



RAVINSKY RYAN LEMOINE

Hybrid Transactions

Structuring the sale of a Canadian Business to a non-Canadian Buyer

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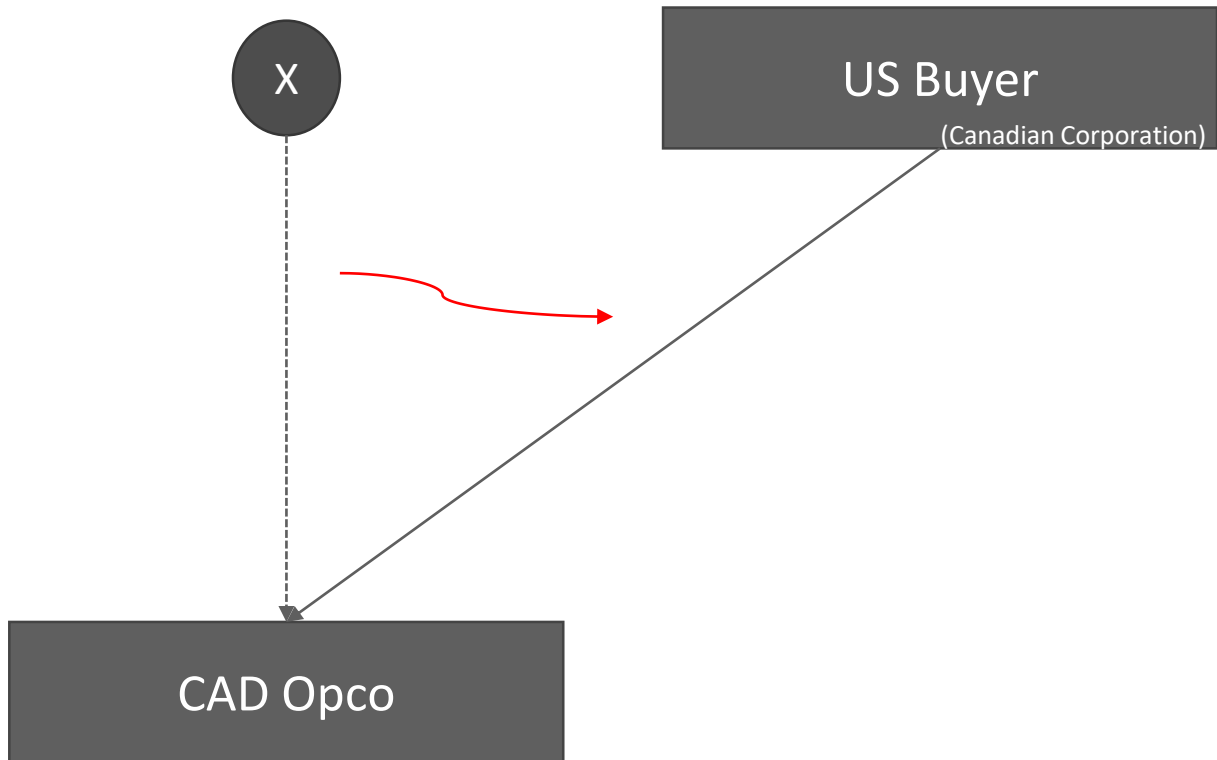
Ways to Structure the Sale of a Canadian Business to a non-Canadian Buyer

1. Straight sale of shares
2. Straight sale of assets
3. Hybrid sale

Example:

<u>Balance Sheet</u>		
	<u>Book Value</u>	<u>FMV</u>
Assets		
Cash	500,000	500,000
A/Receivable	1,000,000	1,000,000
Equipment	1,000,000	1,000,000
Goodwill	0	7,500,000
	2,500,000	10,000,000
Liabilities		
A/Payable	750,000	750,000
Long-Term loans	1,000,000	1,000,000
<u>Shareholders' Equity</u>	<u>750,000</u>	<u>8,250,000</u>
	2,500,000	10,000,000

Straight Sale of Shares by an Individual



Taxes

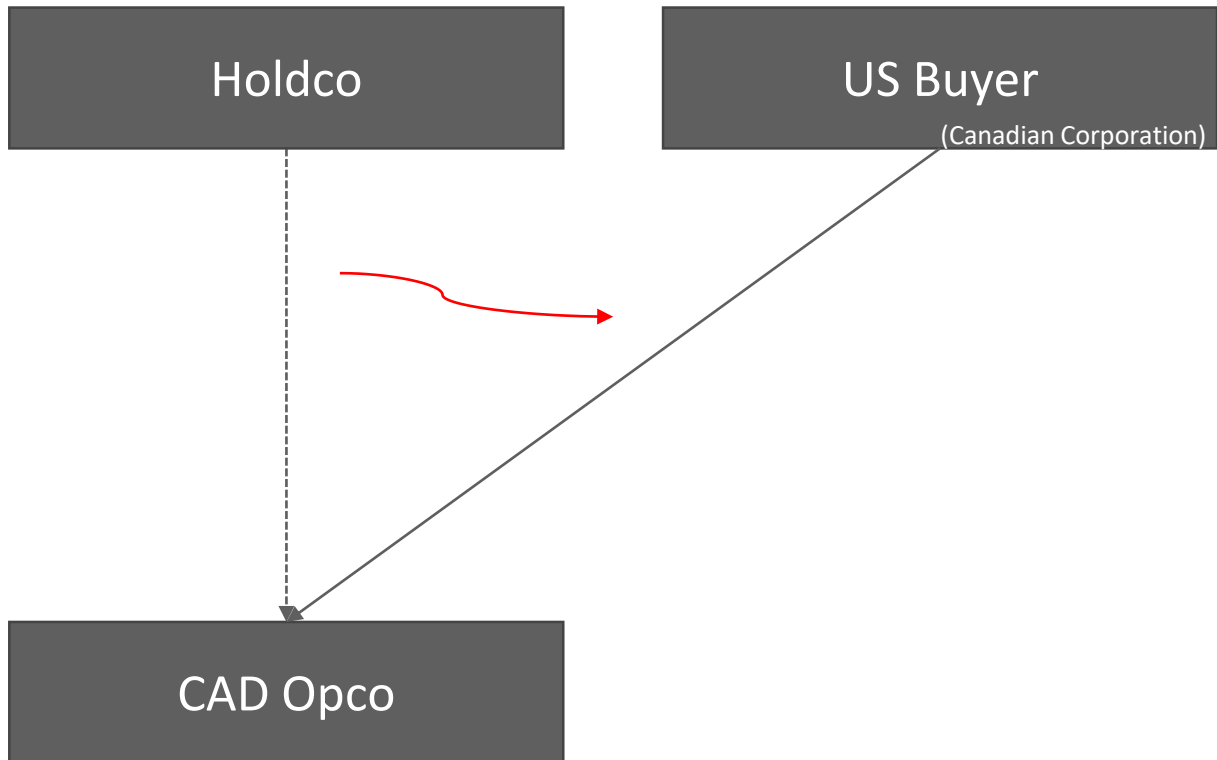
Capital Gain

Sale Price	8,250,000
<u>Adjusted Cost Base</u>	<u>- 750,000</u>
Total	7,500,000

<u>Lifetime Capital Gain Exemption</u>	<u>- 866,912</u>
Total	6,633,088

Sale Price	8,250,000
<u>Taxes (26.66% of 6,633,088)</u>	<u>- 1,768,381</u>
Net Proceeds for X	6,481,619

Sale of Shares by Corporate Seller with Share Income Strip



Taxes

Capital Gain

Sale Price 8,250,000

Adjusted Cost Base - 750,000

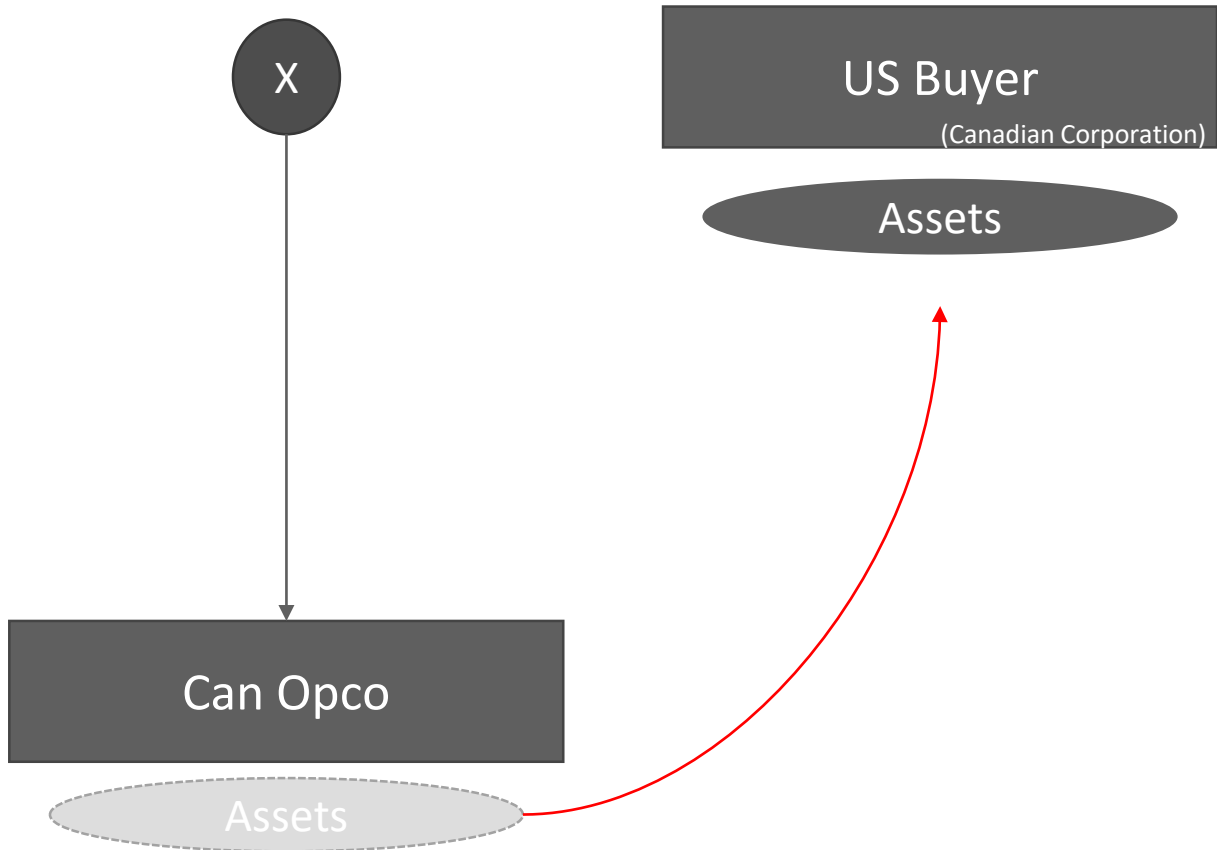
Total 7,500,000

Sale Price 8,250,000

Taxes (25.14% of 7,500,000) - 1,885,500

Net Proceeds for Holdco 6,364,500

Straight Sale of Assets



Taxes

Capital Gain

Sale Price	10,000,000
<u>Adjusted Cost Base</u>	<u>2,500,000</u>
Total	7,500,000

Sale Price	10,000,000
Pay liabilities	- 1,750,000
<u>Taxes* (25.14% of 7,500,000)</u>	<u>- 1,885,500</u>
Net Proceeds for CAD Opco	6,364,500

*Note that this is the upfront tax cost for the corporation but the RDTOH and CDA will be increased.

CCPC : Canadian-Controlled Private Corporation

1. Canadian corporation
2. Not controlled by a non-resident
3. Not controlled by a public corporation

Note: To determine if a Corporation is a CCPC, shares subject to a purchase agreement are treated as sold

Tax treatment of CCPC vs. Non-CCPC

	CCPC	NON-CCPC
Active Income	15,0% on first \$500,000 26,6% on income in excess	26,6%
Investment Income	50.4%	No special rate (26,6%)
Capital Gain	25.2%	13.3%

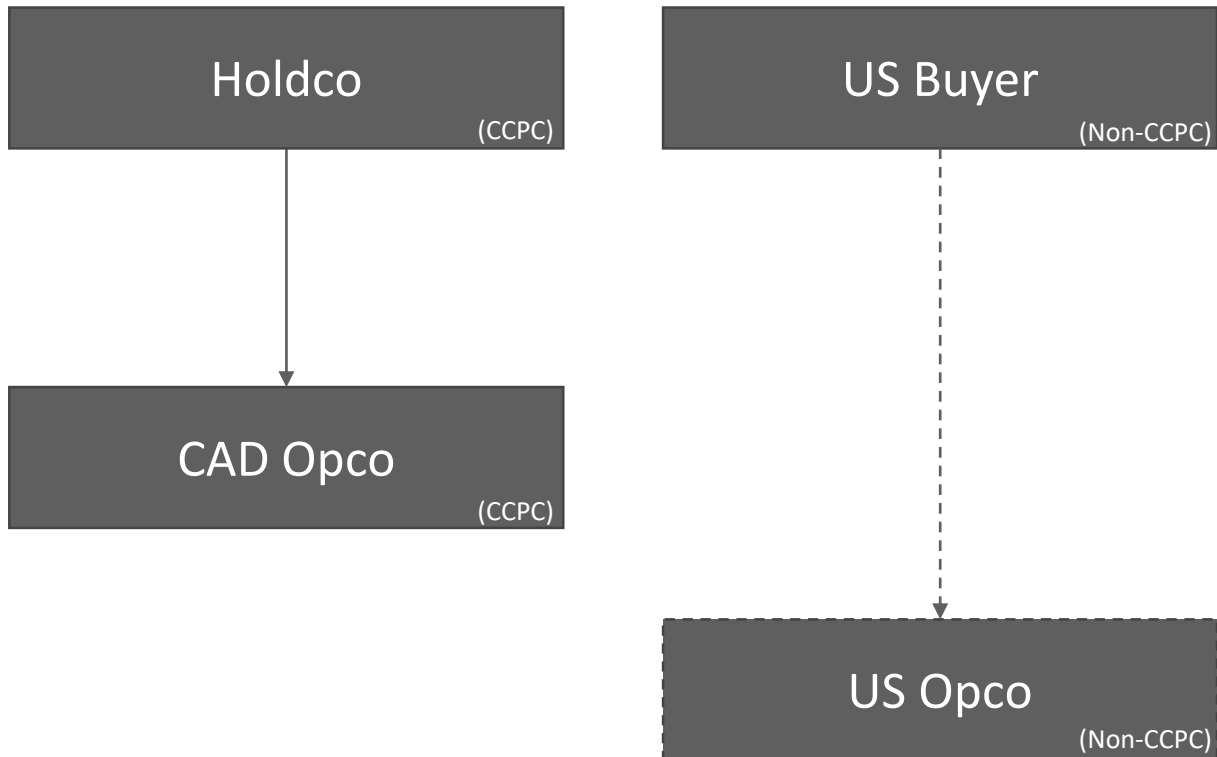
Favours small businesses

Lower than personal rate to attract foreign capital and for international competitiveness

Tax on "passive income" +/- equal to personal rate

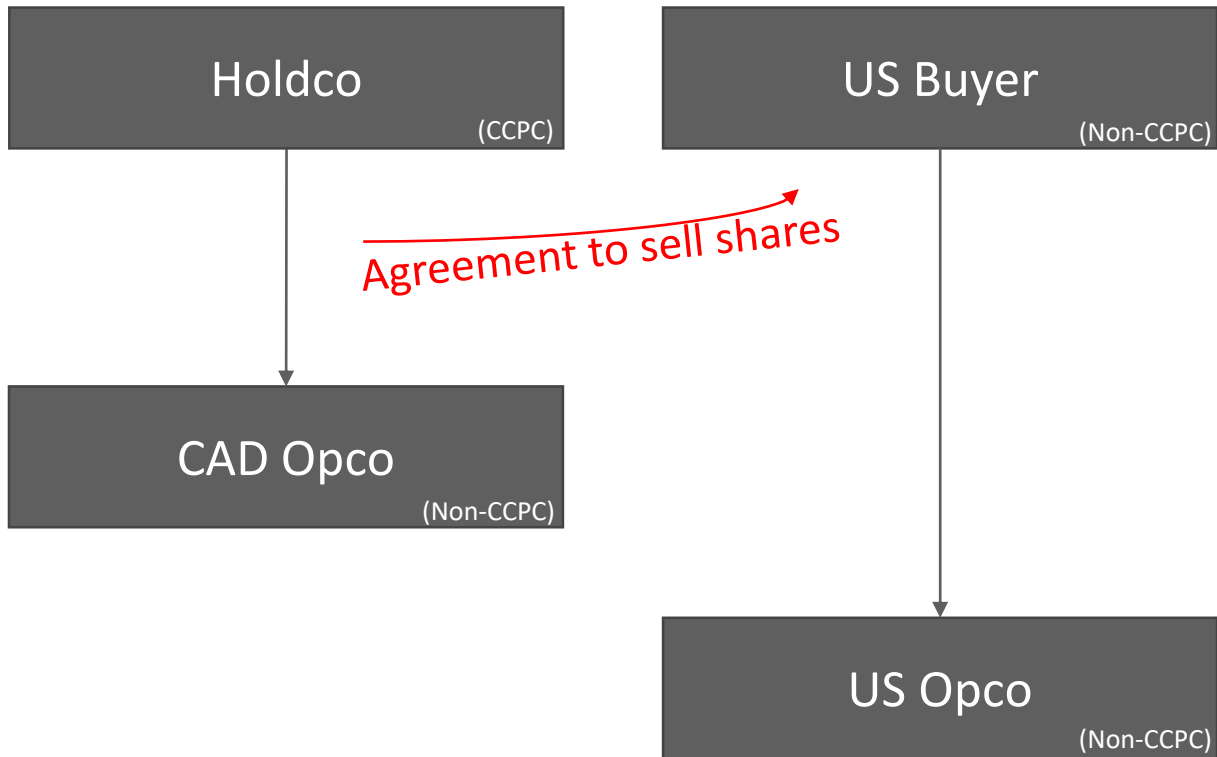
Hybrid Transaction

Step 1: US Buyer Establishes an US Opco



Hybrid Transaction

Step 2: Holdco concludes SPA with US Buyer

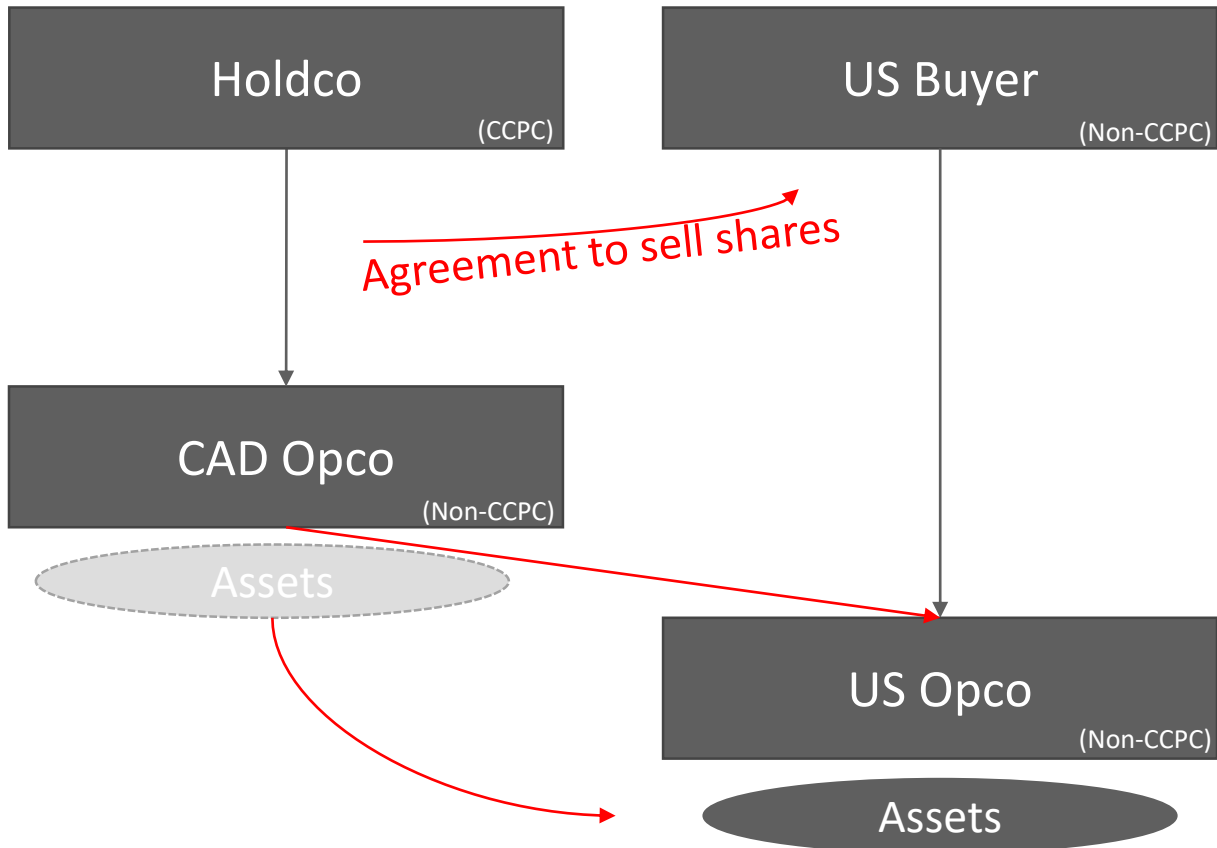


Agreement between Holdco and US Buyer in which Holdco agrees to sell the shares of CAD Opco at a later time.

CAD Opco ceases to be a CCPC

Hybrid Transaction

Step 3: CAD Opco Sells Assets to US Opco



Taxes

Capital Gain

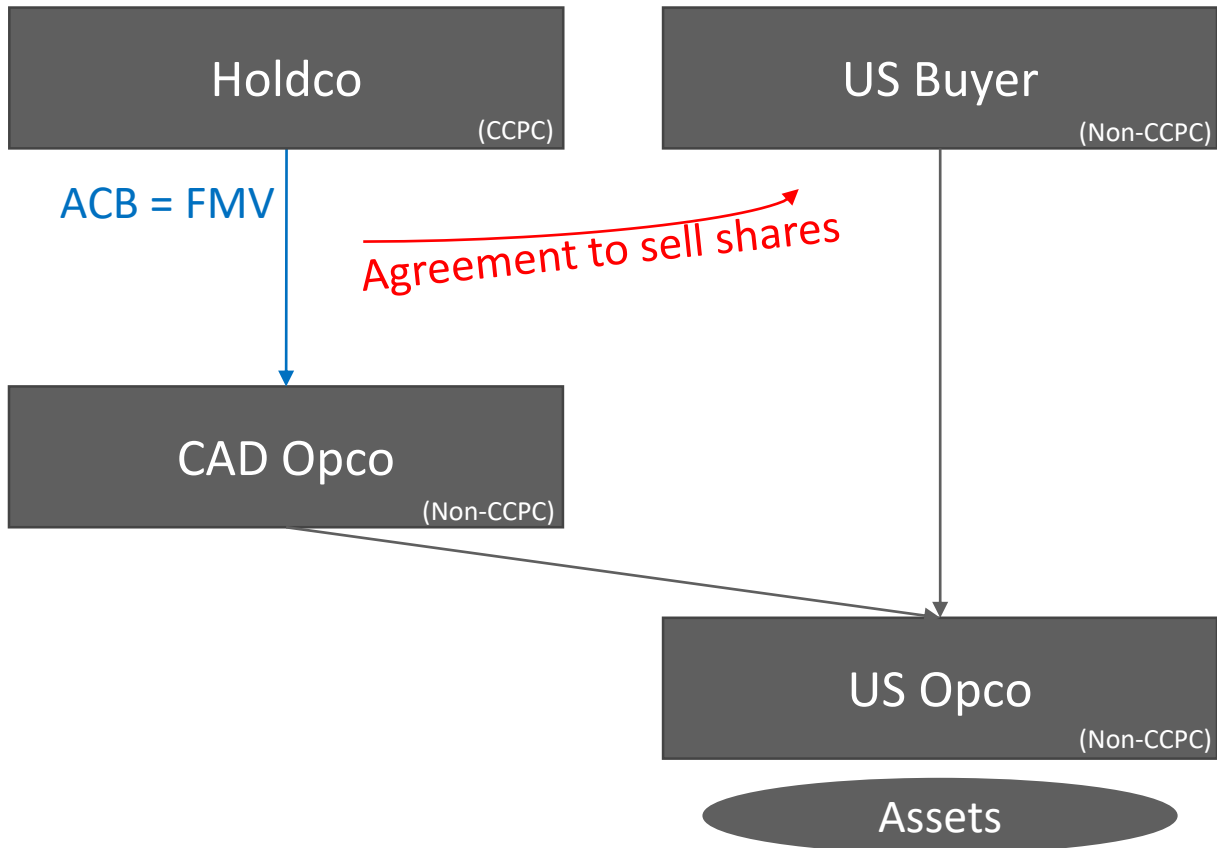
Sale Price	10,000,000
Adjusted Cost Base	2,500,000
Total	7,500,000

Sale Price	10,000,000
Pay liabilities	- 1,750,000
Taxes (13.3% of 7,500,000)	- 997,500
Net Proceeds for CAD Opco	7,252,500

- CDA of CAD Opco to increase by \$3,750,000
- Assets are sold in exchange for shares of US Opco (No money transferred)
- FMV of shares of CAD Opco is now of \$7,252,500.

Hybrid Transaction

Step 4: CAD Opco increases PUC of its shares



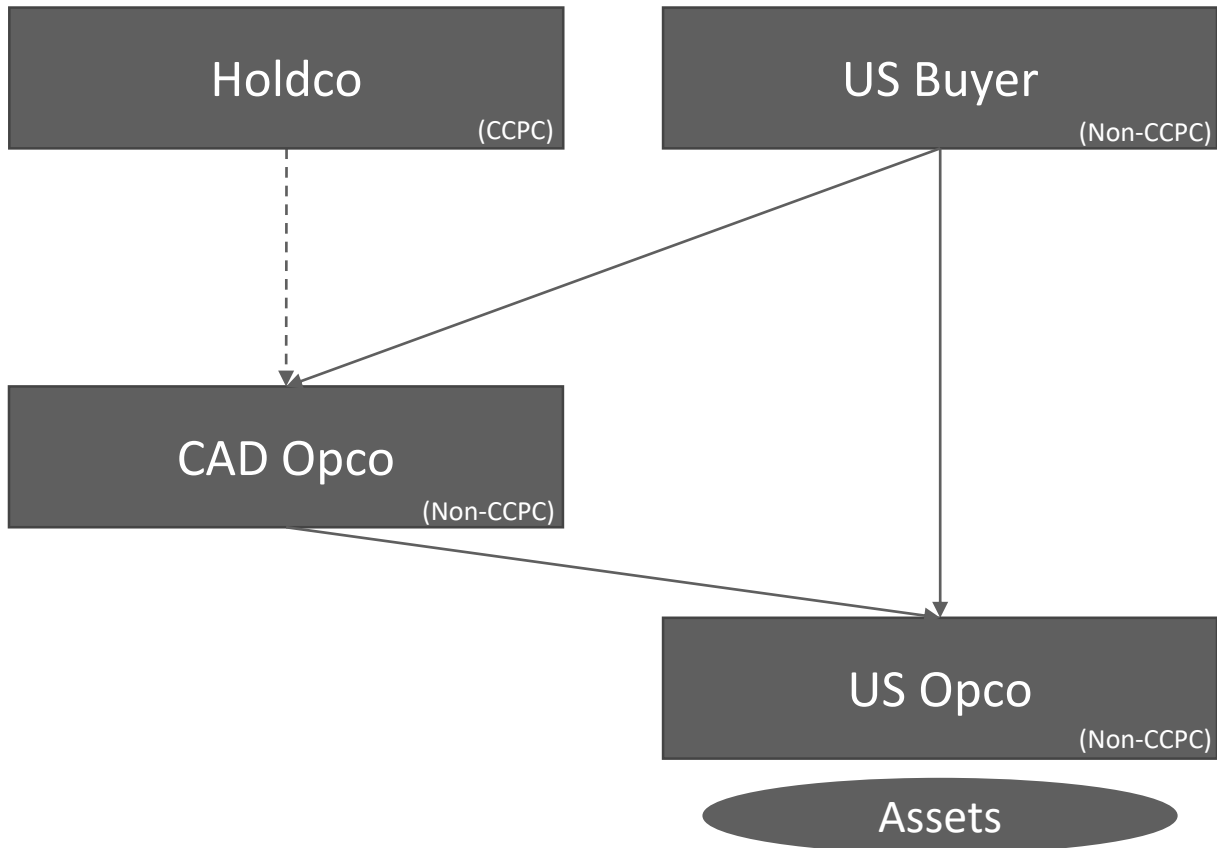
Opco to adopt resolution to increase the PUC of the shares of its share capital up to FMV of shares

Consequences:

- ACB of shares held by Holdco increased up to the FMV of the shares
- Increase deemed to be a dividend (part of which will be (i) a Capital Dividend from the CDA (no tax) and the other part (ii) a tax-free intercorporate dividend).

Hybrid Transaction

Step 5: Buyer Buys Shares of Opco



Buyers pays \$7,252,500 to Holdco for the shares, and will have to assume the liability of \$ 997,500 for taxes.

Taxes

Capital Gain

Sale Price	7,252,500
Adjusted Cost Base	7,252,500
Total	0

- No tax consequence for Holdco.
- US Buyer has to inject \$997,500 in CAD Opco to pay for the taxes.
- Amalgamation of CAD Opco and US Opco can occur post-closing to rationalize the structure.
- Tax treatment neutral to US Buyer and US Opco.

Comparison of the Net Proceeds

Difference of \$888,000 compared to straight sale of Assets

Share by Individual	Shares by Holdco	Assets by Opco	Hybrid Transaction
6,481,619	6,364,500	6,364,500	7,252,500*

*Note that in many circumstances hybrid transaction can be combined with the capital gain exemption.

General Anti-Avoidance Rule

Section 245 of the Income Tax Act

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