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Introduction to Tax Attributes
Canadian Bar Association
Tax Law for Lawyers

By Michael D. Templeton

Basic Accounting Concepts

- Shareholders Equity Consists of:
 - Retained Earnings
 - Contributed Surplus
 - Share Capital

Basic Accounting Concepts *(cont'd)*

- Retained Earnings
 - Undistributed Income

Basic Accounting Concepts *(cont'd)*

- Contributed Surplus
 - Amounts Paid for Shares in Excess of Par Value
 - Surplus Contributed by Shareholders
 - Proceeds paid for No - Par Value Shares Allocated to Surplus

Basic Accounting Concepts *(cont'd)*

- Share Capital
 - Generally Stated Capital of Corporation

Stated Capital

- Par Value
 - The amount stated as par value for all issued shares

Stated Capital *(cont'd)*

- No Par Value Jurisdictions
 - Consideration received for issue of shares
 - CBCA & OBCA allow lesser amount if non arm's length
 - Redemption of share results in reduction to Stated Capital

Stated Capital *(cont'd)*

- May increase Stated Capital by Resolution or Special Resolution

Paid-Up Capital

- ITA Concept of Capital
- Can be returned to Shareholders free of Tax (On Dividends - Still subject to Capital Gains Regime)
 - private corps can distribute funds as a return of capital
 - Ordinary course return of capital distribution by Public Corp. deemed dividend - 84(4.1)

Paid-Up Capital *(cont'd)*

- PUC of class = Stated Capital + (-) Adjustments
- PUC per Share = $\frac{\text{PUC of Class}}{\text{\# of Shares}}$

Example

	Shares	Price	PUC per Share
Purchaser 1	100	\$ 100	\$ 1
Purchaser 2	200	\$20,000	\$67
Total PUC	Purchaser 1	100 x 67 = \$ 6,700	
Total PUC	Purchaser 2	200 x 67 = \$13,400	

Use separate Share Classes to Avoid

Deemed Dividends

- Increases in PUC without capital contribution causes deemed dividend 84(1)
- Distribution to shareholders on wind-up in excess of PUC causes deemed dividend - 84(2)

Deemed Dividends *(cont'd)*

- Payment or redemption in excess of PUC causes deemed dividend - 84(3)
- Payment on reduction of capital in excess of PUC results in a deemed dividend - 84(4)

Deemed Dividends *(cont'd)*

- Ordinary course payment on reduction of capital by a public corporation results in a deemed dividend - 84(4.1)
- Exception for reduction of capital payment by Public corporation of proceeds arising from a transaction conducted outside the ordinary course of business within the previous 24 months

Permitted PUC Increases

- Stock Dividends
- Capitalizing Surplus arising from:
 - share issues of that class - other than rollover transactions
 - property contributed by shareholder of that class
 - prior PUC reductions of that class

PUC — Stated Capital Differences

- 4 Major Categories
 - Rollover transactions
 - Anti-Surplus Stripping
 - Tax Benefit Adjustments
 - Historical

Rollover Transactions

- Permit Share Exchanges or Property transfers at historical tax values
- Designed to permit deferral of tax

Rollover Transactions *(cont'd)*

- 51 - Convertible Property
 - allows exchange of capital property that is shares or exchangeable bonds/debentures for shares of the same corporation
 - no other consideration can be received

Rollover Transactions *(cont'd)*

- 85.1 - Arm's Length Share Exchange
 - allows exchange of shares of one Canadian corporation for another Canadian corporation
 - no other consideration
(modified by allocation rule)

Rollover Transactions *(cont'd)*

- 86 - Capital Reorganization
 - allows exchange of all the shares of a class of a corporation for shares of the same corporation
 - must be in the course of a reorganization
 - shareholder may receive other consideration in addition to shares
- Amalgamations

Rollover Transactions *(cont'd)*

- 85 - Property Transfer
 - allows transfer of eligible property (includes shares) in exchange for at least one share of transferee and other property

PUC Reductions Sections 51, 85.1, 86 and 87 Rollovers

- PUC of New Shares cannot exceed PUC of Old Shares (less any non-share consideration received)

PUC Reductions

- Section 85 Rollover
 - PUC of shares received on transfer of property cannot exceed “elected amount” less the amount of any non-share consideration
 - If shares transferred under section 85 PUC of new shares can exceed PUC of old shares
 - subject to 84.1 and 212.1

Anti-Surplus Strip Rules

- 84.1 Domestic
- 212.1 Cross Border

Anti-Surplus Strip Rules *(cont'd)*

– 84.1 - Application

- Non arms length transfer of Cdn Corp Shares to another Corp
- 2 Corps Connected after transfer
- 84.1 Rule designed to prevent:
 - V day Value Strips
 - Capital Gain Exemption Strips

Anti-Surplus Strip Rules *(cont'd)*

– 84.1 - Impact

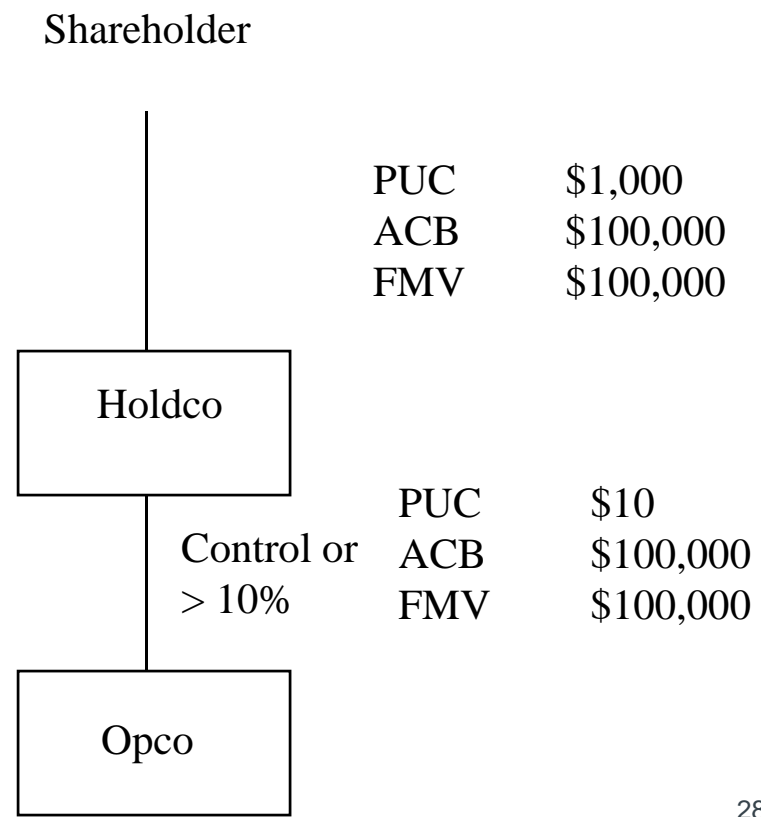
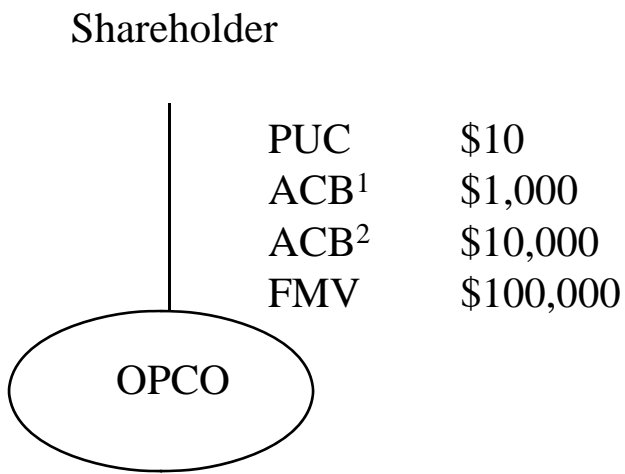
– PUC of New Shares cannot exceed greater of:

- PUC of Old Shares
- Arms length ACB of Old Shares
- less in both cases any non-share consideration

Anti-Surplus Strip Rules *(cont'd)*

- Deemed Dividend if non share consideration exceeds greater of:
 - PUC of Old Shares
 - Arm's length ACB of Old Shares

84.1 Example



ACB¹ arm's length ACB
 ACB² non arm's length ACB

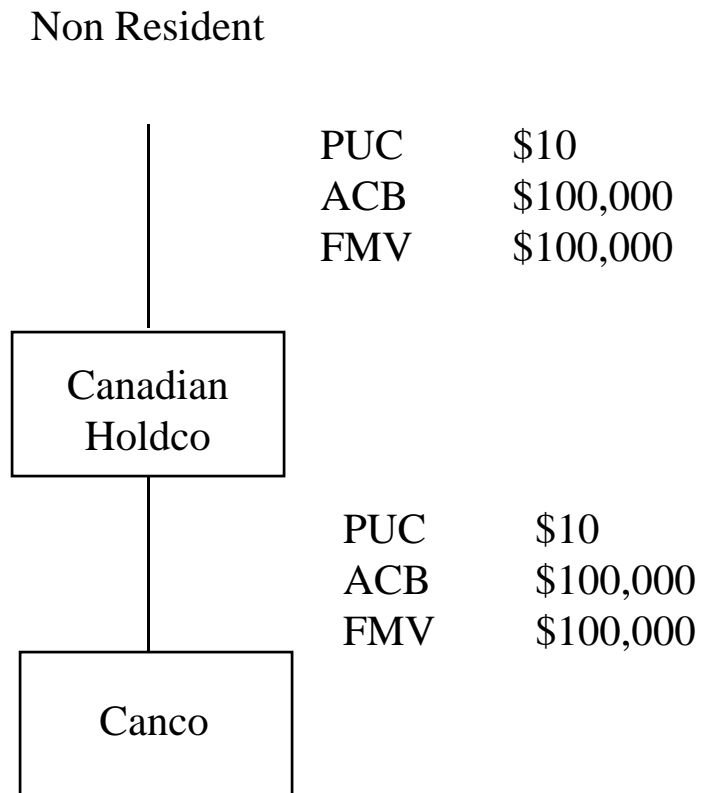
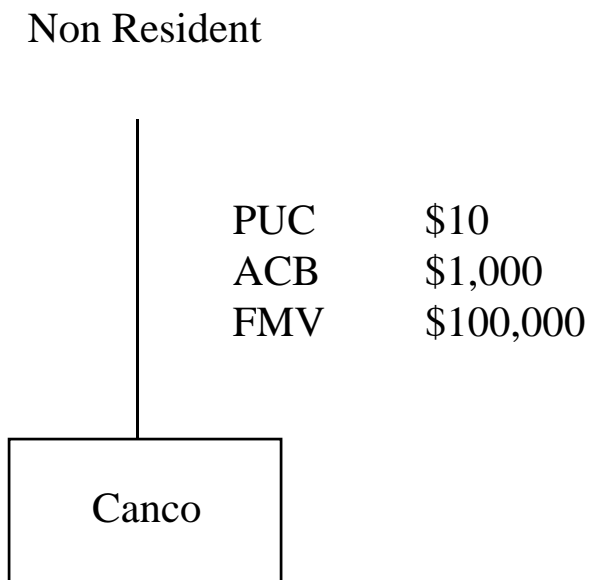
Anti-Surplus Strip Rules *(cont'd)*

- 212.1 - Application
 - Non arm's length transfer of Cdn Corp Shares by a Non Resident to another Cdn Corp.
 - After transfer - 2 corps connected
 - Rule designed to prevent strip of value using Treaty Exemption

Anti-Surplus Strip Rules *(cont'd)*

- 212.1 - Impact
 - PUC of New Shares cannot exceed PUC of Old Shares less non-share consideration
 - Deemed Dividend if non share consideration exceeds PUC of Old Shares

212.1 Example



Tax Benefit Adjustments

- Flow through shares, SRED tax credits, ITC Tax Credits
- Reduce PUC of Shares by value of tax benefit

Historical Adjustments

- Pre April 1977 Shares - reduce PUC by “Paid Up Capital Deficiency”

Adjusted Cost Base

- Starting Point is Historical Cost
- V-Day Value Adjustments
 - non-depreciable property - median rule
 - depreciable property - proceeds adjustment

Section 52 Amounts

- Income Amounts
- Dividends
- Prizes

Section 53 Adjustments

- Avoids Double Counting
- Specific Examples
 - Deemed Dividends ↑
 - Capital Contributions ↑
 - PUC Reduction Payments ↓
 - Deductible Amounts ↓

Identical Properties Rule

- ACB of Identical Properties is average cost
- Identical Properties
 - Shares
 - Bonds
 - Fungibles

Identical Properties Example

	First Lot	Second Lot	Combined
# of Shares Purchased	50	10	60
Purchase Price Per Share	\$2	\$8	--
Total Cost	100	80	\$180
Total ACB	100	--	\$180
ACB Per Share	\$2	--	\$3

- Sale of 2nd Lot at Original Purchase Price Triggers Gain

Negative ACB

- ACB Deductions - [ACB & Additions] = Capital Gain
- Exception for Participating Partners

Allocating ACB

- Allocation amongst Multiple Share Classes
- 51, 86, 87 allocation based on FMV of shares received
- Available ACB x $\frac{\text{fmv of Shares of Class}}{\text{fmv of all Shares}}$

Section 85 Mechanism

- First to Non Share Consideration
- Next to Preferred Shares
- Next to Common Shares
- Can use section 85 to create high ACB - high value shares

Example - 85 ACB Allocation

Before Rollover

	Common Shares
number	100
ACB	\$250,000
value	\$600,000

After Rollover

	Redeemable Common Shares	Convertible Preferred Shares
number	1	50
ACB	\$0	\$250,000
value	\$300,000	\$300,000

Disposition & Proceeds of Disposition

- Disposition defined by Reference to Inclusions & Exclusions
- Excludes
 - Security Transfers
 - No Beneficial Ownership Change
 - Issue of Shares or Bonds

Proceeds Definition

- Proceeds defined by reference to inclusions & exclusions
- Excludes deemed dividends

Example - Share Redemption

PUC	10
ACB	20
FMV	100
Deemed Dividend	$100 - 10 = 90$
Proceeds	$100 - 90 = 10$
Capital Gain (Loss)	$10 - 20 = (10)$

Stop Loss Rules

- Cannot trigger loss on transfer to Affiliate
- Add Disallowed Loss to Remaining Shares
ACB (40(3.6))

Questions & Answers

Michael D. Templeton

Partner, McMillan LLP

Tel: 416-865-7837

E-mail: michael.templeton@mcmillan.ca

