

Tax Window Files

Date: 2015-XX-XX

2014-0563081R3 Post-mortem pipeline

Income Tax Act:

[84\(2\)](#)

[84.1\(1\)](#)

[245\(2\)](#)

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA.

Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: Post-mortem pipeline planning

POSITION: See below

REASONS: See below

XXXXXXXXXX

2014-056308

XXXXXXXXXX, 2015

Dear Sir:

Re: XXXXXXXXXXXX

XXXXXXXXXX

Advance Income Tax Ruling

This is in reply to your letter of XXXXXXXXXXXX in which you requested an advance income tax ruling on behalf of the taxpayers referred to above. The documents submitted with your request are part of this document only to the extent described herein.

We understand that to the best of your knowledge and that of the taxpayers on whose behalf this ruling was requested, none of the issues involved in this ruling are:

- (a) in an earlier return of the taxpayers referred to above or a related person;
- (b) being considered by a tax services office or taxation centre in connection with a previously filed tax return of the taxpayers referred to above or a related person;
- (c) under objection by the taxpayers referred to above or a related person;
- (d) in relation to the taxpayers referred to above or a related person, before the courts or the subject of a judgment the time limit for appeal from which has not expired; or
- (e) the subject of a ruling previously considered by the Income Tax Rulings Directorate in relation to the taxpayers referred to above or a related person.

DEFINITIONS

In this letter, unless otherwise indicated, all monetary amounts are expressed in Canadian dollars, and unless otherwise indicated or the context otherwise requires, the following terms have the meanings specified:

"A Co" means XXXXXXXXXXXX;

"Act" means the Income Tax Act, R.S.C. 1985 (5th Supp.), c.1, as amended to the date hereof and, unless otherwise stated, all references to a section, subsection, paragraph, subparagraph and clause contained herein are to the Act;

"adjusted cost base" or "ACB" has the meaning assigned by section 54;

"Agreed Amount" means the amount agreed on by the transferor and transferee in respect of the transfer of an eligible property in a joint election filed pursuant to subsection 85(1);

"B Co" means XXXXXXXXXXXX;

"Beneficiaries" means Child 1, Child 2, Child 3, Child 4, and Child 5;

"Business" means the operation of a XXXXXXXXXXXX;

"C Co" means XXXXXXXXXXXX;

"Canadian Controlled Private Corporation" ("CCPC") has the meaning assigned by subsection 125(7);

"capital gain" has the meaning assigned by paragraph 39(1)(a);

"capital property" has the meaning assigned by section 54;

"Child 1" means the late XXXXXXXXXXXX;

"Child 2" means XXXXXXXXXXXX, a resident of Canada for purposes of the Act;

"Child 3" means XXXXXXXXXXXX, a resident of Canada for purposes of the Act;

"Child 4" means XXXXXXXXXXXX, a resident of Canada for purposes of the Act;

"Child 5" means XXXXXXXXXXXX, a resident of Canada for purposes of the Act;

"connected" has the meaning assigned by subsection 186(4);

"CRA" means the Canada Revenue Agency;

"D Co" means XXXXXXXXXXXX;

"disposition" has the meaning assigned by subsection 248(1);

"Facts" means the information described in Paragraphs 1 through 17 of this letter;

"Fair Market Value" or "FMV" means the highest price available in an open and unrestricted market between informed, prudent parties acting at arm's length and under no compulsion to act;

"Grandchildren" means XXXXXXXXXXXX, who are the children of the late XXXXXXXXXXXX and the beneficiaries of his estate, and who are all residents

of Canada for purposes of the Act;

"Mr. X" means XXXXXXXXXXXX;

"Mrs. X" means XXXXXXXXXXXX, the widow of Mr. X;

"paid-up capital" or "PUC" has the meaning assigned by subsection 89(1);

"Paragraph" means a numbered paragraph in this letter;

"Proposed Transactions" means the transactions described in Paragraphs 18 through 24 of this letter;

"related persons" has the meaning assigned by subsection 251(2);

"SIN" means social insurance number;

"Subco1" means XXXXXXXXXXXX;

"Subco2" means XXXXXXXXXXXX;

"Subco3" means XXXXXXXXXXXX;

"Subco4" means XXXXXXXXXXXX;

"taxable Canadian corporation" has the meaning assigned by subsection 89(1);

"taxable dividend" has the meaning assigned by subsection 89(1);

"Trust" means the XXXXXXXXXXXX, which is a testamentary trust created by the operation of Mr. X's Will;

"U.S.A." means the United States of America;

"U.S. entities" means: Subco 1, Subco 2, Subco 3 and Subco 4; and

"V-day basis" means the amount, if any, described in paragraph 84.1(2)(a.1)(i).

FACTS

1. A Co was incorporated by Mr. X on XXXXXXXXXXXX, and is a CCPC and a taxable Canadian corporation. A Co has a XXXXXXXXXXXX taxation year-end, and files its tax returns with the CRA's XXXXXXXXXXXX Tax Services Office.

2. Mr. X passed away on XXXXXXXXXXXX. Prior to his death, he held all of the issued and outstanding shares of A Co, being XXXXXXXXXXXX Class A voting common shares and XXXXXXXXXXXX Class B non-voting shares. Upon his death, these shares were transferred to the Trust.

3. The Trust is a spousal trust that satisfied the requirements of paragraph 70(6)(b) and is a testamentary trust as defined in subsection 108(1).

4. Mrs. X passed away on XXXXXXXXXXXX. At that time, the only assets of the Trust were its XXXXXXXXXXXX Class A voting common shares of A Co with FMV equal to \$XXXXXXXXXX and ACB of \$XXXXXXXXXX, and its XXXXXXXXXXXX Class B non-voting shares of A Co with FMV equal to \$XXXXXXXXXX and ACB of \$XXXXXXXXXX. These shares comprised all of the issued and outstanding

shares of A Co, and were capital property to the Trust.

5. Pursuant to paragraph 104(4)(a) of the Act, the Trust reported a deemed disposition of its assets upon the death of Mrs. X, resulting in a significant capital gain to the Trust, which was reported on the Trust's XXXXXXXXXXXX T3 Trust Income Tax and Information Return.

6. As A Co was incorporated in XXXXXXXXXXXX, the XXXXXXXXXXXX Class A voting common shares and the XXXXXXXXXXXX Class B non-voting shares of A Co described in Paragraphs 2 and 4 above have no V-day basis. No amount in respect of a disposition of these shares has been claimed as a capital gains exemption under section 110.6 by either Mr. X or a person with whom Mr. X did not deal at arm's length.

7. A Co continues to carry on the Business through C Co, D Co, and the U.S. entities. Historically, A Co's assets included shares in B Co which were redeemed on XXXXXXXXXXXX, to fund the income tax liability described in Paragraph 5 above. The B Co shares that were held by A Co and redeemed in XXXXXXXXXXXX had no V-day basis, and no amount in respect of these shares, or in respect of any shares substituted for these shares (for purposes of subsection 84.1(2)), had been claimed as a capital gains exemption under section 110.6 by either Mr. X or a person with whom Mr. X did not deal at arm's length.

7.1. B Co was incorporated by Mr. X and Mrs. X in XXXXXXXXXXXX in order to operate a XXXXXXXXXXXX. In XXXXXXXXXXXX, Mr. X and Mrs. X transferred their shares in B Co to A Co, and the share capital of B Co was reorganized in the course of an estate freeze in favour of the Beneficiaries. On XXXXXXXXXXXX, subsequent to the redemption of the B Co shares held by A Co as described in Paragraph 7 above, all of the shares of B Co that were held directly or indirectly by the estate of Mrs. X and the Beneficiaries were transferred to an arm's length third party.

8. As at the date of this letter, A Co's sole asset is XXXXXXXXXXXX Class A common shares in C Co, being all of the issued and outstanding shares in C Co.

9. C Co is a CCPC and a taxable Canadian corporation. C Co carries on XXXXXXXXXXXX business with its sole asset being all of the issued and outstanding shares in D Co. C Co's year-end is XXXXXXXXXXXX and its business number is XXXXXXXXXXXX.

10. The head office address of A Co, C Co and the Trust is XXXXXXXXXXXX.

11. D Co and its four wholly-owned subsidiaries: Subco 1, Subco 2, Subco 3, and Subco 4 (ie., the U.S. entities) carry on the Business, which is similar to the business that was carried on in B Co during the time that its shares were owned by A Co.

12. Management fees have historically been paid by the U.S. entities to the Trust for management services provided to the Business by Child 2 in her role as Trustee of the Trust. It is the intention that these fees will be paid to A Co in the future for management services provided to the Business by Child 2 in her role as the President of A Co. Child 2 became the President of A Co in XXXXXXXXXXXX.

13. Child 2's involvement in the Business involves a variety of daily, weekly and annual duties and varies from month to month depending on the needs of the Business. XXXXXXXXXXXX.

14. The Business employs over XXXXXXXXXXXX individuals. Day to day onsite

management of the Business is fulfilled by the General Manager. The current General Manager has been in his role since XXXXXXXXXXXX.

15. For greater certainty, as of the date of this letter, the XXXXXXXXXXXX Class A voting common shares of A Co have an ACB of \$XXXXXXXXXX and PUC of \$XXXXXXXXXX. The XXXXXXXXXXXX Class B non-voting shares of A Co have an ACB of \$XXXXXXXXXX and PUC of \$XXXXXXXXXX. These shares currently represent all of the issued and outstanding shares of A Co, and are capital property to the Trust.

16. The total combined ACB of the Class A voting common and Class B non-voting shares of A Co is \$XXXXXXXXXX, and is equal to the FMV of the shares at the time of Mrs. X's death. The current FMV of A Co has been determined by a third party valuator to be approximately \$XXXXXXXXXX. This represents a decline in FMV since the date of Mrs. X's passing, and the FMV of each of these two classes of shares will be less than their respective ACBs at the time that the Proposed Transactions are implemented.

17. In accordance with XXXXXXXXXXXX of Mr. X's will, the Trust will continue until XXXXXXXXXXXX, the XXXXXXXXXXXX anniversary of Mr. X's death. At that time, the Trust will be deemed to dispose of its assets at their ACB to the Trust, and the Trust's assets are to be distributed equally amongst the Beneficiaries then alive, with the share of any of them already deceased being divided equally amongst his or her children.

PROPOSED TRANSACTIONS

18. A new corporation ("Newco") will be incorporated. Newco will be a CCPC and a taxable Canadian corporation. The Trust will subscribe for XXXXXXXXXXXX Class A common shares in Newco for \$XXXXXXXXXX.

19. Newco's Class A common shares will be voting, participating shares. Newco's authorized share capital will include Class C preferred shares which will be non-voting, non-participating shares with a \$XXXXXXXXXX redemption value. The Class C preferred shares will be both redeemable and retractable.

20. The Trust will transfer its Class A voting common and Class B non-voting shares in A Co to Newco, and the Trust will receive from Newco as consideration:

(a) A note payable equal to the combined FMV of the Class A voting common and Class B non-voting shares in A Co at the transaction date, less \$XXXXXXXXXX.

(b) One Class C preferred share with redemption value equal to \$XXXXXXXXXX.

The Trust and Newco will jointly elect, in prescribed form and within the time referred to in subsection 85(6), to have the provisions of subsection 85(1) apply to the transfer of the Class A voting common and Class B non-voting shares of A Co held by the Trust to Newco. The Agreed Amount in respect of the transfer will be limited to the FMV of the Class A voting common and Class B non-voting shares of A Co to the Trust, as at the date of the transfer, by the application of paragraph 85(1)(c). For greater certainty, the Agreed Amount will not be less than the least of the amounts specified in subparagraphs 85(1)(c.1)(i) and (ii), and will not be less than the amount described in paragraph 85(1)(b).

Newco will add \$XXXXXXXXXX to the stated capital of its Class C preferred share which, for greater certainty will not exceed the maximum amount that

could be added to the PUC of this share, having regard to paragraph 84.1(1)(a).

21. As the ACB of the Class A voting common and Class B non-voting shares transferred to Newco as described in Paragraph 20 above will be greater than their FMV at the time of the transfer, the capital loss arising on the disposition will be suspended under subsection 40(3.4).

22. A Co will not be amalgamated or wound-up into Newco for a period of at least one year following the transfer of the Class A voting common and Class B non-voting A Co shares described in Paragraph 20 above. During that year, A Co will continue to carry on its business in the same manner as previously.

23. After at least one year has elapsed since the transfer of A Co shares described in Paragraph 20 above, A Co and C Co will be amalgamated with, or wound-up into, Newco.

24. After the amalgamation or wind-up described in Paragraph 23 above, Newco may gradually begin to make payments on the note payable to the Trust and/or to the Beneficiaries and Grandchildren, to whom the note will be distributed on XXXXXXXXXX. For greater certainty, the amount paid in any quarter of the first year that the note is outstanding after the amalgamation or wind-up described in Paragraph 23 will not exceed XXXXXXXXXX% of the principal amount of the note when it was issued. Newco will continue to carry on the Business in the same manner that it was carried on by A Co prior to the implementation of the Proposed Transactions.

PURPOSE OF THE PROPOSED TRANSACTIONS

25. The purpose of the Proposed Transactions is to ensure that the Trust and ultimately the Beneficiaries hold property with an ACB reflective of that of the A Co shares received upon Mrs. X's death, recognizing that some portion of this ACB will be lost due to the decline in the FMV of the company since that time.

RULINGS

Provided that the preceding statements constitute a complete and accurate disclosure of all relevant facts, proposed transactions, and the purposes of the Proposed Transactions, and provided that the Proposed Transactions are completed as described above, our rulings are as follows:

A. Section 84.1 of the Act will not apply to deem the Trust to have received a dividend upon the transfer of the Class A voting common and Class B non-voting shares in A Co to Newco.

B. Subsection 84(2) of the Act will not apply as a result of the Proposed Transactions, in and by themselves, to deem A Co to have paid, and the Trust to have received, a dividend on the Class A voting common and Class B non-voting shares in A Co held by the Trust.

C. Subsection 245(2) of the Act will not apply as a result of the Proposed Transactions, in and by themselves, to redetermine the tax consequences stated in the rulings given above.

Our rulings are given subject to the limitations set out in Information Circular 70-6R5 dated May 17, 2002, and are binding on the CRA provided the Proposed Transactions are completed within six months of the date of this letter. Our rulings are based on the law as it currently reads and

do not take into account any proposed amendments to the Act or Regulations.

Our Comments

Nothing in this ruling should be construed as implying that CRA has reviewed any tax consequences relating to the facts or the Proposed Transactions other than those described in the rulings given above, or has agreed:

- (a) to the fair market value or adjusted cost base of any asset or to the paid-up capital of any share;
- (b) to the characterization, reasonableness, or tax consequences of any amounts paid or received as described at Paragraph 12; or
- (c) to any other tax consequences relating to any transaction or event described herein other than those specifically described in the rulings given above.

Furthermore, none of the rulings given in this letter are intended to apply to, or in the event of, the operation of a price adjustment clause, since such adjustment will be due to circumstances that do not constitute proposed transactions that are seriously contemplated. The general position of the CRA with respect to price adjustment clauses is stated in Income Tax Folio S4-F3-C1, dated March 28, 2013.

An invoice for our fees in connection with this ruling request will be forwarded to you under separate cover.

Yours truly,

for Director
Reorganizations and Resources Division
Income Tax Rulings Directorate
Legislative Policy and Regulatory Affairs
Branch

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