RBC Wealth Management Services

THE NAVIGATOR

SALE OF YOUR BUSINESS – PART 4

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Year after the sale of your business

The content of this article is for information purposes only and does not provide tax or legal advice. It is imperative that you obtain professional advice from a qualified tax and legal advisor before acting on any of the information in this article. This will ensure that your own circumstances are properly considered and that action is taken based on the most current legislation.

A study done by the Canadian Federation of Independent Business (CFIB) revealed that 70% of small and medium-sized business owners intend to exit their businesses within 10 years. The most common method among owners of exiting their businesses is to sell outright to non-family members (37%).

The last in a four-part series, this article introduces some tax planning strategies to consider in the year after the sale of your business. This four-part series takes you through some of the key issues and tax planning strategies to consider during the various stages of your business:

Part 1: Running an active business with no immediate plans to sell

Part 2: Planning to sell your business or impending sale

Part 3: Year of sale of your business

Part 4: Year after the sale of your business

The terms 'corporation' and 'company' are used interchangeably to refer to a Canadian-controlled private corporation (CCPC). This means that the corporation is not controlled by a non-resident of Canada or a public corporation and no class of shares of the corporation is listed on a prescribed stock exchange. This four part series does not apply to public corporations.

If you expect to reinvest some or all of your proceeds from the sale of your business in shares of another active Canadian business in the very near future, then you may be able to defer the recognition of some or all of the capital gain on the original sale.

Tax Strategies to Consider in Stage 4

The fourth stage of selling your business is the year/s after the sale of your business. You may want to consider the following tax strategies in the year/s after the sale of your business. These are discussed briefly as well.

1. Reinvest in a new active business within 120 days after the year of sale to defer the tax on the sale of your business
2. Trigger capital losses on other assets (stocks, US currency, etc) and carry back the loss 3 years to year of sale
3. If continuing to work for the purchaser, consider incorporating yourself. However, talk to your qualified tax advisor since the tax rules with respect to incorporated employees and personal services business have changed and may not be as attractive as before.
4. Other post sale wealth planning – financial plan, retirement income planning, update wills, tax planning, etc.

Reinvest in a New Active Business

If you expect to reinvest some or all of your proceeds from the sale of your business in shares of another active Canadian business in the very near future, then you may be able to defer the recognition of some or all of the capital gain on the original sale.

The Income Tax Act allows you to defer the recognition of all or a portion of your capital gain arising on a disposition, by an individual, of an "eligible small business corporation share" generally to the extent that the proceeds are reinvested in newly issued shares of another such corporation or corporations. A replacement share is generally defined as a share of an eligible small business corporation that you designate in your personal income tax return to be a replacement share and that you acquired in the year of the qualifying disposition or within 120 days after the end of that year.

Eligible small business corporation shares have the following characteristics:

- They consist of common shares issued by the corporation to you, the investor.
- The issuing corporation must be an eligible small business corporation at the time the shares were issued.
- The total carrying value of the assets of the corporation and related corporations cannot exceed $50 million immediately before, and immediately after, the share was issued.
- While you hold the shares, the issuing corporation is an eligible active business corporation.

To be able to defer the capital gain, you must have held the eligible small business corporation shares for more than 185 days from the date you acquired them.

An eligible active business corporation generally is a taxable Canadian corporation, where all or substantially all of the fair market value of its assets are used principally in an active business carried on primarily in Canada by the corporation or by a related active business corporation while the investor holds the shares, or for at least 730 days of the ownership period, if you hold the shares for longer than 730 days. It can also be shares of, and/or a debt issued by, other related active business corporations or a combination of such assets, shares, or debt.

If some of your sale proceeds are in a holding company there may be tax strategies available to enable your beneficiaries to withdraw funds from the holding company on a tax-free basis after your death.

An eligible active business corporation does not include:

- a professional corporation;
- a specified financial institution;
- a corporation whose principal business is leasing, renting, developing, or selling real property that it owns or any combination of these activities; and
- a corporation where more than 50% of the fair market value of its property (net of debts incurred to acquire the property) is attributable to real property.

If you are interested in pursuing this strategy, you should speak to your qualified tax advisor to confirm that your corporation qualifies and the corporation you are considering investing in also qualifies.

Trigger Capital Losses

Or, if you have publicly traded securities that are in a capital loss position, you could consider selling these loss securities prior to year-end to trigger the capital loss. If your current year capital losses exceed your current year capital gain, then the net capital loss can be carried back to offset capital gains in the prior three years. So if you sold your business in 2011, then net capital losses in 2012, 2013, or 2014 can be carried back to 2011 to reduce the capital gain on the sale of your business and you would get a refund of some of the tax you paid in 2011 on the sale. This decision should be made based on investment merits and you should also bear in mind the 30-day superficial loss rules if you want to repurchase the security that was sold at a loss.

Incorporate to Provide continuing Service to the Business After the Year of Sale

If you are going to work for the purchaser after the sale of your business to assist with the transition, speak to your qualified tax advisor to determine the best structure in which you should receive your compensation going forward – either as an employee or a consultant. If you are considered a consultant, you may be able to incorporate yourself so that the income you earn from the business is taxed at lower active business rates. If you are considered an employee then it may not be advisable to incorporate yourself since new rules make this option not as attractive.

Financial and Wealth Planning

Work with your RBC advisor to manage your sale proceeds to create adequate retirement income to meet your lifestyle needs. Consider getting a financial plan completed to determine all your sources of retirement income and to determine whether you have an excess or shortfall. Your RBC advisor will take into account your income needs now and in the future and the effect of those needs, your risk tolerance and investment knowledge on asset allocation. This analysis along with your objectives will assist them in determining the types of investments appropriate for your needs. There are a host of different investments available that satisfy different needs. For example, individuals who don't have the financial ability or willingness to accept risk can buy GICs for income but will forego growth. Individuals who want regular interest income with a little risk can look to bonds but again will give up growth. Individuals seeking certainty may consider annuities to get a guaranteed income. Individuals with longer investment time horizons and that are more risk tolerant may consider equities. Of course there are many other types of investment solutions available that meet various needs, including investments that are designed to be tax-efficient. Your RBC advisor, as well as your qualified tax advisor, can assist you with these decisions.

If some of your sale proceeds are in a holding company there may be tax strategies available to enable your beneficiaries to withdraw funds from the holding company on a tax-free basis after your death. You should work with your qualified tax advisor to determine whether these tax strategies will work in your situation. In addition, Please contact us for more information about the topics discussed in this article.

they can assist you on an ongoing basis to determine the most tax-efficient ways of receiving the funds from your corporation in your retirement.

Finally, don't forget to talk to your legal advisor to determine if your Will may need updating.

NAV0124-EN (10/2013)