Minden Gross LLP BARRISTERS AND SOLICITORS
145 King Street West, Suite 2200, Toronto, ON M5H 4G2
P. 416.362.3711 ▪ F. 416.864.9223 ▪ @MindenGross ▪ www.mindengross.com

Tax Planning in Recessionary Times*

Michael Goldberg
Partner,** Tax Group
Minden Gross LLP
T. 416.369.4317
mgoldberg@mindengross.com

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Recently I've been giving a lot of thought about how to help clients in these difficult recessionary times. To that end, I've realized that by using good common sense, strategic planning and a bit of creativity it may be possible to take "tax lemons" and make "tax lemonade."

I plan on writing in some detail about some of the different types of tax lemonade that I've been thinking about. However, in the meantime, this article contains what I refer to as a tax person's Top 10 list (ignoring the sub-headings there are 10 numbers in the list below) of some of the tools and strategies that advisors may be able to really assist their clients during recessionary times.[1]

1. Corporate Capital Loss Strategies

(a) Don't just sell now – sell to maximize the capital dividend account ("CDA")

(i) Realize capital gains first

(ii) Pay out CDA next

(iii) Then Realize capital losses

I sometimes refer to these steps collectively as a "Strategic CDA Plan"

(b) Capital gains may exist in unusual places – its still possible to maximize CDA

(c) Use a Strategic CDA Plan that maximizes CDA by internally realizing gains on assets without actually disposing of the assets ("crystallization transactions")

I sometimes refer to this type of Strategic CDA Plan as a "4C Strategy" - **C**apital Gain **C**rystallization, **C**DA, & **C**apital Loss

(d) CDA can be used to redeem fixed value preferred shares, including shares typically used in an existing estate freeze, which can provide tax free liquidity and at the same time reduce death tax exposure (a "wasting freeze")

(e) May be able to use capital loss strategies to make corporate charitable giving even more tax efficient

[1] The list should not be considered comprehensive. Also, the ordering in the list closely follows the order of my recent "Tax Lemonade" presentation and is not representative of the importance of any particular item on the list.

2. **Personal Capital Loss Strategies**
   (a) Consider carefully if the benefits of combining the use of capital losses and surplus strips are worth the additional risks
   (b) Shift capital losses from low tax spouse to high tax spouse
   (c) Shift capital losses from an individual to an "affiliated" corporation
   (d) Shift unrealized losses from a trust to beneficiaries
3. **Consider viability of claiming non-capital losses**
   (a) If writing down inventory consider planning to avoid a future write-up – especially for real property
   (b) Consider ability to claim terminal losses
   (c) Allowable business investment losses ("ABILs") are a powerful form of capital loss that can be used to offset any income
   (d) Be prepared for extra scrutiny of non-capital loss and ABIL claims
   (e) Same or similar business tax loss transactions could still work
4. **Using Loss Planning to Claim Refunds**
   (a) Consider if there are risks and/or tax issues of carrying back losses to refund taxes paid in respect of prior capital gains
5. **Debt restructuring considerations**
   (a) Debtors can be impacted differently depending on method of enforcement
   (b) Planning may be put in place to minimize/manage impact of debt forgiveness rules
6. **Depressed values can lead to estate planning opportunities if you seek them out**
   (a) Use losses to allow for the transfer of assets with unrealized gains on what becomes "effectively" a tax free basis – some examples
   (b) Transition a business or other assets to family members at less tax cost or possibly the cost of using up unutilized capital losses
      (i) Capital gains exemption claims may reduce tax cost
         (A) Reserves on gains may be available to spread any tax cost (typically over 5 years but can be 10 years if dealing with children and small business corporations)
      (ii) US citizens could use their gift tax exemptions and pay little or no US or Canadian gift or income taxes

(c) Estate freeze planning is a tool that is always worth considering

  (i) Estate Freeze planning fixes (completely or partially) the value of a shareholder's corporate interests with the intention that some or all of the future growth in value will accrue to the benefit of other shareholders, which could include a family trust

  (ii) Estate Freeze planning can be used to minimize death tax, provide access to capital gains exemptions for multiple family members and assist with ensuring estate planning can be completed in an orderly fashion

  (iii) Putting an estate freeze in place when values are low *but are expected to recover and continue to grow* can, among other benefits, minimize death tax exposure and improve opportunities to allow family members to use their capital gains exemptions

(d) For shareholders who have previously implemented estate freezes

  (i) Low values could offer an opportunity for them to further reduce their death tax exposure by allowing them to reduce the value of their fixed corporate interests to their current lower value

  (ii) If a freeze is already in place and the current "unfrozen" shareholders shareholdings have considerable value a freeze of the "unfrozen shareholders' interests may be worth considering

    (A) If the "unfrozen" shareholder is a trust, the new freeze can minimize "pressure" that may be placed on trusts due to Canadian deemed disposition rules applicable on the 21st anniversary of most trusts

7. Successful clients will still be able to use non-recessionary exit planning structures, some of which are noted below

(a) Planning to access multiple capital gains exemptions

(b) Planning to move "safe income" out of an operating corporation tax free before a sale

(c) Planning to access corporate surplus tax efficiently

(d) Where appropriate, planning that combines asset and share sales

(e) More creative planning that can offer multiple benefits, including material tax deferrals

8. Consider if client structures are appropriate for their needs

(a) Move funds from an operating corporation to shareholders tax efficiently (including using CDA and "safe income") and then lending funds as needed on a secured basis

(b) Consider other planning opportunities to minimize creditor risk

(i) Internal securitizations might exceed safe income but beware tax risks due to CRA statements

(ii) Domestic or foreign asset protection trusts and other planning may be worth considering

9. Prescribed rate is now 1% (as of July 1, 2020) - consider planning opportunities

10. Review and update or put in place key legal and non-legal planning documents including:

(a) Wills

(b) Powers of attorney (property and healthcare)

(c) Probate planning

(d) Shareholders agreements

(e) Insurance planning documents

(f) Family and ownership charter/constitution documents

(g) Strategic business plans

For more information or guidance on tax and succession planning for businesses and owner managers, contact Michael Goldberg, Tax Group, at mgoldberg@mindengross.com .

Michael Goldberg, BComm, LLB, TEP, FEA, Partner,** Tax Lawyer at Minden Gross LLP, MERITAS© Law Firms Worldwide and founder of "Tax Talk with Michael Goldberg," a quarterly conference call about, current, relevant, and real life situations for professional advisors who serve high net worth clients.

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