WELCOME TO THE

EXITING YOUR BUSINESS

SEMINAR

March 9, 2016

You've found a buyer!
….now what?

By: Elisabeth Colson
B.A.(Hons.), LL.B.

My Focus

- Corporate considerations, from the pre-planning stage to Closing.
- Sabina will interject with some tax considerations. Her main presentation will follow and will focus on post-sale tax structuring.

Things to Consider

1. Starting to think about your exit

a) What is motivating your exit?

b) What are your goals?

c) Will you be involved post-exit?

d) Get your house in order

2. Structuring the deal

a) Is it an asset sale or share sale?

Things to Consider (cont'd)

3. The purchase price

   (a) How will you be paid?

4. Due Diligence

   (a) What is it and how does it work?

5. Negotiating the purchase price

   (a) Typical heads of negotiation

   (b) Assumption of liabilities?

Things to Consider (cont'd)

6. Papering the deal
   (a) Starting point
   (b) Conveyancing documents
   (c) Employment agreements
7. For the buyer: Paying for the business
8. Making it public – when and how?
9. Closing

Starting to Think About Your Exit

(a) What is motivating your exit?

(b) What are your goals?

(c) Will you be involved post-exit?

(d) Get your house in order: what needs to be done to optimize your sale proceeds?

Starting to Think About Your Exit (cont'd)

These considerations help form your idea of your "ideal“ purchaser, of your own must-have deal points and how you find the purchaser.

All this takes time. Pre-exit planning can take 2 years or more.

Structuring the Deal

(a) Is it an asset sale or share sale?

The fundamental differences and how they impact your due diligence process:

- Asset sale
- Share sale

The Purchase Price

(a) How much do you want, and how will you be paid?

1. Keep your personal goals in mind as you consider these questions.

Due Diligence

(a) What is it and how does it work?

1. Asset sale
2. Share sale
3. Aspects common to both cases

Negotiating the Purchase Price

(a) Typical heads of negotiation

(b) Assumption of liabilities

Papering the Deal

(a) Starting point:

1. Confidentiality Agreement
2. Letter of Intent or Deal Memo

(b) Conveyancing documents:

1. Purchase Agreement
2. Ancillary documents

Papering the Deal (cont'd)

(c) Employment Agreements

1. Asset sale: Purchaser is a successor employer.
2. Share sale: Existing corporation continues as the employer.
3. New employment agreements are encouraged.

Paying for the business

(a) For the buyers: Paying for the business

1. High-level view of bank financings
2. How the vendor can help

Making it Public

(a) Making it public – when and how?

1. The usual options
2. It is a business decision

Closing

Once all the outstanding issues are resolved, all the paperwork is signed and you have your money…..

See Sabina to strategize as to how best to keep as much of it as possible out of the government's coffers.

Tax considerations in buying and selling a business

Sabina Mexis
LL.B., TEP

Things to consider

1. Structuring the deal – pre sale considerations
   a) Is it an asset sale or a share sale?
   b) Tax considerations
      i. Acquisition of Control
      ii. Loss of CCPC status
      iii. Triggering the Association Rules

Things to Consider (cont'd)

2. Capital Gains Exemption

   a) Eligibility

   b) Multiplying the capital gains exemption

Structuring the Deal

a) Is it an asset sale or a share sale?

A purchase and sale transaction generally involves 3 parties:

1. Vendor
2. Purchaser
3. Target corporation

The tax implications of structuring the deal are significant considerations and may be different for each of the parties to the transactions.

Structuring the Deal (cont’d)

i. Share sale

- offers the potential benefits of a capital gains exemption claimed by the vendor and the possible utilization of non-capital losses by the purchaser but results in some additional administrative complexity due to the deemed year end that arises from the acquisition of control of the target company

Structuring the Deal (cont'd)

ii. Asset sale

- Generally permits the purchaser to achieve a step-up in the tax basis of the assets acquired and avoids a deemed year end but subjects the vendor to potential double taxation at the corporate and at the shareholder level as a consequence of the distribution of after-tax proceeds

Structuring the Deal (cont'd)

b) Tax considerations:

- Share sale: ability to access the capital gains exemption
- Asset sale: purchase price allocation is fundamental as it directly drives the tax implications to all parties on an asset-by-asset basis
  - Vendor will generally want to maximize capital gain and minimize recapture
  - Purchaser prefers to maximize future tax shelter by allocating more value to depreciable assets with the highest CCA rates

Pre-sale considerations

i) Change of control issues on a share sale

- In structuring a share sale, we need to be mindful of the potential for triggering multiple year-ends during the closing process
    - Subsection 249(4) of the ITA deems a year end to have occurred immediately prior to an acquisition of control of a corporation
    - If one of the consequences of a proposed acquisition is that the target corporation will either become, or cease to be, a CCPC, then subsection 249(3.1) can also apply to create an additional year end.

Pre-sale considerations (cont'd)

Acquisition of control

- Subsection 249(4) applies where control of a corporation is acquired by a person or group of persons
- This provision triggers a year end immediately prior to the acquisition of control
- A new taxation year then commences at the time of the acquisition of control
- Subsection 249(4) refers to acquisition of control NOT change of control, therefore a transaction whereby a shareholder loses control, but no other person acquires control, does not give rise to a deemed year end

Pre-closing acquisition of control

- Paragraph 251(5)(b) of the ITA provides that where at any time a person has a right under a contract, in equity or otherwise, either immediately or in the future, and either absolutely or contingently to acquire shares of the capital stock of a corporation, the person shall be deemed to have the same position in relation to control of the corporation as if the person owned the shares at that time
- Where a vendor and purchaser enter into a binding purchase and sale agreement to sell shares of a target corporation at some time in the future, paragraph 251(5)(b) will apply to deem the purchaser to own the shares at the moment the purchase and sale agreement is executed

Pre-closing acquisition of control

- One way to avoid the application of paragraph 251(5)(b) is to not sign the purchase and sale agreement until the actual closing date
- The vendor and purchaser should instead proceed on the basis of a non-binding letter of intent, with the binding APA to be signed at closing
- This is not always a realistic alternative given various business considerations

Pre-closing acquisition of control

- As a result, executing a binding purchase and sale agreement with a prospective closing date can prematurely trigger an acquisition of control for income tax purposes and a number of adverse tax consequences can arise from so doing, including a deemed year end under subsection 249(4)
- The association rules can also unintentionally be triggered which may affect the allocation of the small business deduction and investment tax credits for the taxation year prior to the closing date

Loss of CCPC status

- Signing an APA with a prospective closing date can also result in the premature loss of CCPC status if the purchaser is a non-resident or a public corporation
- For example, an APA with a future closing date may provide the purchaser with a paragraph 251(5)(b) right as of the time that the agreement is signed and delivered and not just on the closing date
- A binding LOI may also be sufficient to trigger paragraph 251(5)(b)

Loss of CCPC status

- In order to avoid the loss of CCPC status on signing, where the buyer is a non-resident or a public company, it may be beneficial to structure the transaction as a “sign and close” whereby no binding agreements are signed until the closing time
- If one of the consequences of a proposed acquisition is that the target corporation will either become, or cease to be, a CCPC, then subsection 249(3.1) can also apply to create an additional year end.

Loss of CCPC Status - EXAMPLE

- TargetCo is a CCPC with a December 31 year end
- On October 1, it enters into a binding LOI to sell all of the shares of TargetCo to an arm's- length non-resident purchaser ("ForeignCo")
- The LOI contemplates a due diligence period during which the definitive agreements would be drafted.
- The closing is scheduled for December 1st
- ForeignCo acquired the TargetCo shares through the use of a single-purpose Canadian acquisition company and amalgamated the acquisition company with TargetCo immediately after closing

Loss of CCPC status – Analysis of example

- As soon as ForeignCo entered into the binding LOI, it had a conditional right to acquire control of TargetCo.
- For the purposes of determining TargetCo's CCPC status, ForeignCo is deemed to own those shares that it has a conditional right to acquire (ss. 251(5)(b))
- Even though actual ownership of the shares remained with TargetCo's shareholders until the closing date, TargetCo ceased to be a CCPC immediately upon the execution of the LOI
- Since there was no actual acquisition of control, subsection 249(4) did not apply on the date of execution of the LOI
- However, since there was a loss of CCPC status on that date, subsection 249(3.1) triggered a year end on October 1st immediately prior to signing the LOI.

Loss of CCPC Status – Analysis of example

- Assuming that the transaction closed as scheduled, there would have been an acquisition of control on December 1st
- By virtue of 256(9), the acquisition of control would be deemed to have occurred at the commencement of the day on December 1st thereby resulting in a deemed year-end at the end of the day on November 30th.
- Furthermore, if the amalgamation agreement did not set out a specific effective time for the amalgamation, then the amalgamation would have been deemed to have occurred concurrently with the acquisition of control resulting in a year end on November 30th.
- If Amalco wanted a calendar year end, there would be another short taxation year from December 1 to December 31.

Triggering the Association Rules

- Signing an APA with a prospective closing date may inadvertently trigger the association rules which also could impact the ability of the target corporation to access the small business deduction and investment tax credits
- Paragraph 256(1.4) is a similar rule to paragraph 251(5)(b) which applies for the purposes of the determination of association.
- Under subsection 256(1.4), where a person has under a contract a right to acquire shares of the capital stock of a corporation, for the purposes of determining whether a corporation is associated with another corporation, the person is deemed to own the shares at that time

Triggering the Association Rules

- It is possible to mitigate the associated corporation risk by, for example, having representations and warranties in the APA that the purchasing corporation is not associated with any other corporations for purposes of the ITA
- Consideration should also be given to the purchaser providing a covenant that if the target corporation does become associated with any corporation in the purchaser group, all concerned parties will take the necessary steps to ensure that allocation of the business limit will be in favour of the target corporation to enable it to claim the maximum small business deduction prior to closing

Capital Gains Exemption

(a) Eligibility

1. Allows a vendor, if qualifying, to receive up to $813,600 (for 2015) of capital gains on the disposition of qualified small business corporation shares tax free
2. First step is to determine whether the share is a share of a "qualified small business corporation" (subsection 110.6(1) ITA)
3. Two-part test:
   - Holding period test
   - Asset test

Capital Gains Exemption (cont'd)

Holding period test:

1. For the 24 months prior to the disposition, a QSBC share must have been owned by the individual, the individual's spouse or common-law partner or a partnership related to the individual; and
2. For the 24 months prior to the disposition, the share may not have been owned by anyone other than the vendor, or a person related to the vendor

Asset test:

1. For the 24 months prior to disposition, the corporation must have been a CCPC, and more than 50% of the fair market value (FMV) of its assets must have been used principally in an active business carried on primarily in Canada by the corporation or a related corporation;
2. At the time of disposition, all or substantially all (90%) of the FMV of assets must be attributable to assets used principally in an active business carried on primarily in Canada

Capital Gains Exemption (cont'd)

(b) Multiplying the Capital Gains Exemption

1. If the taxpayer is contemplating a share sale, then consideration should be given to adding family members as shareholders (either directly or through a family trust) in order to gain access to multiple capital gains exemptions.
2. Provided that the shares of the corporation qualify and all other conditions to claim the CGE are met, the gain can be allocated between each shareholder (or beneficiary of the trust) who could then shelter their portion of the gain with their CGE.

Post-sale tax considerations

(a) Tax elections

Numerous tax elections exist to reduce tax otherwise payable on the sale transaction

- Section 167 *Excise Tax Act* – provides that where a vendor sells a business to a purchaser, they can jointly elect for GST / HST to not be payable on the purchase price
- Requirements:
    - i. Vendor makes a supply of a business or part of a business; and
    - ii. The recipient acquires all or substantially all of the property necessary to carry on the business
- Election must be filed on or before the due date of the purchaser's GST return for the given reporting period

Conclusion

- The foregoing represents just some of the complexities and tax issues that need to be considered in planning for the purchase and sale of a business
- Tax considerations apply at virtually all stages of the purchase and sale process, therefore tax advice before the transaction is entered into is critical.

THANK YOU!

QUESTIONS?

Sabina Mexis
(416) 446-3348
sabina.mexis@devrylaw.ca

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Tax considerations in buying and selling a business

Cristina S. Shortt, CPA, CA, CMA, CFP, MAcc

March 9, 2016

Things to Consider

1. The purchase price – tax considerations

a) Purchase Price Allocation

b) Reserves

c) Earnouts

d) Capital Dividend Account

Things to Consider (cont'd)

2. Post-sale tax considerations

a) Tax elections

b) Use of losses following acquisition of control

The Purchase Price – Tax Considerations

a) Purchase Price Allocation:

1. Fundamental concept in an asset sale as it directly drives the tax implications to all parties on an asset-by-asset basis

2. In the context of a share transaction, the allocation of a value between different share classes can be subject to negotiation

3. Be mindful of section 68 of the *Income Tax Act*

    - Requires a “reasonable” allocation among assets and provides for a reallocation where the consideration is not reasonably allocated

The Purchase Price – Tax Considerations

b) Reserves:

1. A reserve is permitted under s. 40(1)(a) of the *Income Tax Act* when all or some of the proceeds are not payable until after the end of the year
2. Permitted over a 5-year period on a sale of capital property

The Purchase Price – Tax Considerations

c) Earnouts:

1. An earnout is a portion of the sale price which is dependent upon potential future earnings
2. Proceeds for shares under an earnout will generally be treated as proceeds on the sale of capital property provided that:
   - Vendor and purchaser are dealing at arm's length;
   - The earnout feature relates to underlying goodwill, the value of which cannot reasonably be expected to be agreed upon at the date of sale:
   - The duration of the sale agreement does not exceed 5 years; and
   - The vendor is a Canadian resident
3. Payments based on production or use from a property will be included in income and not treated as proceeds of sale

The Purchase Price – Tax Considerations

c) Capital dividend account (CDA):

1. The capital dividend account keeps track of various tax-free surpluses accumulated by private corporations including:
   - Non-taxable portion of a capital gain;
   - Non-taxable portion from the disposition of eligible capital property;
   - Receipt of capital dividend from another corporation;
   - Net proceeds of a life insurance policy.
2. In a share sale, the balance in the corporation’s CDA should be analyzed and paid to the vendor shareholder prior to the closing date
3. Timing issues on an asset sale in respect of :
   - Sale of capital property
   - Sale of eligible capital property (i.e. goodwill)

Post-sale tax considerations

(a) Tax elections

- Section 22 *Income Tax Act* – accounts receivable election – permits the vendor and purchaser in an asset transaction to jointly elect to transfer a reserve for doubtful debts from the vendor to the purchaser
- The effect of this election is that the vendor deducts losses incurred on the sale of the debts receivable and the purchaser includes the same amount in the income
- The purchaser may deal with the debts as though they had arisen during the course of the purchaser's business
- Form T2022 must be filed

Post-sale tax considerations

(b) Use of losses following acquisition of control

- Net capital losses effectively expire on an acquisition of control and cannot be carried forward and utilized in a taxation year beginning after the acquisition of control
- Non capital losses can be carried forward and deducted from income in a post-acquisition year provided that:
- The business that gave rise to the losses must be carried on with a reasonable expectation of profit in the post-acquisition taxation year ("**same business**"); and
- The losses can then be applied only to the extent of income from the same or similar business

Conclusion

The sale or transfer of a business is the culmination of your work and effort.
Ensure that you enjoy the tax savings available to you.
Tax advice before the transaction is entered into is critical.

Thank you!

Questions?

Cristina Shortt (x104) & Jane Ritchie (x103)
905-668-7788
cris@rstaccountants.com
jane@rstaccountants.com

Wealth Advisory Services & TD Core Equity Portfolios

Portfolio Advice & Investment Research

TD Wealth

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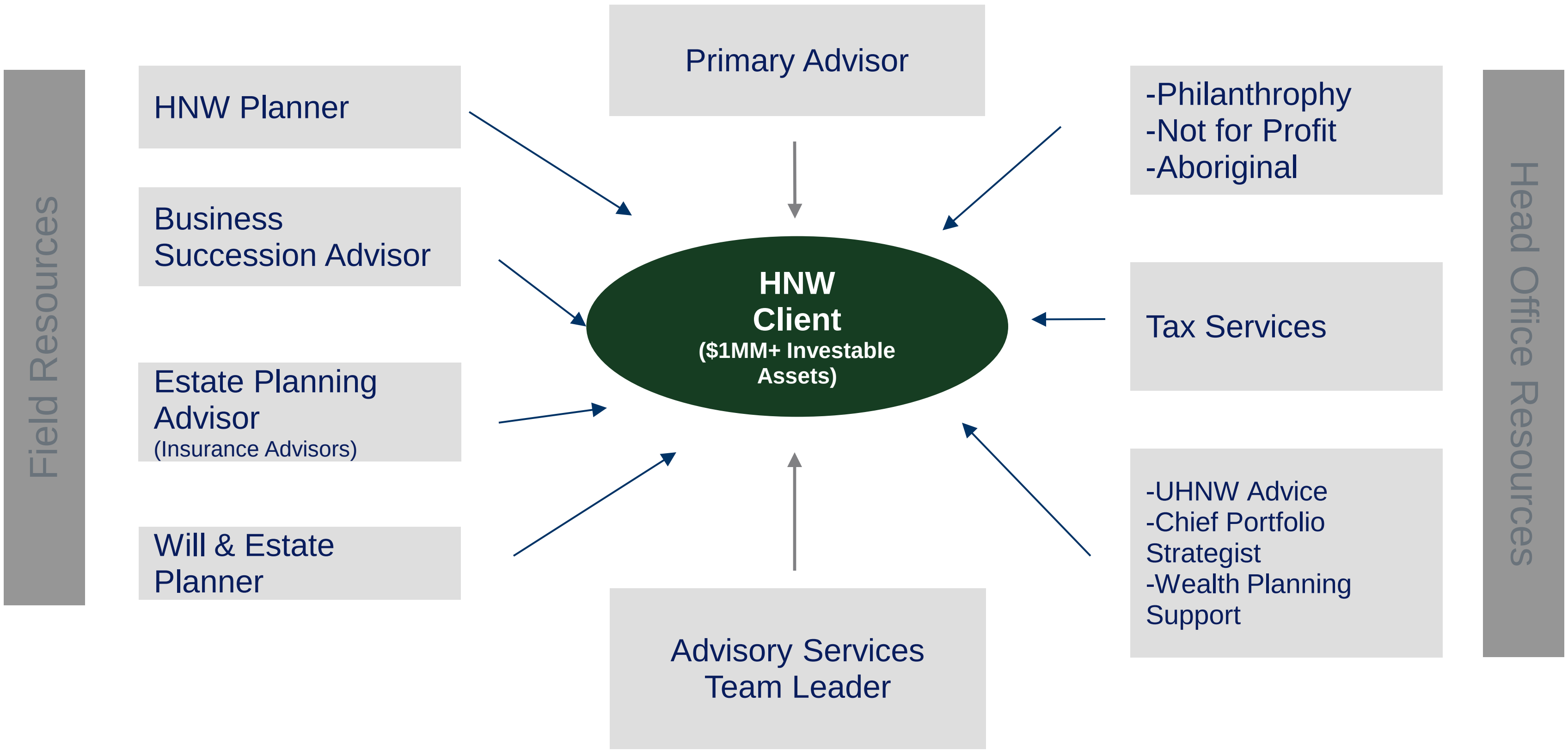
High Net Worth Relationship Model

World Class Advice and Legendary Client Experience



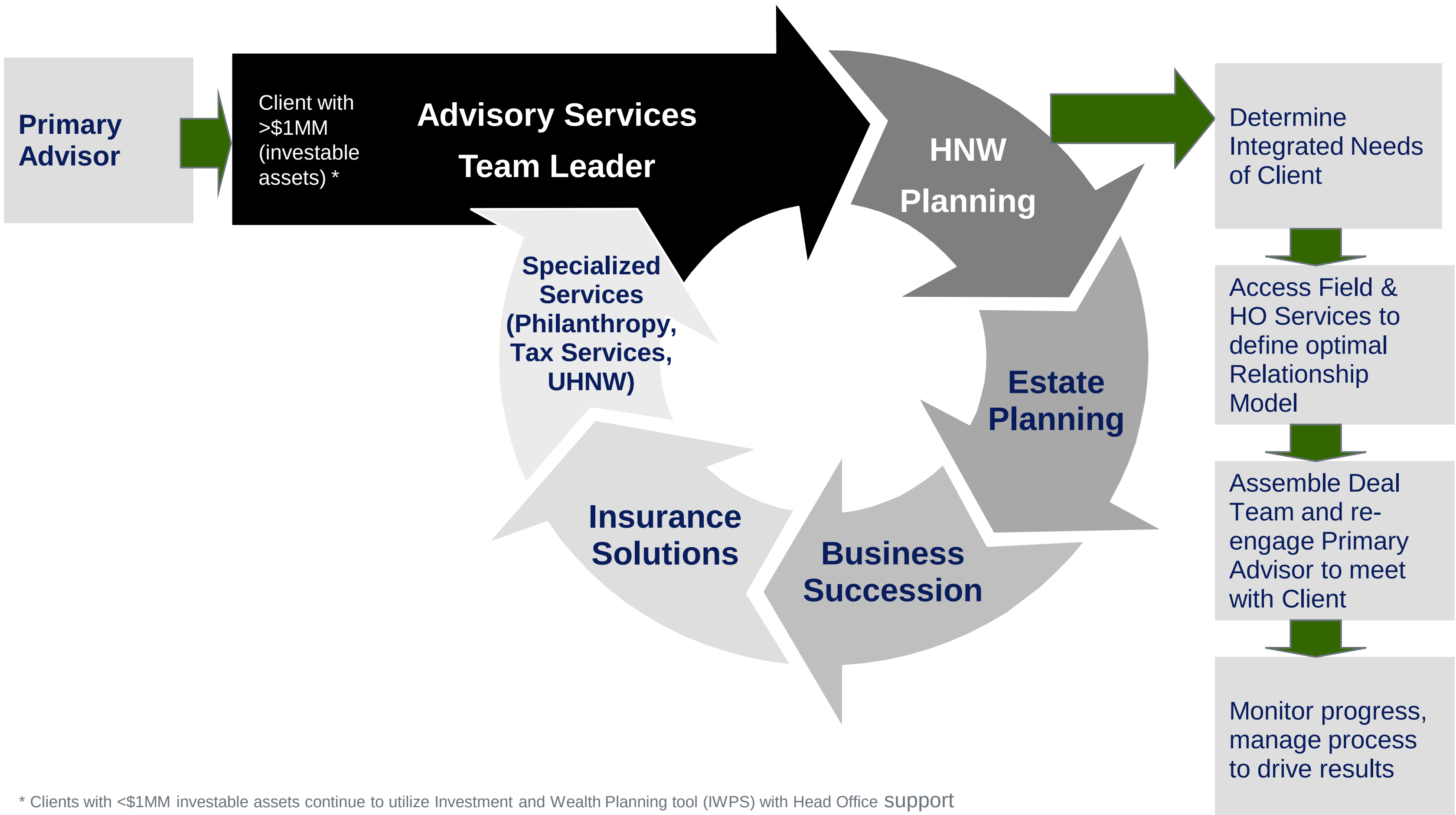
Full solution set discovery and re-discovery process

Integrated & coordinated approach from deal team

Primary Advisor & Advisory Service RM are anchors to drive Client relationship model to deliver solution set

Engaging Wealth Advisory Services:

Our Value Proposition



* Clients with <$1MM investable assets continue to utilize Investment and Wealth Planning tool (IWPS) with Head Office support

Core Equity Portfolios

- Foundational, core portfolios for your equity allocation
- Focused yet diversified portfolios of mostly large-cap stocks
- Security selection: high quality, lower-risk equity investments
- 25-35 securities across a range of industry sectors

All equity portfolios contain an element of risk. For clients with low risk tolerances, the asset allocation to equities is expected to be modest.

Portfolio Advice & Investment Research
North American equity team

Catherine Carlin
CFA
25 years of experience

- Senior equity portfolio manager for a large Canadian pension fund; 20 year tenure
- Strong investment performance and absolute returns
- Experience in corporate credit research and analysis

Chris Blake
CFA
20 years of experience

- Senior analyst: global industrial sector, technology, industrials
- OMERS, RBC Asset Management, EL Financial
- Engineering degree as well as MBA and CFA

Scott Booth
CFA
10 years of experience

- Experience in Forex, money market, and fixed income sales & trading
- In-depth knowledge of the capital markets with a fixed income focus
- Valuable analysis & recommendations for income oriented portfolio construction

Robert Marck
CFA, CPA, CMA
8 years of experience

- Equity research associate covering financial institutions
- Corporate development associate for a mid-sized Canadian health care company
- Experience as an associate investment advisor supporting a top ranked broker

Core Equity Portfolios
Investment Approach

- Top-down economic and bottom-up fundamental analysis for sector allocation and security selection
- Leverage the insight and expertise of research teams at TD, including TD Economics and TD Securities, as well as supplemental outside providers
- Large capitalization companies
- Invest in companies that have a sound financial position, defensible business models, a superior track record and future potential for growth in earnings and/or cash flows

Core Equity Portfolios
Investment Approach – Sell Discipline

- Holdings are managed on a continuous basis to ensure their fundamentals and valuations continue to warrant inclusion
- Sell Discipline: change which alters investment thesis
- Positions which appreciate to represent too much of a Core Portfolio's market value are reduced
- Better idea is identified

Core Dividend Equity Portfolio

Objective

- Constructed to provide a stable stream of dividend income, with potential for modest growth in income and capital over time
- Invests in dividend-paying common equities of Canadian and U.S. companies
- Diversified across a broad range of industry sectors
- Take a North American perspective for security selection

Expectations

- Focus of the portfolio is to generate income
- May be significant deviation from conventional indices
- Modest level of turnover

May be appropriate for investors who are outcome rather than benchmark-oriented, and seeking an income stream from the equity allocation of their investment portfolio.

Performance – Core Dividend

Performance

	3 months (%)	YTD (%)	1 Year (%)	3 Years (%)	5 Years (%)	Since Inception (%)
Portfolio	**5.21**	**3.94**	**3.94**	**12.72**	**9.49**	**9.96**
Blended Benchmark	**1.98**	**0.40**	**0.40**	**12.08**	**7.96**	**8.70**
Added Value	**3.23**	**3.53**	**3.53**	**0.64**	**1.53**	**1.27**
S&P/TSX 60 Index (TR)	-1.70	-7.76	-7.76	5.46	2.88	4.63
S&P 500 Index (C$) (TR)	10.91	21.59	21.59	28.64	20.37	18.41

Calendar Year Returns

	2015 (%)	2014 (%)	2013 (%)	2012 (%)	2011 (%)
Portfolio	**3.94**	**13.90**	**20.98**	**4.42**	**5.22**
Blended Benchmark	**0.40**	**15.75**	**21.13**	**9.74**	**-5.06**
Added Value	**3.53**	**-1.86**	**-0.15**	**-5.31**	**10.28**
S&P/TSX 60 Index (TR)	-7.76	12.27	13.26	8.07	-9.08
S&P 500 Index (C$) (TR)	21.59	23.93	41.27	13.43	4.64

Source: TD Asset Management Inc. Portfolio Benchmark: 70% S&P/TSX 60 Index, 30% S&P 500 Index (C$). Model Portfolio Inception date: December 31, 2009. % total return unaudited, gross of fees. Returns (gross of fees) for periods longer than 1 year are compound annual returns. As at December 31, 2015. TR denotes Total Return. Please refer to Appendix A for important disclosures.

Core North American Equity Portfolio

Objective

- Constructed to provide growth of capital over a medium to long term investment horizon
- Invests in common equity securities of Canadian and U.S. companies
- Diversified across a broad range of industry sectors
- Take a North American perspective for security selection

Expectations

- Moderate level of turnover

May be appropriate for investors seeking a moderate level of capital growth over a medium to long term investment horizon, through investment in Canadian and U.S. companies

Performance – Core North American

Performance

	3 months (%)	YTD (%)	1 Year (%)	3 Years (%)	5 Years (%)	Since Inception (%)
Portfolio	**3.24**	**4.33**	**4.33**	**12.26**	**8.09**	**3.97**
Blended Benchmark	**2.81**	**1.43**	**1.43**	**12.64**	**8.44**	**5.44**
Added Value	**0.43**	**2.90**	**2.90**	**-0.38**	**-0.35**	**-1.47**
S&P/TSX Composite Index (TR)	-1.40	-8.32	-8.32	4.62	2.30	2.04
S&P 500 Index (C$) (TR)	10.91	21.59	21.59	28.64	20.37	10.77

Calendar Year Returns

	2015 (%)	2014 (%)	2013 (%)	2012 (%)	2011 (%)
Portfolio	**4.33**	**15.55**	**17.35**	**10.15**	**-5.31**
Blended Benchmark	**1.43**	**15.19**	**22.31**	**9.43**	**-4.13**
Added Value	**2.90**	**0.36**	**-4.95**	**0.71**	**-1.18**
S&P/TSX Composite Index (TR)	-8.32	10.55	12.99	7.19	-8.71
S&P 500 Index (C$) (TR)	21.59	23.93	41.27	13.43	4.64

Model Portfolio Inception date: November 30, 2007. % total return unaudited, gross of fees. Returns (gross of fees) for periods longer than 1 year are compound annual returns. Source: TD Asset management Inc. Portfolio Benchmark: 65% S&P/TSX Composite Index, 35% S&P 500 Index.
As at December 31, 2015. TR denotes Total Return. Please refer to Appendix A for important disclosures.

Core Canadian Equity Portfolio

Objective

- Constructed to provide growth of capital over a medium to long term investment horizon
- Invests in common equity securities of Canadian companies
- Diversified across Canadian industry sectors

Expectations

- Moderate level of turnover
- A higher level of sector concentration is to be expected, although the manager will seek to ensure an adequately diversified level of portfolio construction

May be appropriate for investors seeking a moderate level of capital growth over a medium to long term investment horizon, through investment in Canadian companies

Performance – Core Canadian

Performance

	3 months (%)	YTD (%)	1 Year (%)	3 Years (%)	5 Years (%)	Since Inception (%)
Portfolio	**-0.04**	**-0.52**	**-0.52**	**9.44**	**4.72**	**2.74**
S&P/TSX Composite Index (TR)	-1.40	-8.32	-8.32	4.62	2.30	2.00
Added Value	1.35	7.80	7.80	4.82	2.42	0.74

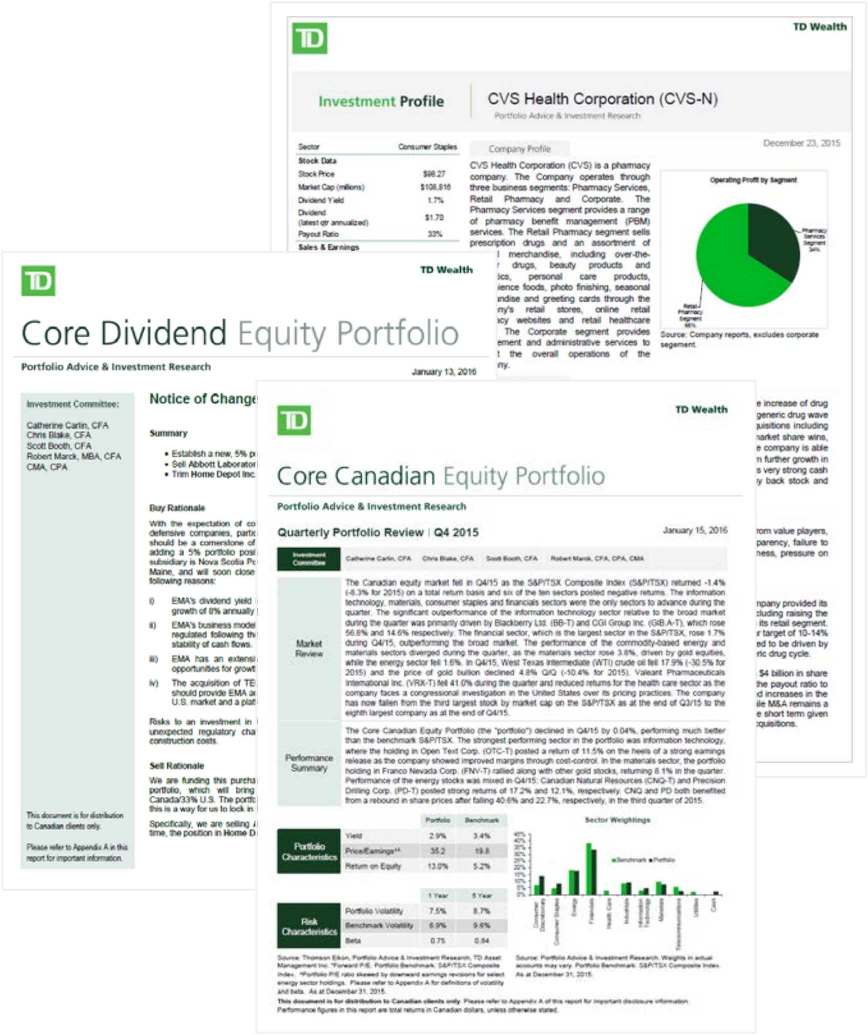
Calendar Year Returns

	2015 (%)	2014 (%)	2013 (%)	2012 (%)	2011 (%)
Portfolio	**-0.52**	**13.75**	**15.85**	**8.33**	**-11.30**
S&P/TSX Composite Index (TR)	-8.32	10.55	12.99	7.19	-8.71
Added Value	7.80	3.19	2.86	1.14	-2.59

Model Portfolio Inception date: September 30, 2007. % total return unaudited, gross of fees. Returns (gross of fees) for periods longer than 1 year are compound annual returns. Source: TD Asset Management Inc. Portfolio Benchmark: S&P/TSX Composite Index. TR denotes Total Return.
As at December 31, 2015. Please refer to Appendix A for important disclosures.

Communications and Support

- Investment Profile for each holding – updated at least quarterly
- Notice of Change - provides the rationale behind each trade
- Quarterly Reviews - highlights the performance and portfolio changes for the quarter, and provide insights on a broader investing environment



The Benefits of Core Portfolios

- Disciplined investment process
- Experienced investment team
- Advisor access to the portfolio managers
- Transparency

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