Parallel Universe:

La Survivance and the Capital Gains Exemption

by David Louis, B. Com., J.D., C.A., Tax Partner
Minden Gross LLP, a member of MERITAS Law Firms Worldwide.

No doubt, many readers were unpleasantly surprised by the March 13th edition of *Tax Topics* (No. 1879): because of a recent case, *La Survivance* v. *The Queen*[1], it seems that the capital gains exemption will not normally be available to an individual where non-residents and/or public corporations acquire control of an otherwise-qualifying small business corporation. This seemingly incongruous result occurs because, absent an election to the contrary, subsection 256(9) deems the acquisition of control to occur at the beginning of the day in which the sale occurs. So in the imaginary tax world – a sort of parallel tax universe that exists at the moment in time when the shares are actually sold - the target corporation is no longer a CCPC. As discussed in *Tax Topics*, this unhappy result was recently confirmed in Technical Interpretation 2006-0214781E5.[2]

For clients trapped in this parallel universe, what's next? Will the CRA boldly assess on this basis - where it has never assessed before? Worse still, will it go on a mission - to *seek out* taxpayers caught in this trap? Will there be remedial legislation, and if so, will it be retrospective, so that the problem will simply vanish, like a bad dream – or should I say like entering a time warp?

To answer these questions, I made some phone calls to a CRA official in Ottawa - and got some preliminary answers.

I was told that, yes, the CRA would assess on the basis indicated in the Technical. However, the CRA does not like the result of *La Survivance*. So there is unlikely to be any programs planned to actively look for problematic situations, e.g., by "pulling" capital gains exemption claims.

As indicated previously, it is possible to escape the effects of *La Survivance* by electing out of subsection 256(9). Subsection 256(9) itself requires the target corporation to make the election in its income tax return for the taxation year ending immediately before the acquisition of control. If it is too late to make the election, subsection 220(3.2) provides that the CRA may extend the time for making elections for provisions specified in Regulation 600, which includes subsection 256(9).

But this is at the discretion of the CRA - i.e., as part of the taxpayer relief provisions (formerly known as the "fairness package.") Will the CRA necessarily accept a late-filed election? The official indicated that the CRA is not "walking away" from its general policy to assess on a case-by-case basis. I reminded the official that if a late-filed election were submitted, this would involve disclosure of the taxpayer's particulars, and therefore the risk that the CRA could deny the late-filed election and reassess the taxpayer. The officer described this risk as "slight", particularly because the CRA

does not like the result of the case, and because of its policy that late-filed elections may be accepted to remedy an unintended tax result.**[3]**

But another issue could be whether, having sold shares of a targetco, the vendor could cause targetco to file an election to begin with. The co-operation of the purchaser would normally be needed, unless there is a provision in the purchase and sale agreement whereby the vendor could force the election to be made. In most cases, this would be unlikely unless the vendor's advisors were previously aware of the issue**[4]**. Also, making the election might jeopardize tax planning that is based on control being acquired at the beginning of the particular day**[5]**.

As for the possibility of retrospective legislation, it's too early to tell - because the matter is new, the Department of Finance is still looking at the issue of remedial legislation and whether such legislation might be retrospective.

Many thanks to Joan Jung and Michael Goldberg of Minden Gross, who pointed out this issue a year and a half ago.

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[1] 2007 DTC 5096, FCA.

[2] While some readers might surmise that the parallel tax universe is evil, this is not necessarily the case. *La Survivance* itself involved a public company that sold shares of a targetco to a private corporation. By the time of the actual sale, the targetco was deemed to be a CCPC and the public-company vendor was able to successfully claim an ABIL.

[3] See paragraph 56(b) of Information Circular IC 07-1, which indicates that a request for a late-filed election may be accepted where there have been tax consequences not intended by the taxpayer, and there is evidence that the taxpayer took reasonable steps to comply with the law. Query whether the latter requirement would be considered to be met for late-filed elections in respect of transactions occurring after the publication of *Tax Topics* #1879.

[4] As indicated in *Tax Topics* #1873, the issue was identified in the 2nd edition of *Tax and Family Business Succession Planning*, CCH Canadian Limited. It has also been identified in recent *Canadian Tax Foundation* papers, including "Sale or Succession of the Owner Managed Business – Selected Topics", Jason Stephan, 2007 PPC p.7:13; and "Selected Tax Aspects Related to Canadian-Controlled Private Corporations", Jeffrey Foreman, 2006 BCC p.19:21.

[5] For example, if an amalgamation of a targetco occurred on the same day as the acquisition of its shares, a subsection 256(9) election would result in an extra taxation year: as the amalgamation is considered to occur on the first moment of the day (unless otherwise specified in the certificate of amalgamation), the CRA has confirmed that, in the absence of a subsection 256(9) election, both the acquisition of control and the amalgamation are considered to happen simultaneously, with only one resulting taxation year-end. Also, because the capital dividend account ("CDA") does not arise until the paragraph 14(1)(b) inclusion - at the end of the year - a subsection 256(9) election may adversely impact CDA dividends, e.g., a CDA dividend timed to 12:01 am of the day in which control is acquired may be jeopardized if a subsection 256(9) election is made.