Minden Gross LLP

POST MORTEM TAX PLANNING

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MERITAS LAW FIRMS WORLDWIDE

Post-Mortem Planning

Why is Post mortem planning needed?

- To avoid the double (or even triple) tax for situations where a deceased owns shares in a private company

Individual:

- Deemed disposition on death

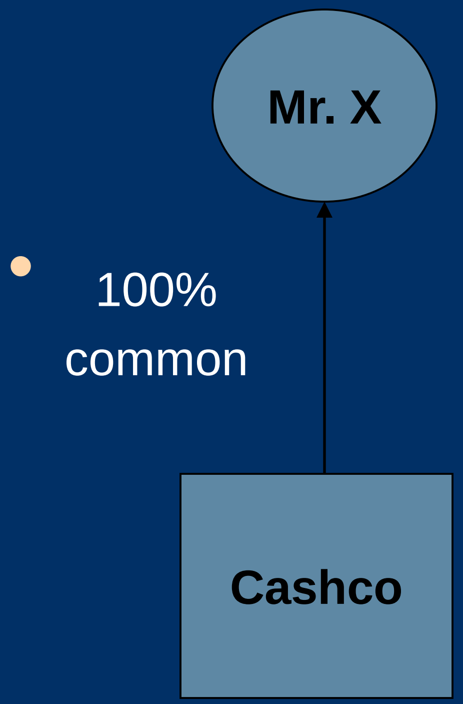
Corporation:

- Tax payable when it sells the assets

Estate/Beneficiary:

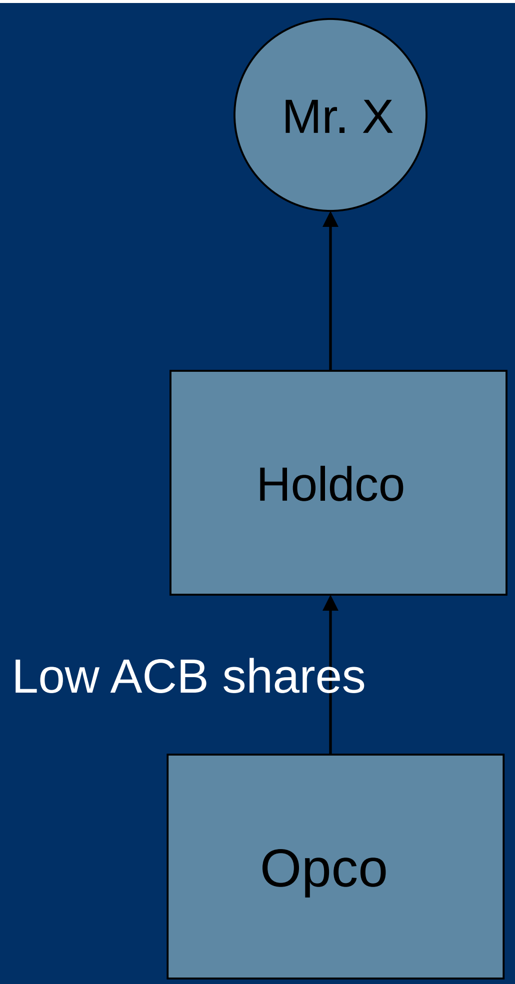
- Dividend tax when corporation pays a dividend or is wound up

Simple Example



- Mr. X dies – deemed disposition of Cashco shares
- Mrs. X predeceased
- How do the children extract the cash?

Simple Example #2



- Mr. X dies w/o spouse
- Deemed disposition on death
- Children wish to sell Opco shares

Post Mortem Planning Tools

- Subsection 164(6)
  - triggers capital loss to offset against capital gain on death
  - replaces capital gain with a dividend
- 88(1)(d) Bump
  - bump the cost of underlying undepreciable assets
- Pipeline
  - Extraction technique

Subsection 164(6)

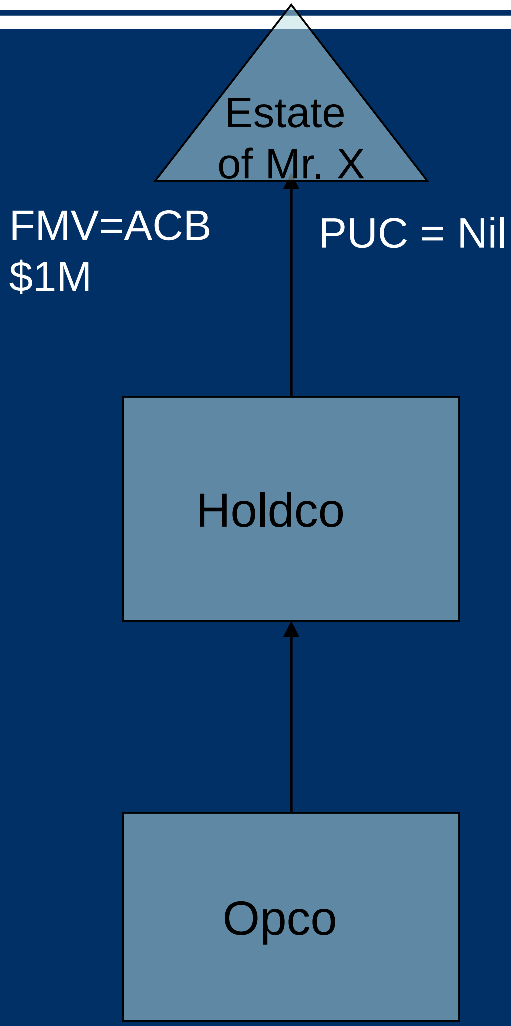
Effect:

- replaces the terminal capital gain with a deemed dividend to estate

How:

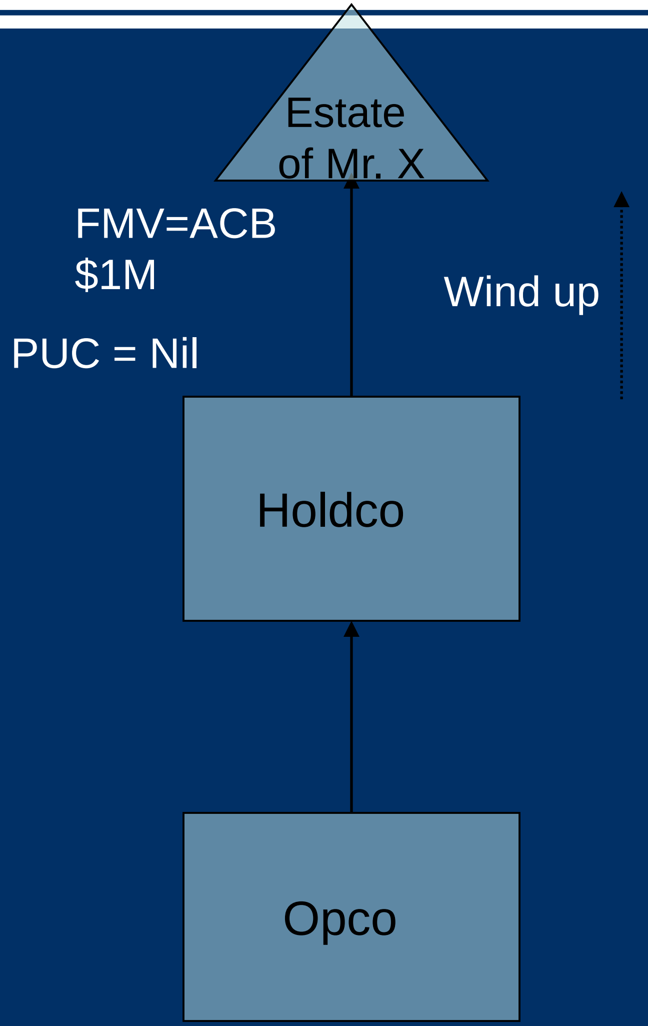
- Estate redeems shares of Holdco having a high ACB OR wind up Holdco – creates deemed dividend
- Creates a loss to the estate
- Estate files s. 164(6) election to designate loss against the terminal return capital gain
- Must be done within the first year of the estate
- Only available for graduated rate estates (GRE) as of Jan 1/16

Subsection 164(6)



- Must be done within first year of estate
- Triggers deemed dividend on shares of Holdco by:
  - redeeming shares that have a high cost base as a result of the capital gain on death
  - winding-up corporation

Subsection 164(6)



- Deemed dividend

  $1M – Nil = $1M
- Capital loss

  Proceeds reduced by deemed dividend

  PofD = $1M - $1M = Nil

  Capital Loss = $1M
- Terminal period gain gets offset

Subsection 164(6)

- Deemed dividend vs terminal period capital gain
  – Dividend at higher rates than capital gain
- Overall tax efficiency where combined with corporate surplus accounts
  – Refundable dividend tax on hand (“RDTOH”)
  – Capital Dividend Account (ability to pay tax-free dividends) – corporate life insurance is an advantage
  – GRIP (allows for dividends at lower tax rate)

Subsection 164(6) Stop Loss Rules

One Caveat: Beware of Certain Stop-loss rules

– Will restrict capital loss in certain circumstances:
  - If tax free capital dividend is paid (whereas a taxable dividend will increase the loss)
  - If after redemption of shares, the company and estate are still affiliated (but there are work arounds – i.e. wind up the company)
  - BUT: if estate is a GRE, then the amount of the disallowed loss will be reduced

Paragraph 88(1)(d) Bump

Effect:

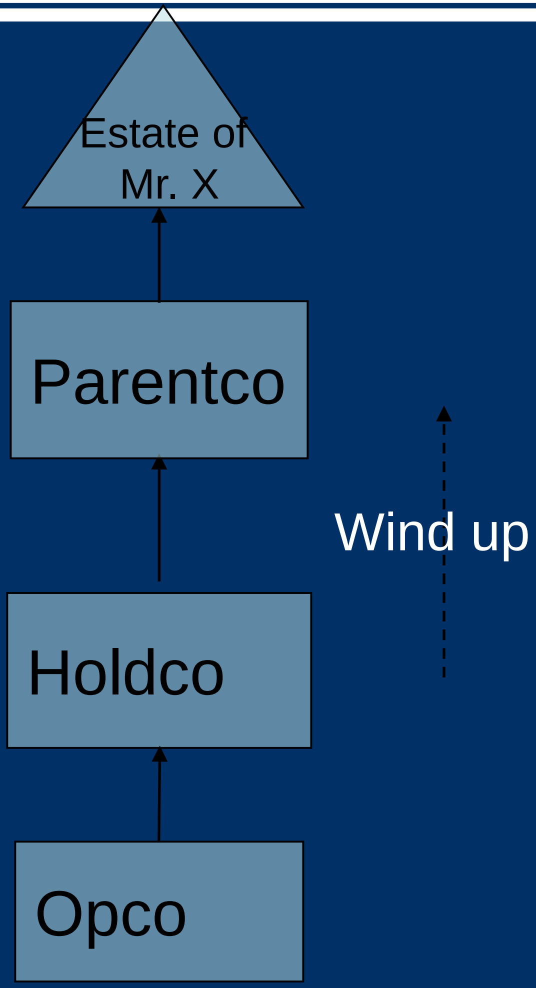
- Increase the cost base of non-depreciable corporate owned assets

How:

- Estate transfers high cost base shares of Opco to a new Holdco
- Opco is amalgamated/wound up into Holdco under this section which results in a bump in the cost base of non-depreciable assets

No impact on deceased's deemed disposition so there is still a capital gain on death

Paragraph 88(1)(d) Bump



- Transfer shares to Parentco (no tax on transfer)
- Wind up Holdco into Parentco
- Bump ACB of Opco shares

Paragraph 88(1)(d) Bump

- Certain conditions to meet:
  - assets were continuously owned since company's last change of control
  - Bump limited to FMV immediately following death
- Total bump available will be reduced by:
  - Net tax cost of assets (incl. cash) immediately before the wind-up
  - Amount of taxable dividends & capital dividends received by parent from subsidiary
  - Gains in respect of disposition of assets by subsidiary pre-bump
- Can be very complicated & there is uncertainty as to how the rules will be applied

Pipeline Procedure

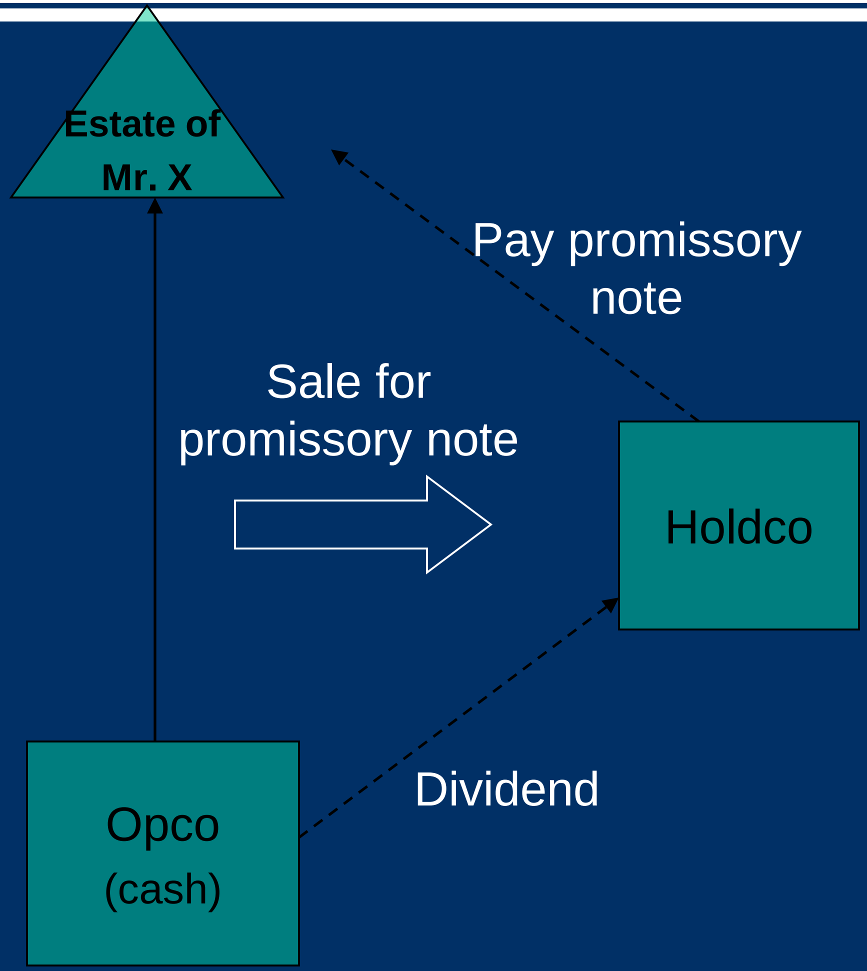
Effect:

- Create a pipeline to allow access to high cost base assets / cash from corporation on a tax-free basis

How:

- Assume Opco has cash
- Estate transfers high ACB shares of Opco to Holdco for a promissory note
- Opco pays dividend to Holdco (alternatively, a redemption, wind-up or amalgamation could be used if there are tax concerns as to a tax-free dividend)
- Holdco uses cash to repay the promissory note to the estate

Pipeline Procedure
Accessing Cash



- Assume Opco is a cash company
- Also works with high ACB assets in Opco
- Terminal capital gain remains
- RDTOH / CDA will get stranded in Opco
- Can combine Pipeline with a Bump

Pipeline Procedure

Tax issues:

Certain tax rule (s. 84(2)) will treat amount of funds or property distributed (less any reduction in PUC of shares) to be a dividend

CRA's position is that this rule may apply where:

- property of Opco would be distributed to the estate within a short time frame following Mr. X's death
- Opco has no business assets (i.e. holds mostly cash)

Pipeline Procedure

CRA has held that 84(2) will not apply if the following conditions are met:

1. Opco' s business or investment activities will continue for at least one year following the implementation of the pipeline structure;
2. Opco will not be amalgamated or wound-up into Holdco for at least one year; and
3. Opco's assets will not be distributed to the shareholders for at least one year after the amalgamation or winding-up, followed by a gradual distribution of assets over an additional period of time (dividends paid out of current earnings and funded without the sale of assets are okay)

Pipeline

July 18, 2017 proposals:

- Anti-surplus striping rules introduced, which would have prevented the pipeline.
- Dept of Finance announced they would not go forward with the rules in October.
- However – they have left the door open for new revised proposals to target anti-surplus stripping.
- Question – not sure if the pipeline will be affected or not

Post-Mortem Planning: Choosing between the Alternatives

Subsection 164(6):

- Possible to eliminate the double tax, leaving the estate with a deemed dividend (but taxed at higher rates than capital gain)
- Efficient if there is RDTOH and CDA (corporate life insurance helps)
- Only available to Graduated Rate Estates
- Can increase the cost of corporate assets, without being limited to non-depreciable assets
- Timing may be an issue – needs to be implemented within the first year

Post-Mortem Planning: Choosing between the Alternatives

Paragraph 88(1)(d) Bump:

- Eliminates double tax by leaving decedent with terminal period capital gain (taxed at lower rates)
- Only applies to non-depreciable assets
- Bump denial rules can be complicated to navigate
- Can be used in conjunction with pipeline procedure to distribute high-cost base assets to estate
- No timing concerns to implement

Post-Mortem Planning: Choosing between the Alternatives

Pipeline Procedure

- Eliminates double tax by leaving decedent with terminal period capital gain (taxed at lower rates)
- Easy to implement
- Effective at accessing cash and tax-paid assets
- No timing concerns to implement
- BUT Timing issue post-implementation: cannot access funds for at least a year, and then still only on a gradual basis
- Can be used in conjunction with Bump

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