\$ 52,480	\$ 52,480	\$ 44,000	\$ 44,000	\$ 44,000	\$ 44,000	
Federal - general rate	\$ -	\$ 154,840	\$ -	\$ 132,720	\$ -	\$ 117,000	\$ -	\$ 114,000	
Alberta - small business rate	\$ 12,000	\$ 12,000	\$ 12,900	\$ 12,900	\$ 13,800	\$ 13,800	\$ 15,000	\$ 15,000	
Alberta - general rate	\$ -	\$ 62,220	\$ -	\$ 57,000	\$ -	\$ 54,000	\$ -	\$ 50,000	
Total corporate income tax	\$ 51,360	\$ 268,420	\$ 65,380	\$ 255,100	\$ 57,800	\$ 228,800	\$ 59,000	\$ 223,000	
Dividend Pool									
Non - Eligible	\$ 248,640	\$ 255,580	\$ 334,620	\$ 336,900	\$ 342,200	\$ 363,200	\$ 341,000	\$ 369,000	
GRIP	\$ -	\$ 476,000	\$ -	\$ 408,000	\$ -	\$ 408,000	\$ -	\$ 408,000	
Personal income tax									
Salary - Federal	\$ 273,000	\$ -	\$ 234,000	\$ -	\$ 234,000	\$ -	\$ 234,000	\$ -	
Total personal income tax on Salary	\$ 273,000	\$ -	\$ 234,000	\$ -	\$ 234,000	\$ -	\$ 234,000	\$ -	
Personal income tax									
Eligible Dividend	\$ -	\$ 86,510	\$ -	\$ 71,193	\$ -	\$ 65,277	\$ -	\$ 59,361	
Total personal income tax on eligible dividend	\$ -	\$ 86,510	\$ -	\$ 71,193	\$ -	\$ 65,277	\$ -	\$ 59,361	
Personal income tax									
Non-eligible dividend	\$ 61,125	\$ 62,831	\$ 84,354	\$ 84,928	\$ 90,542	\$ 96,098	\$ 94,487	\$ 102,245	
Total personal income tax on non-eligible dividend	\$ 61,125	\$ 62,831	\$ 84,354	\$ 84,928	\$ 90,542	\$ 96,098	\$ 94,487	\$ 102,245	
Total taxes	\$ 385,485	\$ 417,761	\$ 383,734	\$ 411,221	\$ 382,342	\$ 390,175	\$ 387,487	\$ 384,606	
Net cash flow (income minus total taxes)	\$ 614,515	\$ 582,239	\$ 616,266	\$ 588,779	\$ 617,658	\$ 609,825	\$ 612,513	\$ 615,394	
Net cash flow after tax per \$ of income	\$ 0.61451	\$ 0.58224	\$ 0.61627	\$ 0.58878	\$ 0.61766	\$ 0.60982	\$ 0.61251	\$ 0.61539	

Alberta Tax Summary – Bonus vs. No Bonus - \$1,000,000 (cont'd)

Alberta Tax Summary						
	2010		2011		2012	
	Bonus	No Bonus	Bonus	No Bonus	Bonus	No Bonus
Taxable income	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Bonus	\$ 400,000	\$ -	\$ 400,000	\$ -	\$ 400,000	\$ -
Taxable income after bonus	\$ 400,000	\$ 1,000,000	\$ 400,000	\$ 1,000,000	\$ 400,000	\$ 1,000,000
Corporate income tax						
Federal - small business rate	\$ 44,000	\$ 44,000	\$ 44,000	\$ 44,000	\$ 44,000	\$ 44,000
Federal - general rate	\$ -	\$ 108,000	\$ -	\$ 99,000	\$ -	\$ 90,000
Alberta - small business rate	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000
Alberta - general rate	\$ -	\$ 50,000	\$ -	\$ 50,000	\$ -	\$ 50,000
Total corporate income tax	\$ 59,000	\$ 217,000	\$ 59,000	\$ 208,000	\$ 59,000	\$ 199,000
Dividend Pool						
Non - Eligible	\$ 341,000	\$ 375,000	\$ 341,000	\$ 384,000	\$ 341,000	\$ 393,000
GRIP	\$ -	\$ 408,000	\$ -	\$ 408,000	\$ -	\$ 408,000
Personal income tax						
Salary - Federal	\$ 234,000	\$ -	\$ 234,000	\$ -	\$ 234,000	\$ -
Total personal income tax on Salary	\$ 234,000	\$ -	\$ 234,000	\$ -	\$ 234,000	\$ -
Personal income tax						
Eligible Dividend	\$ -	\$ 59,361	\$ -	\$ 59,361	\$ -	\$ 59,361
Total personal income tax on eligible dividend	\$ -	\$ 59,361	\$ -	\$ 59,361	\$ -	\$ 59,361
Personal income tax						
Non-eligible dividend	\$ 94,487	\$ 103,908	\$ 94,487	\$ 106,402	\$ 94,487	\$ 108,895
Total personal income tax on non-eligible dividend	\$ 94,487	\$ 103,908	\$ 94,487	\$ 106,402	\$ 94,487	\$ 108,895
Total taxes	\$ 387,487	\$ 380,269	\$ 387,487	\$ 373,763	\$ 387,487	\$ 367,257
Net cash flow (income minus total taxes)	\$ 612,513	\$ 619,731	\$ 612,513	\$ 626,237	\$ 612,513	\$ 632,743
Net cash flow after tax per \$ of income	\$ 0.61251	\$ 0.61973	\$ 0.61251	\$ 0.62624	\$ 0.61251	\$ 0.63274

2007 Tax Rates on \$1,000,000 Active Business Income

	Tax Rate	Taxable Income \$400,000	Tax Rate	Taxable income greater than \$ 600,000	Total Taxable Income \$1,000,000
Federal corporate tax	13.120%	\$ 52,480	22.120%	\$ 132,720	\$ 185,200
Alberta corporate tax - SBR	3.000%	\$ 12,000	3.000%	\$ 900	\$ 12,900
Alberta corporate tax			10.000%	\$ 57,000	\$ 57,000
Total Corporate tax		\$ 64,480		\$ 190,620	\$ 255,100
Eligible Dividend Pool (GRIP)		\$ -		\$ 408,000	\$ 408,000
Ineligible Pool		\$ 335,520		\$ 1,380	\$ 336,900
Personal tax on eligible dividend:					
Federal	14.55%	\$ -	14.55%	\$ 59,361	\$ 59,361
Alberta	2.90%	\$ -	2.90%	\$ 11,832	\$ 11,832
Personal tax on ineligible dividend:					
Federal	19.58%	\$ 65,708	19.58%	\$ 270	\$ 65,978
Alberta	5.63%	\$ 18,873	5.63%	\$ 78	\$ 18,951
Total Personal tax		\$ 84,581		\$ 71,541	\$ 156,122
Total corporate and personal tax		\$ 149,061		\$ 262,161	\$ 411,222
After tax cash flow		\$ 250,939		\$ 337,839	\$ 588,778
Overall effective tax rate		37.27%		43.69%	41.12%

2008 Tax Rates on \$1,000,000 Active Business Income

	Tax Rate	Taxable Income \$400,000	Tax Rate	Taxable income greater than \$ 600,000	Total Taxable Income \$1,000,000
Federal corporate tax	11.000%	\$ 44,000	19.500%	\$ 117,000	\$ 161,000
Alberta corporate tax - SBR	3.000%	\$ 12,000	3.000%	\$ 1,800	\$ 13,800
Alberta corporate tax			10.000%	\$ 54,000	\$ 54,000
Total Corporate tax		\$ 56,000		\$ 172,800	\$ 228,800
Eligible Dividend Pool (GRIP)		\$ -		\$ 408,000	\$ 408,000
Ineligible Pool		\$ 344,000		\$ 19,200	\$ 363,200
Personal tax on eligible dividend:					
Federal	14.55%	\$ -	14.55%	\$ 59,361	\$ 59,361
Alberta	1.45%	\$ -	1.45%	\$ 5,916	\$ 5,916
Personal tax on ineligible dividend:					
Federal	19.58%	\$ 67,368	19.58%	\$ 3,760	\$ 71,128
Alberta	6.88%	\$ 23,650	6.88%	\$ 1,320	\$ 24,970
Total Personal tax		\$ 91,018		\$ 70,357	\$ 161,376
Total corporate and personal tax		\$ 147,018		\$ 243,157	\$ 390,176
After tax cash flow		\$ 252,982		\$ 356,843	\$ 609,824
Overall effective tax rate		36.75%		40.53%	39.02%

2009 Tax Rates on \$1,000,000 Active Business Income

	Tax Rate	Taxable Income \$400,000	Tax Rate	Taxable income greater than \$ 600,000	Total Taxable Income \$1,000,000
Federal corporate tax	11.000%	\$ 44,000	19.000%	\$ 114,000	\$ 158,000
Alberta corporate tax - SBR	3.000%	\$ 12,000	3.000%	\$ 3,000	\$ 15,000
Alberta corporate tax			10.000%	\$ 50,000	\$ 50,000
Total Corporate tax		\$ 56,000		\$ 167,000	\$ 223,000
Eligible Dividend Pool (GRIP)		\$ -		\$ 408,000	\$ 408,000
Ineligible Pool		\$ 344,000		\$ 25,000	\$ 369,000
Personal tax on eligible dividend:					
Federal	14.55%	\$ -	14.55%	\$ 59,361	\$ 59,361
Alberta	0.00%	\$ -	0.00%	\$ -	\$ -
Personal tax on ineligible dividend:					
Federal	19.58%	\$ 67,368	19.58%	\$ 4,896	\$ 72,264
Alberta	8.13%	\$ 27,950	8.13%	\$ 2,031	\$ 29,981
Total Personal tax		\$ 95,318		\$ 66,288	\$ 161,607
Total corporate and personal tax		\$ 151,318		\$ 233,288	\$ 384,607
After tax cash flow		\$ 248,682		\$ 366,712	\$ 615,393
Overall effective tax rate		37.83%		38.88%	38.46%

2010 Tax Rates on \$1,000,000 Active Business Income

	Tax Rate	Taxable Income \$400,000	Tax Rate	Taxable income greater than \$ 600,000	Total Taxable Income \$1,000,000
Federal corporate tax	11.000%	\$ 44,000	18.000%	\$ 108,000	\$ 152,000
Alberta corporate tax - SBR	3.000%	\$ 12,000	3.000%	\$ 3,000	\$ 15,000
Alberta corporate tax			10.000%	\$ 50,000	\$ 50,000
Total Corporate tax		\$ 56,000		\$ 161,000	\$ 217,000
Eligible Dividend Pool (GRIP)		\$ -		\$ 408,000	\$ 408,000
Ineligible Pool		\$ 344,000		\$ 31,000	\$ 375,000
Personal tax on eligible dividend:					
Federal	14.55%	\$ -	14.55%	\$ 59,361	\$ 59,361
Alberta	0.00%	\$ -	0.00%	\$ -	\$ -
Personal tax on ineligible dividend:					
Federal	19.58%	\$ 67,368	19.58%	\$ 6,071	\$ 73,439
Alberta	8.13%	\$ 27,950	8.13%	\$ 2,519	\$ 30,469
Total Personal tax		\$ 95,318		\$ 67,951	\$ 163,269
Total corporate and personal tax		\$ 151,318		\$ 228,951	\$ 380,269
After tax cash flow		\$ 248,682		\$ 371,049	\$ 619,731
Overall effective tax rate		37.83%		38.16%	38.03%

2011 Tax Rates on \$1,000,000 Active Business Income

	Tax Rate	Taxable Income \$400,000	Tax Rate	Taxable income greater than \$ 600,000	Total Taxable Income \$1,000,000
Federal corporate tax	11.000%	\$ 44,000	16.500%	\$ 99,000	\$ 143,000
Alberta corporate tax - SBR	3.000%	\$ 12,000	3.000%	\$ 3,000	\$ 15,000
Alberta corporate tax			10.000%	\$ 50,000	\$ 50,000
Total Corporate tax		\$ 56,000		\$ 152,000	\$ 208,000
Eligible Dividend Pool (GRIP)		\$ -		\$ 408,000	\$ 408,000
Ineligible Pool		\$ 344,000		\$ 40,000	\$ 384,000
Personal tax on eligible dividend:					
Federal	14.55%	\$ -	14.55%	\$ 59,361	\$ 59,361
Alberta	0.00%	\$ -	0.00%	\$ -	\$ -
Personal tax on ineligible dividend:					
Federal	19.58%	\$ 67,368	19.58%	\$ 7,834	\$ 75,202
Alberta	8.13%	\$ 27,950	8.13%	\$ 3,250	\$ 31,200
Total Personal tax		\$ 95,318		\$ 70,445	\$ 165,763
Total corporate and personal tax		\$ 151,318		\$ 222,445	\$ 373,763
After tax cash flow		\$ 248,682		\$ 377,555	\$ 626,237
Overall effective tax rate		37.83%		37.07%	37.38%

2012 Tax Rates on \$1,000,000 Active Business Income

	Tax Rate	Taxable Income \$400,000	Tax Rate	Taxable income greater than \$ 600,000	Total Taxable Income \$1,000,000
Federal corporate tax	11.000%	\$ 44,000	15.000%	\$ 90,000	\$ 134,000
Alberta corporate tax - SBR	3.000%	\$ 12,000	3.000%	\$ 3,000	\$ 15,000
Alberta corporate tax			10.000%	\$ 50,000	\$ 50,000
Total Corporate tax		\$ 56,000		\$ 143,000	\$ 199,000
Eligible Dividend Pool (GRIP)		\$ -		\$ 408,000	\$ 408,000
Ineligible Pool		\$ 344,000		\$ 49,000	\$ 393,000
Personal tax on eligible dividend:					
Federal	14.55%	\$ -	14.55%	\$ 59,361	\$ 59,361
Alberta	0.00%	\$ -	0.00%	\$ -	\$ -
Personal tax on ineligible dividend:					
Federal	19.58%	\$ 67,368	19.58%	\$ 9,596	\$ 76,964
Alberta	8.13%	\$ 27,950	8.13%	\$ 3,981	\$ 31,931
Total Personal tax		\$ 95,318		\$ 72,938	\$ 168,257
Total corporate and personal tax		\$ 151,318		\$ 215,938	\$ 367,257
After tax cash flow		\$ 248,682		\$ 384,062	\$ 632,743
Overall effective tax rate		37.83%		35.99%	36.73%

2007 Eligible Pool Paid Out as Dividend in 2009 and Forward (ineligible dividends taken out in 2007)

	Tax Rate	Taxable Income \$400,000	Tax Rate	Taxable income greater than \$ 600,000	Total Taxable Income \$1,000,000
Federal corporate tax	13.120%	\$ 52,480	22.120%	\$ 132,720	\$ 185,200
Alberta corporate tax - SBR	3.000%	\$ 12,000	3.000%	\$ 900	\$ 12,900
Alberta corporate tax			10.000%	\$ 57,000	\$ 57,000
Total Corporate tax		\$ 64,480		\$ 190,620	\$ 255,100
Eligible Dividend Pool (GRIP)		\$ -		\$ 408,000	\$ 408,000
Ineligible Pool		\$ 335,520		\$ 1,380	\$ 336,900
Personal tax on eligible dividend:					
Federal	14.55%	\$ -	14.55%	\$ 59,361	\$ 59,361
Alberta	2.90%	\$ -	0.00%	\$ -	\$ -
Personal tax on ineligible dividend:					
Federal	19.58%	\$ 65,708	19.58%	\$ 270	\$ 65,978
Alberta	5.63%	\$ 18,873	5.63%	\$ 78	\$ 18,951
Total Personal tax		\$ 84,581		\$ 59,709	\$ 144,290
Total corporate and personal tax		\$ 149,061		\$ 250,329	\$ 399,390
After tax cash flow		\$ 250,939		\$ 349,671	\$ 600,610
Overall effective tax rate		37.27%		41.72%	39.94%

2007 Maximum Amount of Dividend without Personal Tax

2007 maximum amount of dividend without personal tax						
	Rates /	Credit amounts	Non- eligible dividends	Rates /	Credit amounts	Eligible dividends
Actual dividend			\$ 27,440			\$ 49,600
Taxable dividend	125.00%		\$ 34,300	145.00%		\$ 71,920
Federal tax	grad. rate		\$ 4,944	grad. rate		\$ 13,122
Dividend tax credit - Federal	13.33%		\$ 4,572	18.97%		\$ 13,640
Basic personal credit - Federal	15.00%	\$ 9,600	\$ 1,440	15.00%	\$ 9,600	\$ 1,440
Total Federal tax			\$ (1,069)			\$ (1,958)
Alberta tax	10.00%		\$ 3,430	10.00%		\$ 7,192
Dividend tax credit - Alberta	5.50%		\$ 1,887	8.00%		\$ 5,754
Basic personal credit - Alberta	10.00%	\$ 15,435	\$ 1,544	10.00%	\$ 15,435	\$ 1,544
Total Alberta tax			\$ -			\$ (105)
Taxes payable			\$ -			\$ -
Federal Alternative Minimum Tax calculation						
Dividend			\$ 27,440			\$ 49,600
Basic exemption [127.53(1)]			\$ 40,000			\$ 40,000
Taxable income			\$ -			\$ 9,600
Federal tax before credits	15.00%		\$ -	15.00%		\$ 1,440
Federal basic personal tax credit			\$ 1,440	35.00% of federal		\$ 1,440
Net Federal Minimum Tax			\$ -			\$ -
Alberta Minimum tax credit	35.00% of federal		\$ -	35.00% of federal		\$ -
Alternative Minimum Tax			\$ -			\$ -
Total Tax			\$ -			\$ -

2007 Maximum Amount of Dividend – Only AMT

2007 maximum amount of dividend only AMT						
	Rates /	Credit amounts	Non- eligible dividends	Rates /	Credit amounts	Eligible dividends
Actual dividend			\$ 27,440			\$ 53,224
Taxable dividend	125.00%		\$ 34,300	145.00%		\$ 77,175
Federal tax	grad. rate		\$ 4,944	grad. rate		\$ 14,489
Dividend tax credit - Federal	13.33%		\$ 4,572	18.97%		\$ 14,637
Basic personal credit - Federal	15.00%	\$ 9,600	\$ 1,440	15.00%	\$ 9,600	\$ 1,440
Total Federal tax			\$ (1,069)			\$ (1,588)
Alberta tax	10.00%		\$ 3,430	10.00%		\$ 7,717
Dividend tax credit - Alberta	5.50%		\$ 1,887	8.00%		\$ 6,174
Basic personal credit - Alberta	10.00%	\$ 15,435	\$ 1,544	10.00%	\$ 15,435	\$ 1,544
Total Alberta tax			\$ -			\$ (0)
Taxes payable			\$ -			\$ -
Federal Alternative Minimum Tax calculation						
Dividend			\$ 27,440			\$ 53,224
Basic exemption [127.53(1)]			\$ 40,000			\$ 40,000
Taxable income			\$ -			\$ 13,224
Federal tax before credits			\$ -	15.00%		\$ 1,984
Federal basic personal tax credit			\$ 1,440	35.00% of federal		\$ 1,440
Net Federal Minimum Tax			\$ -			\$ 544
Alberta Minimum tax credit		35.00% of federal	\$ -	35.00% of federal		\$ 190
Alternative Minimum Tax			\$ -			\$ 734
Total Tax			\$ -			\$ 734

2007 Maximum Amount of Dividend – Personal Tax and AMT

2007 maximum amount of dividend - personal tax and AMT						
	Rates /	Credit amounts	Non- eligible dividends	Rates /	Credit amounts	Eligible dividends
Actual dividend			\$ 37,300			\$ 68,800
Taxable dividend	125.00%		\$ 46,625	145.00%		\$ 99,760
Federal tax	grad. rate		\$ 7,655	grad. rate		\$ 20,361
Dividend tax credit - Federal	13.33%		\$ 6,215	18.97%		\$ 18,920
Basic personal credit - Federal	15.00%	\$ 9,600	\$ 1,440	15.00%	\$ 9,600	\$ 1,440
Total Federal tax			\$ (0)			\$ 0
Alberta tax	10.00%		\$ 4,663	10.00%		\$ 9,976
Dividend tax credit - Alberta	5.50%		\$ 2,564	8.00%		\$ 7,981
Basic personal credit - Alberta	10.00%	\$ 15,435	\$ 1,544	10.00%	\$ 15,435	\$ 1,544
Total Alberta tax			\$ 555			\$ 452
Taxes payable			\$ 555			\$ 452
Federal Alternative Minimum Tax calculation						
Dividend			\$ 37,300			\$ 68,800
Basic exemption [127.53(1)]			\$ 40,000			\$ 40,000
Taxable income			\$ -			\$ 28,800
Federal tax before credits			\$ -	15.00%		\$ 4,320
Federal basic personal tax credit	15.00%		\$ 1,440	35.00% of federal		\$ 1,440
Net Federal Minimum Tax			\$ -			\$ 2,880
Alberta Minimum tax credit	35.00% of federal		\$ -	35.00% of federal		\$ 1,008
Alternative Minimum Tax			\$ -			\$ 3,888
Total Tax			\$ 555			\$ 4,340

Tax Rate – Investment Income

	2006		2007		2008		2009		2010		2011	
Investment income		\$ 1,000		\$ 1,000		\$ 1,000		\$ 1,000		\$ 1,000		\$ 1,000
Corp tax	46.16%	\$ 462	45.79%	\$ 458	44.67%	\$ 447	44.67%	\$ 447	44.67%	\$ 447	44.67%	\$ 447
Refundable tax	-26.67%	\$ (267)	-26.67%	\$ (267)	-26.67%	\$ (267)	-26.67%	\$ (267)	-26.67%	\$ (267)	-26.67%	\$ (267)
Net Corp tax		194.9		191.2		180		180		180		180
Personal tax	24.58%	\$ 198	25.21%	\$ 204	26.46%	\$ 217	27.71%	\$ 227	27.71%	\$ 227	27.71%	\$ 227
Total taxes		\$ 393		\$ 395		\$ 397		\$ 407		\$ 407		\$ 407
After tax cash flow		\$ 607		\$ 605		\$ 603		\$ 593		\$ 593		\$ 593
Effective tax rate on top rate investment income earned in corporation	39.28%		39.51%		39.70%		40.72%		40.72%		40.72%	
Effective tax rate on top rate investment income earned personally	39.00%		39.00%		39.00%		39.00%		39.00%		39.00%	

Traditional Remuneration Strategies - Revisited Summary

- By 2009 there is a nominal difference between a bonus down to small business deduction ("SBD") limit and no bonus (i.e. full dividend).
- Allows for a deferral of personal taxes if funds kept inside the corporation, i.e. tax deferral of approximately 7% for 2007 (increasing to 15% for 2012).
- Need to determine what the cash needs are of shareholder and corporation; automatic bonus down to SBD limit is not necessary.
- Reduction of bonus will reduce section 67 risks.
- Watch SR + ED issues.

The New Reality

- “Plain Vanilla” has become “Rocky Road”;
- Common strategies require re-thinking/ revisions;
- Administrative and planning costs are higher;
- Educating clients is important; and
- A thorough understanding of your client’s needs and goals is more important than ever.

- The costs to calculate GRIP, designate dividends and track amounts received are material and may be hard for clients to appreciate.
- Dealing with excessive GRIP designations is similar to dealing with excessive CDA elections.
- Focusing purely on the results of GRIP without understanding your client’s overall needs and objectives can result in unexpected negative results. A more holistic view than before may be required.
- Time spent educating clients on the concepts behind the new dividend taxation rules will usually pay off in the form of valuable input from your client that will help you guide them to the optimal decision.

Other Considerations

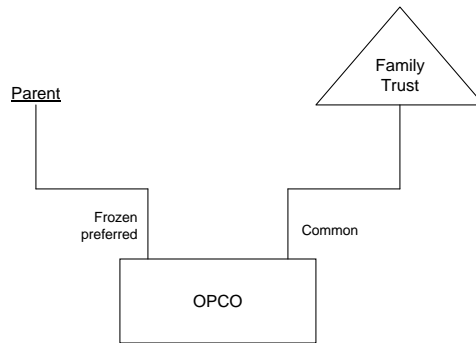
- OAS clawback
- Reduce CNIL
- Increases net income so can affect child care, etc.
- Increased AMT possible
- Loss of QSBC status
- Loss of high rate refundable tax credits
- Increased corporate installments

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- Clawback pursuant to subsection 180.2(2) may be triggered by either a bonus or the payment of an eligible dividend
- While child care expense deduction is limited to 2/3 of the earned income of the parent with the lowest earned income.
- Pursuant to subsection 127(10.2), income above the federal small business limit will grind down expenditure base for purposes of the enhanced refundable SR&ED tax credit in the subsequent year. This may not be an issue of concern if the expenditure limit grind down already applies as a result of the associated groups taxable capital for purposes of Part 1.3 of the Act.

Estate Planning



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- Cost to redeeming shares now reduced, effectively, to capital gains rate for eligible dividends.
- Redeem parent's shares over time using GRIP instead of RDTOH.
- Preferred ordering of dividends
 1. Eligible dividends that trigger dividend refund;
 2. Ineligible dividends that trigger a dividend refund;
 3. Eligible dividends that do not trigger a dividend refund; and
 4. Ineligible dividends with no dividend refund
- The retention of earnings in Opco to create GRIP can increase the value of the shares of Opco (or an investment holding company) thereby increasing the amount of capital gain deferred by an estate freeze;
- Be mindful of subsection 74.4(2) and the implications if Opco ceases to be a small business corporation.
- Subparagraph 256(1.3)(f)(ii) deems each beneficiary to own all the shares owned by an inter-vivos trust where the trustees have discretion as to distribution of income OR capital. Even if trust document does not allow any minor or spouse beneficiary to receive 10% or more of the accumulating income or capital, the trustees' ability to exercise discretion can result in subparagraph 256(1.3)(f)(ii) applying with the resulting application of subsection 74.4(2).

Post Mortem Planning

	Old	New 2010	New 2007	
Capital gain to decedent	19.5	19.5	19.5	
Estate's capital loss carried back	(19.5)	(19.5)	(19.5)	(A)
Tax cost of deemed disposition	0	0	0	
Tax on deemed dividend in estate	24.08	14.5	17.5	(B)
Costs of 164(6) (B-A)	4.58%	(5.0)	(2.0)	(B-A)

(1) Excludes effect of dividend refund

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- The “pipeline” strategy of rolling shares of Investco or Opco to a holding company for a beneficiary for ACB and PUC equal to the fair market value at the date of the decedent’s death pursuant to subsection 85(1) and in compliance with section 84.1 is commonly used to defer the immediate creation of tax where there are appreciated assets.
- This strategy can be beneficial when the tax rate on the deemed dividend that would be realized by the estate using the subsection 164(6) strategy results in a significantly higher tax rate than the resulting capital loss will recover.
- With the reduction of the tax rate on eligible dividends, the tax rate to the estate on the deemed dividend created under the subsection 164(6) strategy will be much closer, to, and perhaps even be less than, the savings from the capital loss carryforward. As a result, the “pipeline” strategy may become less beneficial.
- Beneficiaries can receive the underlying assets and, for their own estate planning purpose, roll them into their own holding company for high PUC and ACB pursuant to subsection 85(1) and in compliance with section 84.1. Attention to subsection 74.4(2), however, is also warranted.
- The 50% solution may be more advantageous.
- Subparagraph 88(1)(d) may be helpful where non-depreciable assets are significant.

Income Splitting

- Eligible and “non-eligible” dividends can be streamed
- Separate share classes may be required or use a trust.

The amount of eligible dividends that can be received tax free will vary from the amounts noted above based on the province of residence and the year of inclusion.

Income Splitting (cont'd)

- Allocation from family trust can eliminate need for separate classes
- Best use of GRIP is to high income shareholders
- Avoid use of GRIP for:
 - Non-residents
 - Lower income taxpayers
 - Where RRSP and other deductions are used to reduce income



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New Restrictive Covenant Proposals Section 56.4 of the Income Tax Act

Small Practitioners Forum
Banff, AB

Kim G C Moody CA,TEP
Moodys Tax Advisors LLP
November 23, 2007



Issues that Arise in the Context of the Sale of a Business Restrictive Covenant Proposals – New Section 56.4 A Little Background

Restrictive covenants very common in sale of business

- Fortino v. The Queen – 2000 DTC 6060 (FCA)
- Manrell v. The Queen – 2003 DTC 5225 (FCA)
- Department of Finance News Release – October 7, 2003 – intention to tax amounts received or receivable by a taxpayer for granting a restrictive covenant as full income with certain exceptions

Issues that Arise in the Context of the Sale of a Business Restrictive Covenant Proposals – New Section 56.4 A Little Background cont'd.

- February 27, 2004 – draft proposals released by Department of Finance – new section 56.4 and proposed change to section 68 – very broad implications
- Significant problems with February 27, 2004 proposals including potential for double taxation
- 2nd proposals released July 18, 2005
- 3rd proposals released November 9, 2006
- CBA/CICA Joint Committee on Taxation release comments via December 20, 2004 and January 30, 2006 letters
- Proposals contained in Bill C-10; passed by the House of Commons on October 29, 2007 and received first reading in the Senate on October 30, 2007

New Restrictive Covenant Proposals

Definitions – Subsection 56.4(1)

- “Restrictive Covenant” – of a taxpayer, means an agreement entered into, an undertaking made, or a waiver of an advantage or right by the taxpayer (other than an agreement or undertaking for the disposition of the taxpayer's property or -- except where the obligation being satisfied is in respect of a right to property or services that the taxpayer acquired for less than its fair market value -- for the satisfaction of an obligation described in section 49.1 that is not a disposition), whether legally enforceable or not, that affects, or is intended to affect, in any way whatever, the acquisition or provision of property or services by the taxpayer or by another taxpayer that does not deal at arm's length with the taxpayer.

New Restrictive Covenant Proposals Definitions – Subsection 56.4(1) cont'd.

- Very broad....overly broad and not necessary
- JCT comments that definition is overly broad in December 2004 and January 2006 letters
- Department of Finance has not responded to this

New Restrictive Covenant Proposals

Definitions – Subsection 56.4(1)

cont'd.

- "eligible corporation" – of a taxpayer, means a taxable Canadian corporation of which,
 - (a) the taxpayer holds, directly or indirectly, shares of the capital stock; and
 - (b) individuals with whom the taxpayer does not deal at arm's length (determined without reference to paragraph 251(5)(b)) hold in aggregate, directly or indirectly, less than 10% of the issued and outstanding share capital which holdings have an aggregate fair market value of less than 10% of the fair market value of all of the issued and outstanding shares of that taxable Canadian corporation.
- Relevant for the purposes of determining whether new subsections 56.4(5) and (7) apply (exception to section 68)

New Restrictive Covenant Proposals

Definitions – Subsection 56.4(1)

cont'd.

- “eligible interest” - of a taxpayer, means capital property of the taxpayer that is
 - (a) a partnership interest in a partnership that carries on a business;
 - (b) a share of the capital stock of a corporation that carries on a business; or
 - (c) a share of the capital stock of a corporation 90% or more of the fair market value of which is attributable to eligible interests in one other corporation.
- This definition relevant for the purposes of determining whether new subsection 56.4(3) applies (exception to income inclusion)

New Restrictive Covenant Proposals

Definitions – Subsection 56.4(1)

cont'd.

- “goodwill amount” – of a taxpayer, is an amount received or receivable by the taxpayer as consideration for the disposition by the taxpayer of goodwill, and that is required by the description of E in the definition "cumulative eligible capital" in subsection 14(5) to be included in computing the cumulative eligible capital of a business carried on by the taxpayer through a permanent establishment located in Canada.
- This definition relevant for the purposes of determining whether new subsections 56.4(5) and (7) apply (exception to section 68).

New Restrictive Covenant Proposals

Main Taxing Provision – Subsection 56.4(2)

- Income -- restrictive covenants [non-competition agreements] -- There is to be included in computing a taxpayer's income for a taxation year the total of all amounts each of which is an amount in respect of a restrictive covenant of the taxpayer that is received or receivable in the taxation year by the taxpayer or by a taxpayer with whom the taxpayer does not deal at arm's length (other than an amount that has been included in computing the taxpayer's income because of this subsection for a preceding taxation year or in the taxpayer's eligible corporation's income because of this subsection for the taxation year or a preceding taxation year).
- JCT comments again in 2006 letter that double taxation can arise with this provisions – new subsection 56.4(12) released November 9, 2006
- Inclusion results in full taxation

New Restrictive Covenant Proposals

Exception to Main Taxing Provision – Subsection 56.4(3)

- Note very narrow exceptions to subsection 56.4(2)
- Note election or joint election for CEC treatment in limited circumstances under paragraph 56.4(3)(b)
- Note “eligible interest” joint election exception in paragraph 56.4(3)(c) – subject to new anti-avoidance rule in subsection 56.4(10)
- Relief under paragraph 56.4(3)(c) is lost if either purchaser or vendor files tax return late – see subsection 56.4(14) – but may be entitled to relief under subsection 220(3).

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(3) Non-application of subsec. (2) -- Subsection (2) does not apply to an amount received or receivable by a particular taxpayer in a taxation year in respect of a restrictive covenant granted by the particular taxpayer to another taxpayer (referred to in this subsection and subsection (4) as the "purchaser") with whom the particular taxpayer deals at arm's length (determined without reference to paragraph 251(5)(b)), if

- (a) section 5 or 6 applied to include the amount in computing the particular taxpayer's income for the taxation year or would have so applied if the amount had been received in the taxation year;
- (b) the amount would, if this Act were read without reference to this section, be required by the description of E in the definition "cumulative eligible capital" in subsection 14(5) to be included in computing the particular taxpayer's cumulative eligible capital in respect of the business to which the restrictive covenant relates, and the particular taxpayer elects (or if the amount is payable by the purchaser in respect of a business carried on in Canada by the purchaser, the particular taxpayer and the purchaser jointly elect) in prescribed form to apply this paragraph in respect of the amount; or

(c) subject to subsection (10), the amount directly relates to the particular taxpayer's disposition of property that is, at the time of the disposition, an eligible interest in the partnership or corporation that carries on the business to which the restrictive covenant relates, or that is at that time an eligible interest by virtue of paragraph (c) of the definition "eligible interest" where the other corporation referred to in that paragraph carries on the business to which the restrictive covenant relates, and

(i) the disposition is to the purchaser (or to a person related to the purchaser),

(ii) the amount is consideration for an undertaking by the particular taxpayer not to provide, directly or indirectly, property or services in competition with the property or services provided or to be provided by the purchaser (or by a person related to the purchaser),

(iii) the restrictive covenant may reasonably be considered to have been granted to maintain or preserve the value of the eligible interest disposed of to the purchaser;

(iv) if the restrictive covenant is granted on or after July 18, 2005, subsection 84(3) does not apply to the disposition,

(v) neither section 85 nor subsection 97(2) applies to the disposition of the eligible interest by the particular taxpayer,

(vi) the amount is added to the particular taxpayer's proceeds of disposition, as defined by section 54, for the purpose of applying this Act to the disposition of the particular taxpayer's eligible interest, and

(vii) the particular taxpayer and the purchaser elect in prescribed form to apply this paragraph in respect of the amount.

New Restrictive Covenant Proposals Exception to Main Taxing Provision – Subsection 56.4(3) Elections

- JCT queries why elections are required for paragraphs 56.4(3)(b) and (c)
- How are the elections made or revised following a reassessment that applies section 68?
- See www.cra-arc.gc.ca/tax/business/topics/life-events/selling/restrictive/letter-e.html for the CRA's version of the elections for paragraphs 56.4(3)(b) and (c)

New Restrictive Covenant Proposals

Section 68(c)

- Amendments to section 68 can deem amounts to be received or receivable by the taxpayer in respect of the restrictive covenant and be deemed to be an amount paid or payable to the taxpayer by the person to whom the restrictive covenant was granted.
- JCT comments that amendments to section 68 are highly impractical.

Technical Notes: Section 68 applies where an amount received or receivable can reasonably be regarded as being in Part consideration for the disposition of a particular property of a taxpayer or as being in Part consideration for the provision of particular services. If the amount is in Part consideration for the disposition of property, that Part of the consideration that can reasonably be regarded as being for the disposition of property is deemed to be the proceeds of disposition of that property and, reciprocally, the cost of the property for the acquirer. If the amount is in Part consideration for the provision of particular services, that part of the consideration that can reasonably be regarded as being for the provision of particular services is deemed to be an amount received or receivable by the taxpayer in respect of those services and, reciprocally, an amount paid or payable by the person to whom the services are rendered.

Section 68 is amended to apply in circumstances where consideration received or receivable from a person is in Part for a restrictive covenant (as defined by new subsection 56.4(1)) granted by a taxpayer. However, exceptions to the application of section 68 to a restrictive covenant are provided in new subsections 56.4(5) to (8). If section 68 applies, the part of the consideration that can reasonably be regarded as being for the restrictive covenant is considered to be an amount that is received or receivable by the taxpayer in respect of the restrictive covenant, and that Part is also considered to be paid or payable to the taxpayer by the person to whom the restrictive covenant was granted.

New Restrictive Covenant Proposals

Section 68(c)

- 68. Allocation of amounts in consideration for disposition of property -**
- Where an amount received or receivable from a person can reasonably be regarded as being in part the consideration for the disposition of a particular property of a taxpayer or as being in part consideration for the provision of particular services by a taxpayer,
 - (c) the part of the amount that can reasonably be regarded as being consideration for the restrictive covenant is deemed to be an amount received or receivable by the taxpayer in respect of the restrictive covenant irrespective of the form or legal effect of the contract or agreement, and that part is deemed to be an amount paid or payable to the taxpayer by the person to whom the restrictive covenant was granted.

New Restrictive Covenant Proposals

Exceptions to Section 68

Subsections 56.4(5) – (8)

- If subsection 56.4(5) applies, section 68 does not apply
- Conditions for subsection 56.4(5) to not apply laid out in subsections 56.4(6) – (8)

New Restrictive Covenant Proposals

Subsection 56.4(6) Exception to Section 68

- Subsection 56.4(6) lays out set out of conditions that, if applicable, result in section 68 not applying to restrictive covenant
- Note clarification rule (new proposed addition in November 9, 2006 proposals) under paragraph 56.4(13)(a) that clarifies how vendors treat amount referred to in paragraph 56.4(6)(f)

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(6) Application of subsec. (5) -- if employee provides covenant -- Subsection (5) applies to a restrictive covenant if

(a) the restrictive covenant is granted by an individual to another taxpayer with whom the individual deals at arm's length (referred to in this subsection as the "purchaser");

(b) the restrictive covenant directly relates to the acquisition from one or more other persons (in this subsection and subsection (8) referred to as the "vendors") by the purchaser of an interest in the individual's employer, in a corporation related to that employer or in a business carried on by that employer;

(c) the individual deals at arm's length with the employer and with the vendors;

(d) the restrictive covenant is an undertaking by the individual not to provide, directly or indirectly, property or services in competition with property or services provided or to be provided by the purchaser (or by a person related to the purchaser) in the course of carrying on the business to which the restrictive covenant relates;

(e) no proceeds are received or receivable by the individual for granting the restrictive covenant; and

(f) the amount that can reasonably be regarded to be consideration for the restrictive covenant is received or receivable only by the vendors.

New Restrictive Covenant Proposals

Subsection 56.4(7) Exception to Section 68

- Subsection 56.4(7) also sets out conditions that, if applicable, result in section 68 not applying
- Subject to new anti-avoidance rule in subsection 56.4(11) – new in November 9, 2006 proposals
- Paragraph 56.4(13)(b) provides clarification as to how the amount in subparagraphs 56.4(7)(d)(i) or (ii) is to be treated for tax purposes – CEC

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(7) Application of subsec. (5) -- goodwill amount -- Subject to subsection (11), subsection (5) applies to a restrictive covenant if

(a) the restrictive covenant is granted by a taxpayer (in this subsection referred to as the "vendor") to another taxpayer with whom the vendor deals at arm's length (referred to in this subsection as the "purchaser");

(b) the restrictive covenant is an undertaking of the vendor not to provide, directly or indirectly, property or services in competition with the property or services provided or to be provided by the purchaser (or by a person related to the purchaser) in the course of carrying on the business to which the restrictive covenant relates;

(c) no proceeds are received or receivable by the vendor for granting the restrictive covenant;

(d) the amount that can reasonably be regarded as being the consideration for the restrictive covenant is

(i) included by the vendor in computing a goodwill amount of the vendor, or

(ii) received or receivable by a corporation that was an eligible corporation of the vendor when the restrictive covenant was granted and included by the eligible corporation in computing a goodwill amount of the eligible corporation in respect of the business to which the restrictive covenant relates;

(e) the restrictive covenant may reasonably be considered to have been granted to maintain or preserve the value of

(i) goodwill acquired by the purchaser from the vendor, or

(ii) goodwill acquired by the purchaser from the vendor's eligible corporation;
and

(f) neither section 85 nor subsection 97(2) applies to the disposition of the goodwill by the vendor or the vendor's eligible corporation;

(g) no portion of the amount of consideration that can reasonably be regarded as being in part the consideration for the restrictive covenant is received or receivable, directly or indirectly in any manner whatever, by an individual (in this subsection and subsection (9) referred to as the "non arm's length individual") with whom the vendor does not deal at arm's length or by another taxpayer in which the non arm's length individual holds, directly or indirectly, an interest; and

(h) the vendor and the purchaser or, if subparagraph (d)(ii) applies, the vendor, the eligible corporation and the purchaser, jointly elect in prescribed form to apply subsection (5) to the restrictive covenant.

New Restrictive Covenant Proposals

Subsection 56.4(8) Exception to Section 68

- Subsection 56.4(8) also sets out conditions that, if applicable, result in section 68 not applying
- Again, subject to new anti-avoidance rule in subsection 56.4(11)
- Paragraph 56.4(13)(c) provides clarification as to how the amount in subparagraphs 56.4(8)(c)(i) and (ii) is to be treated for tax purposes

(8) Application of subsec. (5) -- disposition of property -- Subject to subsection (11), subsection (5) applies to a restrictive covenant granted by a taxpayer if

(a) the restrictive covenant is granted by the taxpayer (in this subsection referred to as the "vendor") to another taxpayer (in this subsection and subsection (9) referred to as the "purchaser") with whom the vendor deals at arm's length (determined without reference to paragraph 251(5)(b));

(b) the restrictive covenant is an undertaking of the vendor not to provide, directly or indirectly, property or services in competition with the property or services provided or to be provided by the purchaser (or by a person related to the purchaser) in the course of carrying on the business to which the covenant relates;

(c) it is reasonable to conclude that the restrictive covenant is integral to an agreement in writing

(i) under which the vendor disposes of property (other than property to which subparagraph (ii) applies) to the purchaser for consideration that is received or receivable by the vendor, or

(ii) under which shares of the capital stock of a corporation (in this subsection and subsection (9) referred to as the "target corporation") are disposed of to the purchaser;

(d) where subparagraph (c)(i) applies, the consideration that can reasonably be regarded as being in part the consideration for the restrictive covenant is received or receivable by the vendor as consideration for the disposition of the property;

(e) where subparagraph (c)(ii) applies, no portion of the amount of consideration that can reasonably be regarded as being in part the consideration for the restrictive covenant is received or receivable, directly or indirectly in any manner whatever, by an individual (in this subsection and subsection (9) referred to as the "non arm's length individual") with whom the vendor does not deal at arm's length or by another taxpayer in which the non arm's length individual holds, directly or indirectly, an interest;

(f) subsection 84(3) does not apply to the disposition;

(g) neither section 85 nor subsection 97(2) applies to the disposition; and

(h) the restrictive covenant can reasonably be regarded to have been granted to maintain or preserve the fair market value of the vendor's property disposed of to the purchaser or of the shares of the target corporation disposed of to the purchaser.

New Restrictive Covenant Proposals Subsection 56.4(9) – Capital Gains Election

- Applies in a very limited circumstances
- Generally, if the exceptions in subsections 56.4(7) and (8) do not apply because some of the consideration for the covenant is received or receivable directly or indirectly in any manner whatsoever, by a non-arm's length individual, then section 68 will only apply to that portion
- New joint election can be filed to treat that portion as a goodwill amount or as proceeds of disposition of capital property thus turning the reallocated amount into a capital gain or goodwill amount.

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(9) To extent s. 68 applies -- capital gain election -- If subsection (7) does not apply to a taxpayer's grant of a restrictive covenant solely because the condition in paragraph (7)(g) has not been satisfied, or if subsection (8) does not apply solely because the condition in paragraph (8)(e) has not been satisfied,

(a) to the extent that the consideration that can reasonably be regarded as being in part the consideration for the restrictive covenant granted by the taxpayer is received or receivable by one or more non arm's length individuals and taxpayers in which one or more non arm's length individuals hold, directly or indirectly, an interest (in this subsection referred to as the "allocable portion"), section 68 applies only to that allocable portion;

(b) a joint election may be filed in prescribed form by the taxpayer and each non arm's length individual and other taxpayer referred to in paragraph (a) to deem the portion of the allocable portion that would otherwise be considered by section 68 to be received or receivable in a taxation year by the taxpayer for granting the restrictive covenant to be received or receivable in the taxation year by the taxpayer as a goodwill amount, if paragraph (7)(g) has not been satisfied, or as proceeds of disposition from the disposition of capital property, if paragraph (8)(e) has not been satisfied;

(c) if paragraph (b) applies to deem consideration to be received or receivable in the taxation year by the taxpayer, except for the purpose of applying this subsection, that consideration is considered not to be received or receivable by each of the non arm's length individuals and other taxpayers who make the joint election with the taxpayer;

(c.1) if paragraph (b) applies to deem consideration to be received or receivable in a taxation year by the taxpayer and the consideration is actually received or receivable by another taxpayer -- referred to in that paragraph -- that is a corporation, partnership or trust, that consideration is deemed to have been received by the corporation, partnership or trust, as the case may be, as an agent of the taxpayer if it is transferred to taxpayer within 180 days from the date of receipt; and

(d) for greater certainty, the outlay to the purchaser for the goodwill amount referred to in subsection (7), or the cost of the shares of the target corporation referred to in subsection (8), as the case may be, does not differ from the amount that those amounts would have been if subsection (7) or (8) had applied to all of the consideration paid or payable by the purchaser to the non arm's length individuals and other taxpayers referred to in paragraph (b) for the goodwill amount or capital stock of the target corporation, as the case may be.

- See David Blom and Karen Yull, "The Ongoing Saga of Changing Legislation for Restrictive Covenants", 4(2) *Tax Hyperion*, (Carswell) February 2007 – for a good explanation of this new provision.

New Restrictive Covenant Proposals Anti-Avoidance Rules

- New subsection 56.4(10) added in November 9, 2006 proposals.
- **(10) Anti-avoidance rule -- non-application of para. (3)(c) --** Paragraph (3)(c) does not apply to an amount that would, if this Act were read without reference to subsections (2) to (15), be included in computing a taxpayer's income from a source that is an office or employment or a business or property under paragraph 3(a).

Technical Notes: New subsection 56.4(10) provides an anti-avoidance rule that, if applicable, denies an election under paragraph 56.4(3)(c) that would have allowed a taxpayer to add to their proceeds of disposition in respect of an eligible interest consideration that can reasonably be regarded as being for granting a restrictive covenant. Subsection 56.4(10) applies -- and paragraph 56.4(3)(c) does not apply -- to an amount received by a taxpayer for granting a restrictive covenant if the amount would, if the Act were read without reference to section 56.4 (other than the definitions in subsection 56.4(1)), be included in computing a taxpayer's income from a source that is an office or employment or a business or property.

New subsection 56.4(10) is meant to preclude elections under subsection 56.4(3)(c) from applying to consideration in respect of a restrictive covenant that is taxable as ordinary income. For example, paragraph 56.4(3)(c) does not apply to consideration receivable by an employee/shareholder that can reasonably be regarded under section 68 to be receivable for a covenant to which subsection 6(3) applies.

New Restrictive Covenant Proposals Anti-Avoidance Rules

- New subsection 56.4(11) added in November 9, 2006 proposals.
- (11) **Anti-avoidance -- non-application of subsecs. (7), (8) and (9)** -- Subsections (7), (8) and (9) do not apply in respect of a taxpayer's grant of a restrictive covenant if one of the results of not applying section 68 to the consideration received or receivable in respect of the taxpayer's grant of the restrictive covenant would be that paragraph 3(a) would not apply to consideration that would, if this Act were read without reference to subsections (2) to (15), be included in computing a taxpayer's income from a source that is an office or employment or a business or property.

Technical Notes: New subsection 56.4(11) provides an anti-avoidance rule that overrides the exceptions to the application of section 68 that are found in subsections 56.4(7) to (9). Subsection 56.4(11) applies, and as a result section 68 applies, to consideration that can reasonably be regarded as being for a restrictive covenant if one of the results of not applying section 68 to the consideration would be that the consideration would not be included in computing a taxpayer's income from a source that is an office or employment or a business or property.

New subsection 56.4(11) is meant to preclude subsections (7) to (9) from applying to consideration in respect of a restrictive covenant that is taxable as ordinary income. For example, if a taxpayer were to grant a restrictive covenant to a purchaser in circumstances where another taxpayer disposes of shares to the purchaser, section 68 would apply to the consideration that can reasonably be regarded as being for the restrictive covenant if that consideration would be ordinary income to the other taxpayer -- which would be the case, for example, if those shares were held by the other taxpayer on income account. As a result, the taxpayer granting the restrictive covenant would be required to apply subsection 56.4(2) to the consideration deemed by section 68 to have been received by the taxpayer for the covenant when computing income.

New Restrictive Covenant Proposals

Double Tax Relief

- New subsection 56.4(12) added in November 9, 2006 proposals.
- Intended to relieve double tax possibilities.
- **(12) Clarification if subsec. (2) applies -- where another person receives the amount** -- For greater certainty, if subsection (2) applies to include in computing a taxpayer's income an amount received or receivable by another taxpayer, that amount is not to be included in computing the income of that other taxpayer.

New Restrictive Covenant Proposals

Filing of Prescribed Forms

- Subsection 56.4(14) lays out conditions as to how conditions for filing elections is to be done.

(14) Filing of prescribed form -- For the purpose of paragraphs (3)(b) and (c), (7)(h) and (9)(b) an election in prescribed form filed under any of those provisions is to include a copy of the restrictive covenant and be filed

(a) if the person who granted the restrictive covenant is a person resident in Canada when the restrictive covenant was granted, by the person with the Minister on or before the person's filing-due date for the taxation year that includes the day on which the restrictive covenant was granted; and

(b) in any other case, with the Minister on or before the day that is six months after the day on which the restrictive covenant is granted.

New Restrictive Covenant Proposals Treatment to Purchaser

- Subsection 56.4(4) lays out treatment for purchaser
- Not exhaustive list
- Note if amount is treated as wages pursuant to paragraph 56.4(4)(a), the purchaser, must withhold source deductions.

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(4) Treatment of purchaser -- An amount paid or payable by a purchaser for a restrictive covenant is

(a) if the amount is required because of section 5 or 6 to be included in computing the income of an employee of the purchaser, to be considered to be wages paid or payable by the purchaser to the employee;

(b) if an election has been made under paragraph (3)(b) in respect of the amount, to be considered to be incurred by the purchaser on account of capital for the purpose of applying the definition "eligible capital expenditure" in subsection 14(5) and not to be an amount paid or payable for all other purposes of the Act; and

(c) if an election has been made under paragraph (3)(c), in respect of the amount and the amount relates to the purchaser's acquisition of property that is, immediately after the acquisition, an eligible interest of the purchaser, to be included in computing the cost to the purchaser of that interest and considered not to be an amount paid or payable for all other purposes of the Act.

New Restrictive Covenant Proposals

A Little More Detail

- “New” subsection 14(5.1) proposed – clarifies that variable ‘E’ of the definition of “cumulative eligible capital” does not apply to an amount that is received or receivable by a taxpayer in a taxation year if that amount is required to be included in the taxpayer’s income because of subsection 56.4(2) – restrictive covenant income inclusion
- However, if subsection 56.4(2) does not apply because of proposed paragraph 56.4(3)(b), then section 14 could apply

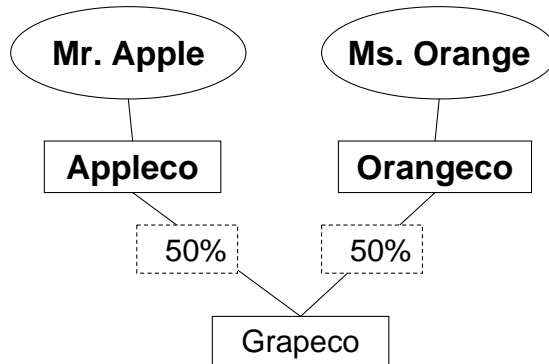
New Restrictive Covenant Proposals

- WHEW!
- CONFUSED YET?

Issues that Arise in the Context of the Sale of a Business

Example 1 – Sale Of Business Assets

Facts – Corporate Structure



Issues that Arise in the Context of the Sale of a Business

Example 1 – Sale Of Business Assets

- Assets of Grapeco, mostly goodwill, are sold to an arm's length purchaser – "Purchaseco" for \$30M; Grapeco realizes income under subsection 14(1) of approximately \$15M (ignoring section 56.4 issues)
- In order to facilitate the sale, Mr. Apple and Ms. Orange grant restrictive covenants to not compete with Purchaseco for consideration of \$1.00 each
- Mr. Apple and Ms. Orange deal at arm's length.

Issues that Arise in the Context of the Sale of a Business

Example 1 – Sale Of Business Assets

- All parties agree that the restrictive covenant amounts are worth approximately \$2M for each of Mr. Apple and Ms. Orange's covenant – amounts included in purchase price of \$30M to be paid by Purchaseco.

Issues that Arise in the Context of the Sale of a Business

Example 1 – Sale Of Business Assets

ANALYSIS

- Grapeco will be an “eligible corporation” – see definition under subsection 56.4(1) – of Mr. Apple or Ms. Orange
- Accordingly, subsection 56.4(7) exception – see subparagraph 56.4(7)(d)(ii) – may apply
- However, subsection 56.4(7) will not apply because the individuals received proceeds - \$1.00 – therefore paragraph 56.4(7)(c) not met.
- Paragraph 68(c) will therefore deem amount of \$2M for each of Mr. Apple and Ms. Orange to be received or receivable by them

Issues that Arise in the Context of the Sale of a Business

Example 1 – Sale Of Business Assets

- Exceptions under subsection 56.4(3) will not apply – conditions under paragraph 56.4(3)(b) not met since Mr. Apple and Ms. Orange do not carry on business.
- Subsections 56.4(8) and 56.4(9) relief not available.

Issues that Arise in the Context of the Sale of a Business

Example 1 – Sale Of Business Assets

- Planning Point – what if the restrictive covenant was granted for no proceeds (i.e. under seal)?
- Exclusion for section 68 could then apply – see elective provisions of subsection 56.4(7)
- Election under paragraph 56.4(7)(h) could then be made to treat proceeds received by Appleco and Orangeco to have subsection 56.4(5) apply
- Will be treated as CEC proceeds of Grapeco – see paragraph 56.4(13)(b)



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Other Miscellaneous Tidbits

Small Practitioners Forum
Banff, AB

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November 23, 2007



Miscellaneous Tidbits

Section 67 Case – “Fransyl” – 2005 TCC 122

Facts

1. “Fransyl Ltd” claimed rental expenses of \$1,865,726 for taxation year ending May 31, 1995.
2. CRA denied the above amount and established the expenses at \$545,525 on the grounds that the amount claimed was not reasonable in the circumstances within the meaning of section 67 of the Act.
3. Rental expenses at issue relate to 3 buildings:
 - a. 2 buildings in Quebec owned by 2859-2699 Quebec Inc. (“2699”); and
 - b. 1 building in Quebec owned by 2859-2996 Quebec Inc. (“2996”)
4. 2699, 2996 and Fransyl were related for purposes of the Act.
5. Rental expenses claimed in 1994 were \$669,000 and \$609,000 in 1996.

Miscellaneous Tidbits

Section 67 Case – “Fransyl” cont’d.

Issue

- Why the increase in rental expense for 1995?

Analysis

- Very factual, of course
- CRA hired experts to provide reports on what FMV rents on properties would be
- Factual analysis found that increased rents allowed 2699 and 2996 to deduct losses incurred in previous year
- Would a “reasonable business person” have committed such expenses on the basis of business considerations only?
- Appellant argued extraordinary circumstances

Miscellaneous Tidbits

Section 67 Case – “Fransyl” cont’d.

Conclusion

- Answer to “reasonable business person” question above was “no”.
- Excess expense was disallowed.

Miscellaneous Tidbits

Taxation of Bonus Case – Garcia – 2007 TCC 548

Facts

1. Herve Garcia – French citizen.
2. In 1993, he moved with his family to the U.S. – obtained Green Card.
3. At the end of 2002, his employer sent him to Canada.
4. Given move to Canada, he sold his house in Los Angeles and purchased one in Canada, obtained work permit to work in Canada and in December 2002 moved to Canada.
5. He did not want to lose his Green Card and therefore obtained re-entry permit – valid for 2 years expiring on March 26, 2004 – not renewable.

Miscellaneous Tidbits

Taxation of Bonus Case – Garcia – 2007 TCC 548 cont'd.

Facts cont'd

6. Investment accounts and mailing address remained in U.S.
7. Mr. Garcia never re-entered U.S. after leaving and his re-entry permit expired.
8. Mr. Garcia received a US\$30,000 bonus in 2003 that related to his 2002 employment.
9. Mr. Garcia filed his tax return for 2003 in Canada as a non-resident. Also filed in the U.S. but took advantage of the foreign earned income exclusion – result was no U.S. tax on his bonus.

Miscellaneous Tidbits

Taxation of Bonus Case – Garcia – 2007 TCC 548

Facts cont'd.

10. Mr. Garcia filed for 2003 pursuant to section 115 and included the US\$30,000 in his income but deducted it as foreign source income.
11. Mr. Garcia was reassessed as a resident of Canada for 2003 – not really disputed. Accordingly, CRA included the US\$30,000 bonus in his income as employment income (pursuant to section 3 and 5 of the Act.)

Miscellaneous Tidbits

Taxation of Bonus Case – Garcia – 2007 TCC 548 cont'd.

Issue

- Was the bonus taxable in Canada if it was derived from employment while he was non-resident?
- Article XV of Canada-US treaty – “remuneration derived by a resident [of the US] in respect of an employment...taxable only in [the US] unless the employment [was] exercised in [Canada].”
- CRA argued that since bonus was received by Mr. Garcia while he was resident in Canada, the meaning of the word “derived” in Article XV is the same as “received”.

Miscellaneous Tidbits

Taxation of Bonus Case – Garcia – 2007 TCC 548 cont'd.

Conclusion

- Court looked at Canada-US treaty and the residency tie-breaker rules under Article IV.
- Court found Mr. Garcia to be a resident of Canada.
- Court did not agree with Mr. Garcia that “derived” should be interpreted as referring to the “accrual basis of accounting”.
- Court did not agree with a case – *Hewitt* – that supported Mr. Garcia.
- Court concluded that employment bonus was taxable at the time of receipt regardless of when or where the employment to which it relates was exercised.
- Bonus taxable in Canada.

Miscellaneous Tidbits

U.S. Tax Issues

- US AMT
 - President Bush demanded, November 17, 2007, that Congress send him legislation that keeps middle-class Americans from being hit for 2007.
 - If no fix by December 31, 2007, between 21-25 million middle-income taxpayers will be subject to AMT costing about US\$2,000 each in extra taxes.
- IRS Scrutiny
 - Homeland Security and IRS apparently now share information. See article by Carol Fitzsimmons in September 2007 Canadian Tax Highlights.
- US Estate Tax
 - Applicable Exclusion Amount for US citizens is still US\$2,000,000 for 2008 rising to US\$3,500,000 for 2009

Miscellaneous Tidbits

November 13, 2007 – Draft Legislation

- Functional Currency
 - Draft amendments released
 - New section 261 of the Act.
- T3 Trust Returns
 - New section 204.1 of the Regulations
 - New subsection 204.1(2) requires that if a trust is, at any time in a taxation year, a public trust (a new defined term) it shall make public information in respect of the trust on the website of CDS Innovations Inc. that is publicly accessible.
 - Information must be released by public trust on or before 60 days after the end of the taxation year; and
67 days for a public investment trust (a new defined phrase).
 - Similar amendments for public partnership in new section 229.1