Share Capital Design

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Evelyn (Evy) Moskowitz
Moskowitz & Meredith LLP, an affiliate of KPMG LLP

Ronald Durand
Stikeman Elliott LLP

Paul Tamaki
First Regime

General Principles:

• Taxable dividends included in income under ss. 82(1)

• Deductible in computing taxable income under ss.112(1)
First Regime
(No ss. 112(1) Deduction)

- Term Preferred Shares (s.112(2.1))
- Guaranteed Preferred Shares (s.112(2.2))
- Collateralized Preferred Shares (ss. 112(2.4) - (2.9))
- Dividend Rental Arrangements (ss. 112(2.3))
Second Regime
(Part VI.1 & IV.1 Tax)

• Taxable Preferred Shares

• Short-Term Preferred Shares

• Taxable RFI Shares
# BORROWER TAXABLE PAYMENT OF INTEREST

<table>
<thead>
<tr>
<th></th>
<th>BORROWER</th>
<th>LENDER</th>
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<tbody>
<tr>
<td>Interest Expense (A)</td>
<td>$1,000,000</td>
<td></td>
</tr>
<tr>
<td>Interest Income (B)</td>
<td></td>
<td>$1,000,000</td>
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<tr>
<td>Tax Deduction (C)</td>
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<tr>
<td>Value of Tax Deduction (D)</td>
<td>($330,000)</td>
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<tr>
<td>(33% of C)</td>
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<tr>
<td>Tax (E)</td>
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<td>($330,000)</td>
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<tr>
<td>(33% of B)</td>
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</tr>
<tr>
<td>Net After-Tax Interest Expense (A-D)</td>
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<td>Net After-Tax Interest Income (B-E)</td>
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### BORROWER NOT TAXABLE PAYMENT OF DIVIDEND

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<tbody>
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<td>Dividend (A)</td>
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<td>Dividend Income (B)</td>
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<tr>
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<tr>
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</tr>
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<td>Tax (F)</td>
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<td>Net After-Tax Income (B-F)</td>
<td></td>
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Part VI.1 Tax

• 66 2/3% (50% proposed) on STPS
• 40% tax if ss. 191.2(2) election
• 25% if no s. 191.2(2) election, but 10% Part IV.1 tax on public corporate shareholder
Paragraph 110(1)(k) Deduction

Dividend $670,000

Part VI.1 Tax $268,000
(40%)(A)

Para. 110(1)(k) Deduction $804,000
(3 times A)(B)

Part I Tax Savings $265,000
(33% of (B))
Taxable Preferred Shares

- Dividend Entitlement
- Liquidation Entitlement
- Guarantee Rights
- Conversion or Exchange Rights
Exclusions from Part VI.1 and/or Part IV.1 Tax

- Dividend Allowance of $500,000 (Part VI.1 Tax only)
- Substantial Interest Exemption
Substantial Interest Exception

• Related

OR

• Satisfy 25% Test
Substantial Interest Exception

25% Test

- 25% votes and value

AND EITHER:

- 25% of all non-taxable preferred shares

OR

- 25% of all issued classes of shares
Exclusions from Part VI.1 and/or Part IV.1 Tax

- Dividend Allowance of $500,000 (Part VI.1 Tax only)
- Substantial Interest Exemption
- Subsection 191(4) Deemed Dividend Exception
- Private Company Exception (Part IV.1 Tax only)
- Purchase Obligations on Death
- Fair Market Value Exception
- 60-Day Exception
Discretionary Dividends

- Champ
  - corporate law problem because shares identical
Discretionary Dividends

• McClurg
  - shares not identical because of discretionary dividend right
  - discretionary dividends valid under corporate law
  - ss. 56(2) does not apply to dividends
  - contribution necessary?
Discretionary Dividends

- Neuman
  - discretionary dividends valid under corporate law
  - ss. 56(2) does not apply to dividends
  - no contribution necessary
Transfer of Economic Interest

• Keiboom

- Crown argued that father transferred economic interest in shares with an existing value by allowing children to subscribe for shares for a nominal amount

- Crown won
Transfer of Economic Interest

• Shepp

- Crown argued that father transferred an economic interest in shares with an existing value by allowing son’s discretionary dividend shares to become voting

- Illustrates CRA approach to valuation of non-voting discretionary shares

- Crown lost
Transfer of Economic Interest

- **Romkey**

  - Crown argued that father transferred future economic interest in shares by allowing family trust for kids to subscribe for shares

  - shares had no value at time of “transfer” and trust paid full value for the shares it acquired

  - Crown won

- CRA pronouncement re application of Romkey to estate freezes