

Clarity is seeing
the path to your

Potential

2013 CASE STUDY

Pre-Mortem Tax Planning – The Bakers Halifax Estate Planning Council

Greg Leslie, CA

Collins Barrow Nova Scotia Inc.

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THE BAKERS

- The Bakers own a bakery – “BakeCo”
- Value of business - \$500,000
- Inactive Real Estate in BakeCo - \$500,000
- Business Real Estate owned personally - \$1,000,000
- Shares in Investco - \$1,500,000

THE BAKERS

What is the inherent tax liability on the death of the Bakers?

- Deemed disposition of capital property
- Spousal Rollover on first death
- Tax deferred until death of the surviving spouse

THE BAKERS

Tax Liability

ITEM	FMV	COST	UCC	GAIN	RECAPTURE
BAKECO SHARES	1,000,000	----	----	1,000,000	----
BUSINESS LAND	400,000	100,000	----	300,000	----
BUSINESS BLDG	750,000	300,000	50,000	450,000	250,000
INVESTCO SHARES	1,500,000	----	----	1,500,000	----
TOTAL	3,650,000	400,000	500,000	3,250,000	250,000

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TAX LIABILITY:

Capital Gain	\$3,250,000
Taxable Portion	<u>50%</u>
Taxable Gain	1,625,000
Recapture	<u>250,000</u>
Taxable Income	1,875,000
Tax Rate	<u>50%</u>
Tax Liability	\$ 937,500

THE BAKERS

THE PROBLEM

- No access to Lifetime Capital Gains Exemption
 - Only available on QSBC shares
 - Subject to asset tests
 - Assets must be employed in active business

- InvestCo doesn't qualify
- BakeCo doesn't qualify
- Real Estate doesn't qualify

THE BAKERS

THE SOLUTION

- Purify BakeCo
- Transfer Business Real Estate into company

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PURIFY BAKECO

- Rental Property is a “bad asset”
- Transfer it out to another company – InvestCo?
- Complete transfer in a tax deferred manner
- Don't replace one bad asset with another

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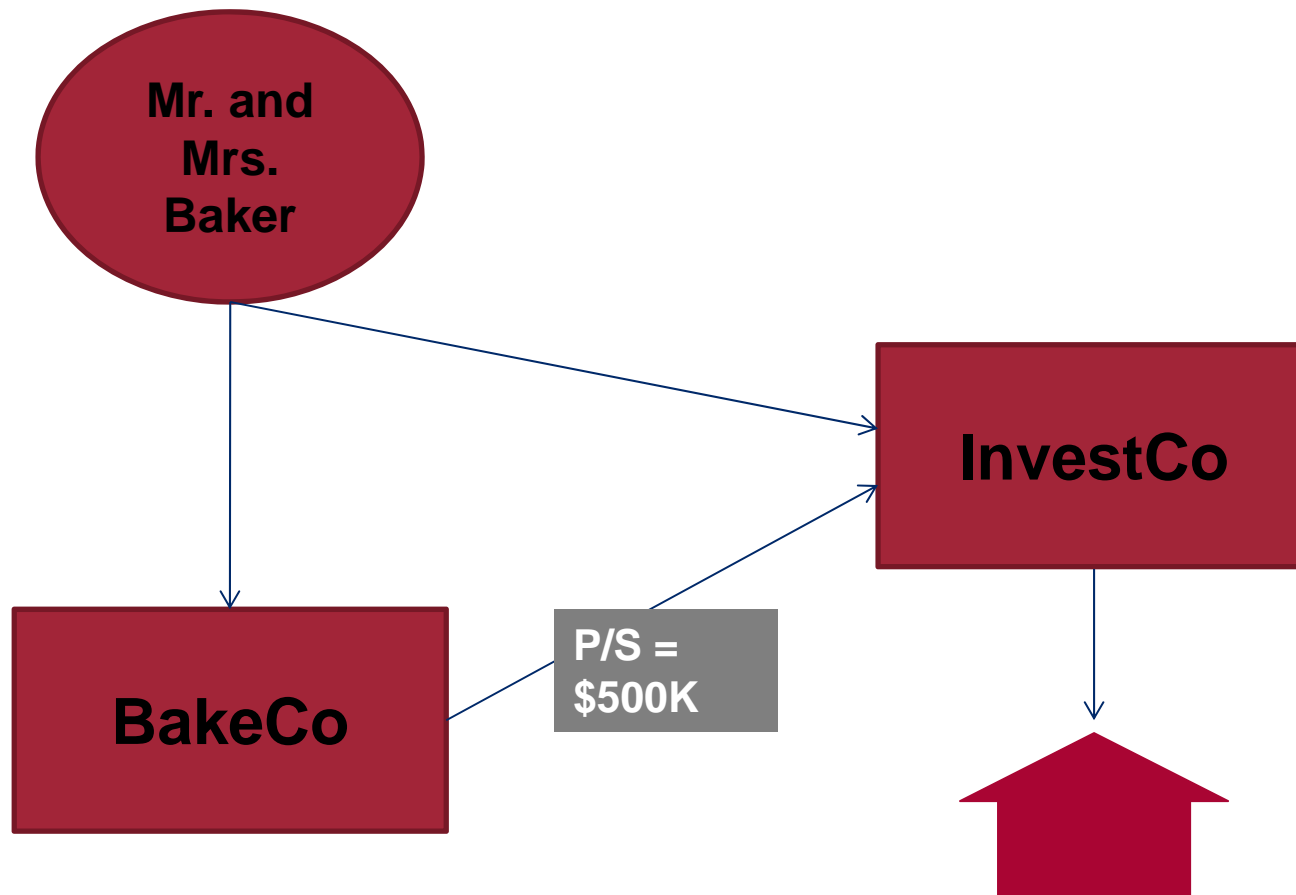
PURIFY BAKECO - STEPS

- BakeCo sells real estate to Investco

- Purchase and Sale Agreement
 - Section 85 election at tax cost
 - Price Adjustment Clause

- Consideration
 - Preferred Shares in Investco
 - Redemption/Retraction = FMV of Real Estate

THE BAKERS



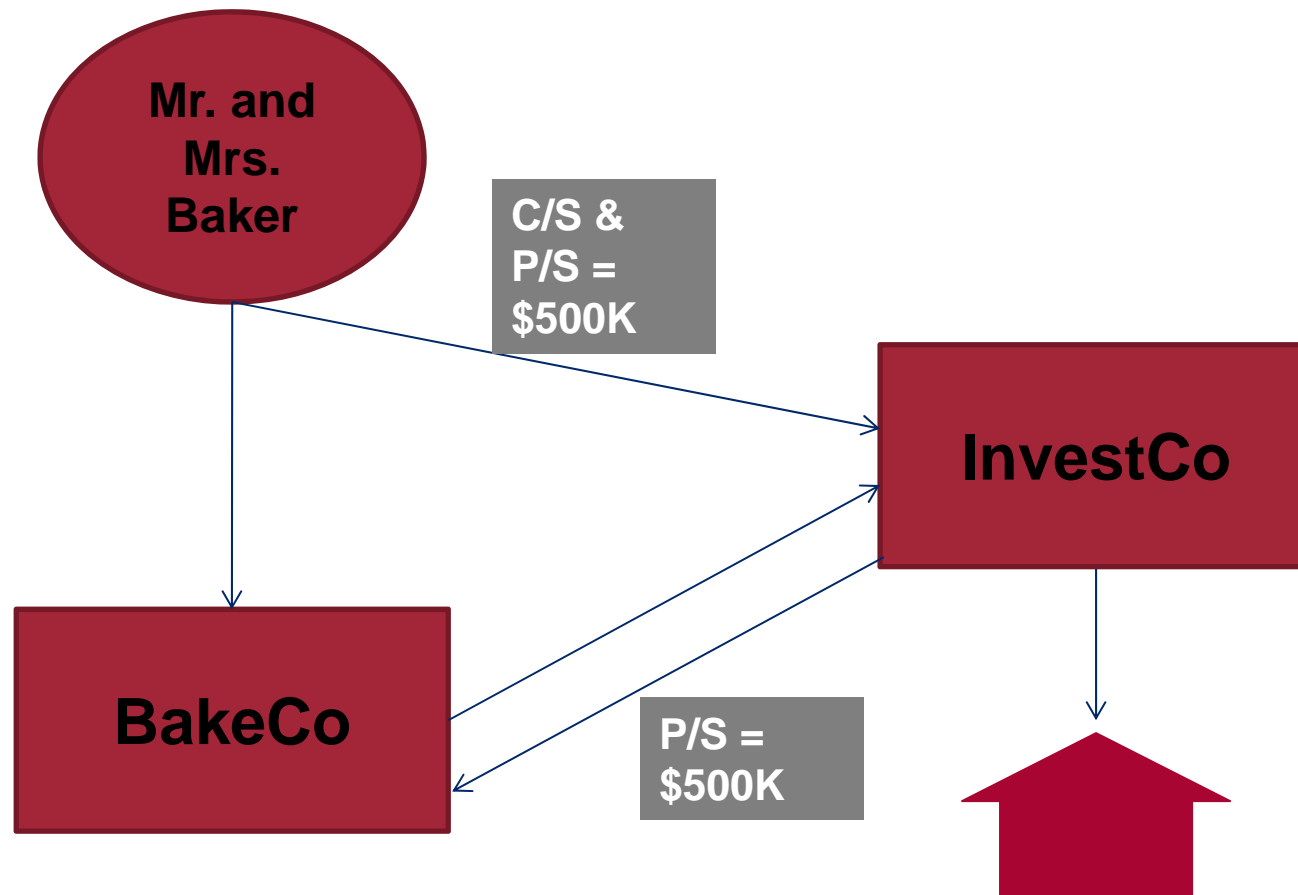
THE BAKERS

PURIFY BAKECO - STEPS

- BakeCo declares stock dividend to the Bakers
 - Preferred shares with redemption value = \$500K
 - Low paid up capital

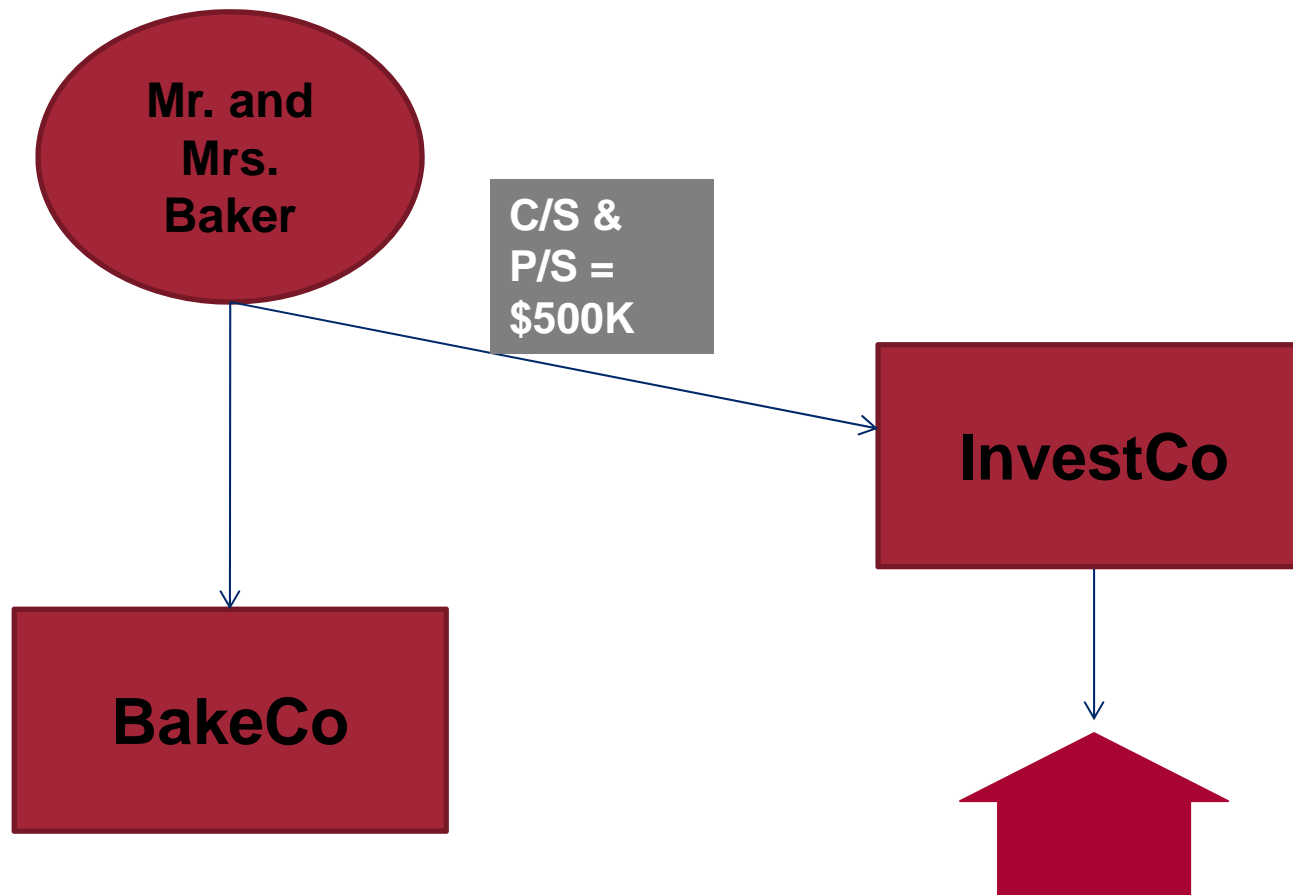
- The Bakers transfer preferred shares to Investco
 - Purchase and Sale Agreement
 - Section 85 election at tax cost
 - Price Adjustment Clause

THE BAKERS



THE BAKERS

CROSS REDEEM PREFERRED SHARES



THE BAKERS

INCORPORATE THE BUSINESS REAL ESTATE

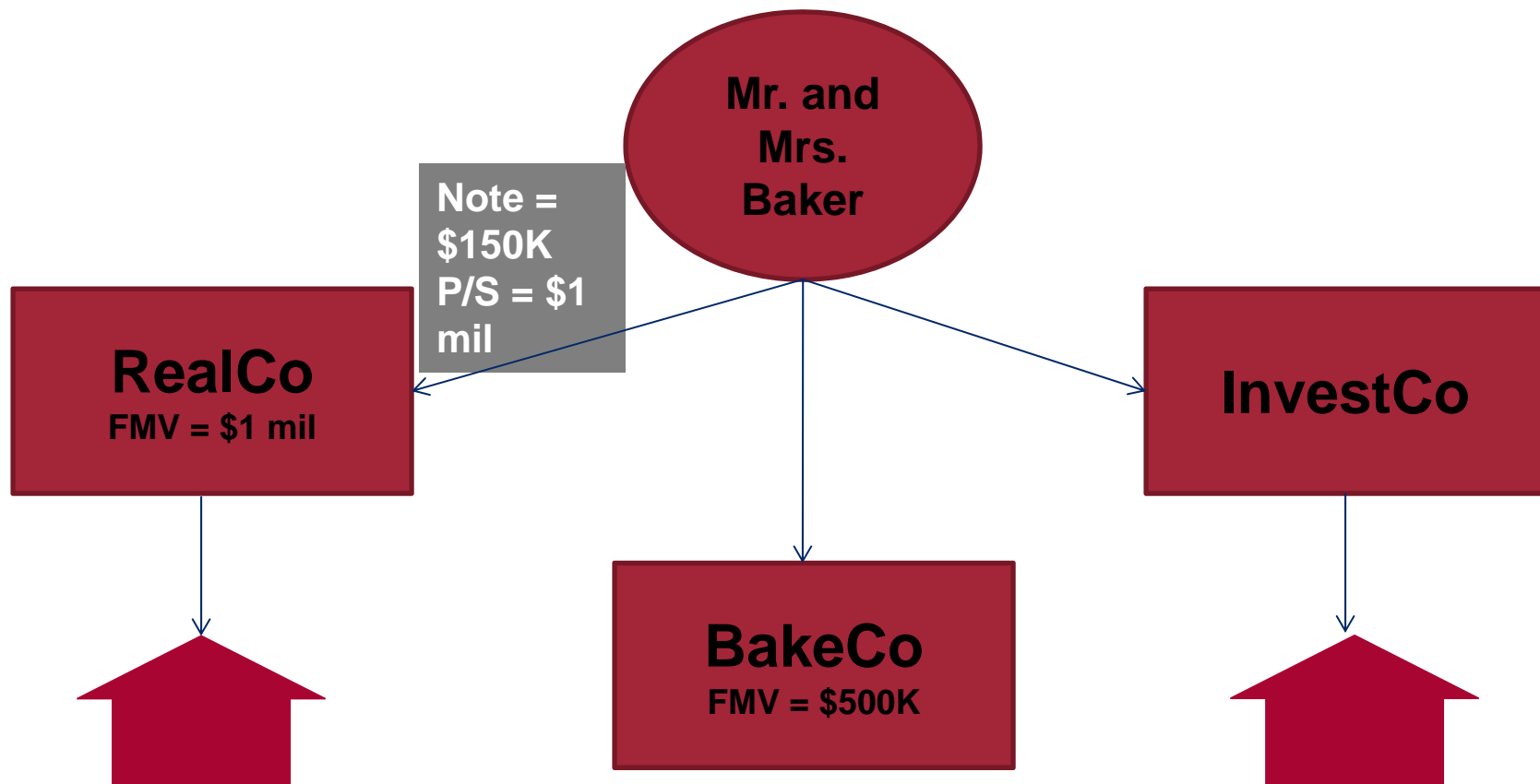
- Transfer Real Estate to BakeCo
- Or use a separate RealCo
- Subject to Section 85 Election to Defer Tax
- Consideration can include promissory note equal to tax cost

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THE SECTION 85 ELECTION

ITEM	FMV	TAX COST/ ELECTED AMOUNT	CONSIDERATION	FMV OF CONSIDERATION
LAND	400,000	100,000	PROM. NOTE PREF. SHARES	100,000 300,000
BUILDING	750,000	50,000	PROM. NOTE PREF. SHARES	50,000 700,000

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THE BAKERS

CAPITAL GAINS EXEMPTION ELIGIBILITY

- If we transferred Real Estate to BakeCo instead – asset test would be met
 - “Principally” test
 - Rental portion is okay

- Do RealCo shares qualify?
 - Only asset is a rental property
 - RealCo and BakeCo are “related”
 - RealCo Real Estate is a “good asset”

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Tax Liability – After Reorganization

ITEM	FMV	COST	GAIN
BAKECO SHARES	500,000	250,000	250,000
REALCO SHARES	1,000,000	500,000	500,000
INVESTCO SHARES	2,000,000	----	2,000,000
TOTAL	3,500,000	750,000	2,750,000

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Tax Liability – After Reorganization

Capital Gain	\$2,750,000
Less: CGE	<u>(750,000)</u>
Unsheltered Gain	2,000,000
Taxable Portion	<u>50%</u>
Taxable Gain	1,000,000
Tax Rate	<u>50%</u>
Tax Liability	\$ 500,000

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COMPARISON

Tax Liability Before	\$937,500
Tax Liability After	<u>500,000</u>
Savings	\$437,500

Tax Savings by Source:

From Dual CGE	\$375,000
Conversion of Recapture	<u>62,500</u>
Savings	\$437,500

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OTHER CONSIDERATIONS

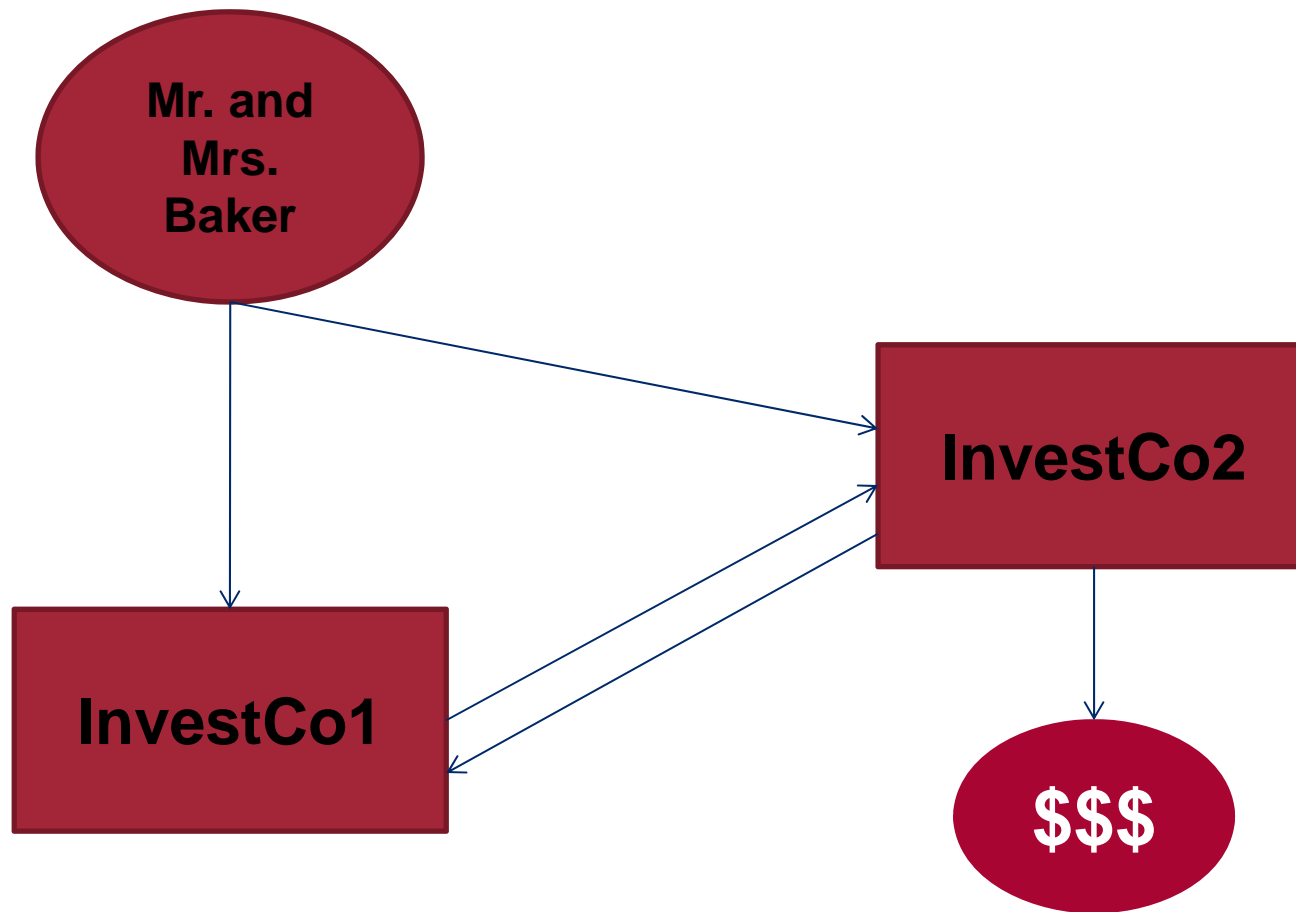
- Holding Period Test
- AMT
- Deed Transfer Tax
- HST
- Estate Freeze/Family Trust

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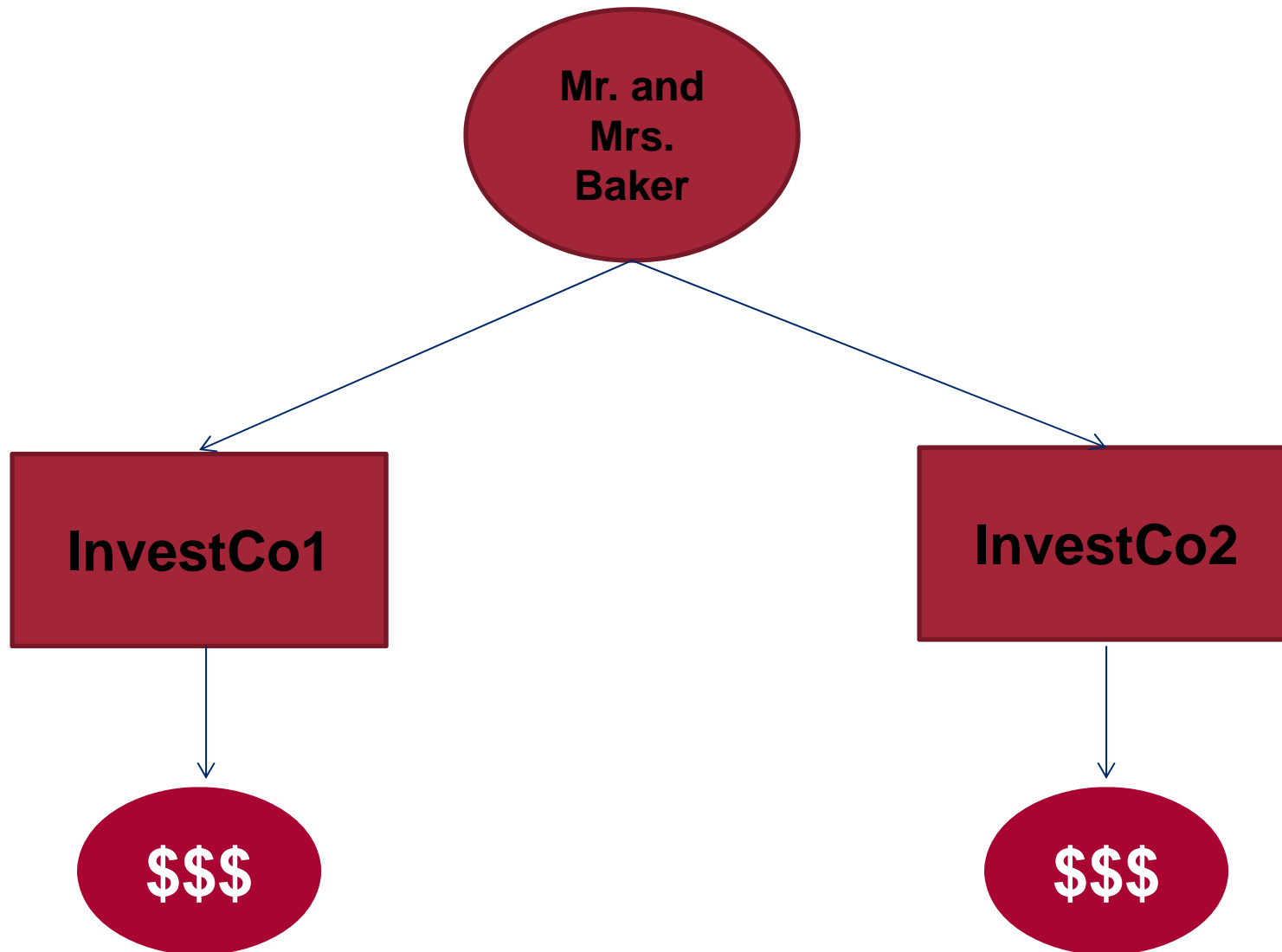
INVESTCO PLANNING

- Intend to leave investments to two children
- Separate companies – one for each

THE BAKERS



THE BAKERS



THE BAKERS

INVESTCO PLANNING

- Share Redemptions:
 - Dependent on tax-free intercorporate dividends
 - Could be recharacterized as capital gains
 - Two exemptions:
 - Related Party Exemption
 - Arm's Length Butterfly Exemption

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INVESTCO PLANNING

- Related Party Exemption
 - Makes transaction easier
 - Transactions cannot include unrelated parties
 - Siblings deemed unrelated
 - Parents must hold shares to relate parties
 - Reorganization must occur while parents are alive

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INVESTCO PLANNING

- Arm's Length Butterfly Exemption
 - Only option post-mortem
 - Makes transaction more difficult
 - Tax ruling
 - Compliance with intricate restrictions
 - High implementation costs

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INVESTCO PLANNING

- Consider implementing while Bakers are still alive
 - Rely on related party exemption
 - Need to run two companies for longer

- Other Considerations
 - Estate equalization
 - Post mortem planning

Clarity Defined.TM