2016 Tax Update

Prepared for: Legal Education Society of Alberta

6th Annual Law & Practice Update

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For presentation in:

Calgary, Alberta – October 14 & 15, 2016

2016 TAX UPDATE

This paper discusses the following topics:

- the sale of goodwill;
- the small business deduction;
- surplus stripping by individuals; and
- capital gains stripping by corporations.

All of these areas arise regularly in practice and contain a number of "traps" that can lead to incorrect tax advice.[1] Furthermore, an update is timely as new legislation and case law has required tax practitioners to focus on issues in these areas over the past year. The goal of this paper is to summarize each topic as it may apply to the general practitioner, and provide a summary of recent developments in legislation, administrative practice, and case law. The paper will be especially relevant to practitioners who are involved in the purchase or sale of businesses or in setting up and reorganizing family businesses and other closely-held corporate structures.

Each of these topics has been the subject of extensive writing in conference reports and other tax publications. This paper is not intended to improve on those writings or to achieve the same level of technical detail, but rather to provide a general overview and summary of the issues so that readers can recognize circumstances where further research or external advice may be required. The footnotes provide references to other sources that contain more comprehensive information.

Unless otherwise noted, all references in this paper to sections, subsections, paragraphs, subparagraphs, clauses, and subclauses refer to the provisions of the *Income Tax Act* (Canada) (the "**ITA**").[2]

For ease of reference, Appendix "A" contains a summary of some common defined terms used throughout the paper.

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[1] See for example the Association of Insured Chartered Accountants' "Risk Management Seminar" presentation at <www.aica.ca/presentation/RiskManagementSeminar.pdf> (last accessed September 25, 2016), indicating that 56.4% of claims against Chartered Accountants in Canada from 1999-2014 were in the area of tax, and specifically noting eligible capital property and section 84.1 (both discussed below) as some of the areas that most often give rise to claims.

[2] R.S.C. 1985, c. 1 (5th Supp.), as amended to date.

SALE OF GOODWILL

When a purchaser buys all of the assets of a business as a going concern (as opposed to the shares of the corporation that owns the business), the purchase price may exceed the net fair market value of the identifiable assets of the business. The excess is attributable to goodwill. CRA has cited the following definitions of goodwill:

> Goodwill is the whole advantage, whatever it may be, of the reputation and connection of the firm which may have been built up by years of honest work or gained by lavish expenditures of money.
>
> It is 'the privilege, granted by the seller of a business to the purchaser, of trading as his recognized successor; the possession of a ready-formed 'connection' of customers, considered as an element in the saleable value of a business, additional to the value of the plant, stock-in-trade, book debts, etc.'[3]

The value of business goodwill will vary with the nature of the business. Some businesses do not have significant goodwill: their going-concern value is not materially greater than the aggregate value of their tangible assets. For example, the value of a farming business may be almost entirely attributable to the value of land and buildings, equipment, and inventory (provided that it does not require valuable quotas or licenses). However a professional services business may earn significant income and yet have no identifiable assets of value. The value of that business is almost entirely attributable to goodwill as represented by its name, brand, or customer lists.

The 2014 federal budget announced consultations on measures to replace the current regime for the tax treatment of goodwill and certain other intangibles. The detailed legislation to implement these measures was released in the 2016 federal budget and is proposed to be effective on January 1, 2017. In some respects the new legislation will be less favourable to vendors who sell goodwill on or after January 1, 2017. Some clients would benefit from planning prior to 2017 to secure the benefits of the current rules.

This section of the paper summarizes the existing and proposed tax treatment of goodwill and highlights some important planning points for practitioners who deal regularly with the purchase and sale of business assets.

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[3] IT-143R3, "Meaning of Eligible Capital Expenditure" (August 29, 2002) [archived].