Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Year of sale of your business

Sale of Your Business – Part 3

Empringham Bridger Private Wealth Partners
of RBC Dominion Securities
259 Wilson Street East, Unit 1B
Ancaster, ON L9G 2B8
http://www.empringham.ca/

Paul Empringham
Senior Portfolio Manager
& Wealth Advisor
Tel: 905-312-2905
paul.empringham@rbc.com

Jeremy Bridger, MBA, CFP
Wealth Advisor & Financial Planner
Tel: 905-945-0112
jeremy.bridger@rbc.com

Ken Lancaster, MBA, FEA, FCPA, FCA
Financial Planner
Tel: 905-312-7696
ken.lancaster@rbc.com

Marianne Currado, CFP
Financial Planner
Tel: 905-388-0432
marianne.currado@rbc.com

This article is the third in a four part series intended to highlight key strategies to consider at different stages of your business. It isn't exhaustive but it may help you to gain deeper understanding of some of the strategies you are already using or that might be suggested to you. This article discusses tax planning strategies to consider in the year of sale of your business. These strategies focus on minimizing your taxes payable in the year of your sale.

The other articles in the series are:

Part 1: Preparing Your Operating Company for Future Sale

Part 2: Planning the Sale of Your Business

Part 4: Year After the Sale of Your Business

In this article, the terms 'corporation' and 'company' are used interchangeably to refer to a Canadian-controlled private corporation (CCPC). In simple terms, a CCPC is a private Canadian corporation that is not controlled by a non-resident of Canada, a public corporation or a combination and no class of shares of the corporation is listed on a designated stock exchange. This four part series does not apply to public corporations or to businesses operating as a partnership or a sole proprietor.

Tax strategies to implement before year-end

The third stage of selling your business is the year of sale. The sale may result in a significant capital gain, either in your hands personally because you have sold shares or in your corporation because you have sold assets of your corporation. If you sold shares of your corporation personally, the applicable tax year-end would be December 31 of the year in which the sale occurred. If your corporation sold assets, the

applicable year-end would be your corporation's tax year-end in which the sale of assets occurred. Determining the year-end is important as many tax planning strategies need to be implemented prior to year-end to be effective.

Some tax strategies to minimize taxes on the capital gains on the sale of your business are listed below and discussed further later on.

1. Charitable donations or establishing a charitable foundation
2. Establishing an Individual Pension Plan (IPP) or a Retirement Compensation Arrangement (RCA)
3. Triggering capital losses to offset the capital gains
4. Investing in flow-through shares to claim the tax deductions
5. Receiving the proceeds from the sale over a number of years to claim a capital gain reserve to defer tax over up to five years

Charitable giving/foundation

You may consider using some of the sale proceeds to make a charitable gift in the year of sale either directly to a registered charity, to a donor advised fund or charitable foundation. If you're interested, ask an RBC advisor for information about the RBC Charitable Gift Program which is adonor advised fund.

In general, every two dollars donated will eliminate one dollar of tax on the sale of the business (actual amount varies by the donation amount and your province/territory of residence). However, for this strategy to be effective, the charitable donation should be made before the end of the year in which the sale occurs (either December 31 in the case of an individual vendor or the tax year-end of the corporation for a corporate vendor). Since the donation is irrevocable, ensure that you have adequate other assets to meet your retirement income and estate planning goals. A financial plan may help in this regard.

Alternatively, if the purchaser is a Canadian public company, consider structuring the sale so that you receive some shares of the Canadian public company as part of the sale proceeds on a rollover or tax-deferred basis. The public company shares could then be donated in-kind to eliminate the capital gains tax relating to the donated shares. You would also receive a donation tax receipt equal to the fair market value of the shares donated allowing you to claim a donation tax credit. This may help reduce the tax on the sale of your business.

Individual Pension Plan (IPP) or Retirement Compensation Arrangement (RCA)

In some cases, you may consider the pros and cons of setting up an IPP or a RCA in the year of sale, if you

You may consider using some of the sale proceeds to make a charitable gift in the year of sale either directly to a registered charity, to a donor advised fund or charitable foundation.

have not already done so. Ask an RBC advisor for more information about IPPs and/or RCAs. If your business is incorporated and the sale is structured as an asset sale, your corporation's contribution to these retirement plans is considered a deduction to the corporation, which would reduce the corporate taxes payable. A more detailed analysis of the pros and cons of this should be performed given that income received from an IPP or an RCA in retirement is taxed as regular income. In comparison, taxes payable today on an asset sale may be at lower tax rates (i.e., at capital gains rates).

Capital losses

If you have publicly traded securities that are in a capital loss position, consider selling these loss securities prior to year-end to trigger the capital loss. The capital loss can be used to offset the capital gains realized from the sale of your business, allowing you to reduce your taxable income and tax liability for the year. This decision should be made based on investment merits of the securities as well. Further, if you want to repurchase the same security, you may want to wait thirty days before repurchasing the security in order to avoid the loss being denied under the "superficial loss" rules. Ask an RBC advisor for a copy of our article discussing the superficial loss rules and planning strategies for more information.

Flow-through shares

Another option might be to purchase flow-through shares prior to year- end to help reduce the tax relating to the sale of the business. Flow- through shares are resource-based investments where the government allows, in certain circumstances, the purchase cost of the investment to be fully deducted against any other taxable income. However, the investments are more speculative in nature and may not be suitable for all individuals. Speak to an RBC advisor to discuss whether this option is suitable for you. If you are considering purchasing these types of investments, it is very important to consider the quality of the investment and not just the potential tax write-off. Keep in mind that for flow-through limited partnerships, there may be an 18 to 24 month holding period (the holding period does not apply to flow- through common shares).

To be eligible for the tax deductions, expenses incurred by the resource company and passed on to the investor must meet certain criteria. There may be a tax risk that the

Canada Revenue Agency may deny the resource company from passing on their expenses if they do not meet these qualifications, which means that you would not be eligible for the tax deduction.

Alternative Minimum Tax (AMT) may also apply on large personal flow- through purchases, so this should be discussed with a qualified tax advisor before making a purchase. In addition, you should seek the assistance of a qualified tax advisor to determine the optimal use of your share of the federal/provincial deductions/credits and for assistance with tax reporting.

Capital gains reserve

Instead of receiving all the sale proceeds in the year of sale, consider taking back a promissory note and having the purchaser pay the proceeds over a number of years, assuming you have an adequate guarantee of payment and an attractive interest rate on the note. In this case, a capital gain reserve may be taken to spread the capital gain on the sale over a maximum of five years. If your marginal tax rate is expected to be lower in the near future, the deferral of the capital gain can help minimize your overall tax on the capital gain. However, if you are always going to be in the top marginal tax bracket, this strategy may not be effective.

> If you have publicly traded securities that are in a capital loss position, consider selling these loss securities prior to year-end to trigger the capital loss.

Conclusion

It may be possible to implement some or all of the strategies discussed above at the same time to reduce your taxes on the capital gain that results from the sale of your business. If you are interested in any of these strategies, an RBC advisor may be able to provide additional articles that contain more information. Review these strategies with a qualified tax advisor to determine if they are suitable in your circumstances.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax, or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal, and/or insurance advisor before acting on any of the information in this article.

Wealth Management

This document has been prepared for use by the RBC Wealth Management member companies, RBC Dominion Securities Inc. (RBC DS)*, RBC Phillips, Hager & North Investment Counsel Inc. (RBC PH&N IC), RBC Global Asset Management Inc. (RBC GAM), Royal Trust Corporation of Canada and The Royal Trust Company (collectively, the “Companies”) and their affiliates, RBC Direct Investing Inc. (RBC DI) *, RBC Wealth Management Financial Services Inc. (RBC WMFS) and Royal Mutual Funds Inc. (RMFI). *Member-Canadian Investor Protection Fund. Each of the Companies, their affiliates and the Royal Bank of Canada are separate corporate entities which are affiliated. “RBC advisor” refers to Private Bankers who are employees of Royal Bank of Canada and mutual fund representatives of RMFI, Investment Counsellors who are employees of RBC PH&N IC, Senior Trust Advisors and Trust Officers who are employees of The Royal Trust Company or Royal Trust Corporation of Canada, or Investment Advisors who are employees of RBC DS. In Quebec, financial planning services are provided by RMFI or RBC WMFS and each is licensed as a financial services firm in that province. In the rest of Canada, financial planning services are available through RMFI, Royal Trust Corporation of Canada, The Royal Trust Company, or RBC DS. Estate and trust services are provided by Royal Trust Corporation of Canada and The Royal Trust Company. If specific products or services are not offered by one of the Companies or RMFI, clients may request a referral to another RBC partner. Insurance products are offered through RBC Wealth Management Financial Services Inc., a subsidiary of RBC Dominion Securities Inc. When providing life insurance products in all provinces except Quebec, Investment Advisors are acting as Insurance Representatives of RBC Wealth Management Financial Services Inc. In Quebec, Investment Advisors are acting as Financial Security Advisors of RBC Wealth Management Financial Services Inc. RBC Wealth Management Financial Services Inc. is licensed as a financial services firm in the province of Quebec. The strategies, advice and technical content in this publication are provided for the general guidance and benefit of our clients, based on information believed to be accurate and complete, but we cannot guarantee its accuracy or completeness. This publication is not intended as nor does it constitute tax or legal advice. Readers should consult a qualified legal, tax or other professional advisor when planning to implement a strategy. This will ensure that their individual circumstances have been considered properly and that action is taken on the latest available information. Interest rates, market conditions, tax rules, and other investment factors are subject to change. This information is not investment advice and should only be used in conjunction with a discussion with your RBC advisor. None of the Companies, RMFI, RBC WMFS, RBC DI, Royal Bank of Canada or any of its affiliates or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. ®/™ Registered trademarks of Royal Bank of Canada. Used under licence. © 2020 Royal Bank of Canada. All rights reserved. NAV0123 (08/18)