

Taxation of Private Corporations – An Update

Presented by: Lorne Saltman
November 28, 2017



Topics to discuss

1. Introduction: tax reform in Canada and internationally
2. Proposals to prevent income sprinkling
3. Proposals to limit claims for the lifetime capital gains exemption
4. Proposals to modify the taxation of passive investment income of private corporations
5. Proposals to limit conversion of income into capital gains

Proposal to prevent income sprinkling

- Income paid to a family member from a CCPC will be taxed at the highest personal rate, unless the member can demonstrate his/her contribution to the business (extension of the “kiddie tax”)
- The Government will introduce reasonableness tests for adult family members aged 18-24, as well as those 25 and older

Proposal to prevent income sprinkling ...cont'd

These adults will be asked to demonstrate their contribution to the business based on four basic principles—whether they have made a contribution through any combination of the following:

- Labour contributions;
- Capital or equity contributions to the business;
- Financial risks of the business taken on, such as co-signing a loan or other debt; and/or
- Past contributions in respect of previous labour, capital or risks.

Proposal to limit claims for the lifetime capital gains exemption

- Proposal to limit the lifetime capital gains exemption to the patriarch/matriarch of the family business and not permit other family members to claim it
- The Government will not be moving forward with measures that would limit access to the LCGE

Taxation of Passive Investment Income of a Private Corporation

- Proposal to deny refundable taxes on investment income earned by a CCPC, having claimed the small business deduction and invested the after-tax amount in so-called “passive investments”, resulting in tax rate of potentially 73% once fully distributed
- The Government will move forward with measures to limit tax deferral opportunities related to passive investments, while:
 - Ensuring that investments already made by private corporations' owners, including the future income earned from such investments, are protected. The measures will apply only on a go-forward basis;

Taxation of Passive Investment Income of a Private Corporation

- Propose an annual passive income threshold of \$50,000 (equivalent to \$1 million in savings based on a nominal 5-per-cent rate of return)
- There will be no tax increase on passive income below this threshold. Further details will be released in Budget 2018, including a technical description of how the passive income threshold will be applied

Taxation of Passive Investment Income of a Private Corporation ...cont'd

- The Government will work with the venture capital and angel investment sectors to identify how incentives can be maintained to invest in the next generation of Canadian innovation
- The Government will also examine all deferral benefits from passive investments and will continue to assess key design aspects. For example, consideration will be given as to the appropriate scope of the new tax regime with respect to capital gains, including whether in certain circumstances the new rules should exclude capital gains realized on the sale of shares of a corporation engaged in an active business

Taxation of Passive Investment Income of a Private Corporation ...cont'd

- In this proposal, the Government remains committed to tax fairness, and the approach will ensure the measures are focused on a small number of high-income individuals who get the biggest advantage from existing rules. The Government will propose measures to limit tax deferral opportunities related to passive investments and release draft legislation as part of Budget 2018
- Small business corporate income tax rate (combined Federal and Ontario) will be lowered from 15% to 13.5% in 2018 and to 12.5% in 2019

Conversion of Income into Capital Gains

- The Income Tax Act has rules intended to address the use of various transactions by some taxpayers “to avoid paying their fair share of taxes”
- Section 84.1 is intended to address the conversion of amounts that would otherwise be taxed as dividends into lower-taxed capital gains
- Proposed Section 246.1 would prevent “surplus stripping” by imposing the highest level of tax on corporate surplus being distributed to individual shareholders in certain cases

Conversion of Income into Capital Gains ...cont'd

- The consultation raised issues with respect to unintended consequences (blocking “pipeline transactions”) and potential challenges with respect to intergenerational transfers of businesses, including farms
- Given these issues, the Government will not move forward with the proposed changes regarding the conversion of income into capital gains



Questions?



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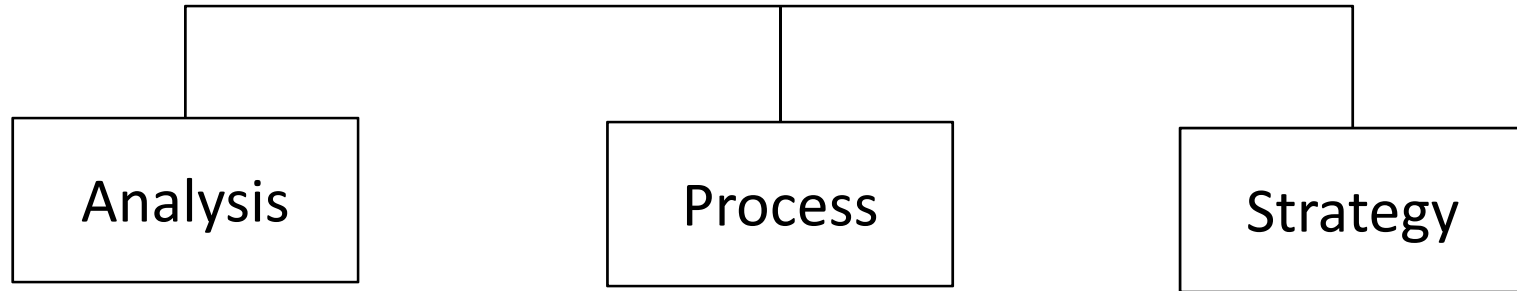
Bring Me Your Disputes and I will Set You Free

Presented by: John Campion
November 28, 2017

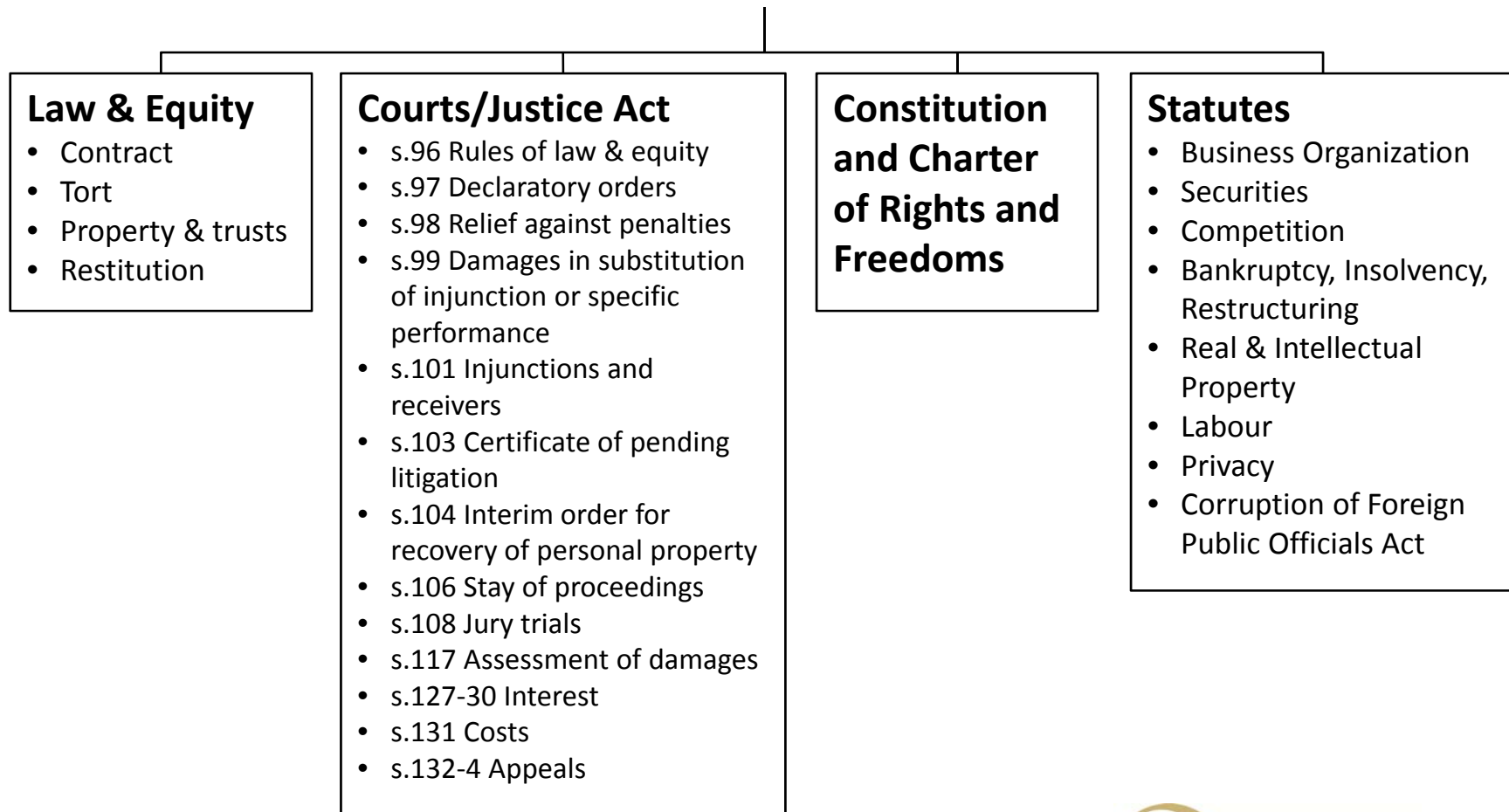


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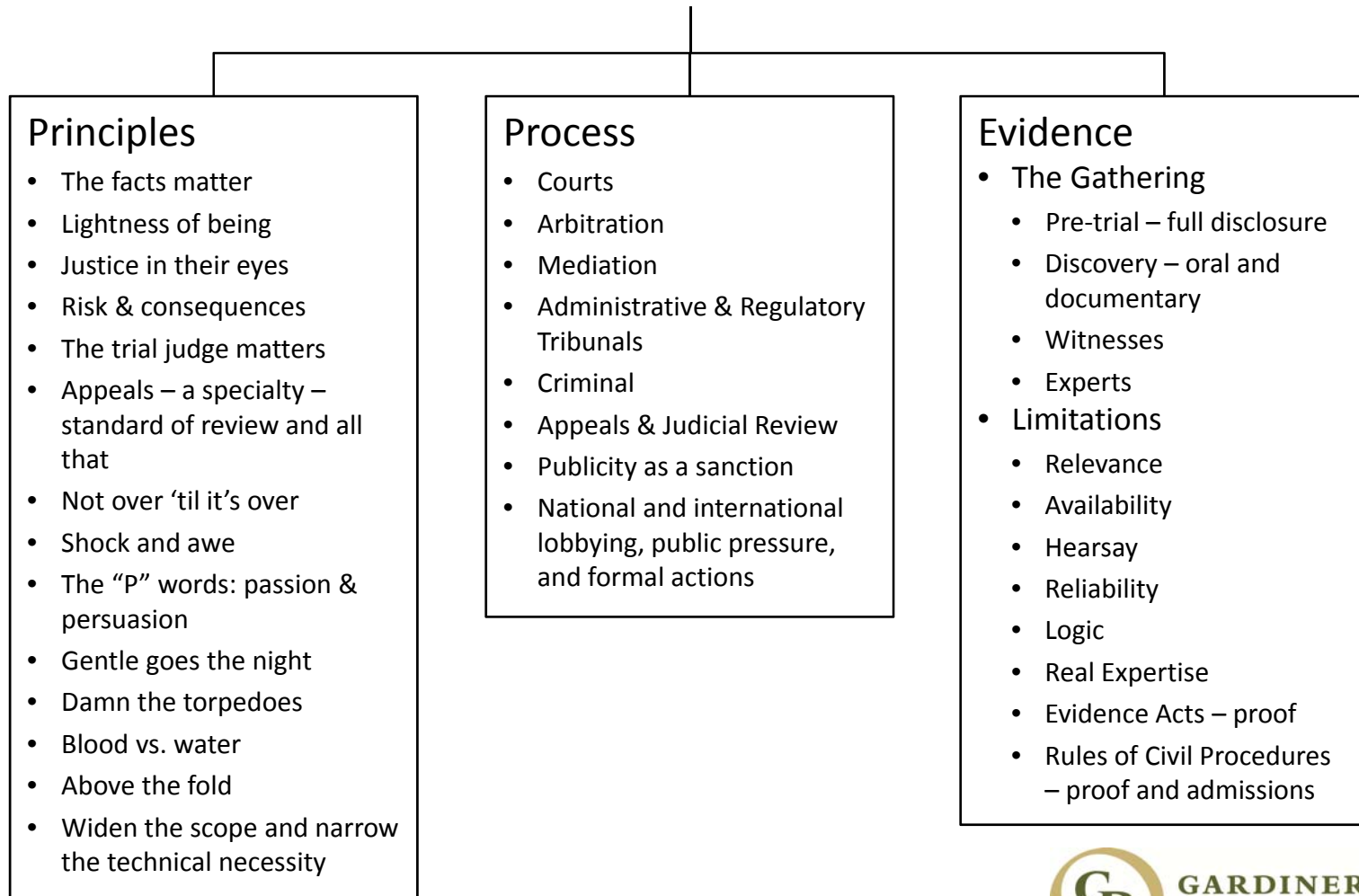
The Code: The Legal Mind



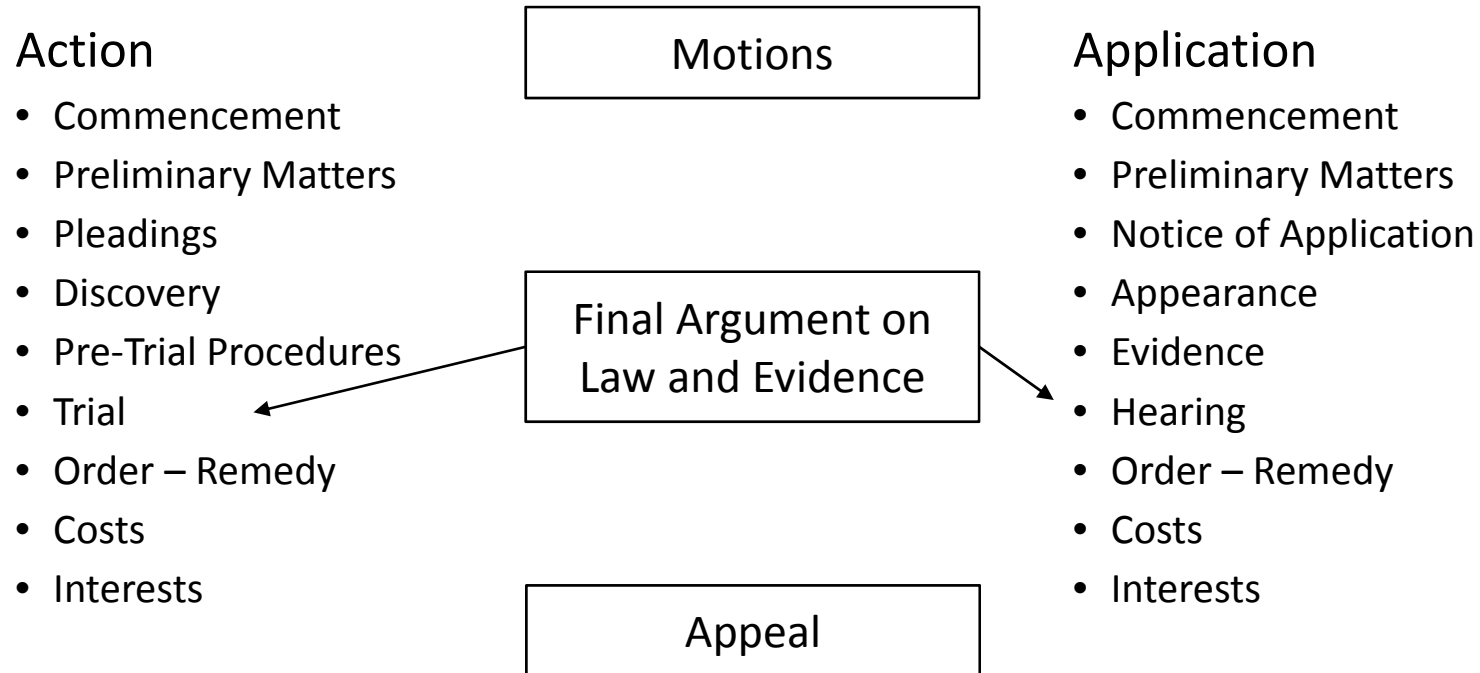
Analysis: Overview – The Learning of The Ages



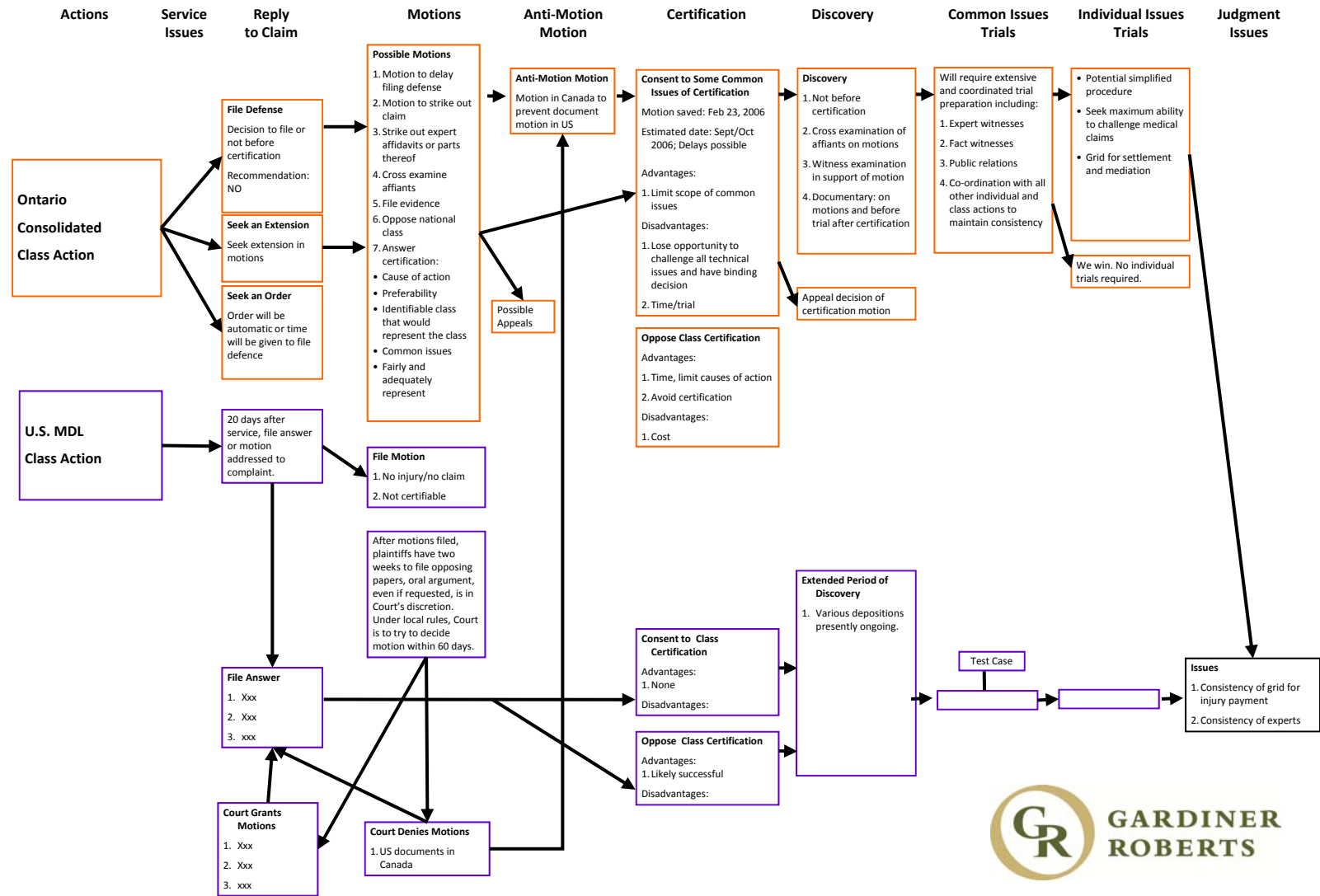
Process: Proof and Principles



Litigation Process - The Universal Main Event



Litigation Process – Class Action



Arbitration – Process Globalization

1. An existing dispute (not merely an unresolved issue);
2. Parties choose neutral decision-maker under an arbitration agreement;
3. Expressed intention in the agreement that the decision be binding and be made in a judicial or quasi-judicial manner;
4. The hearing be impartial and fair;
5. The decision in the hearing be based on evidence and argument;



Arbitration – Process Globalization

6. International arbitration (not defined in model code – see federal and provincial Acts): parties have places of business in different States when arbitration agreement is made; one of the following is outside the State where parties have places of business – place of arbitration, place for performance of obligations, place where subject matter of dispute is most closely connected; commercial arbitration acts that adopt or incorporate UNCITRAL Model Law – applicable to all provinces and federal arbitrations;

Arbitration – Process Globalization

7. Domestic commercial arbitration: modern provincial arbitration Acts that provide for domestic arbitration based on the model law; provisions vary significantly from province to province (contracting out, appeal rights and contracting out, procedural rules, administration of arbitration and deemed agreement provisions;

Arbitration – Process Globalization

8. Federal legislation: United Nations Foreign Arbitral Awards Convention Act R.S.C. 1985, C.16 (2nd Supp): Implements the New York Convention on recognition and enforceability of arbitral awards (effective May 7, 1986). New York Convention: Contracting States recognize arbitral awards; limited grounds for refusal to recognize and enforce; limited to recognition and enforcement of commercial arbitration awards made in contract in the States;
9. Guidelines: for arbitrators, awards, remedies, enforcement, legal requirements, appeals, ethics, finality.



Mediation – Process Maximizing Client’s Role

1. Pillars of Process: Contracting, story, interests, options, alternatives, best alternative to negotiated agreement (BATNA), agreement.
2. Contracting: Engage the participants in the process of making a contract; explain the process, clarify roles and responsibilities of participants and mediator; negotiate ground rules.
3. Defining the problem and dealing with conflict: understanding the conflict, the parties’ view of the conflict (individual stories), working with the dynamics of the conflict; understanding the law – analyzing the legal risks and opportunities.



Mediation – Process Maximizing Client's Role

4. Understanding interests: explore the parties' needs and interests (what matters to them going forward); generate options; evaluate options using the parties' goals, needs and interests, the law and other reference points; develop packages; test packages against parties' goals, needs and interests for stability, durability and commitment.
5. Looking to the future: draft agreements; review, refine and improve upon agreements; have a concern for the unrepresented; determine next steps; implementation – provision for future review and modification.



Mediation – Process Maximizing Client’s Role

6. Identify and control: drama, narrative, identity and emotion.
7. Trust in the mediation and commitment to trust for future action.
8. Imperfections: dysfunctional communication and emotion; asymmetries of information; extreme “partisan perception” bias; disrespect (real or perceived); failure to understand others’ views, or care; strong desire for revenge or vindication; agreement has unpalpable meaning.
9. Process variance: preliminary work (pre-planned, a formal evaluation phase, mediate discovery, caucuses single-text model.



Mediation Made Simpler

Variable **Five Stage© Resolution Process** to early and later stage dispute assessment, strategy, risk audit assessment, mediation, arbitration, litigation and resolution.

- **Stage 1** – Setting the base for success – trust, creativity and tailoring the process, mediation/arbitration agreements, desire/pressure to resolve.
- **Stage 2** – the gathering – facts, chronology, analysis, explanations, documents and data and compiling all in a common independent programme developed on consent.



Mediation Made Simpler

- **Stage 3** – process selection – interchange, combinations and switching: managed direct settlement negotiation or offer exchange (online or face to face), mediation, arbitration.
- **Stage 4** – expert advice – area of dispute (large corporate, closely held enterprise, estates, on-going relationships) psychological factors, settlement design, tax implications, media, regulatory and government relations.
- **Stage 5** – philosophy – settle what is known through identifying and prioritizing legal issues and actual interests; have a process to deal with future issues if and when they arise through negotiation or arbitration.



Process – Regulatory & Criminal: Ceding Control

Business Corporations
Securities
Energy
Office of the Children's
Guardian
Public Trustee
Labour
Real Estate & Business
Brokers
Criminal Code
Tax

Insurance
Broadcasting
Transportation

Professional Complaint:
Self-regulating professions
Lawyers
Doctors
Nurses
Accountants
Other



Strategy – Psychology 101

- LAMS: Litigation, arbitration, mediation, settlement
- Analysis and process – combine in a complex interaction, depending on realistic goals, timing, financial, psychological and other limitations, advantages and disadvantages
- Impacts inside legal system – “In” Factors
 - Corporate
 - Directors
 - Public – negative
 - Securities – disclosure
 - Professional status
 - Criminal act and recovery



Strategy – Psychology 101

- Outside legal system – “Out” Factors
 - Business and political impact
 - Publicity as a tool and a sanction
 - Resources of parties
 - Financial
 - psychological

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Evolution of Shareholders' Agreements

Presented by: Peter Moffatt
November 28, 2017



Introduction

- Overview
- Common elements
- Context

Overview

- What is a shareholders' agreement?
- What is a unanimous shareholders' agreement?

Common Elements

- Governance and control
- Dealing with shares
- Funding/Dispute resolution

Common Elements – Governance and Control

- Rights to nominate directors
- Observer rights
- Protective provisions
- Compensation arrangements
- Variance to statutory requirements for directors' meetings and shareholders' meetings

Common Elements – Dealing with Shares

- Restrictions on transfer (and permitted transfers)
- Pre-emptive rights (or right of first offer)
- Rights of first refusal
- Tag-along rights (or piggyback or co-sale rights)
- Drag-along rights
- Involuntary share transfers
- Put/call options
- Shotgun clauses

Common Elements – Funding/Dispute Resolution

- Capital calls
- Mediation
- Arbitration
- Court

Context

- Closely-held business
- Venture capital
- Subsidiary of foreign parent

Context – Closely-held Business

- Succession planning
- Time commitment/duties
- More restrictive transfer provisions
- Right of first refusal
- Involuntary share transfers
- Shotgun

Context – Venture Capital

- Senior share protective provisions
- Anti-dilution protections
- Board representation
- Information rights
- Redemption/liquidity provisions
- Key-person insurance
- Registration rights

Context – Unanimous Shareholder Declaration

- Wholly-owned subsidiary can be subject to a shareholder agreement

Evolution?

- Attracting U.S.-based investors
 - Voting Agreement
 - Right of First Refusal and Co-Sale Agreement
 - Investors' Rights Agreement
- Complex valuation methodology
- Creative buy/sell arrangements



Questions?



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